27 February 2013 | Visit Note

Hartalega Holdings Berhad

Ramping up Plant 6

Maintain BUY

***Unchanged* Target Price (TP):RM5.19**

INVESTMENT HIGHLIGHTS

- **Half of Plant 6 in full swing.**
- **Leadership in efficiency enhanced with Plant 6.**
- **NGC Project to start construction this year.**
- **Minimum impact from minimum wage policy implementation.**
- **Competition to affect profitability, but market share expected to be sustained.**
- **Maintain BUY with an unchanged TP of RM5.19.**

We visited Hartalega recently. The key takeaways are:

Half of Plant 6 already in full force. Hartalega's latest plant, Plant 6, commenced construction in Jan 2012 and commissioned its first production line in Sept 2012. This plant will in total have in total ten nitrile glove production lines, adding up another 3.9b pieces per annum of nitrile glove production capacity to the Group. To date, five production lines are already in operation, with another five lines scheduled to be fully operational by the middle of 2013.

Plant 6 strengthens Hartalega's leadership in efficiency. Already possessing speed of production lines that are consistently higher than the industry average, Plant 6 marked a new milestone to the Group, with record speed of lines reaching 45,000 pieces per hour. We believe the Group's continuous strive for higher output per production line will enable it to maintain its competitive advantage over the long run, as it is set to reap the benefit of economies of scale from the higher efficiency and productivity, which would translate into lower fixed costs per glove.

Products mainly sold to the developed markets. As the largest nitrile glove producer, the majority of the Group's products are sold to the more developed and quality demanding markets, such as USA, Europe and Japan. Currently, 52% of the Group's products are exported to USA, with Europe coming in second with 33% of the Group's products sold in this region. As of 2011, the Group commands a 16% share of USA's synthetic exam glove market.

Europe the main growth contributor. While USA still consumes more than half of the Group's products, the main growth potential is expected to come from Europe. In FY2012 alone, sales of nitrile gloves to Europe surged 168.7%yoy to 2.4b pieces, while over the last five years, sales of nitrile glove to this region recorded a staggering 45-fold growth. As compared to USA, with currently 68% of total glove consumption made up by nitrile gloves, nitrile gloves currently make up 41% of the total glove consumption in Europe. As such, we remain convinced that the nitrile wave in Europe is set to be sustained for the next few years, until at least half of its glove market is made up by nitrile gloves.

RETURN STATS	
Price (26 Feb 2013)	RM4.75
Target Price	RM5.19
Expected Share Price Return	9.3%
Expected Dividend Yield	3.3%
Expected Total Return	**12.6%**
STOCK INFO	
KLCI	1,624.18
Bursa / Bloomberg	5168 / HART MK
Board / Sector	Main/ Industrial Products
Syariah Compliant	Yes
Issued shares (mil)	733.0
Par Value (RM)	0.50
Market cap. (RM'm)	3,474.4
Price over NA	4.80x
52-wk price Range	RM3.58–RM5.07
Beta (against KLCI)	0.62
3-mth Avg Daily Vol	0.37m
3-mth Avg Daily Value	RM1.80m
Major Shareholders	
Hartalega Industries	50.2%

INVESTMENT STATISTICS

FYE Mar	FY11	FY12	FY13F	FY14F
Revenue (RM'm)	734.9	931.1	1,015.3	1,173.8
EBIT (RM'm)	245.3	260.1	284.3	328.7
Pretax Profit (RM'm)	242.8	258.4	281.2	325.1
Net Profit (RM'm)	190.3	201.4	219.4	253.6
EPS (sen)	26.18	27.65	29.93	34.60
EPS growth (%)	33.2	5.8	8.9	15.6
PER(x)	18.3	17.3	15.9	13.7
Net Dividend (sen)	10.5	10.8	13.5	16.0
Net Dividend Yield (%)	2.2	2.3	2.8	3.3

Source: Company, Forecasts by MIDFR

Asia the next frontier. With the still relatively underserved markets in the developing countries, we expect the next huge growth opportunity for the rubber glove industry lies in the emerging markets, with China, Asia, and South America holding the largest potential for growth opportunities. For instance, annual glove consumption per capita for USA and Europe stands at 149.3 and 98.0 pieces respectively, while Asia's and China's consumption per capita stands at 4.6 and 4.8 pieces per annum. This huge disparity in per capita consumption of glove signifies the huge untapped growth potential for rubber glove producers, Hartalega included. Assuming the consumption level in Asia reaches the similar level to Europe's, Asia as a whole has market potential of 369b pieces per annum, which is enormous by any mean.

