

10 March 2021

Consumer Cyclical | Rubber Products

Top Glove Corp (TOPG MK)

Buy (Maintained)

Value Emerged Post Selldown; Keep BUY

- **Keep BUY with a new DCF-derived MYR6.80 TP from MYR8.45, 31% upside and c.16% yield.** 1HFY21 (Aug) earnings met expectations. We reduced the TP, as we expect a lower long-term nitrile gloves ASP of USD40 per 1,000 pieces. After the share price declined 43% from its peak, Top Glove turned into a value play with its attractive near-term dividend yield of 16%, a low FY23 P/E multiple of 10.5x (average: 18.0x), and strong balance sheet with net cash of MYR4.06bn.
- **Earnings matched expectations.** 1HFY21 earnings of MYR5.23bn made up 51% of consensus and 49% of our full-year estimates. 1HFY21 earnings surged 23x YoY due to a better ASP and volume.
- **Announced a 25.2 sen dividend** which represents 70% of its EPS of MYR0.358 in 2QFY21. Against the current share price, this dividend alone already offers a 4.9% yield (Ex-date is 23 March and payment date 6 April).
- **Prospects.** The company stated that the global glove demand is estimated to grow from a pre-pandemic level of c.10% pa to c.15% pa post-pandemic, following an increase in usage, coupled with heightened hygiene awareness. We are more conservative in estimating a post-pandemic demand growth of 8-10% due to the high base effect. The growth is from developing countries as the gloves usage per capita (at c.10 pieces pa) still lags significantly that of developed countries (at c.200 pieces pa).
- **FY23 earnings estimates reduced by 10%.** We have lowered our nitrile gloves ASP to USD40.0 per 1,000 pieces and therefore the blended gloves' ASP for Top Glove has been reduced to USD35.0. Our FY21-22 earnings estimates remain unchanged. For Top Glove, we assume the long term volume mix at 60% for nitrile and 40% for non-nitrile gloves.
- **Maintain BUY with a lower TP of MYR6.80** which is consistent with the reduction in FY23 earnings and long term blended ASP reduced to USD35. We believe the near-term high ASPs will encourage more competition in the future. We also rolled over our DCF methodology to begin in FY22.
- **We expect USD40.0 to be the long term ASP for nitrile gloves.** As the US plans to build its own gloves manufacturing plants, we estimate a USD40.0 cost of production. This should set the long-term global nitrile gloves price. If the ASP may drop below USD40.0, the US producers would probably stop producing and, in the long term, the ASP should revert back to USD40.0.
- **Undervalued.** At MYR5.19, Top Glove's share price has declined 43% from its Oct 2020 peak. It is trading at 3.9x FY21F P/E and offers a 16% dividend yield. By using the expected trough EPS in FY23, Top Glove is trading at FY23 P/E of 10.5x representing -0.7SD discount against its average of 18x.
- **Risks.** Worse-than-expected gloves ASP after COVID-19 ends, lower-than-expected sales volume, and higher-than-estimated raw material prices.

Forecasts and Valuation	Aug-19	Aug-20	Aug-21F	Aug-22F	Aug-23F
Total turnover (MYRm)	4,801	7,236	24,775	20,099	15,668
Recurring net profit (MYRm)	365	1,605	10,711	7,234	4,037
Recurring net profit growth (%)	(15.0)	340.2	567.3	(32.5)	(44.2)
Recurring P/E (x)	116.30	26.42	3.96	5.86	10.50
P/B (x)	16.7	8.5	4.8	3.4	2.9
P/CF (x)	80.58	13.37	4.23	5.34	9.10
Dividend Yield (%)	1.4	2.2	16.4	8.5	4.8
EV/EBITDA (x)	64.37	17.14	2.67	3.54	5.88
Return on average equity (%)	14.8	42.7	155.8	68.4	30.1
Net debt to equity (%)	84.9	net cash	net cash	net cash	net cash

Source: Company data, RHB

Target Price (Return): MYR6.80 (31.0%)
Price: MYR5.19
Market Cap: USD10,082m
Avg Daily Turnover (MYR/USD): 284m/70.3m

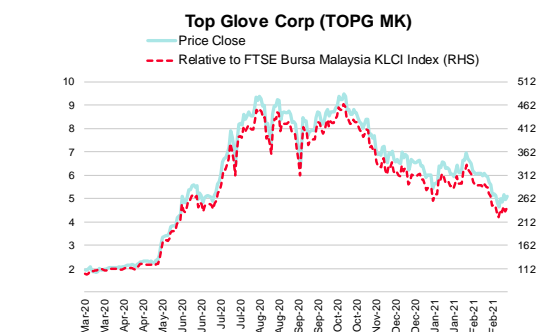
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Share Performance (%)

