

15 January 2018 | Briefing Note

Top Glove Corporation Berhad

Transforming to largest global producer of surgical gloves

INVESTMENT HIGHLIGHTS

- **Targeting three M&As in FY18**
- **Potential capacity expansion in Vietnam as demand for gloves remain robust**
- **Growing the specialty gloves segment**
- **Acquisition of Aspion earnings accretive with double-digit FY19 EPS growth expected**
- **Maintain NEUTRAL with a revised TP of RM8.55 per share**

Targeting three M&As in FY18. Top Glove in its analyst briefing held last Friday indicated that it is targeting to achieve at least a double-digit growth of 10% annually in terms of revenue and earnings – this will be achieved via both organic and inorganic growth. As organic growth will only lead to approximately 3% growth in earnings, inorganic growth will help to propel its earnings to double-digit growth. Hence, it targets to undergo three merger and acquisition activities in FY18, one of which is currently underway with Aspion Sdn Bhd (Aspion).

Potential capacity expansions in Vietnam as demand for gloves remain robust. We also understand from the management that demand for gloves remains robust with factories currently in an overbooked position with a lead time of two months. Demand remains strong at 8-10% growth annually and predominantly comes from examination gloves. That said, other glove division such as the TPE/CPE gloves are still gaining traction with +83% sales growth volume year-over-year and +14%qoq respectively. New capacity expansions in Vietnam remain a viable option for Top Glove due to this overbooked position. Top Glove noted that Vietnam has: (i) good infrastructure; (ii) friendly government as well as; (iii) tax benefit of 7% that is supportive of the glove industry.

Growing the specialty gloves segment. Management also revealed during the briefing that it plans to grow its specialty gloves segment by venturing into glove segments which are high in margin and less competitors such as the: (i) industrial gloves; (ii) safety gloves as well as; (iii) surgical gloves. The acquisition of Aspion which is currently underway is expected to drive its surgical gloves segment with sales volume and revenue expected to increase by >50% for the segment.

Maintain NEUTRAL
Revised Target Price: RM8.55
(Previously RM5.53)

RETURN STATS	
Price (12 January 2018)	RM9.00
Target Price	RM8.55
Expected Share Price Return	-5.0%
Expected Dividend Yield	+2.1%
Expected Total Return	-2.9%

STOCK INFO	
KLCI	1,822.67
Bursa / Bloomberg	7113 / TOPG MK
Board / Sector	Main / Industrial Products
Syariah Compliant	YES
Issued shares (mil)	1,255.16
Market cap. (RM'm)	11,296.43
Price over NA	5.31
52-wk price Range	RM4.56-RM9.25
Beta (against KLCI)	0.09
3-mth Avg Daily Vol	4.01m
3-mth Avg Daily Value	RM28.3m
Major Shareholders (%)	
Lim Wee Chai	29.4
Employees Provident Fund	6.0
Firstway United Corp	5.1

Acquisition of Aspion earnings accretive with double-digit growth in FY19 EPS expected. To recall, on 24th November 2017, Top Glove announced that it has entered into a term sheet agreement with Adventa Capital Pte Ltd to negotiate on the potential acquisition of the entire equity interest in Aspion Sdn Bhd, Adventa’s surgical glove manufacturing division. Subsequently, the parties have announced on 12th of January 2018 that they have signed the sales and purchase (SPA) agreement with a purchase consideration of RM1,370m of which, RM1,233m will be satisfied via cash from borrowings and the remaining RM137m will be through the issuance of 20.5m of new Top Glove shares. As a result, Top Glove’s gearing ratio will increase to about 0.7x which is still below its internal threshold of 0.88x. This values the acquisition at 16.9x PER on FY18F expected profit.

Following this acquisition which is expected to be completed in April 2018, we understand that Top Glove and Aspion have entered into an incentive-based agreement where the core profit after tax (PAT) for the first two years (RM80.9m for the first year and RM108.3m for the second year) following the acquisition are guaranteed by Aspion. Therefore, we believe that the acquisition price is fair given that the purchase consideration was arrived at based on a guaranteed profit for a period of two years. According to our forecasts, the core PAT contribution from Aspion will lead to an overall double-digit growth in EPS for FY18-19 of +25% and +18.9% respectively. Additionally, the acquisition of Aspion will make Top Glove the single largest producer of surgical gloves in the world with a combined market share of 29% in the surgical gloves market.