Nitrile wave set to continue. Currently, nitrile gloves make up approximately 40% of the global glove demand, with the remaining majority 60% still being made up by latex gloves. However, in 2011, with Malaysia being world's largest rubber glove producer, total export of nitrile glove grew by 29%yoy, as compared to the average annual 8%yoy growth for rubber gloves as a whole. Furthermore, all major markets registered contraction in importation of latex gloves from Malaysia, while registering growth in nitrile glove import from Malaysia. Consequently, nitrile glove made up 39% of Malaysia's total rubber glove export in 2011, up 8%-points from the previous year. We expect the global switching trend from latex to nitrile glove to continue at around 20% annually over the foreseeable future due to a couple of factors, namely the anti-latex policy being implemented among the hospitals in the developed markets due to protein allergy, and the still relatively lower raw material price of nitrile compared to natural rubber.

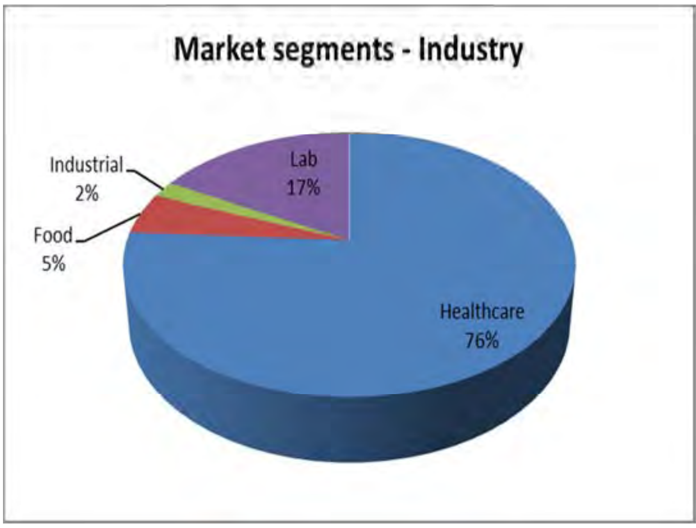
NGC project set to start this year. The next phase of the Group's growth, the Next Generation Integrated Glove Manufacturing Complex (NGC) project, is set to start construction this year. The Group has identified a 112-acre land, and is in the process of signing the Sales and Purchase Agreement. This NGC project is a massive and ambitious project by the Group, requiring RM1.5b of investment and a duration of eight years to be completed, with a projected total installed capacity of 28.3b pieces per annum. With the huge size of the project, there is a concern of whether the Group's management will be able to succeed in implementing the project. However, with the excellent track record of the management, we remain confident that they will be able to ensure the project is going to be completed within the stipulated costs and timeframe.

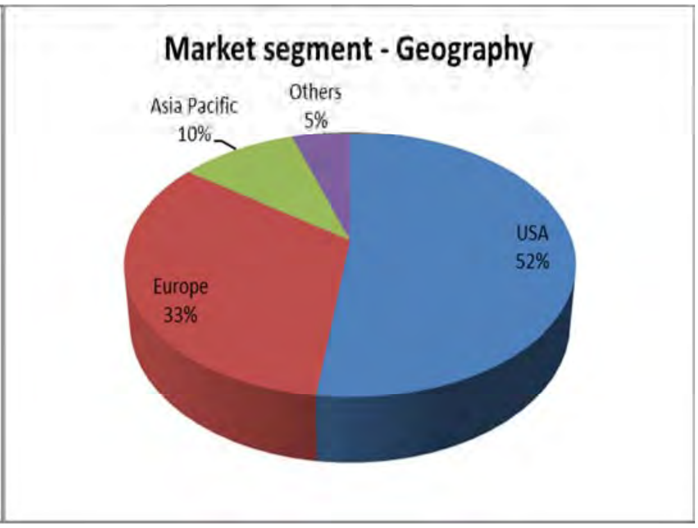
Minimal impact from minimum wage policy implementation. There is a worry that the implementation of the minimum wage policy will adversely affect the profitability of the Group. However, we expect the incremental costs associated with the new policy to be more than mitigated by higher selling prices and further automation of the manufacturing processes, As is always the case with the rubber glove industry, the selling price will be determined through negotiation between the manufacturers and the buyers, thus we expect the higher labor costs to be passed through to the buyers to protect the profitability of the manufacturers. Additionally, further automation of the manufacturing processes will significantly reduce the number of labor force and labor costs over the next few years, which would also lead to a lower impact on the Group from the minimum wage policy.

