Top Glove Corporation Berhad

(7113 | TOPG MK) Health Care | Health Care Equipment & Services

***Maintain* SELL**

High production costs per unit

***Revised* Target Price: RM0.42**

(Previously RM0.54)

KEY INVESTMENT HIGHLIGHTS

- **1QFY23 earnings missed expectations**
- **Net loss continued in 1QFY23**
- **Lower raw material costs that partially offset the impact of rising energy costs**
- **Slashed earnings projection for FY23F-24F by -77.8%/-60.7%**
- **Maintain SELL with a revised TP of RM0.42 (from RM0.54)**

1QFY23 earnings missed expectations. Top Glove Corporation (Top Glove) 1QFY23 results came in below expectations as it reported core net loss of RM131.4m in 1QFY23. This is after excluding a one-time item of RM36.9m. The negative deviation was mainly due to weaker-than-expected sales volume and higher-than-expected production cost. No dividend was declared for the quarter.

Net loss continued in 1QFY23. 1QFY23 revenue plunged -36.1%qoq to RM632.5m primarily due to lower blended average selling prices (ASP) (-8%qoq) and decreased sales volume across all product ranges (-32%qoq). Production costs per unit was higher, owing to low utilization rates and increased natural gas prices which more than offset the lower raw material costs. Hence, that compressed margin and dragged net loss widen from -RM80.7m in 4QFY22 to -RM131.4m in 1QFY23. On yearly basis, earnings were weak as Top Glove reported a core net loss of RM131.4m in 1QFY23 against a core net profit of RM172.9m in 1QFY22. This is in tandem with reduced revenue from RM1.58b in 1QFY22 to RM632.5m in 1QFY23. The poor performance was largely due to: (1) reduced sales volume (-48%yoy), (2) lower blended ASPs, (3) increased energy cost, and (4) higher production cost per unit due to lower volume. While the remaining region experienced negative growth for the quarter, North America continued to record a robust increase in sales volume of +11%yoy.

Reduced sales volume across all product categories. In 1QFY23, overall sales volume dropped by -32%qoq as Top Glove passed on the additional costs by raising its ASP by 5% in 4QFY22, which led to some customers switching to other glovemakers. Sales volume for nitrile gloves plummeted -33%qoq while NR gloves sales volume fell by -30%qoq due to the persistent headwinds. Similarly, sales volume for surgical gloves dropped by -29%qoq, largely due to an unplanned shutdown of a major 3rd party sterilization facility, which restricted sales. Meanwhile, sales volume for vinyl gloves was lower due to the oversupply in the market. Thus, the group has temporarily stopped the production of vinyl gloves.

RETURN STATISTICS	
Price @ 14th December 2022 (RM)	0.785
Expected share price return (%)	-46.51
Expected dividend yield (%)	2.19
Expected total return (%)	**-44.32**

SHARE PRICE CHART



Share price performance (%)	Absolute	Relative
1 month	-23.5	-24.5
3 months	24.8	-1.6
12 months	-61.0	-61.0

KEY STATISTICS	
FBM KLCI	1,483.17
Syariah compliant	Yes
Issue shares (m)	8007.34
F4BGM Index	Yes
ESG Grading Band (Star rating)	☆☆☆
Estimated free float (%)	44.20
Market Capitalisation (RM'm)	6,245.73
52-wk price range	RM0.56 - RM2.59
Beta vs FBM KLCI (x)	1.63
3-mth average daily volume (m)	85.01
3-mth average daily value (RM'm)	65.00
Top Shareholders (%)	
Lim Wee Chai	27.79
Central Depository Pte Ltd/The	7.65
FIRSTWAY UNITED CORP	6.93

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Declining ASPs. Nitrile gloves' ASP dropped by -10%qoq in 1QFY23 due to aggressive price competition from other glovemakers, oversupply of gloves, and low customer orders following overstocking during the pandemic. NR gloves also recorded lower ASP (-10%qoq), impacted by continued headwinds. Meanwhile, vinyl gloves' ASP dropped the most, by -13%qoq due to oversupply in the market.

Lower utilization rate. The utilization rate decreased from 35% in 4QFY22 to 30% in 1QFY23. This is lower than average utilization rate of 50% in FY22. Moving forward, Top Glove expects an improvement in the utilization rate to 40% thanks to customers' inventory replenishment activities.

