

PP14767/09/2012(030761)

Wednesday, August 03, 2016

Hartalega Holdings Berhad

“Record Sales with Lower Margins”

Results Review

- Actual vs. Expectations.** Hartalega Holdings Berhad (Hartalega) recorded strong revenue growth in 1Q17 after delivering record high top line of RM401.8 million (+25% y-o-y), surpassing the previous record of RM400.4 million in 4Q16. The record sales were boosted by a number of factors including continuous capacity expansion, strengthening of USD and rising demand. Notwithstanding that, EBITDA slid 3% y-o-y from RM95 million to RM92 million and PBT saw a fall of 15% y-o-y to RM68 million. The drop in earnings margin was driven by the increase in production costs (raw material prices, natural gas, etc) and higher overheads. PATMI stood at RM56 million, making up 18% of our FY17 forecast, marginally below expectation due to the reasons aforementioned.
- Dividend.** No dividend was declared in 1Q17. The Board proposed a final dividend of 2 sen which would be paid on 23 September 2016 upon shareholders' approval at the AGM dated 23 August 2016. Note that the final dividend of 2 sen is 50% lower than what was paid in the last corresponding period. Yield is expected to remain at 2% level in FY17/18.
- Lower operating margins.** Hartalega's saw its 1Q17 EBIT and EBITDA margins slid by 6% y-o-y and 7% y-o-y to 23% and 19%, respectively due to higher production costs and high start-up cost at new NGC plants. EBITDA per thousand gloves touched RM19.13 (-30% y-o-y ; -8% q-o-q), which was within our expectations. Note that, production cost to sales percentage increased from 74% in 1Q16 to 83% in 1Q17. Most of the increase was caused by higher overhead expenses such as utilities, maintenance, labour costs, etc. The recent hike in natural gas from existing average RM25.53 MMBtu to RM27.05 MMBtu effective on 15th July 2016 will

BUY (TP:RM4.78)

Current Price (RM)	RM4.24
New Target Price (RM)	RM4.78
Previous Fair Value (RM)	RM5.70
Previous Recommend.	HOLD
Upside To Fair Value	13%
Dividend Yield (FY16)	2%

Stock Code

Bloomberg	HARTA MK
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Stock & Market Data

Listing	MAIN MARKET	
Sector	Glove	
Shariah Compliance	Yes	
Issued Shares (mn)	1,641.0	
Market Cap (RM mn)	6,958.2	
YTD Chg In Share Price	-28.6%	
Beta (x)	0.51	
52-week Hi/Lo (RM)	RM6.15	RM3.81
3M Average Volume (shrs)	1.8mn	
Estimated Free Float	30.9%	

Major Shareholders

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

continue to add pressure to the group's overhead costs.

- **Continued meeting market demand.** Despite facing increasingly intense competition with other big players, Hartalega managed to ship out 4.1 billion pieces of gloves (+26% y-o-y; +1% q-o-q), with 92% made up by nitrile gloves. The collapse of latex prices had also stimulated the growth in import of natural rubber gloves which we noticed 122% surge in the sales quantity of latex gloves in 1Q17 from 160 million pieces to 355 million pieces. This proved that Hartalega had responded fast to meet market demand regardless of its nitrile-centric production planning.
- **Revenue from latex gloves improved.** As mentioned, as latex gloves regain traction among importers due to cheap commodity prices, sales contribution of latex gloves expanded from RM15.6 million to RM30 million (+92% y-o-y ; +30% q-o-q). We expect the off-take of latex gloves will see continued improvement and stay on course until further recovery in raw material prices that would drive the cost of production. Product mix shifted from NBR 95:NR 5 in 1Q16 to NBR 92:NR 8 in 1Q17.
- **Capacity output remained stable.** There were 69 production lines running in 1Q17 with slightly higher utilisation rate of 82% (compared to 81% in 4Q16). On year-on-year, production capacity grew 33% from 4.1 billion pieces to 5.4 billion pieces per annum in 1Q17 and we see much room for Hartalega to fetch pent-up demand by ramping up their output level should the off-take increases as the company can utilize >85% of their capacity based on past record.
- **Changes to forecast.** No changes of forecast for now. We maintain our FY17/18 earnings estimates, assuming RM4.00 exchange rate for FY17/18 and expect the group's bottom line to achieve our targets of RM313 million and RM329 million at PATMI level in 2 years down the road.
- **Outlook.** Hartalega will continue to focus on growing its top-line by opening up more new markets with high growth potential such as Thailand, France, Italy and Spain. Widening clientele base and geographical outreach would help mitigate the pricing pressure from customers, subsequently sustaining the bottom-line growth in the coming years.
- **Valuation & Recommendation.** We deem the current latex prices and USD/Ringgit exchange rate are favourable to Hartalega despite facing price competition. The potential interest rate hike in the U.S. in 2H16 could lift US dollar further and hence expanding the top-line of Hartalega as >90% of the sales are from export markets. On the other hand, the demand for glove will continue to drive glove industry by 8-10% per annum, projecting world import of 245 billion pieces of examination gloves in 2018, which is 26% higher than last year. The demand for nitrile glove is expected to grow in the long run despite seeing opportunistic switch to latex gloves by importers in recent quarters due to the collapse of latex prices.

