

Hartalega Holdings Bhd

RESULTS UPDATE

BUY

Target Price RM 5.73
Current Price RM 5.24
Consensus Target Price RM 5.25

Key Statistics

| | |
|------------------------------|------------|
| Bloomberg Ticker | HART MK |
| Masa Ticker / Stock Code | HARTA/5168 |
| Shares Issued (m) | 732.6 |
| Market Capitalisation (RM'm) | 3,843 |
| 52 Week Hi/Lo Price (RM) | 5.30/3.56 |
| Avg Trading Volume (3-mth) | 675,008 |
| Est Free Float (m) | 329.6 |
| YTD Returns (%) | 10.4 |
| Beta (x) | 0.68 |

Major Shareholders (%)

| | |
|--------------------|------|
| Hartalega Holdings | 50.2 |
| Budi Tenggara | 5.0 |

1-Year Share Price Performance



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Positive Economic Backdrop

Rubber glove exports continue to be resilient as they grew 16% YoY. Furthermore, weakening raw material prices provides stronger margin despite lower revenue. We maintain BUY with a target price of RM5.73 (pegged to 14x PER FY14 EPS). The main catalysts for the share price upside potential are 1) lower than expected raw material costs 2) USD appreciation against Ringgit.

Highlights:

- ◆ Nitrile rubber (NBR) gloves grew 16% as more consumers switch away from nature rubber (NR) gloves
- ◆ The avian flu outbreak in China will not be a significant catalyst for Hartalega's earnings
- ◆ A new gas supply agreement
- ◆ Next Generation Integrated Glove Manufacturing Complex (NGC) is expected to operate at August 2014
- ◆ Lower raw material prices offsets lower ASP for Hartalega leading to better margins

Table 1: Earnings Forecasts

| FYE Mar | FY11 | FY12 | FY13(F) | FY14(F) | FY15(F) |
|-----------------------|----------|----------|----------|----------|----------|
| Revenue (m) | 735 | 931 | 1,025 | 1,323 | 1,589 |
| Pretax Profit (m) | 243 | 258 | 285 | 393 | 477 |
| Net Profit (m) | 190 | 201 | 222 | 300 | 363 |
| EPS (sen) | 26.0 | 27.5 | 30.3 | 40.9 | 49.6 |
| Pretax margin (%) | 33.0 | 27.8 | 27.8 | 29.7 | 30.0 |
| Net Profit margin (%) | 25.9 | 21.6 | 21.6 | 22.7 | 22.8 |
| PER (x) | 20.2 | 19.1 | 17.4 | 12.9 | 10.6 |
| DPS (sen) | 10.5 | 10.8 | 13.6 | 18.4 | 22.3 |
| Dividend Yield (%) | 2.0 | 2.1 | 2.6 | 3.5 | 4.3 |
| ROE (%) | 38.5 | 32.5 | 35.8 | 32.9 | 33.7 |
| ROA (%) | 30.0 | 26.6 | 29.2 | 33.5 | 36.1 |
| Net Gearing Ratio (%) | Net Cash | Net Cash | Net Cash | Net Cash | Net Cash |
| BV/Share | 0.7 | 0.8 | 0.8 | 1.2 | 1.5 |
| Price/Book Ratio (x) | 7.8 | 6.2 | 6.2 | 4.3 | 3.5 |

Source: Inter-Pacific

♦ **Nitrile Rubber Gloves Growing In Popularity**

NBR strong production growth continues as more NR glove users switch to NBR gloves. NBR gloves are preferred due to their price stability and growing latex allergy awareness. Total NBR glove exports from Malaysia grew 16.6% while latex gloves grew 3.9% in 2012. Export trends are in tandem with the positive growth of NBR gloves as the NR:NBR ratio stood at 54:46 in 2012 compared to 58:42 in 2011. In respect of glove exports growth, total glove exports expanded 15% from 35.6 billion pairs to 40.7 billion pairs YoY, signaling that expansion of demand continues.

