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Hartalega Holdings Berhad

“Stressing On Top-Line Growth”

- 4Q16 results review.** To recap, Hartalega Holdings Berhad (Hartalega) registered double-digit growth in revenue and net profit in 4Q16. However, compared to 3Q16, revenue improved by merely 0.6% q-o-q coupled with disappointing PBT of RM67 million (-22% q-o-q) due to the weakening of USD and intensified price war among its peers. Operating margin plunged from 23% to 13% amid a slew of unfavourable factors including the lowest average selling price (ASP) and raw material prices in the last 10 years as well as the increase in natural gas price limiting the potential surge in earnings growth.
- Skewing towards volume play.** As an industry leader, Hartalega is seeing as quick to adapt to fast changing environment by skewing towards volume play to continue to stay competitive. Management guided that the group is working harder to achieve sales target by boosting its utilization to 85-90% from the previous 80-83% as well as further encroaching further into the European market to fetch strong demand for NBR gloves.
- Margins normalization.** The supply surge in nitrile (NBR) gloves has ended Hartalega’s legendary >30% EBITDA margin performance, morphing into margins normalization phase in line with peers of around 18-20% region. Apart from further employing production automation to boost efficiency, the group is also working to diversify its clientele base to reduce dependency on big accounts (10 clients make up 60% group sales) and regain bargain power to deal with much fragmented client base.

Thursday, June 09, 2016

BUY (TP:RM4.78)

Current Price (RM)	RM4.15
New Target Price (RM)	RM4.78
Previous Fair Value (RM)	RM5.70
Previous Recommend.	HOLD
Upside To Fair Value	15%
Dividend Yield (FY16)	2%

Stock Code	
Bloomberg	HARTA MK

Stock & Market Data		
Listing	MAIN MARKET	
Sector	Glove	
Shariah Compliance	Yes	
Issued Shares (mn)	1,641.0	
Market Cap (RM mn)	6,810.3	
YTD Chg In Share Price	-30.1%	
Beta (x)	0.51	
52-week Hi/Lo (RM)	RM6.15	RM3.81
3M Average Volume (shrs)	1.8mn	
Estimated Free Float	28.6%	

Major Shareholders		
Hartalega Industries S/B	49%	
EPF	7%	
Budi Tenggara S/B	3%	

- **Expecting a spike in latex prices.** According to International Rubber Study Group (IRSG), there were substantial planting in 2008-2012 and the new plants would take 7 years to mature, triggering the fear of oversupply in 2015-2019. However, the management is comfortable with nitrile latex price ranging USD1,000 - 1,300 per metric ton while expecting rubber latex to stay between RM5-6 per kg level. Note that suppressed raw material prices could spill over pressure on ASP pricing among manufactures whereas overpricing could lead to stagnant growth in sales volume as customers would rather wait-and-see instead of staking up inventories.
- **Initiate commissioning of Plant 3 & 4.** As the infrastructure works on Plant 3 & 4 have been completed, Hartalega would initiate line commissioning in these two plants in third quarter this year. This would eventually ramp up total production output to around 20 billion pieces per annum by in FY17, which is only -1.4% variance from our expectation for FY17 earnings forecasts.
- **Reaping tax benefits.** Hartalega is set to benefit from tax incentive schemes namely Allowance for Increased Export (AIE) and Reinvestment Allowance (RA). Only one of them can be chosen each year and we understand that the group has benefited from AIE in FY16 and likely to go for for the same in FY17 until the new NGC plant fulfils the 3-year operational period required under the RA scheme. Note that up to 60% of the capex is claimable under RA scheme with a ceiling of 70% statutory income and infinite carry forward for balance surplus to the following year. Hence the management expects a significant rebate in FY18 onwards.
- **Outlook.** There will be a new product launching of lightweight nitrile glove by the end of 2016 which would be another booster for the top-line in FY17 onwards. This new lightweight nitrile glove with additional coating has been studied since the last 5 years according to the management.

On the macro side, the world demand for rubber glove is still believed to command a healthy 8-10% growth according to MARGMA, anticipating 245 billion pieces of examination gloves imported by the world in 2018, compared to 194 billion pieces in 2015. We believe there would be enough room of demand to absorb new capacity from glove manufacturers in the next 4-5 years in post-expansion.

- **Key challenges.** 1) Demand-supply gap in NBR glove segment has been narrowed with more competitors coming in; 2) Pressure to absorb new capacity which could end high inventories or decline in ASP; 3) Potential rise in utilities especially natural gas and electricity ; 4) Freeze hiring of foreign worker could delay the scheduled expansion plans
- **Valuation & Recommendation.** We maintain our target price at RM4.78 based on our target PER and FY17 earnings estimates, suggesting a BUY call with an upside of 15% from yesterday's closing price. Despite losing ground in premium product pricing which has been factored in our current valuation, we reckon that bottom-line growth could also be supported by greater economies of scale after the group decided to shift into volume play strategy. All in, we still like

Company Update - Hartalega Holdings Berhad

Hartalega for its defensive nature of business with sound fundamentals backed by its high production efficiency and on-going innovation in glove manufacturing.

