PUBLIC INVESTMENT BANK

KDN PP17686/03/2013(032117)

HARTALEGA HOLDINGS BERHAD

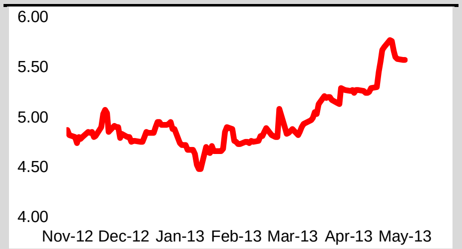
Neutral

DESCRIPTION

The world's largest nitrile glove manufacturer. Renowned for its innovative technological methods.

12-Month Target Price	RM5.59
Current Price	RM5.57
Expected Return	0.4%
Market	Main
Sector	Rubber Gloves
Bursa Code	5168
Bloomberg Ticker	HART MK

SHARE PRICE CHART



52 Week Range (RM)	3.56-5.84
3-Month Average Vol ('000)	652.4

SHARE PRICE PERFORMANCE

	1M	3M	6M
Absolute Returns	5.7	18.1	14.2
Relative Returns	1.5	7.0	3.8

KEY STOCK DATA

Market Capitalisation (RM m)	4085.6
No. of Shares (m)	733.5

MAJOR SHAREHOLDERS

	%
Hartalega Industries	50.2
BNP Paribas	7.4
Budi Tenggara	5.0
EPF	3.7
JP Morgan	2.4

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Growing On Efficiency

Hartalega saw an opportunity in synthetic (nitrile) (NR) gloves back in 2002, and since 2010 has become the world's largest nitrile glove producer currently manufacturing 11.2bn gloves and to increase to c.14bn by FY14. While promising, we believe most of this growth has been priced-in, thereby leading us to initiate coverage on the group with a ***Neutral*** recommendation and a target price of RM5.59. The group is underpinned by its growth capacities from current and Next Generation Integrated Glove Manufacturing Complex (NGC) development which would quadruple current capacity (<42.5bn within next 5 to 8years). Other driving factors include i.) opportunities from new markets, ii.) favourable pricing iii.) high earnings margins to be maintained going forward.

- **Next Generation Integrated Glove Manufacturing Complex (NGC).** The commissioning of the NGC Project by August of 2014 is the group's organic growth plan via capacity expansion. An RM1.9bn investment, the NGC comprises of 72 high-tech production lines with total installed capacity of 28.1bn pcs/yr.

- **Kaizen in technology.** Renowned for its technological advances, the group invests over RM10m into research and development each year to ensure its manufacturing process is beyond the industry efficiency.

- **High margins.** Through its efficiency improving efforts coupled with product mix, Hartalega currently yields the highest margins of c.22% amongst its peers. We expect this margin to be maintained in the next 3 years supported by the exponential growth plans the group has, coupled with favourable cost effect sentiments.

- **Stable and growing.** We commend Hartalega for its top and bottom-line y-o-y uptrend since 2008 with a CAGR of 11%, expanding further to a forward CAGR of 16%. Trading at 17.5x PE multiple, the group's valuations are well above its peers, hence we believe would trade at this band in the near-term rendering a Neutral performance.

KEY FORECAST TABLE (RM m)

FYE Mar (RM m)	2011A	2012A	2013F	2014F	2015F	CAGR
Revenue	734.9	931.1	1,032.0	1,175.5	1,263.9	11.5%
Gross Profit	273.1	296.6	344.2	392.1	403.2	8.1%
Pre-tax Profit	242.8	258.4	305.9	345.1	351.3	7.7%
Net Profit	190.3	201.4	234.7	268.9	273.8	7.5%
EPS (Sen)	26.2	27.6	32.0	34.9	33.9	5.3%
P/E (x)	21.3	20.2	17.4	16.0	16.5	
DPS (Sen)	10.4	11.9	14.5	16.5	16.8	
Dividend Yield (%)	1.9	2.2	2.6	2.8	2.7	

Source: Company, PublicInvest Research estimates

A Growth Story

Founded by the Kuan family in 1988, the group's rubber glove operations is located in Bestari Jaya, Selangor. Operating a multi-factory site spanning 37 acres, the group currently has 6 plants which run most of its lines at an average of 30,000 pieces/hr production, with their new lines at 45,000 pieces/hr – the fastest in the industry. Today, the group has over 130 customers in 39 countries, with sales predominantly to the US, Germany and Japan.

