

30 April 2014 | Sector Update

## Glove sector

**Maintain POSITIVE**

### Opportune buying time for Top Glove and Hartalega

- **Top Glove and Hartalega are currently priced at a two-year low and eight-month low respectively**
- **Expect share prices of both companies to rebound on 1) potential spread of MERs-Cov infection; 2) improving raw material prices and; 3) increased production capacity from completed plant expansions**
- **Upgrade Top Glove and Hartalega to TRADING BUY (from Neutral previously)**
- **Maintain POSITIVE on the glove sector**

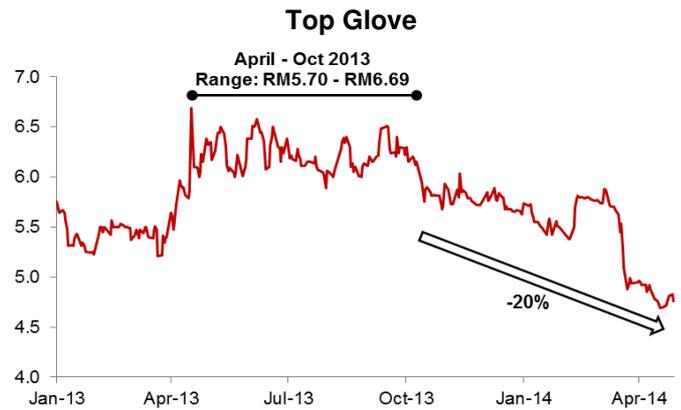
**Top Glove and Hartalega's share prices are currently depressed – opportune entry time.** Top Glove and Hartalega's share prices are currently at a two-year low and eight-month low respectively. Year-to-date, Hartalega's share price dropped -12% to RM6.35. Meanwhile, Top Glove's share price dropped by a larger quantum of -17%ytd to RM4.76. The lacklustre share prices are largely attributable to the reduction in average selling prices (ASP) of gloves as a result of lower raw material prices. Price of natural centrifuged latex fell by -15%ytd to RM4.51/kg from RM5.31/kg. Similarly, the price of nitrile also fell, but by a smaller quantum of -6%ytd to USD1355/MT from USD1445/MT. Due to the depressed raw material prices, customers have demanded for lower ASPs. Hence, in order to maintain revenue growth, most glove players are forced to increase their production volume. However, for players such as Top Glove, several orders had to be rejected due to the unreasonably low prices requested by customers (to avoid market cannibalism). This has affected its revenue and earnings in 4QCY13 as the volume decreased by 8.5% during that quarter compared to 3QCY13.

**Share prices to rise.** We believe that the share prices of both companies have bottomed. We expect share prices to rise in the near-term due to the following reasons:

- **Potential spread of the Middle East Respiratory symptom coronavirus (MERs-Cov) infection.** According to the World Health Organization (WHO) assessment on 24 April 2014, a total of 254 people have been infected with MERs-Cov and there have been 93 deaths (since April 2012 till 24 April 2014). The WHO assessment also stated that the MERs-Cov has spread to a total of 14 countries including Malaysia and Philippines. MERs-Cov is believed to have the ability to be transferred from human-to-human as 75% of the confirmed cases were secondary cases (acquired infection from another infected person). We believe that glove demand will increase especially from the Middle East as increasing awareness in people to prevent the spread of the MERs-Cov infection.
- **Raw material prices are expected to increase in the near-term.** With increasing raw material prices, we expect glove makers to be able to benefit by increasing their ASPs to maintain their revenue growth. The management of Hartalega concurred, noting that increasing nitrile butadiene price is too low now.
- **Increased capacity from new plant expansions.** Most of Top Glove and Hartalega's capacity expansions will conclude by 2014. Hartalega's New Generation Complex (NGC) is expected to start operating at least two production lines in October 2014 and Top Glove will be completing two factory expansions, namely Factory 27 and Factory 29 in May and December 2014 respectively.

**Upgrade Top Glove and Hartalega to TRADING BUY.** We are upgrading Top Glove and Hartalega to **TRADING BUY** (from Neutral previously) as we believe that the share prices of Hartalega and Top Glove to rebound in the near-term. This is based on the expected increased demand of gloves from the MERs-Cov infection as well as the expected improvement in raw material prices. Despite this upgrade, we are maintaining our earnings forecasts and target prices of Top Glove and Hartalega as we have imputed earnings accretions and plant expansions into our forecasts. For Top Glove, our target price is RM5.70 with a potential upside of +23.1% (including dividend yield of 3.4%). Meanwhile, for Hartalega, our target price is RM7.69 with a potential upside of 23.6% (including dividend yield of 2.5%).