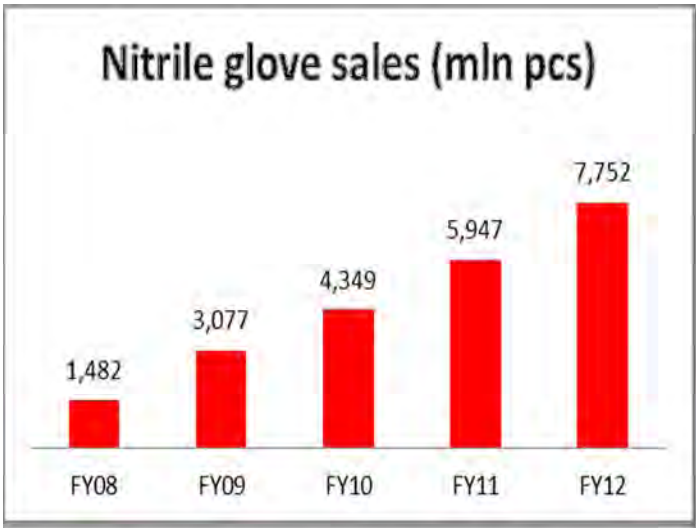
Competition to affect profitability, but market leadership to be maintained. As of now, Hartalega boasts one of the highest profit margins in the industry. The main reason can be contributed to the fact that nitrile gloves typically fetch a premium in selling prices compared to latex gloves, and Hartalega is the world's largest nitrile glove producer currently. However, due to the increasing competition from other players that are eager to have a slice of the nitrile glove market, we expect the profitability of the Group to be to a certain extent affected by the anticipated lower selling price of the nitrile glove. Nonetheless, we continue to believe that due to the Group's continuous obsession in its research and development activities, we expect the Group to come out with more breakthrough products and technologies, hence maintain its advantage in productivity and efficiency, which will ensure its leadership in profitability would be maintained.

FY14 prospect. The operating environment for the glove producers has improved substantially in the last few months, contributed by the easing of raw material prices. The easing in prices of butadiene, which is a key component for nitrile, and natural rubber latex, has been attributed to the slowdown in global economy. On the view that the world economic condition is not going to show substantial improvement in the next 12 months, we expect the prices for both commodities to remain around the current level. As nitrile latex and natural rubber latex each makes up 45% and 5% of the total production cost for Hartalega, we expect Hartalega would be able to maintain its impressive performance over the foreseeable future.

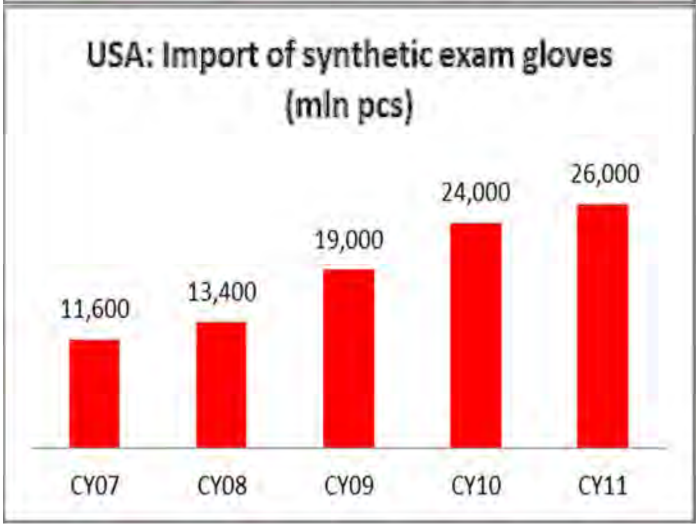
Maintain BUY with an unchanged TP of RM5.19. We maintain our BUY recommendation for the stock with an unchanged TP of RM5.19 per share. Our valuation is derived from a multiple of 15 times of the Group's forecasted FY14F EPS, based on the industry's weighted average price earnings multiple. Based on its track record, we are confident that the Group's management is more than capable of sustaining the revenue and profit Growth of the Group. At the current price, we are of the opinion that the stock is still undervalued and therefore offers an ample appreciation potential over the next twelve months, hence reiterating our BUY call on the counter.