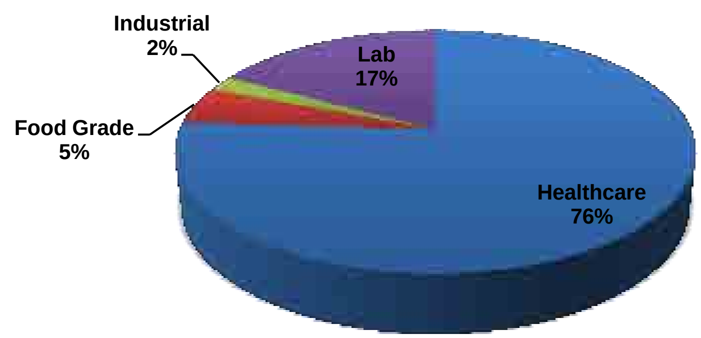
Hartalega is at the forefront of the current nitrile wave, having proposed the lightweight nitrile glove as an alternative to latex medical examination glove back in 2005. Since then, its focus on producing high quality nitrile gloves have become the group's back bone which we believe will continue to stimulate the group's performance.

The management. Hartalega is managed by the second generation of the Kuan family. The Managing Director, Kuan Mun Leong and Corporate Finance and Sales Director, Kuan Mun Keng are the sons of the founder Kuan Kam Hon who recently retired as Managing Director but remains active as Group Chairman. Both Mun Leong and Mun Keng have been under their father's pupilage for the past 15 years hence we are assuaged over the previous succession concerns.

OEM. A major original equipment manufacturer (OEM), Hartalega's products are sold to global medical distributors such as Medline Industries Inc. and Paul Hartmann AG.

Products. The group currently produces about 94% of nitrile gloves, with the remaining 6% dedicated to latex rubber gloves (NR) mainly sold to the US, Europe and Asia Pacific. Its product mix includes powder free nitrile glove for the medical examination, cleanroom, laboratory and industrial sectors, powdered nitrile glove for the food handling sector, powder free latex glove for the dental sector and powdered latex glove for the emerging markets (Figure 1).

Figure 1: Product Mix – 2QFY13



Source: Company

Figure 2: Product Branding

Hartalega	Pharmatex	GloveOn
Reinforce image of Hartalega as a quality rubber glove manufacturer with growth prospects & technology innovator	A reputable healthcare and rubber glove distributor	A principal unified brand to focus on all products under one core brand
Build employer branding – branding Hartalega as preferred employer to attract and retain staff	Communicate Pharmatex as an umbrella brand for all future brands created by Hartalega	Create brand awareness and medium to penetrate emerging markets, the engines of future growth

Source: Company

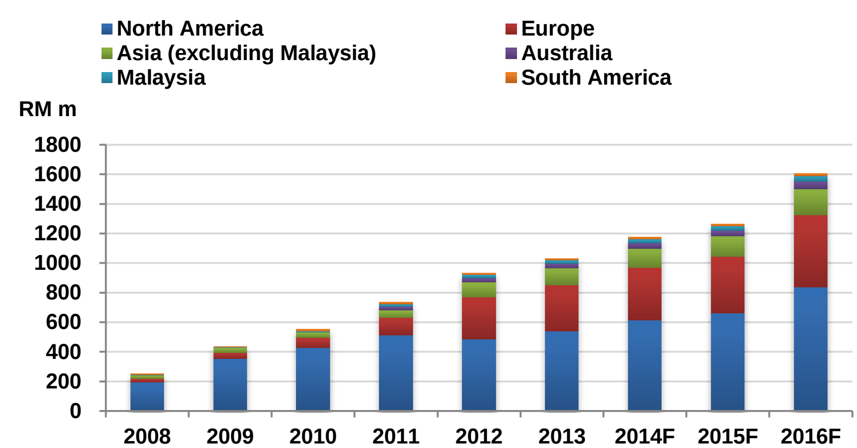
Pharmatex. Hartalega's overseas brand operations arm, which distributes gloves to the respective domestic markets. Acting as the group's local retail distributor, Pharmatex has its presence in US, Australia, China and India (Figure 3). Pharmatex Australia, currently commands about 20% market share of the Australian medical glove market and dominates 100% of South Australia's hospital market.