	YTD	1m	3m	6m	12m
Absolute	(15.2)	(16.3)	(24.1)	(27.4)	154.8
Relative	(15.0)	(18.7)	(22.8)	(36.0)	140.7
52-wk Price low/high (MYR)				1.92 – 9.60	



Source: Bloomberg

Overall ESG Score: 2.78 (out of 4)

E: Good

Top Glove measures its CO₂ emissions, and aims to reduce them by 8% annually. For nature preservation, it has installed On-Site Detention and rain harvesting tanks, with a combined capacity of 2,500 m³ at its factories. To reduce pollution, six of its factories are powered by biomass, which is a renewable source of energy.

S: Moderate

Recently, a high number of COVID-19 cases were reported at Top Glove's hostels. We believe that improvements are needed in this area. The company has spent MYR20m to purchase 100 units of apartments for its workers in the past two months (on top its current 100 units of double-storey houses and hostels).

G: Excellent

50% of its board members are independent, and 42% are female, exceeding the MCG requirement of 30%. Additionally, Top Glove provides full disclosure on its directors' remuneration, including salaries and bonuses. Top Glove has an in-house investors relations team, and holds investor briefings regularly, embodying good transparency and disclosure practices.

10 March 2021

Consumer Cyclical | Rubber Products

Financial Exhibits

Asia	Financial summary (MYR)	Aug-19	Aug-20	Aug-21F	Aug-22F	Aug-23F
Malaysia	Recurring EPS	0.04	0.20	1.31	0.89	0.49
Consumer Cyclical	DPS	0.08	0.11	0.85	0.44	0.25
Top Glove Corp	BVPS	0.31	0.61	1.07	1.52	1.76
TOPG MK	Return on average equity (%)	14.8	42.7	155.8	68.4	30.1
Buy						
Valuation basis	Valuation metrics	Aug-19	Aug-20	Aug-21F	Aug-22F	Aug-23F
DCF	Recurring P/E (x)	116.30	26.42	3.96	5.86	10.50
	P/B (x)	16.7	8.5	4.8	3.4	2.9
	FCF Yield (%)	(0.2)	5.7	22.5	17.5	9.8
	Dividend Yield (%)	1.4	2.2	16.4	8.5	4.8
Key drivers	EV/EBITDA (x)	64.37	17.14	2.67	3.54	5.88
Our earnings forecasts are most sensitive to sales volume, USDMYR and raw material prices	EV/EBIT (x)	89.71	19.06	2.72	3.65	6.24
Key risks	Income statement (MYRm)	Aug-19	Aug-20	Aug-21F	Aug-22F	Aug-23F
Lower than expected sales volume/USD and higher than expected raw material prices	Total turnover	4,801	7,236	24,775	20,099	15,668
	Gross profit	884	2,732	16,268	11,172	6,524
	EBITDA	690	2,329	14,568	9,880	5,573
	Depreciation and amortisation	(195)	(235)	(259)	(285)	(313)
	Operating profit	495	2,094	14,309	9,595	5,260
	Net interest	(69)	(53)	(7)	60	123
	Pre-tax profit	424	2,040	14,314	9,664	5,391
	Taxation	(56)	(398)	(3,578)	(2,416)	(1,348)
	Reported net profit	365	1,605	10,711	7,234	4,037
	Recurring net profit	365	1,605	10,711	7,234	4,037
Company Profile	Cash flow (MYRm)	Aug-19	Aug-20	Aug-21F	Aug-22F	Aug-23F
Top Glove is the world's largest disposable gloves producer	Change in working capital	(42)	864	(906)	524	479
	Cash flow from operations	526	3,171	10,035	7,941	4,661
	Capex	(624)	(765)	(500)	(500)	(500)
	Cash flow from investing activities	(494)	(393)	(194)	(191)	(191)
	Cash flow from financing activities	(28)	(44)	(7,162)	(3,802)	(2,191)
	Cash at beginning of period	165	166	1,210	3,637	7,392
	Net change in cash	4	2,734	2,679	3,948	2,279
	Ending balance cash	163	2,897	5,577	9,525	11,804
	Balance sheet (MYRm)	Aug-19	Aug-20	Aug-21F	Aug-22F	Aug-23F
	Total cash and equivalents	253	2,885	3,637	7,392	9,536
	Tangible fixed assets	2,480	3,035	4,939	5,108	5,414
	Total investments	164	164	164	164	164
	Total assets	5,688	8,673	12,242	15,650	17,630
	Short-term debt	1,041	323	273	223	173
	Total long-term debt	1,379	217	63	(111)	(106)
	Total liabilities	3,134	2,363	2,157	1,931	1,885
	Total equity	2,554	6,310	10,086	13,719	15,745
	Total liabilities & equity	5,688	8,673	12,242	15,650	17,630
	Key metrics	Aug-19	Aug-20	Aug-21F	Aug-22F	Aug-23F
	Revenue growth (%)	13.8	50.7	242.4	(18.9)	(22.0)
	Recurrent EPS growth (%)	(15.0)	340.2	567.3	(32.5)	(44.2)
	Gross margin (%)	18.4	37.7	65.7	55.6	41.6
	Operating EBITDA margin (%)	14.4	32.2	58.8	49.2	35.6
	Net profit margin (%)	7.6	22.2	43.2	36.0	25.8
	Capex/sales (%)	13.0	10.6	2.0	2.5	3.2
	Interest cover (x)	6.22	39.47	238.05	173.05	103.58