Elsewhere, total glove exports to USA increased 16.2% from 11.2 billion pairs to 13 billion pairs, while NR:NBR ratio stands at 26:74 in 2012 as compared to 32:67 in 2011. In Europe, total exports expanded 4% from 10.7 billion pairs to 11.2 billion pairs, while the NR:NBR ratio stands at 48:52 in 2012 as compared to 41:59 in 2011. Furthermore, total exports to Japan grew 17.7% from 1.8 billion pairs to 2.1 billion pairs, while NR:NBR ratio stood at 35:65 in 2012 compared to 43:57 in 2011. In short, increasing demand for NBR gloves provides a favorable backdrop for Hartalega.

Chart 1(a): Malaysia Total Glove Exports

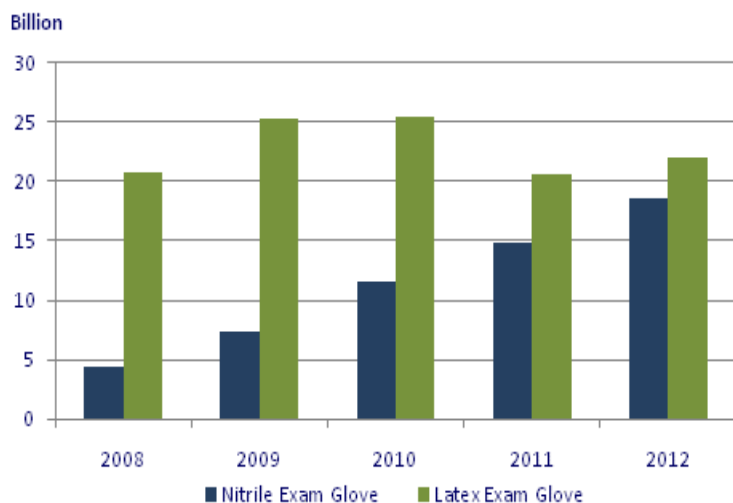


Chart 1(b): Malaysia Total Glove Exports Ratio

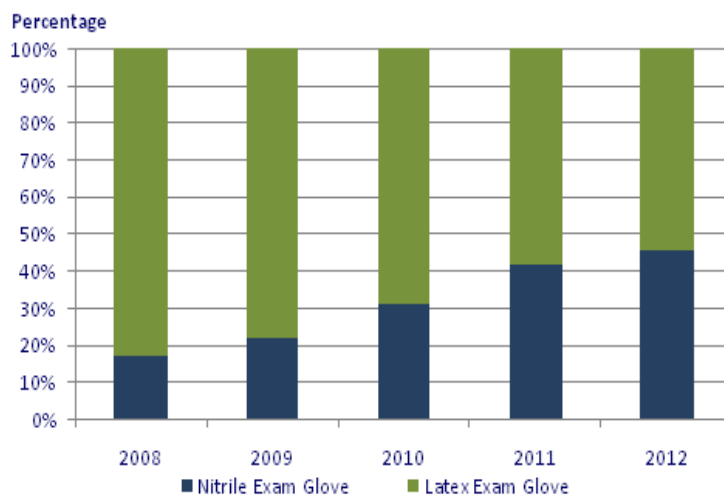


Chart 2: Malaysia Glove Exports to USA

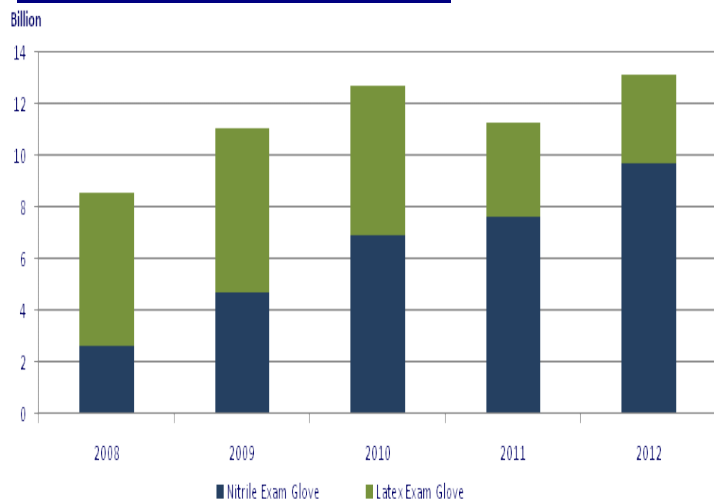
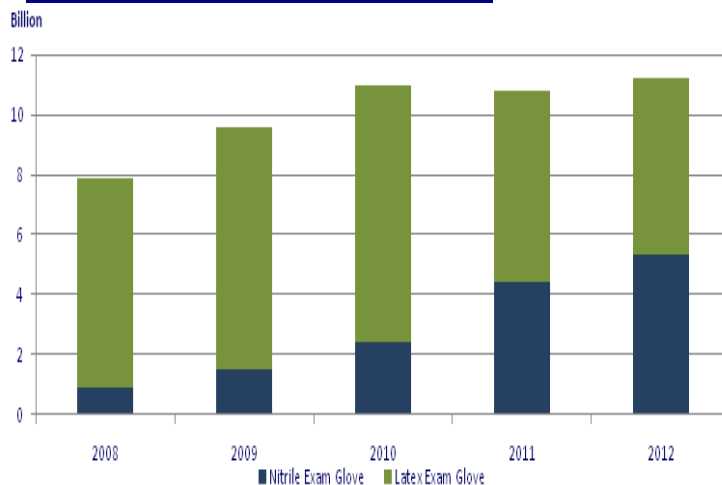
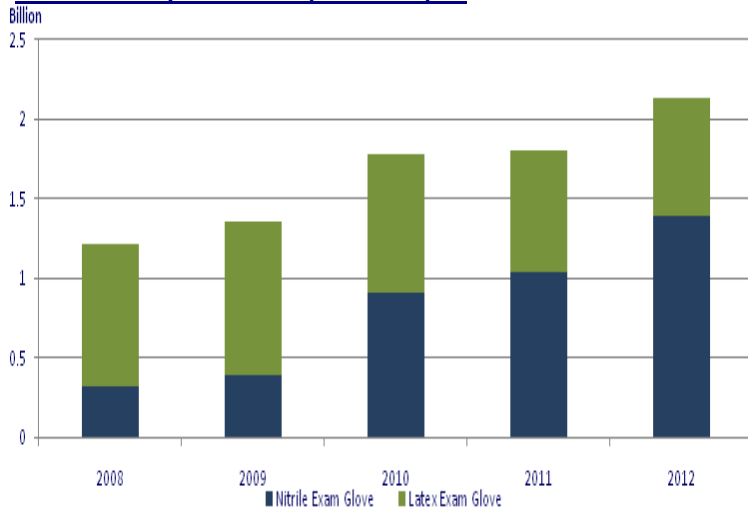


Chart 3: Malaysia Glove Exports to Europe



Source: MREPC

Chart 4: Malaysia Glove Exports to Japan



Source: MREPC

◆ Avian flu in China

The outbreak of the H7N9 avian flu poses an earnings risk to the food industry, airlines and insurance. As a side note, it is a positive catalyst for healthcare services. As we mentioned in our initiation report, bird flu is constantly mutating and no permanent vaccine offers reliable prevention. In this respect, examination gloves are constantly needed in the healthcare industry and are a necessity regardless of economic conditions. China's market share for NR (natural rubber) stands at 15% while standing at 5% in respect of nitrile rubber gloves (NBR). China's glove production is dominated by PVC (Polyvinyl Chloride) gloves, as gleaned from industry sources.

Hartalega owns a distribution centre in China and may capture the surge there in demand for examination gloves. More than half of Hartalega's production capacity can be switched between NR and NBR gloves. However, we believe Hartalega's priority is to establish a stronger foothold in Europe as more users there are switching to NBR gloves. Furthermore, Hartalega's utilization capacity is well above 90%, with a long order backlog. Hartalega does not have spare capacity to use as a bargaining chip to take advantage of higher prices in this current epidemic. Hence we believe the current avian flu will not be a significant earnings catalyst for the company.

◆ New gas supply agreement

The take-or-pay agreement stipulates that the user has to purchase a fix amount of gas regardless if the gas is not used. The user has to pay 10% more for consumption above the quota. There will be an eight-month trial period until year end with no penalties if variation occurs. From the viewpoint of both sides, the new gas agreement will increase Hartalega's operational costs as consumption below the quota is considered as resource wastage while consumption above quota will cost 10% more. Fuel is 8% of Hartalega's production cost in FY12. We also believe energy costs could rise after the 13th General Elections and as commonly happens, glove manufacturers will pass the additional cost on to the consumers.