Figure 3: Hartalega's Marketing Arm - Pharmatex

Overseas Operation	Location	Association
Pharmatex USA Inc.	Palm Desert, California, USA	80% owned – Marketing arm
Pharmatex (Australia) Pty Ltd	New South Wales. Australia	82% owned – subsidiary
YanCheng Pharmatex Medical Equipment Co Ltd	China	70% owned – subsidiary
Pharmatex Healthcare Pvt.Ltd	Bombay, India	70% owned – subsidiary

Source: Company

Figure 4: Geographical Revenue



Source: Company, PublicInvest Research estimates

Geographical growth. US' import of rubber gloves have been on an uptrend (Figure 5 –sector initiation), signifying continuous demand for the products which contributes positively to Hartalega as the country is Hartalega's largest geographical revenue contributor (Figure 4).

The Glove Operations

Current capacity. Producing about 11.2bn pcs/yr of rubber gloves, the group will increase its Bestari Jaya operations to produce up to 14bn gloves by FY14. The latest plant 6, when completed by this July, will operate 10 production lines running about 45,000 pcs/hr. According to Hartalega, the group has sold off plant 6's capacity and are ready to embark on increased capacities from their NGC project.

Technological advances. Operating out of 6 plants, the group carries out research and develops their glove processing machines to progressively improve efficiency. Hartalega's innovative successes include its double former production lines, mechanical stripping system, glove stacking devices and dipping simulator.

Quadrupling capacity. The group will be investing RM1.9bn to develop their Next Generation Integrated Glove Manufacturing Complex (NGC), an 8-year plan to begin commissioning this August 2014. Located in Sepang, the development spans over 112 acres and will include 72 high-tech production lines. The installed capacity is c.28.5bn pcs/yr with estimated revenue of RM2.38bn per annum (based on ASP of RM95.1000pcs – guidance only).

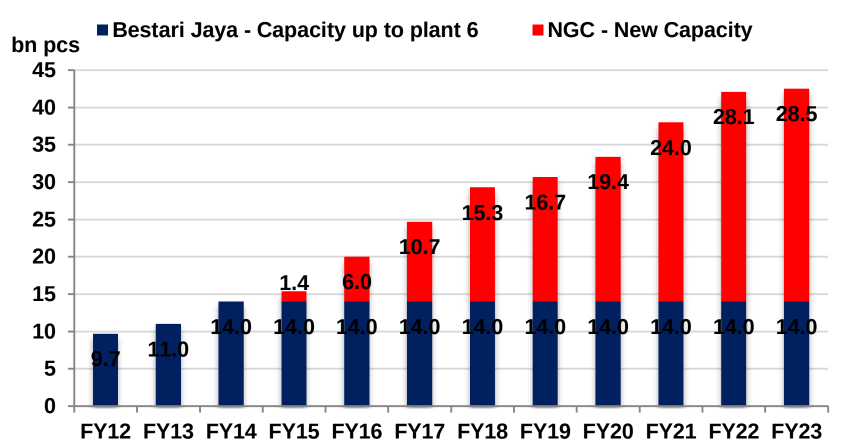
NGC impact. The mass-scaled project will provide more jobs as the workforce is projected to increase to an additional 4,600 workers, (24% reduction in manual labour due to technological advances) to support the operations. All new production lines will also be interchangeable, to produce NR or SR gloves without modifications.