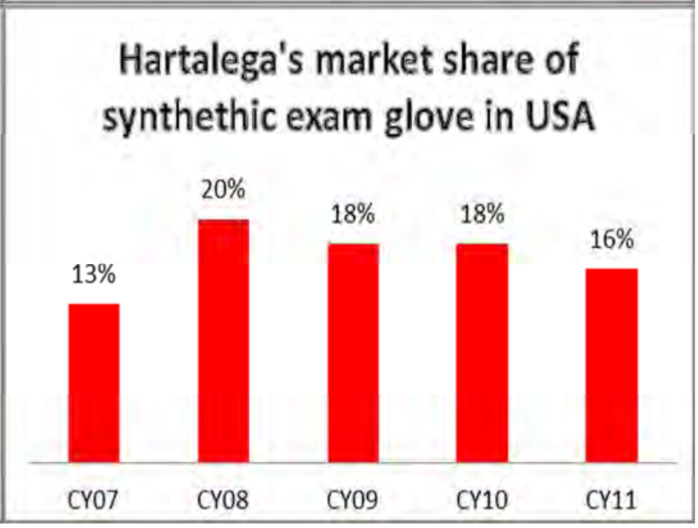


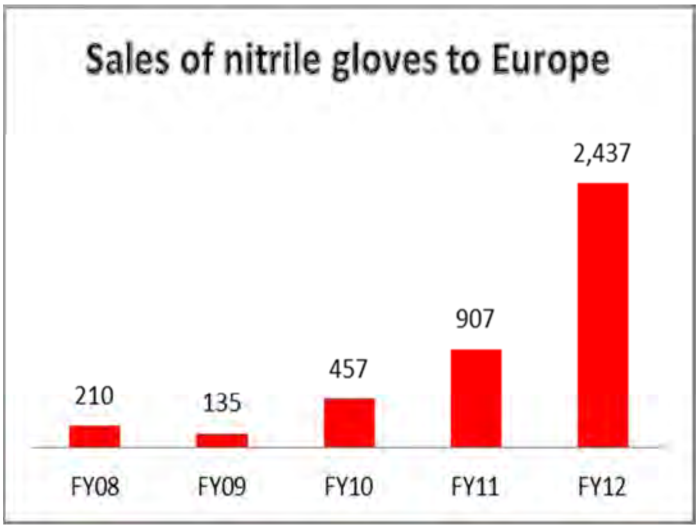


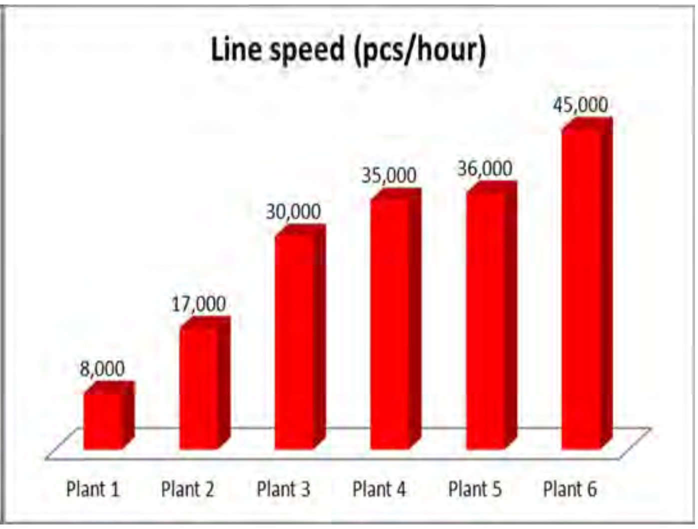

Nitrile glove sales (mln pcs)
1,482
3,077
4,349
5,947
7,752
FY08
FY09
FY10
FY11
FY12

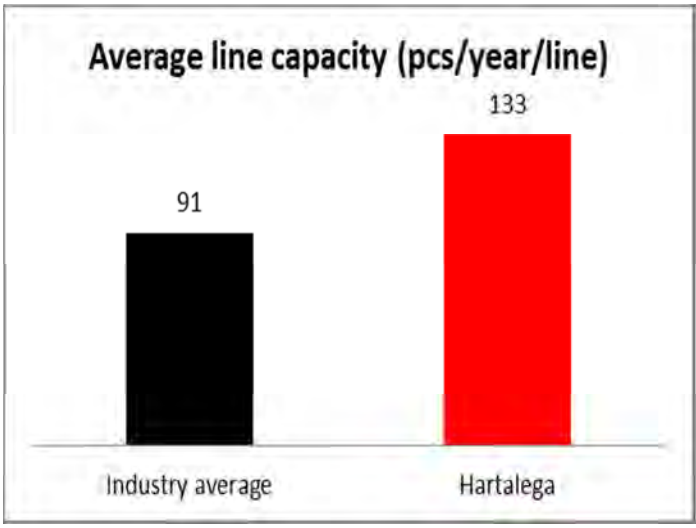

Sales of nitrile gloves to USA (mln pcs)
1,412
2,481
3,375
4,325
4,209
FY08
FY09
FY10
FY11
FY12

