

Glove Sector

Maintain POSITIVE

Minimal impact from hike in natural gas tariff

- **Natural gas tariff increase by 5.95%**
- **Percentage increase within companies' expectations**
- **Minimal impact on earnings**
- **Maintain POSITIVE on the sector**

Natural gas tariff increase by 5.95%. On 28 June 2016, the Government issued an instruction for Gas Malaysia to effect the revision of the natural gas tariff for the non-power sector in Peninsular Malaysia which is effective starting 15 July 2016. The tariff revision is in line with the national rationalisation plan and Gas Cost Pass Through (GCPT) mechanism that will see the revision of piped gas price taking place every six months as indicated by Suruhanjaya Tenaga. The average gas tariff will be revised upwards by RM1.52/MMBtu or 5.95%, from RM25.53/MMBtu to RM27.05/MMBtu.

Table 1: Revised tariff schedule

Tariff Category	Annual Gas Consumption	Existing Tariff (RM/MMBtu)	Revised Tariff Effective 15 July 2016
A	Residential	19.52	19.52
B	0-600	23.78	25.20
C	601 – 5,000	23.90	25.33
D	5,001 – 50,000	24.14	25.58
E	50,001 – 200,000	25.19	26.69
F	200,001 – 750,000	25.19	26.69
L	Above 750,000	26.03	27.58
Average		25.53	27.05

Source: Bursa Malaysia

Percentage increase within companies' expectations. Our channel checks indicate that the hike in gas tariff is within their expectations and considered to be reasonable. Glove players also have imputed the tariff hike in their pricing which has been communicated to their customers.

Minimal impact on earnings. Typically, the major glove makers fall within category F and L which constitutes a 5.95% increase in their respective categories. In aggregate, natural gas makes up around 5-10% of the total cost structure for the major glove makers. Based on our analysis, the hike would result in a cost increase which is <1% across the major glove makers. Henceforth, impacts on earnings are expected to be minimal. Having said that, the effect would not be large if they were to bear the cost on the back of intense competition especially in the nitrile glove sector. Additionally, if the Ringgit were to weaken again, it will be more than enough to offset the hike in natural gas tariff.


Maintain POSITIVE on the sector. While the increase in natural gas tariff in general is negative news for the overall sector. However, as mentioned earlier, the increase in cost as a result of the hike will be fairly minimal at <1%. Furthermore, it must be noted that this is assuming that: i) the employers were to bear the increased tariff, and ii) the increase in natural gas tariff is not passed on the customers. We remain positive on the sector as we expect i) gradual increase in glove production capacity among the players, as well as ii) the resilient demand for rubber gloves globally will eventually offset the increase in labour cost going forward. Our Top Pick for the sector is Top Glove mainly due to its: i) well-diversified customer base, ii) attractive valuation against peers, and iii) wider product mix. 

Table 2: Rubber gloves peer comparison table

Company	Bloomberg Ticker	Market Cap* (RM'm)	Current Price* (RM)	Target Price (RM)	FY16F EPS	FY17F EPS	FY16F P/E	FY17F P/E
Hartalega	HART MK	6,974.6	4.25	4.56	15.7**	17.1	27.0**	24.8
Top Glove	TOPG MK	5,824.4	4.65	6.28	31.4	33.1	14.8	14.1
Kossan	KRI MK	4,386.7	6.86	8.94	34.5	40.7	19.9	16.9
Supermax	SUCB MK	1,443.2	2.15	3.21	25.8	22.9	8.3	9.4
Average							17.5	16.4

*Market cap and current price is based on closing price on 29 June 2016.

** Actual figures

Source: Bloomberg

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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.