Source: Company data, RHB

10 March 2021

Consumer Cyclical | Rubber Products

Figure 1: 2QFY21 results snapshot

FYE Aug (MYR m)	2QFY21	1QFY21	2QFY21	QoQ (%)	YoY (%)	1H20	1H21	YoY (%)	Comments
Revenue	1,229.8	4,759.3	5,365.5	12.7	336.3	2,439	10,124	315.1	Revenue surged due to a higher ASP and better volume 1H FY21 sales volume improved 25% YoY
EBITDA	205.6	3,167.0	3,801.4	20.0	1,748.9	401.6	6,961	1,633.5	
<i>EBITDA Margin (%)</i>	<i>16.7</i>	<i>66.5</i>	<i>70.8</i>			<i>16.5</i>	<i>68.8</i>		
Depreciation	(56.2)	(70.7)	(76.5)	8.3	36.1	(110.6)	(151.1)	36.5	
EBIT	149.4	3,096.3	3,724.9	20.3	2,393.7	291.0	6,810	2,240.7	
<i>EBIT Margin (%)</i>	<i>12.1</i>	<i>65.1</i>	<i>69.4</i>			<i>11.9</i>	<i>67.3</i>		
Interest expense	(18.2)	(1.5)	(1.2)	(20.8)	(93.3)	(36.9)	(2.8)	(92.5)	
Associates	(0.8)	0.8	1.3	nm	nm	1.8	2.1	19.3	
Pretax profit	130.4	3,095.5	3,725.0	20.3	2,757.2	255.8	6,810	2,561.8	
<i>Pretax Margin (%)</i>	<i>10.6</i>	<i>65.0</i>	<i>69.4</i>			<i>10.5</i>	<i>67.3</i>		
Tax	(14.4)	(690.3)	(823.3)	nm	5,632.4	(28.1)	(1,521)	5,320.0	
<i>Effective tax rate (%)</i>	<i>11.0</i>	<i>22.3</i>	<i>22.1</i>			<i>11.0</i>	<i>22.3</i>		
Minority Interest	(0.3)	(16.5)	(19.9)	nm	5,935.9	(0.7)	(36.5)	5,423.6	
Perpetual Sukuk	0.0	(12.9)	(12.9)			0.0	(25.7)		
Net Profit	115.7	2,375.8	2,869.0	20.8	2,380.0	227.1	5,227	2,201.4	Makes up 51% of consensus and 49% of our full year estimates
<i>Net Margin (%)</i>	<i>9.4</i>	<i>49.9</i>	<i>53.5</i>			<i>9.3</i>	<i>51.6</i>		Within expectations

Source: Company data, RHB

Sector view: ASP for nitrile gloves to normalize towards a long-term USD40.0 level

We expect USD40.0 per 1,000 pieces to be the long-term bottom ASP for nitrile gloves.

As the US plans to build its own glove manufacturing plants, we estimate production costs at USD40.0 per 1,000 pieces of nitrile gloves. We expect the cost of production in the US to set the bottom of future global nitrile glove prices. If ASP drops below USD40.00, the US producers will probably stop producing and, in the long term, ASPs should revert back to the USD40.00 level.

