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(Member of Alliance Bank group)
PP7766/03/2013 (032116)

13 June 2013

News Flash

Hartalega Holdings — Buy

Rubber Glove | *Bloomberg Ticker: HART MK | Bursa Code: 5168*

Analyst
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12-month upside potential

Previous target price	6.05
Revised target price	6.80
Current price (as at 12 Jun)	6.30
Capital upside (%)	8.0
Net dividends (%)	2.6
Total return (%)	10.6

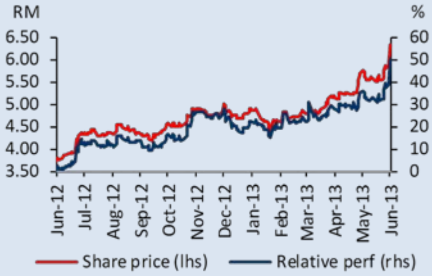
Key stock information

Syariah-compliant?	Yes
Market Cap (RM m)	4,624.1
Shares outstanding (m)	734.0
Free float (%)	66.4
52-week high / low (RM)	6.31 / 3.73
3-mth avg volume ('000)	712.6
3-mth avg turnover (RM m)	3.8

Share price performance

	1M	3M	6M
Absolute (%)	9.9	24.8	26.7
Relative (%)	10.7	14.4	18.0

Share price chart



Source: Bloomberg

Signed land deal for NGC project

Yesterday, Hartalega announced that it has signed the SPA for a proposed 112-acre land acquisition that is worth RM97m and will be used to build the Next Generation Integrated Glove Manufacturing Complex (NGC) project (ground breaking in Sept 2013). We view this announcement positively as it implies that this game-changing project will see no more delays. Given that the project will be partially funded by the proceeds raised from warrants conversion, we trim Hartalega's FY15 EPS by 7.8%, to take into account the effect of EPS dilution. Nonetheless, we are optimistic that earnings growth from FY16 onwards will be strong and this prompts us to raise its target P/E from 16x to 18x, as Hartalega will be the the market leader in 3 years' time. We reiterate our BUY call on Hartalega with a higher TP of RM6.80 (+12.4%), based on 18x 12-month forward P/E.

What's in the news

- Yesterday, Hartalega announced that it has signed the SPA for a proposed 112-acre land acquisition that is worth RM97m and will be used to build the Next Generation Integrated Glove Manufacturing Complex (NGC) project. The SPA is conditional on the fulfillment of certain terms and conditions by the seller, including land filling which would be undertaken by the seller at the buyer's cost.
- According to management, the land filling works will be done in July and Aug 2013, which will then pave the way for the ground breaking of its first NGC plant. The project would be built in two 4-year phases, starting from Sept 2013 to 2021, with a revised total capex of RM1.9 bn (+26.7%).
- Management attributes the higher capex to (1) higher production speed per line (from 40,000 pieces per hour to 45,000 pieces per hour), and (2) escalated construction cost. This implies an annual capex requirement of RM237.5m, which we believe can be easily funded by (1) proceeds raised from warrants conversion (RM100m p.a. up to FY16), and (2) strong operating cash flow of more than RM230m from FY14 onwards.
- Based on the revised plan, the whole NGC project will have 6 plants consisting of 72 high-tech production lines. This translates to a total annual capacity of 28.5 bn pieces of gloves, which is 16.8% higher than its initial estimate of 24.4 bn.
- On completion of the NGC project, the total installed production capacity of Hartalega will be boosted from 14bn pieces as at FY13 to 42.5bn pieces p.a. by 2021. This translates to an 8-year capacity CAGR of 14.9%.

Our comments

- We view this announcement positively as it implies that this game-changing project will see no more delays.
- In addition, management has shown strong commitment and preparedness to this project as they have already increased their labour force from 2,900 factory workers in 2012 to 3,900 factory workers currently. We understand that management plans to commission all the 12 production lines for its first NGC plant simultaneously, if the external engineering firm manages to install all the lines concurrently.
- In conclusion, we reaffirm our view that this is a strategic move by the group which could change the industry landscape in 3 years' time, as it can now takes full advantage on its above-industry profit margin (20% vs 7-10%) by expanding aggressively to capture larger global market share.