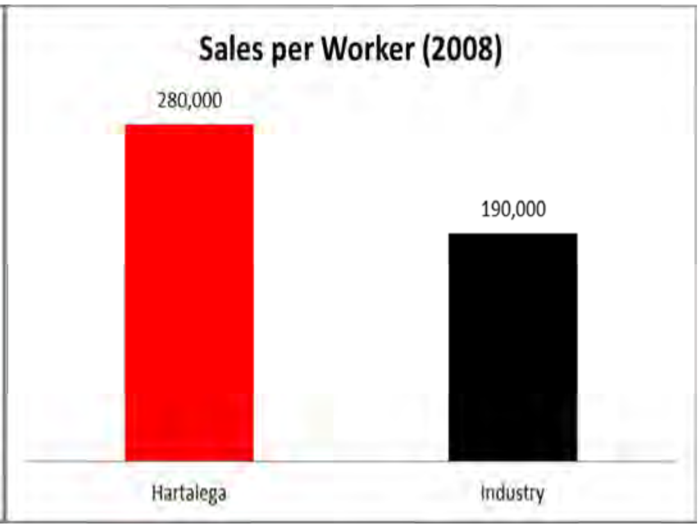

USA: Import of synthetic exam gloves (mln pcs)
11,600
13,400
19,000
24,000
26,000
CY07
CY08
CY09
CY10
CY11


Hartalega's market share of synthethic exam glove in USA
13%
20%
18%
18%
16%
CY07
CY08
CY09
CY10
CY11


Sales of nitrile gloves to Europe
210
135
457
907
2,437
FY08
FY09
FY10
FY11
FY12


Line speed (pcs/hour)
8,000
17,000
30,000
35,000
36,000
45,000
Plant 1
Plant 2
Plant 3
Plant 4
Plant 5
Plant 6





DAILY PRICE CHART

Zulkifli Hamzah
Azman Hussin
azman@midf.com.my
03-2772 1663

MIDF RESEARCH is part of MIDF Amanah Investment Bank Berhad (23878 - X).
(Bank Pelaburan)
(A Participating Organisation of Bursa Malaysia Securities Berhad)

DISCLOSURES AND DISCLAIMER

This report has been prepared by MIDF AMANAH INVESTMENT BANK BERHAD (23878-X). It is for distribution only under such circumstances as may be permitted by applicable law.

Readers should be fully aware that this report is for information purposes only. The opinions contained in this report are based on information obtained or derived from sources that we believe are reliable. MIDF AMANAH INVESTMENT BANK BERHAD makes no representation or warranty, expressed or implied, as to the accuracy, completeness or reliability of the information contained therein and it should not be relied upon as such.

This report is not, and should not be construed as, an offer to buy or sell any securities or other financial instruments. The analysis contained herein is based on numerous assumptions. Different assumptions could result in materially different results. All opinions and estimates are subject to change without notice. The research analysts will initiate, update and cease coverage solely at the discretion of MIDF AMANAH INVESTMENT BANK BERHAD.

The directors, employees and representatives of MIDF AMANAH INVESTMENT BANK BERHAD may have interest in any of the securities mentioned and may benefit from the information herein. Members of the MIDF Group and their affiliates may provide services to any company and affiliates of such companies whose securities are mentioned herein This document may not be reproduced, distributed or published in any form or for any purpose.

MIDF AMANAH INVESTMENT BANK : GUIDE TO RECOMMENDATIONS	
STOCK RECOMMENDATIONS	
BUY	Total return is expected to be >15% over the next 12 months.
TRADING BUY	Stock price is expected to *rise* by >15% within 3-months after a Trading Buy rating has been assigned due to positive newsflow.
NEUTRAL	Total return is expected to be between -15% and +15% over the next 12 months.
SELL	Total return is expected to be <15% over the next 12 months.
TRADING SELL	Stock price is expected to *fall* by >15% 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.