The NGC would also contribute positively to the group and the public with:-

- R&D Centre
- Renewable Energy Complex (palm waste)
- Training and Development Centre (open to public)
- Sports and Recreational Complex (open to public)
- Eco-friendly Workers Quarters

Source: Company

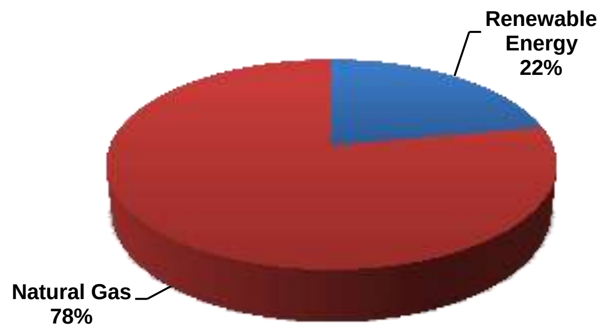
Figure 5: NGC Capacity Growth



Source: Company

Reduced natural gas consumption. The NGC will consume about 7.4Sm^3/1000pcs of natural gas, 17% less than its current operations (8.8 Sm^3), through the increase of biomass renewable energy (Figure 5). The installation capacity of 58MW biomass renewable energy plants can support about 22% of NGC's energy requirement.

Figure 6: Energy Source For NGC



Source: Company

Competitive Edge

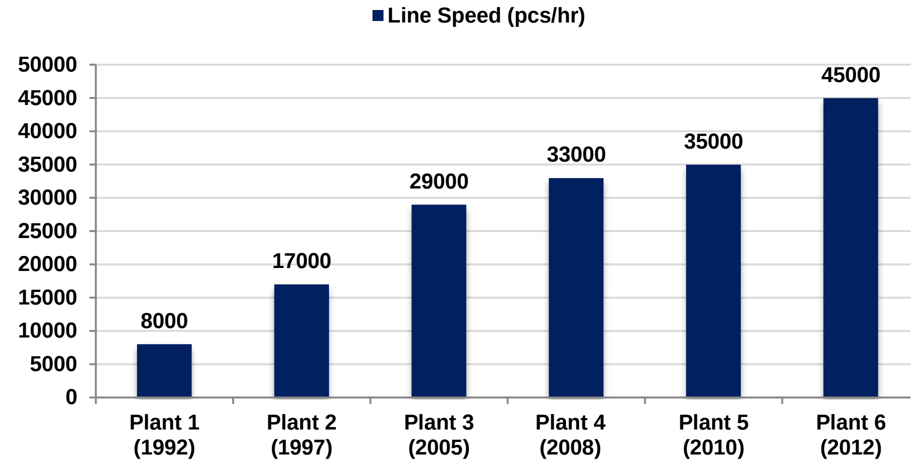
Efficiency. The group's innovative technology has supported the group to grow ahead of its peers, especially with its line speed technology (Figure 7). The increase in productivity, has enabled the group to create new products and to target niche markets in lightweight nitrile glove for the medical examination and industrial sectors. Examples of product variations include anti-bacterial and aloe vera coated gloves.

Higher line speed. Installed capacity from 10bn in FY12 increased to about 11.2bn in FY13 due to improved production line speeds. One of Hartalega's competitive advantages is owning the industry's fastest line-speed has proven to influence productivity levels positively. This is reflected in Hartalega's revenue and PBT per employee to be rising y-o-y (Figure 9).