Lower raw material costs that partially offset the impact of rising energy costs. In 1QFY23, average latex concentrate price decreased by -19%qoq to RM4.73/kg and average nitrile latex price fell by -13%qoq to USD0.91/kg. Hence, the raw material cost contribution dropped from 44% in 4QFY22 to 38% during the quarter. Due to lower demand and consumption for glove production, the group expects price of natural latex concentrate for December 2022 to decline by -11%qoq to USD1.02/kg. The price of nitrile latex is projected to be USD0.86/kg for December 2022, due to the deferred capacity expansion and lower production by glovemakers. Meanwhile, the proportion of energy costs in total production costs increased from 3% in 4QFY22 to 4% in 1QFY23, mainly due to higher natural gas tariff (+21%qoq).

Outlook. The group will postpone its expansion plans for FY23F until supply and demand have stabilized. The group temporarily shut down inefficient plants and only operate effective manufacturing facilities to reduce the fixed cost and hence lower the production cost per unit. Although the rate of reduction in ASP is slowing down and shown signs of stabilizing, we still anticipate it to remain around USD19-USD21 per 1000 pieces going forward due to the oversupply of gloves and reduced demand as most countries entered an endemic phase. Besides, we do not anticipate any cost-pass-through mechanisms in the near term due to the intense price competition from both domestic and Chinese glovemakers. We gather that average ASPs for Malaysian glovemakers is at USD17 -18/1000 pieces. Meanwhile, Chinese glovemakers are selling at a loss with an average ASP of USD14-15/1000 pieces. Hence, we believe that the Top Glove will keep its ASP at a competitive level to maintain and improve sales volume.

Slashed earnings projection for FY23F-24F by -77.8%/-60.7%. In view of the weak earnings in 1QFY23, we cut our earnings estimations for FY23F and FY24F to reflect: (1) lower sales volume ahead, which resulted in a lower utilization rate, (2) lower ASPs and (3) higher energy cost. This is after accounting for a (1) lower utilisation rate of 33.8%/38% for FY23F/FY24F, (2) reduced ASP estimate for FY23F-24F of USD18.3/USD20 per 1000 pieces, and (3) higher production cost per unit due to the low utilisation rate. We also introduced our FY25F earnings forecast.

Maintain SELL with a revised TP of RM0.42 (from RM0.54) given the downward earnings adjustment. Our valuation is based on a lowered FY24F earnings of 1.6sen (from 4.0sen) multiplied by 26.2x PER. We changed our PE valuation from its 2-year historical average PE of 13.2x to its pre-pandemic 3-year historical pre-pandemic average PE of 26.2x. This is to better reflect the company's mid-to longer-term outlook by excluding the extraordinary profits during the COVID-19 pandemic which skewed its 2-year historical average PER. Meanwhile, we remain **cautious** about Top glove's FY23F outlook mainly due to its inability to increase the ASP as customers can easily switch to other glovemakers that offer cheaper prices. Besides, we think that the group may remain in the red for the next 1-2 quarters before attaining break-even due to the weaker sales order and lower utilization rate which resulted in higher production cost per unit.

Potential upside risks are: (i) increased ASP and sales volume; (ii) smaller players leaving the market and (iii) existing players permanently shut down some of their facilities to reduce the supply of gloves in the market.