Maintain Buy with a raised TP of RM6.80 (+12.4%)

- While management is still assessing whether the production lines for first plant could be commissioned concurrently, we prefer to be prudent now by assuming gradual commissioning of its first 12 production lines of NGC project, starting from Aug 2014.
- Apart from that, we assume that the total 71m warrants, which are exercisable starting from May 2013, will be exercised proportionately over the next 3 years. This results in EPS dilution and leads us to trim Hartalega's FY15 EPS by -7.8%.
- Nonetheless, we are optimistic that earnings growth will resume in FY16, once its NGC project starts to contribute to the group positively. All in, Hartalega is expected to deliver 16.6%, 3.8% and 19.6% EPS growth for FY14 to FY16.
- Note that there is potential upside (+15%) to our FY15 earnings forecasts, if the group manages to commission all 12 production lines concurrently.
- In view of Hartalega's (1) promising medium to long term outlook, and (2) leading position in both capacity growth and pricing power, we raise Hartalega's target P/E from 16x to 18x, valuing the stock as a market leader of the glove industry over the next 3 years.
- As a result, we reiterate our BUY recommendation on Hartalega with a higher TP of RM6.80 (+12.4%), based on 18x 12-month forward P/E (July 2013-June 2014). Again, we advocate investors to accumulate the stock for a medium to long term view, as we view Hartalega as the game-changer for the glove industry.
- Key risks include slower than expected take-up of additional capacity.

Figure 1 : Key financial data

FYE 31 March	FY12	FY13	FY14F	FY15F	FY16F
Revenue (RM m)	931.1	1,032.0	1,263.5	1,368.6	1,741.1
EBITDA (RM m)	288.2	337.9	408.9	447.6	550.5
EBIT (RM m)	259.2	299.4	363.3	386.2	476.2
Pretax profit (RM m)	258.4	305.9	363.7	386.8	477.2
Reported net profit (RM m)	201.4	234.7	279.1	296.8	366.2
Core net profit (RM m)	201.4	234.8	279.1	296.8	366.2
EPS (sen)	27.6	32.1	37.4	38.9	46.5
Core EPS (sen)	27.6	32.1	37.4	38.9	46.5
Alliance / Consensus (%)			105.4	101.3	110.4
Core EPS growth (%)	5.4	16.1	16.6	3.8	19.6
P/E (x)	22.8	24.0	16.8	16.2	13.6
EV/EBITDA (x)	7.9	16.0	12.0	11.5	9.5
ROE (%)	32.5	30.7	27.4	24.1	23.1
Net gearing (%)	Net cash	Net cash	Net cash	Net cash	Net cash
Net DPS (sen)	12.5	10.5	16.8	17.5	20.9
Net dividend yield (%)	2.0	1.7	2.7	2.8	3.3
BV/share (RM)	0.85	1.05	1.37	1.62	2.01
P/B (x)	7.4	9.3	4.6	3.9	3.1