We maintain our target price at RM4.78 based on the target PER of 25x against FY17 EPS of 19.1 sen with a **BUY**.

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	4.26	14	20	32	29	3	7	17.9	1.8	4.78	BUY
Top Glove	Aug	4.33	58	67	17	21	4	4	22.5	2.3	6.12	BUY
Kossan	Dec	6.80	29	38	19	20	5	5	21.7	1.7	8.62	BUY
Supermax	Dec	2.08	16	20	11	16	1	2	10.8	1.5	2.94	HOLD
Average			29	36	41	22	3	5				

Source: Bloomberg, M&A Securities

Table 2: Financial Summary

FYE MAR (RM million)	1Q17	4Q16	1Q16	Q-o-Q	Y-o-Y
Revenue	402	400	321	0%	25%
EBITDA	92	109	95	-16%	-3%
D&A	(17)	(38)	(15)	-55%	12%
EBIT	75	71	80	5%	-6%
Net interest income	0	0	0	151%	-41%
PBT	68	71	80	-4%	-15%
Tax	(12)	(9)	(17)	25%	-32%
PAT	56	62	63	-9%	-10%
MI	(0)	(0)	(0)	363%	104%
PATMI	56	62	63	-9%	-11%
EPS	3	4	4	-9%	-11%
EBITDA margin	23%	27%	30%	4%	-7%
EBIT margin	19%	18%	25%	-1%	-6%
PBT margin	17%	18%	25%	1%	-8%
Net profit margin	14%	15%	20%	1%	-6%

Source: M&A Securities

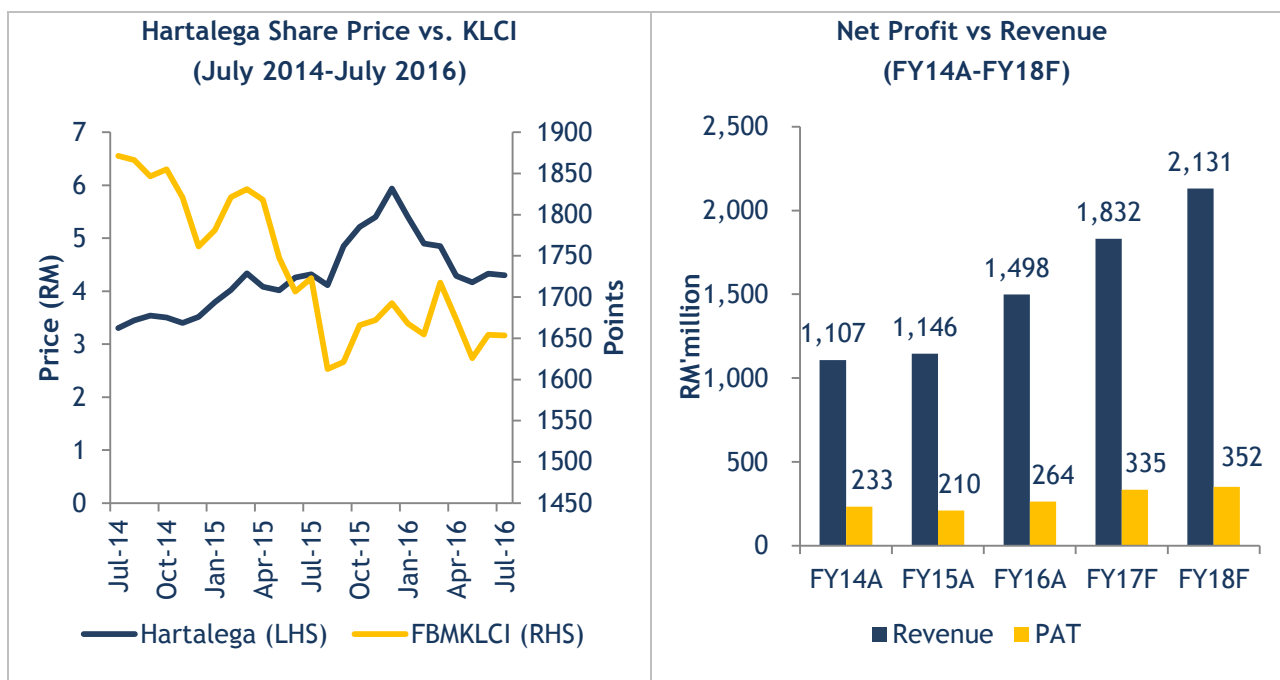
Table 3: Financial Forecast

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%

Results Review- Hartalega Holdings Berhad

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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