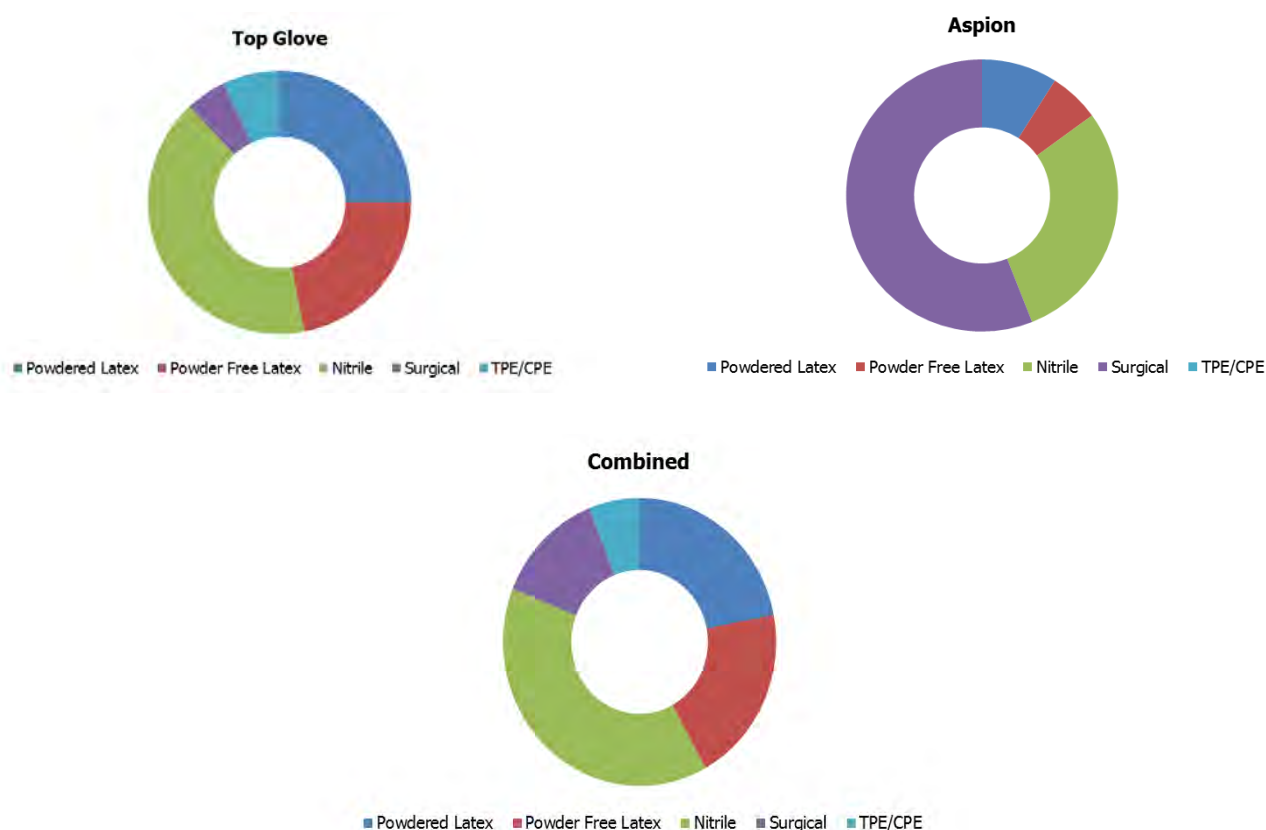
Furthermore, following the acquisition, Top Glove’s surgical sales volume will increase to 2% to 4% of its total gloves sales volume while in terms of value, Top Glove’s surgical sales is expected to increase to 13% of its total revenue vs 5% currently. The acquisition will also allow Top Glove to tap on Aspion’s current exposure in various markets worldwide especially the developed markets.

Chart 1: Top Glove’s before and after sales volume increase



Source: Company, MIDFR

Chart 2: Top Glove's before and after sales value increase



Source: Company, MIDFR

Earnings forecast. Following the recently announced 1QFY18 results and analyst briefing, we are revising our FY17-18F earnings forecasts by +12.8% and +17.4% respectively as **we incorporate four months of contribution from Aspion in FY18 and full-year contribution in FY19 into our earnings**. Key risks to our earnings would be: (i) higher than expected increase in production costs i.e: raw material prices, labour costs etc; (ii) delays in plant expansions and; (iii) failed acquisition of Aspion.

Maintain NEUTRAL with a revised Target Price (TP) of RM8.55. Post earnings revision and rolling forward our valuation base year to FY19, we revised our TP to **RM8.55** (from RM5.53 previously). Our valuation is premised on FY19 EPS of 38.9sen pegged to a higher PER of 22x which is +0.5SD of the company's 3-year historical average PER to better reflect the earnings accretion coming from the acquisition of Aspion and the current earnings upcycle. However, we maintain our **NEUTRAL** recommendation as we believe all the positives have been priced in at this juncture and the stock is now fully-valued. Additionally, we opine that despite the current improvement in raw materials price, the cost savings might be offset by: (i) lower ASPs - as a result of the low raw materials price and; (ii) the strengthening of Ringgit, which could limit its earnings potential going forward.