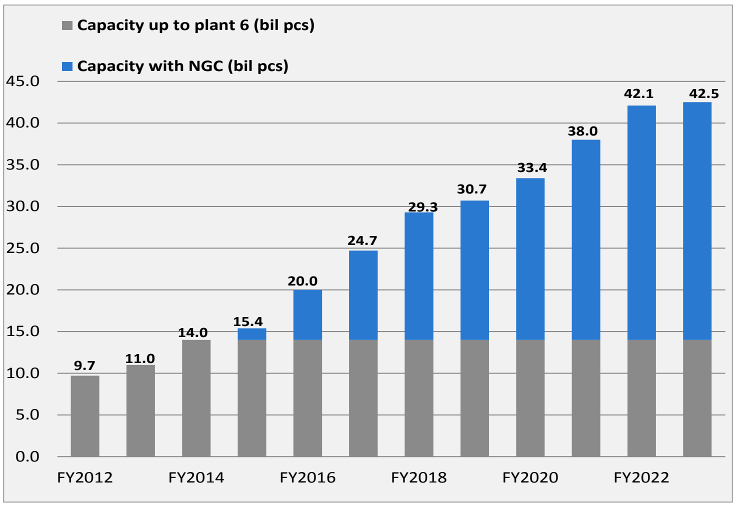
Source: Alliance Research, Bloomberg

Figure 2 : Earnings revision

	Previous EPS Sen	Revised EPS Sen	Change
2014F	36.9	37.4	+1.3%
2015F	42.2	38.9	-7.8%

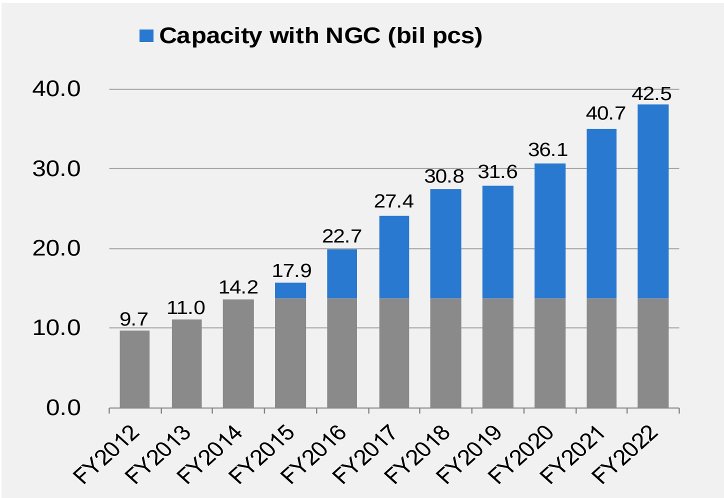
Source: Alliance Research

Figure 3 : Hartalega's capacity projection on gradual commissioning



Source: Bloomberg data, Alliance Research

Figure 4 : Hartalega's capacity projection on concurrent commissioning



Source: Bloomberg data, Alliance Research

DISCLOSURE

Stock rating definitions

Strong buy	- High conviction buy with expected 12-month total return (including dividends) of 30% or more
Buy	- Expected 12-month total return of 15% or more
Neutral	- Expected 12-month total return between -15% and 15%
Sell	- Expected 12-month total return of -15% or less
Trading buy	- Expected 3-month total return of 15% or more arising from positive newsflow. However, upside may not be sustainable

Sector rating definitions

Overweight	- Industry expected to outperform the market over the next 12 months
Neutral	- Industry expected to perform in-line with the market over the next 12 months
Underweight	- Industry expected to underperform the market over the next 12 months

Commonly used abbreviations

Adex = advertising expenditure
bn = billion
BV = book value
CF = cash flow
CAGR = compounded annual growth rate
Capex = capital expenditure
CY = calendar year
Div yld = dividend yield
DCF = discounted cash flow
DDM = dividend discount model
DPS = dividend per share
EBIT = earnings before interest & tax
EBITDA = EBIT before depreciation and amortisation

EPS = earnings per share
EV = enterprise value
FCF = free cash flow
FV = fair value
FY = financial year
m = million
M-o-m = month-on-month
NAV = net assets value
NM = not meaningful
NTA = net tangible assets
NR = not rated
p.a. = per annum
PAT = profit after tax

PBT = profit before tax
P/B = price / book ratio
P/E = price / earnings ratio
PEG = P/E ratio to growth ratio
q-o-q = quarter-on-quarter
RM = Ringgit
ROA = return on assets
ROE = return on equity
TP = target price
trn = trillion
WACC = weighted average cost of capital
y-o-y = year-on-year
YTD = year-to-date

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Published & printed by:

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