Table 1: Peers Comparison

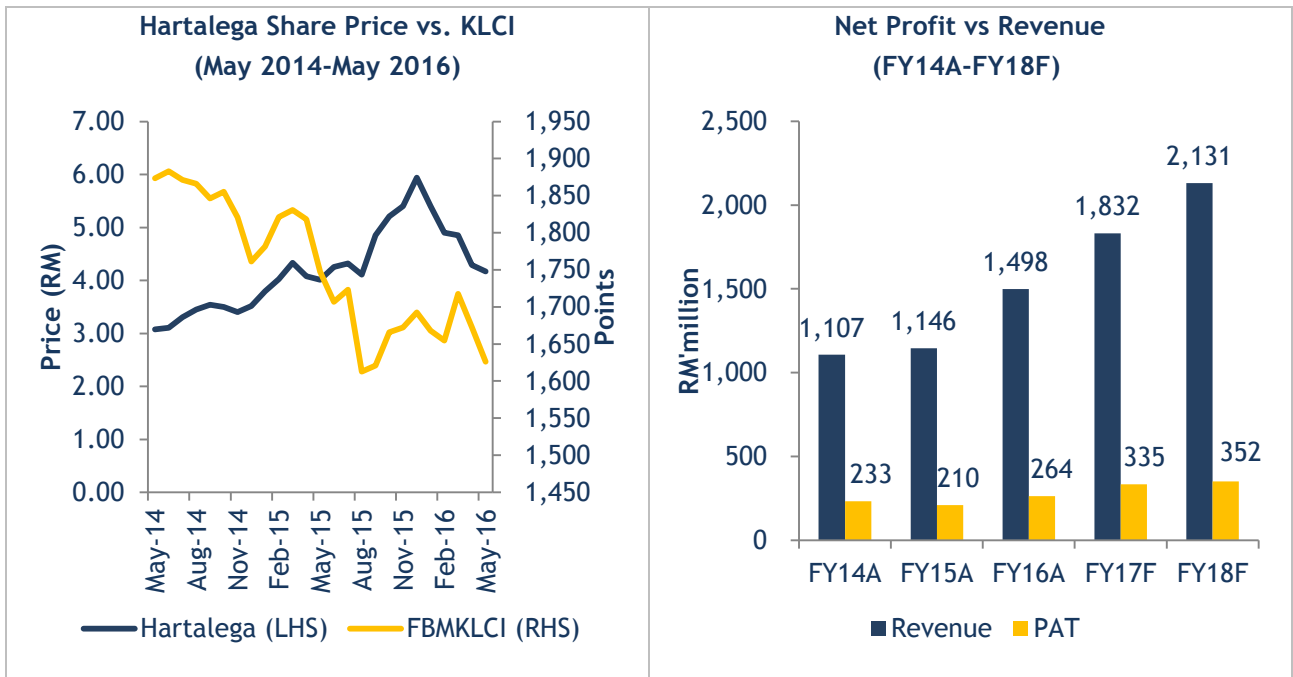
Company	Year Ended	Price (RM)	EPS (sen)		P/E (X)		P/B (X)		ROE (%)	Div Yield (%)	Target Price	Call
			FY15	FY16	FY15	FY16	FY15	FY16				
Hartalega	Mar	4.15	14	20	32	29	3	7	17.9	1.8	4.78	BUY
Top Glove	Aug	5.14	58	67	17	21	4	4	22.5	2.3	6.12	BUY
Kossan	Dec	6.53	29	38	19	20	5	5	21.7	1.7	8.62	BUY
Supermax	Dec	2.31	16	20	11	16	1	2	10.8	1.5	2.94	BUY
Average			29	36	41	22	3	5				

Source: Bloomberg, M&A Securities

Table 3: Financial Forecast

FYE MAR (RM million)	FY14A	FY15A	FY16A	FY17F	FY18F
Revenue	1,107.2	1,146.0	1,498.3	1,744.4	2,029.6
EBITDA	353.6	321.6	401.1	482.3	522.9
D&A	(45.2)	(45.9)	(70.6)	(90.6)	(110.6)
EBIT	308.4	275.7	330.5	391.7	412.3
Net interest income	0.8	1.2	0.0	0.0	0.0
PBT	309.2	276.9	330.5	391.7	412.3
Tax	(75.4)	(66.7)	(66.1)	(78.6)	(83.0)
PAT	233.2	209.7	264.4	313.1	329.3
MI	(0.5)	(0.5)	(0.4)	(0.5)	(0.5)
PATMI	232.7	209.2	264.0	312.6	328.9
EPS	14.2	12.8	16.1	19.1	20.1
EBITDA margin	32%	28%	27%	28%	26%
EBIT margin	28%	24%	22%	22%	20%
PBT margin	28%	24%	22%	22%	20%
Net profit margin	21%	18%	18%	18%	16%
PER (x)	42.1	46.8	37.1	31.3	29.8
P/BV (x)	10.5	7.9	6.6	5.7	5.0
Dividend (sen)	14.5	13.5	8.1	9.5	10.0
Dividend yield	2%	2%	1.35%	1.60%	1.68%

Source: M&A Securities



Source: Bloomberg, M&A Securities

M&A Securities

STOCK RECOMMENDATIONS

BUY	Share price is expected to be $\geq +10\%$ over the next 12 months.
TRADING BUY	Share price is expected to be $\geq +10\%$ within 3-months due to positive newsflow.
HOLD	Share price is expected to be between -10% and $+10\%$ over the next 12 months.
SELL	Share price is expected to be $\geq -10\%$ over the next 12 months.

SECTOR RECOMMENDATIONS

OVERWEIGHT	The sector is expected to outperform the FBM KLCI over the next 12 months.
NEUTRAL	The sector is expected to perform in line with the FBM KLCI over the next 12 months.
UNDERWEIGHT	The sector is expected to underperform the FBM KLCI over the next 12 months.

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