Production costs in the US are likely to be higher than Malaysia's since labour costs are higher in the US, with the minimum wage at USD7.25 per hour, equivalent to six times that of Malaysia's level. The cost to build a plant in the US is also much higher, as this is a time when commodities - such as steel - are near historical peaks.

Glove ASPs should not fall off the cliff despite an optimism on vaccines. We do expect the demand for gloves specifically for COVID-19 testing to decline – assuming that the pandemic will start to be contained in 2H21. However, some hospitals are using gloves during vaccinations which should keep the demand high. Also the demand for gloves outside of the medical industry is growing faster than expected. In the US, during 4Q20, the importing of items with Code 3962.20.10 "Gloves, seamless, of plastics" (which are polyvinyl chloride (PVC) gloves) has grown 93% YoY. We understand the surge was due to some consumers having no choice but to accept PVC gloves. Such customers would probably shift towards nitrile gloves, once supply is available, which should support demand.

Why long-term ASP should not revert to pre-COVID levels? Our assumption of USD40.0 is higher than the pre-pandemic ASP range of USD20.00-25.00, for nitrile gloves. This is because prior to COVID-19, almost all glove suppliers were efficient producers, incurring costs below USD20.0. When COVID-19 spread across the globe, many new entrants that came into the market began operated at higher costs – estimated between USD30.0 and USD45.0. During this current period of high-priced nitrile gloves (>USD100.00), such inefficient players were able to make a good profit. However, as prices have declined to around USD40.0, some US manufacturers may start to post losses. As such, the demand-supply dynamic should move closer back towards the equilibrium level.

10 March 2021

Consumer Cyclical | Rubber Products

Figure 2: DCF valuation

FYE 31 Aug (MYR m)	FY22F	FY23F	FY24F	FY25F	FY26F	FY27F	FY28F	FY29F	FY30F	FY31F	Terminal
CFO	8,141	4,690	4,355	4,522	4,669	4,797	4,919	5,050	5,302	5,568	
+ Interest (1 - Tax Rate)	42	39	35	32	28	26	23	21	21	21	
- capital expenditure	(500)	(500)	(500)	(500)	(500)	(500)	(500)	(500)	(500)	(500)	
Free cash flow to firm (FCFF)	7,683	4,229	3,890	4,054	4,197	4,322	4,443	4,571	4,823	5,089	74,280
Discount factor	0.92	0.85	0.78	0.72	0.66	0.61	0.56	0.52	0.48	0.44	0.44
PV of FCFF	7,074	3,585	3,037	2,914	2,778	2,635	2,494	2,362	2,296	2,230	32,551
Risk-free	2.9%										
Beta	0.81										
Cost of Equity	8.6%										
WACC	7.9%										
Terminal growth	1.0%										
Enterprise value (MYRm)	63,957										
Cash	4,536										
- Debt	(473)										
Equity value (MYRm)	68,020										
No of shares (m)	8001										
Equity value per share	8.50										
ESG discount	10%										
Operation risk discount	10%										
Total discount	20%										
Target price (MYR)	6.80										

Source: RHB

Figure 3: Key assumptions

Key Assumptions	FY21F	FY22F	FY23F
Installed year-end capacity (m ppa)	85,500	105,000	121,000
Blended ASP (USD per 1000 pieces)	69	49	35
Average USDMYR	4.10	4.10	4.10
Utilisation rate	85%	90%	90%

Source: RHB

Figure 4: TP based on bull, base and bear cases of ASP

Scenario	Aug-21F	Aug-22F	Aug-23F	Long term	TP (MYR)
Bull	69	59	45	45	10.80
Base	69	49	35	35	6.80
Bear	69	39	25	25	2.80

Source: RHB

10 March 2021

Consumer Cyclical | Rubber Products

Recommendation Chart



Source: RHB, Bloomberg

Date	Recommendation	Target Price	Price
2021-01-18	Buy	8.5	6.3
2020-09-18	Buy	9.5	8.0
2020-07-21	Buy	33.3	8.3
2020-07-14	Buy	28.9	7.7
2020-07-07	Buy	24.8	6.8
2020-06-12	Buy	20.5	5.6
2020-06-05	Buy	18.3	5.5
2020-05-14	Buy	13.3	3.4
2020-03-20	Buy	7.0	2.1
2020-01-23	Buy	6.4	1.8
2019-10-07	Neutral	4.5	1.5
2019-09-27	Neutral	4.7	1.5

Source: RHB, Bloomberg

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