Figure 7: FY12 to FY13 Improvements In Line Speed

Source: Company, PublicInvest Research

Figure 8: Line Speed Progression

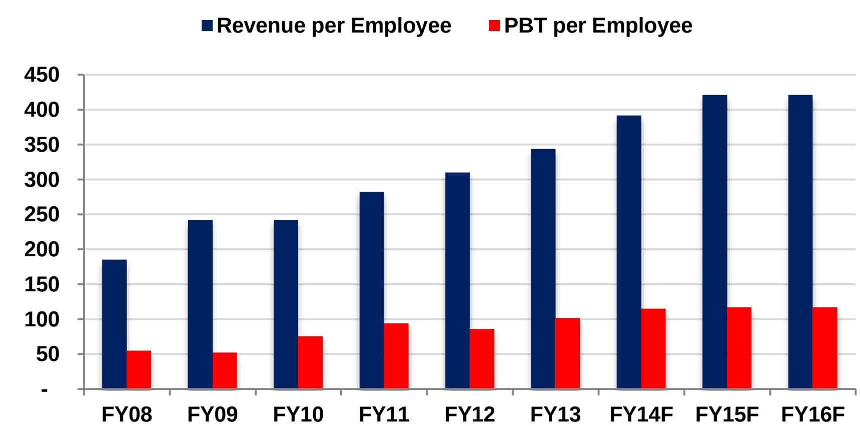


Source: Company

Productivity improvements. Revenue per employee is projected by the group to increase despite the increase in labour costs due to the commissioning of the NGC that requires additional employees. We expect the group to enjoy further economies of scale by FY15 from the larger scale of their NGC development. Hartalega has also implemented a performance management system based on Kaplan's Balanced Score Card since 2011. This management tool we assume would allow management to improve productivity as well as monitor the effects of the processing activities – to minimise errors.

Investing in human capital. A main foundation of the group to sustain growth through initiating i.) talent development programs, ii.) learning and development programs, and iii.) revised salary structure based on a global HR consulting firm (2012) to ensure employees are fairly rewarded.

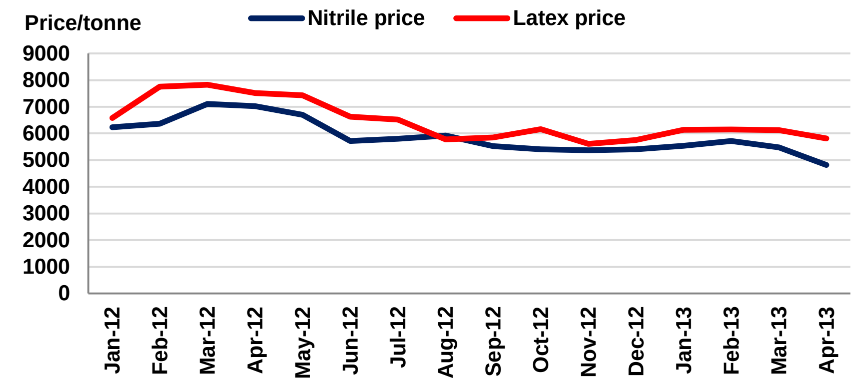
Figure 9: Revenue and PBT Per Employee



Source: Company, PublicInvest Research estimates

Hedging. The group has proven to be apt in hedging their raw material prices to ensure they are locked into the best prices. This is carried out monthly by its top management. A vital component to the group's cost structure, the softening of both nitrile and latex prices will ease the compression on margins for the group.

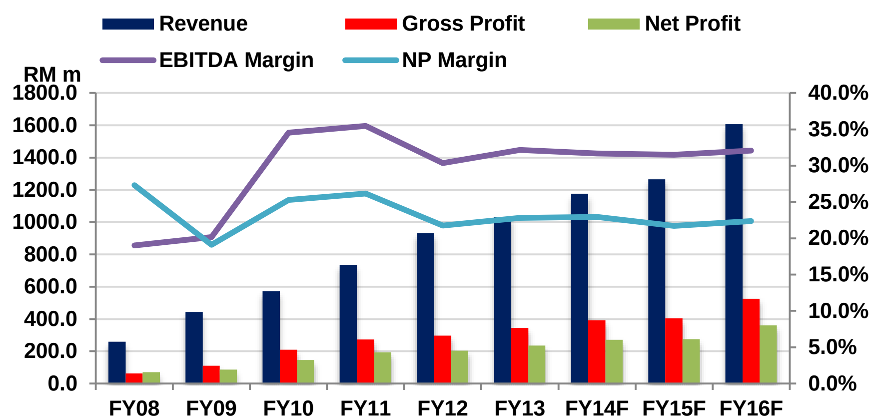
Figure 10: Hartalega's Monthly Nitrile and Latex Price