INVESTMENT STATISTICS

FYE AUG (RM'm)	FY2021	FY2022A	FY2023F	FY2024F	FY2025F
Revenue	16,361.4	5,572.3	2,656.2	3,398.7	4216.9
Cost of sales	(5,259.3)	(4,619.0)	(2,295.6)	(2,863.8)	(3482.1)
Gross profit	**11,102.1**	**953.4**	**360.6**	**534.9**	**734.7**
Interest income	61.6	24.3	11.6	14.8	18.4
Other operating income	83.3	88.5	42.2	54.0	67.0
Distribution and selling costs	(253.7)	(171.7)	(83.1)	(107.4)	(134.5)
Administrative and general expenses	(958.0)	(528.0)	(253.7)	(327.8)	(410.8)
Operating profit	**10,035.4**	**366.6**	**77.7**	**168.5**	**274.7**
Finance costs	(4.2)	(4.4)	(6.2)	(7.0)	(7.7)
Share of gain/(loss) of associate	2.6	(3.7)	0.0	0.0	0.0
PBT	**10,033.8**	**358.4**	**71.5**	**161.5**	**267.1**
Income tax expense	(2,209.8)	(76.8)	(15.3)	(32.3)	(53.4)
PAT	**7,824.0**	**281.6**	**56.1**	**129.2**	**213.7**
PATANCI	7,761.7	275.7	55.7	128.3	212.2
Core PATANCI	**7,741.1**	**549.2**	**55.7**	**128.3**	**212.2**
EPS (sen)	96.9	3.4	0.7	1.6	2.6
Dividend per share (sen)	65.1	1.7	0.3	0.8	1.3
Dividend yield (%)	86.8	2.3	0.5	1.1	1.8
Growth & Valuation (%)					
Revenue Growth	126.1	(65.9)	(52.3)	28.0	24.1
Gross Profit Growth	289.5	(91.4)	(62.2)	48.3	37.4
Core PATANCI Growth	337.7	(92.9)	(89.8)	130.2	65.3
Gross Profit Margin	67.9	17.1	13.6	15.7	17.4
PBT Margin	61.3	6.4	2.7	4.8	6.3
Core PATANCI Margin	47.3	9.9	2.1	3.8	5.0
Effective tax rate	22.0	21.4	21.4	20.0	20.0
PER (x)	0.8	21.8	107.7	46.8	28.3
Cash/Mkt Cap (x)	6.6	0.7	1.0	1.3	1.6

Source: Company, MIDFR

Table 1: Top Glove's 1QFY23 Quarterly Earnings Review

FYE AUG (RM'm)	Quarterly results					Cumulatively results		
	1QFY23	4QFY22	1QFY22	YoY (%)	QoQ (%)	3MFY23	3MFY22	YoY (%)
Revenue	632.5	990.1	1,584.1	(60.1)	(36.1)	632.5	1,584.1	(60.1)
Operating expenses	(792.8)	(1,073.4)	(1,367.1)	(42.0)	(26.1)	(792.8)	(1,367.1)	(42.0)
Other operating income	10.6	42.0	43.5	(75.5)	(74.7)	10.6	43.5	(75.5)
Operating profit (EBIT)	**(149.6)**	**(41.3)**	**260.6**	**(157.4)**	**262.6**	**(149.6)**	**260.6**	**(157.4)**
Net finance income/(cost)	(1.9)	(1.3)	(1.1)	78.0	42.5	(1.9)	(1.1)	78.0
Profit before Associates & JV	**(151.6)**	**(42.6)**	**259.5**	**(158.4)**	**255.7**	**(151.6)**	**259.5**	**(158.4)**
Share of results of an associate	(0.1)	(1.4)	(0.6)	(85.4)	(93.5)	(0.1)	(0.6)	(85.4)
Income tax expense	**(6.0)**	**2.3**	**(56.5)**	**(89.4)**	**(360.8)**	**(6.0)**	**(56.5)**	**(89.4)**
Profit After tax (PAT)	(157.6)	(41.7)	202.4	(177.9)	277.7	(157.6)	202.4	(177.9)
PATANCI	**(168.2)**	**(52.6)**	**185.7**	**(190.6)**	**219.9**	**(168.2)**	**185.7**	**(190.6)**
Core PATANCI	**(131.4)**	**(80.7)**	**172.9**	**(176.0)**	**62.8**	**(131.4)**	**172.9**	**(176.0)**
Basic EPS (sen)	(2.1)	(0.5)	2.5	(183.1)	302.9	(2.1)	2.5	(183.1)
Core EPS (sen)	(1.6)	(1.0)	2.2	(176.0)	62.8	(1.6)	2.2	(176.0)
Growth & Margin (%)				*+/(-) ppts*	*+/(-) ppts*			*+/(-) ppts*
Revenue Growth	(36.1)	(32.4)	(23.7)	(12.5)	(3.7)	(88.5)	(90.3)	1.8
Operating Profit Growth	262.6	(199.5)	(58.1)	320.7	462.1	(140.1)	(97.4)	(42.6)
Core PATANCI Growth	62.8	834.9	(60.8)	123.6	(772.1)	(174.6)	(97.7)	(76.9)
Operating Profit Margin	(23.7)	(4.2)	16.4	(40.1)	(19.5)	(23.7)	16.4	(40.1)
PBT Margin	(24.0)	(4.4)	16.3	(40.3)	(19.5)	(24.0)	16.3	(40.3)
Core PATANCI Margin	(20.8)	(8.1)	10.9	(31.7)	(12.6)	(20.8)	10.9	(31.7)
Ratios & Valuation				*+/(-) ppts*	*+/(-) ppts*			*+/(-) ppts*
Net cash/market cap (%)	0.4	0.8	8.3	(7.9)	(0.4)	(0.4)	(8.3)	7.9
ROCE (%)	(2.2)	(0.6)	3.6	(5.7)	(1.6)	(2.2)	3.6	(5.7)
Inventory turnover ratio (x)	1.2	1.5	1.5	(16.2)	(18.1)	(1.6)	(1.3)	21.7
Cash Conversion cycle (Days)	189.0	133.8	144.0	31.2	41.2	189.0	144.0	31.2