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- Hartalega's share price has fallen -14% to RM6.35 (29 April 2014) from its record high of RM7.68 in November 2013.
- Hartalega's current PER is 18.9x which is lower than its 10-month low PER of 19.2x.
- This downtrend was due to the decrease in nitrile butadiene prices (main ingredient for synthetic rubber gloves) which fell to a 4-year low of RM815/tonne in July 2013.
- Subsequent to the lower nitrile butadiene prices, customers have requested for lower ASPs as the production costs have decreased. This initiated higher price competition among the nitrile glove players which caused the management to lower the ASP by approx. 15% which is in-line with the decrease of raw material prices.
- Investors expected this downtrend in raw material price to follow through in 4QCY13 which caused the share price to fall in November 2013. 4QCY13 revenue and earnings fell by -5%qoq and -8%qoq respectively.
- Top Glove's share price has fallen by -20% to RM4.76 per share (29 April 2014) since October 2013.
- Top Glove's current PER is 16.4x which is lower than its 1-year low PER of 17.1x.
- This downward trend is due to the price reduction of centrifuged latex which fell by -10% to RM4.77/kg (average April 2014).
- Due to this continuous raw material price downtrend, the management lowered the glove's ASPs. Furthermore, the management had to reject a few offers by customers as the price requested was too low. The management had announced in their 2QFY14 results that the gloves' ASP was already at its low and will not further reduce its ASP.
- The cumulative impact of the lower raw material prices, reduced glove ASP and reduced production volumes was reflected in its 2QFY14 results (Dec - Feb 2014).
- Top Glove's revenue and earnings fell by -4.5%qoq and -17.3%qoq respectively.

## Prospects

Raw material prices (nitrile butadiene and centrifuged latex) are expected to improve which will aid in improving the glove's ASPs. According to Chaiyos Sincharoenkul, president of the Thai Rubber Association, the supply of latex from Thailand is expected to tighten during this wintering period (Feb – May) as trees produce less latex. In relation to this, we expect this drop in output to reduce the problem of rubber oversupply, thus to improve latex price.

The improved raw material prices is expected to increase the glove's ASP for all glove makers. This increase in ASP will be able to support the revenue and earnings for the companies. There is no sure fact as to how much the ASP will be increased as it mostly depends on the increase of the raw material prices. Even now, the glove makers have slowly increased the ASP due to the gas and electricity price hike. Yet, the cost is expected to be passed on to the customers as the glove's ASP is still low.

Capacity expansion of Hartalega and Top Glove will also aid in improving the revenue and earnings of the company. Hartalega's NGC which is expected to complete in FY2022 will increase its current capacity by two-folds to a strong 42.2b pieces p.a. Meanwhile, Top Glove's capacity upgrades which are due for completion in May and Dec 2014 will increase its total capacity by 5% to 43.5b pieces p.a.

**Maintain POSITIVE on glove sector.** We reiterate our **POSITIVE** stance on the glove sector. We expect a rebound in Top Glove and Hartalega's share prices, which will be a positive reflection of improving investor sentiments on the glove sector. Our upgrade in stock recommendations are premised on; 1) the potential spread of the MERs-Cov which will increase demand of gloves in the Middle East; 2) the improving raw material prices of nitrile butadiene and centrifuged latex and; 3) the completion of glove capacity expansion of the companies. 

## Nitrile Butadiene price movement (per tonne)



Source: Bloomberg, MIDFR

## Centrifuged Latex price movement (per tonne)



Source: Bloomberg, MIDFR

**Top Glove's Investment Statistics**

<b>FYE August (RM'm)</b>	<b>FY2012</b>	<b>FY2013</b>	<b>FY2014F</b>	<b>FY2015F</b>
Revenue	2,314.5	2,313.2	2,397.7	2,541.8
Profit before tax	240.7	242.2	245.8	265.7
Net Profit	207.3	202.8	207.2	225.9
EPS (sen)	32.8	31.7	32.5	35.4
EPS Growth (%)	79.2	-3.2	2.4	9.0
PER (x)	14.5	15.0	14.7	13.4
Net Dividend (sen)	16.0	16.0	16.0	17.0
Dividend yield (%)	3.4	3.4	3.4	3.6

Source: Company, MIDFR

**Hartalega's Investment Statistics**

<b>FYE March (RM'm)</b>	<b>FY2012</b>	<b>FY2013</b>	<b>FY2014F</b>	<b>FY2015F</b>
Revenue	931.1	1,032.0	1,173.8	1,350.0
EBIT	260.1	30.7	328.7	391.5
Profit before tax	258.4	305.9	325.1	390.2
Net Profit	201.4	234.7	253.6	295.5
EPS (sen)	27.7	32.1	34.6	40.3
EPS Growth (%)	79.2	16.1	7.8	16.4
PER (x)	23.0	19.8	18.4	15.8
Net Dividend (sen)	10.8	14.5	16.0	18.1
Dividend yield (%)	1.7	2.3	2.5	2.9

Source: Company, MIDFR

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### MIDF AMANAH INVESTMENT BANK : GUIDE TO RECOMMENDATIONS

#### STOCK RECOMMENDATIONS

BUY	Total return is expected to be >15% over the next 12 months.
TRADING BUY	Stock price is expected to <i>rise</i> by >15% within 3-months after a Trading Buy rating has been assigned due to positive newsflow.
NEUTRAL	Total return is expected to be between -15% and +15% over the next 12 months.
SELL	Total return is expected to be <15% over the next 12 months.
TRADING SELL	Stock price is expected to <i>fall</i> by >15% within 3-months after a Trading Sell rating has been assigned due to negative newsflow.

#### SECTOR RECOMMENDATIONS

POSITIVE	The sector is expected to outperform the overall market over the next 12 months.
NEUTRAL	The sector is to perform in line with the overall market over the next 12 months.
NEGATIVE	The sector is expected to underperform the overall market over the next 12 months.