Source: Company

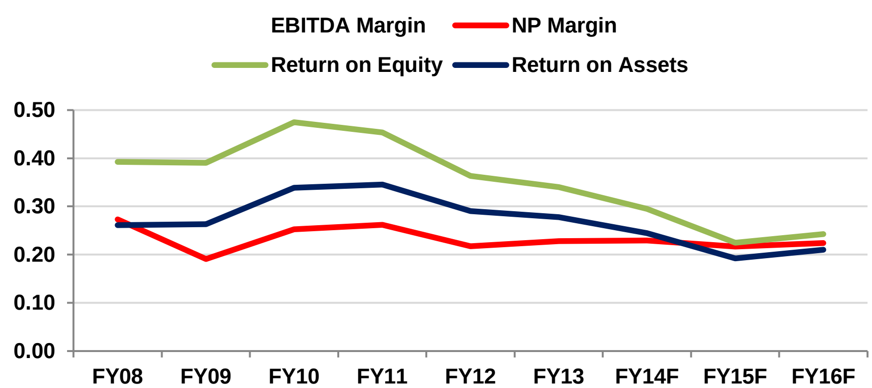
Strong balance sheet. The group has constantly maintained a healthy balance sheet with current cash pile of c.RM180m and advanced credit lines on standby to fulfill any capex requirements. The group's debt-to-equity ratio stands at 2%, supporting its ability to increase gearing when necessary in anticipation of its expansion plans.

Figure 11: Financial Analysis



Source: Company, PublicInvest Research estimates

Figure 12: Performance Indicators



Source: Company, PublicInvest Research estimates

Key Risks

Delay in NGC. Although the group has reassured that the commissioning of the NGC is on schedule, however the risk of licensing delays and approvals could hinder the progress.

Minimum wage. The implementation of the minimum wage since January 2013 has only affected the company marginally, as they were able to transfer the extra costs to customers. Minimum wage costs will only affect the group if average selling price continues to scale down from declining raw material prices.

For Hartalega, the increase in labour cost is attributed to the increase in required workers from 2,900 to 3,700 employing ahead of time for Plant 6 and 7.

Valuation

Figure 13: Dividend Discount Model

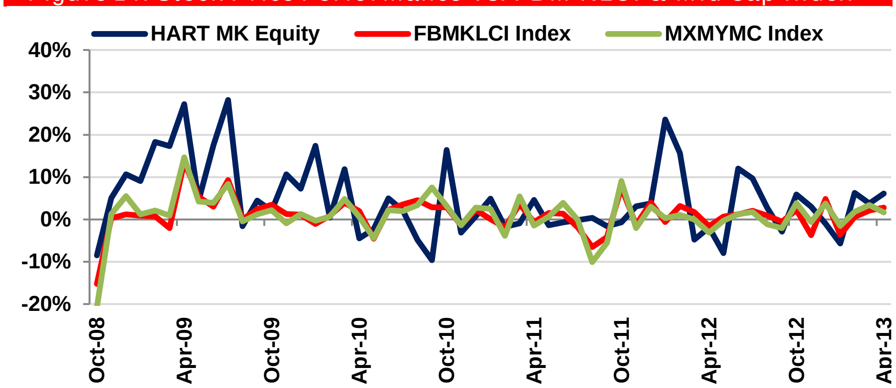
Beta	0.717
Expected market return	8.5%
Risk-free rate	3.4%
Cost of equity	7.1%
Cost of debt	6.0%
Weightage of equity	85.0%
Weightage of debt	15.0%
WACC	6.9%
Terminal Growth Rate	2.0%

Source: Bloomberg, PublicInvest Research estimates

Dividend discount model. We are valuing Hartalega using the dividend discount model, as this method will clearly capture the earnings performance of the company from its dividend payout capabilities. Hartalega has had a minimum 45% dividend pay-out policy since 2011. Management has stated that they could potentially pay out slightly above their pledged threshold for FY13. Based on our estimates, our dividend yield for FY13 stands at 2.7% (FY13), 3.0% (FY14F) and 2.9% (FY15F). Maintaining a conservative stand we have forecasted the group's forward dividend payout at 45% of its earnings, translating to our current DDM-derived target price of RM5.59.