Source: Company, MIDFR

Table 2: SEGMENTAL BREAKDOWN

FYE AUG (RM'm)	Quarterly results					Cumulatively results		
	1QFY23	4QFY22	1QFY22	YoY (%)	QoQ (%)	3MFY23	3MFY22	YoY (%)
Revenue (External):								
Malaysia	548.4	918.0	1,398.4	(60.8)	(40.3)	548.4	1,398.4	(60.8)
Thailand	41.9	90.1	106.9	(60.8)	(53.5)	41.9	106.9	(60.8)
China	3.5	6.4	7.9	(56.2)	(45.7)	3.5	7.9	(56.2)
Others	38.8	60.0	70.9	(45.2)	(35.3)	38.8	70.9	(45.2)
Total	**632.5**	**1,074.4**	**1,584.1**	**(60.1)**	**(41.1)**	**632.5**	**1,584.1**	**(60.1)**
Operating Profit:								
Malaysia	(119.3)	(40.7)	229.3	(152.0)	192.8	(119.3)	229.3	(152.0)
Thailand	(8.3)	5.5	37.2	(122.4)	(250.8)	(8.3)	37.2	(122.4)
China	(1.7)	(4.1)	(0.5)	261.5	(58.7)	(1.7)	(0.5)	261.5
Others	(20.3)	(2.0)	(5.5)	270.8	926.6	(20.3)	(5.5)	270.8
Total	**(149.6)**	**(41.3)**	**260.6**	**(157.4)**	**262.6**	**(149.6)**	**260.6**	**(157.4)**
Operating profit/(loss) margin:				*+/(-) ppts*	*+/(-) ppts*			*+/(-) ppts*
Malaysia	(21.8)	(4.4)	16.4	(38.1)	(17.3)	(21.8)	16.4	(38.1)
Thailand	(19.9)	6.1	34.8	(54.7)	(26.1)	(19.9)	34.8	(54.7)
China	(48.8)	(64.2)	(5.9)	(42.9)	15.4	(48.8)	(5.9)	(42.9)
Others	(52.4)	(3.3)	(7.7)	(44.6)	(49.1)	(52.4)	(7.7)	(44.6)
Total	**(23.7)**	**(3.8)**	**16.4**	**(40.1)**	**(19.8)**	**(23.7)**	**16.4**	**(40.1)**

Source: Company, MIDFR

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MIDF AMANAH INVESTMENT BANK: GUIDE TO RECOMMENDATIONS

STOCK RECOMMENDATIONS	
BUY	Total return is expected to be >10% over the next 12 months.
TRADING BUY	Stock price is expected to *rise* by >10% within 3-months after a Trading Buy rating has been assigned due to positive newsflow.
NEUTRAL	Total return is expected to be between -10% and +10% over the next 12 months.
SELL	Total return is expected to be <-10% over the next 12 months.
TRADING SELL	Stock price is expected to *fall* by >10% 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.
ESG RECOMMENDATIONS* - source Bursa Malaysia and FTSE Russell	
☆☆☆☆	Top 25% by ESG Ratings amongst PLCs in FBM EMAS that have been assessed by FTSE Russell
☆☆☆	Top 26-50% by ESG Ratings amongst PLCs in FBM EMAS that have been assessed by FTSE Russell
☆☆	Top 51%- 75% by ESG Ratings amongst PLCs in FBM EMAS that have been assessed by FTSE Russell
☆	Bottom 25% by ESG Ratings amongst PLCs in FBM EMAS that have been assessed by FTSE Russell

* ESG Ratings of PLCs in FBM EMAS that have been assessed by FTSE Russell in accordance with FTSE Russell ESG Ratings Methodology