Table 1: Top Glove's expansion plan

	Type of glove	No. of production lines	Capacity (bn pieces p.a.)	Targeted to commence production	
				Previous	New
Current no. of production lines		550	51.9		
Expansion plan:					
F31 (Klang, Malaysia) <i>New factory</i>	Nitrile (Phase 1)	30	3.0	March'18	May'18
F32 (Klang, Malaysia) <i>New factory</i>	Nitrile (Phase 2)	48	4.8	May'18	December'18
Total expansion by December 2018		78	7.8		
Total production lines by December 2018		628	59.7		

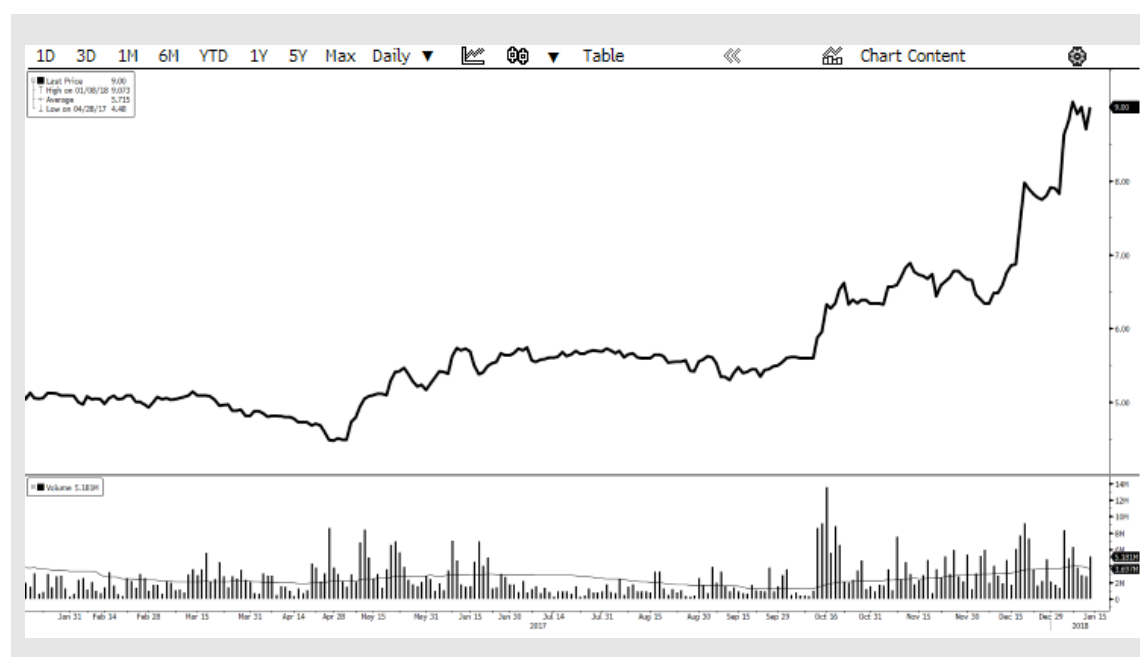
Source: Company, MIDFR

INVESTMENT STATISTICS

FYE Aug (RM'm)	FY2015	FY2016	FY2017	FY2018F	FY2019F
Revenue	2510.5	2888.5	3409.2	4055.2	4491.8
Operating Profit	379.4	446.9	390.4	511.0	606.4
PBT	363.5	442.6	383.1	503.4	598.8
PATAMI	281.2	362.8	332.6	427.9	509.0
Operating Profit margin (%)	15.1	15.5	11.5	12.6	13.5
PBT margin (%)	14.5	15.3	11.2	12.4	13.3
PATAMI margin (%)	11.2	12.6	9.8	10.6	11.3
EPS (sen)	22.6	28.9	26.1	32.7	38.9
EPS Growth (%)	55.5	27.6	-9.4	25.0	18.9
PER (x)	39.8	31.2	34.4	27.6	23.2
Dividend per share (sen)	11.5	17.0	17.0	18.0	19.0
Dividend yield (%)	1.3	1.9	1.9	2.0	2.1

Source: Company, Forecasts by MIDFR

DAILY PRICE CHART



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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 <i>rise</i> 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 <i>fall</i> 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.