Aside from paying dividends, the group also rewards its shareholders while also raising funds via warrants and bonus issues.

Figure 14: Stock Price Performance Vs. FBM KLCI & Mid Cap Index



Source: Bloomberg

KEY FINANCIAL DATA

INCOME STATEMENT DATA

FYE Mar (RM m)	2011A	2012A	2013F	2014F	2015F
Revenue	734.9	931.1	1,032.0	1,175.5	1,263.9
Cost of sales	-461.9	-634.4	-687.8	-783.4	-860.7
Operating Profit	273.1	296.6	344.2	392.1	403.2
Other Gains / (Losses)	-27.8	-36.5	-38.3	-51.7	-55.6
Finance Costs	-2.5	-1.7	-0.1	4.7	3.7
Pre-tax Profit	242.8	258.4	305.9	345.1	351.3
Income Tax	-52.5	-57.0	-70.8	-75.9	-77.3
Effective Tax Rate (%)	21.6	22.0	23.2	22.0	22.0
Minorities	0.0	-0.1	-0.3	-0.3	-0.3
Net Profit	190.3	201.4	234.7	268.9	273.8
Growth					
Revenue	29%	27%	11%	14%	8%
Operating Profit	33%	8%	18%	14%	2%
Net Profit	33%	6%	17%	15%	2%

Source: Company, PublicInvest Research estimates

BALANCE SHEET DATA

FYE Mar (RM m)	2011A	2012A	2013F	2014F	2015F
Property, Plant & Equipment	348.7	370.3	485.8	678.0	915.2
Cash and Cash Equivalents	117.0	163.2	182.4	164.7	291.7
Receivables, deposits and prepayment	101.0	117.1	124.7	142.6	153.3
Other Assets	68.4	107.5	143.4	281.4	228.7
Total Assets	**635.0**	**758.2**	**936.3**	**1,266.6**	**1,588.9**
Payables	57.2	60.4	92.8	105.7	113.7
Borrowings	39.0	24.6	12.2	23.0	24.4
Deferred tax	36.9	40.5	50.3	50.3	50.3
Other Liabilities	7.5	13.1	15.5	25.2	21.6
Total Liabilities	**140.5**	**138.7**	**170.8**	**204.1**	**210.0**
Shareholders' Equity	494.4	619.5	765.5	1,062.5	1,378.9
Total Equity and Liabilities	**635.0**	**758.2**	**936.3**	**1,266.6**	**1,588.9**

Source: Company, PublicInvest Research estimates

PER SHARE DATA & RATIOS

FYE Mar	2011A	2012A	2013F	2014F	2015F
Book Value Per Share	0.7	0.8	1.0	1.4	1.7
NTA Per Share	2.7	3.4	2.1	2.7	3.4
EPS (Sen)	21.7	20.6	17.8	16.3	16.8
DPS (Sen)	10.4	11.9	14.5	16.5	16.8
Payout Ratio	40%	44%	45%	45%	45%
ROA	34%	29%	28%	24%	19%
ROE	45%	36%	34%	29%	22%

Source: Company, PublicInvest Research estimates

RATING CLASSIFICATION

STOCKS

OUTPERFORM	The stock return is expected to exceed a relevant benchmark's total of 10% or higher over the next 12months.
NEUTRAL	The stock return is expected to be within +/- 10% of a relevant benchmark's return over the next 12 months.
UNDERPERFORM	The stock return is expected to be below a relevant benchmark's return by -10% over the next 12 months.
TRADING BUY	The stock return is expected to exceed a relevant benchmark's return by 5% or higher over the next 3 months but the underlying fundamentals are not strong enough to warrant an Outperform call.
TRADING SELL	The stock return is expected to be below a relevant benchmark's return by -5% or more over the next 3 months.
NOT RATED	The stock is not within regular research coverage.

SECTOR

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

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