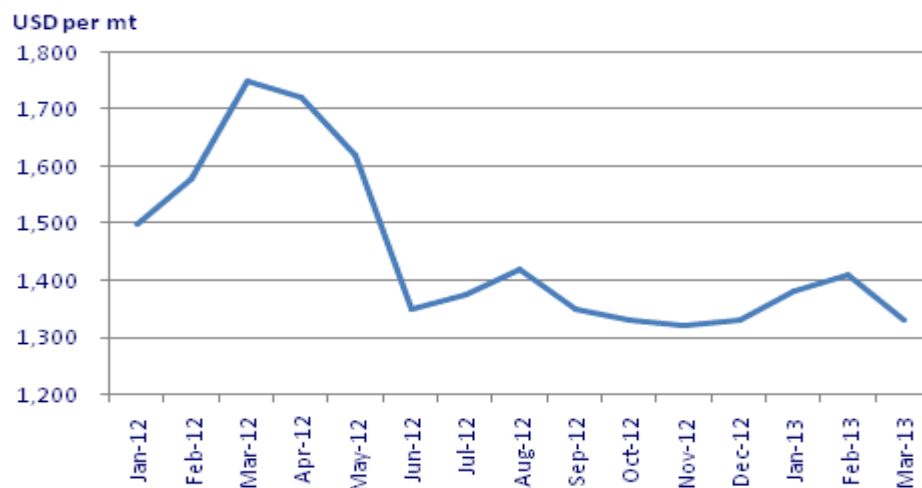
◆ **Update on Next Generation Integrated Glove Manufacturing Complex (NGC)**

Previously we mentioned Hartalega was in the process of acquiring the land in Sepang. Construction would begin at 2HCY2013 and it is scheduled to commission its first production line during CYE August, 2014. NGC will have an annual capacity of 28.3b pieces of gloves and is expected to progressively increase its production from 2014 till 2021.

◆ **Lower raw material prices, lower ASP for Hartalega**

In the respect of overall weakening of commodity prices, nitrile butadiene rubber prices fell 21% YoY from USD1,750/mt to USD1,330/mt. As reported by both Hartalega and Supermax, both manufacturers reduced their ASPs. We believe falling ASP is in tandem with lower input costs albeit with a lag, as both companies reported better margins for the previous quarter.

Chart 5: Nitrile Butadiene Rubber Prices



Source: Company

Valuation

We reiterate our **BUY** recommendation for Hartalega Holdings Bhd with a target price of **RM5.73** (pegged to 14x PER FY14 EPS). Hartalega's PE ranged in the past 2-years between 9.6x-17.4x with the average at 12.7x. The main catalysts for potential price upside are 1) lower than expected raw material costs 2) USD appreciation against the Ringgit.

Ratings System

| Ratings: | Description: |
|----------|--|
| BUY | Total return is expected to exceed 15% in the next 12 months |
| NEUTRAL | Total return is expected to be between above -15% to 15% in the next 12 months |
| SELL | Total return is expected to be below -15% in the next 12 months |

Abbreviation

| Abbreviation | Definition | Abbreviation | Definition |
|--------------|----------------------|--------------|----------------------------------|
| PER | Price Earnings Ratio | CAGR | Compounded Annual Growth Rate |
| PEG | PER to Growth | CAPEX | Capital Expenditure |
| EPS | Earnings per Share | DPS | Dividend per Share |
| FYE | Financial Year End | ROA | Return on Asset |
| FY | Financial Year | ROE | Return on Equity |
| CY | Calendar Year | PBT | Profit Before Tax |
| MoM | Month-on-Month | PAT | Profit After Tax |
| QoQ | Quarter-on-Quarter | EV | Enterprise Value |
| YoY | Year-on-Year | EBIT | Earnings Before Interest And Tax |
| YTD | Year-to-Date | EBITDA | EBIT Depreciation & Amortisation |
| p.a. | Per Annum | WACC | Weighted Average Cost of Capital |
| DCF | Discounted Cash Flow | NTA | Net Tangible Asset |
| FCF | Free Cash Flow | BV | Book Value |
| NAV | Net Asset Value | | |

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