

Hartalega Holdings – Malaysia

Keeping faith with this darling

What's New

- **Ramping up expansion plans** which include the construction of Plant 6. Plant 6 is expected to add 3.5b pieces of gloves, or 35% of its existing production capacity. Construction will start in Jun 11 and is expected to complete by Jan 12.
- **Spending big this year to accelerate growth.** Hartalega has allocated RM170m for FY12's capex for Plant 6, almost three times higher than FY10's capex. With RM85m net cash, Hartalega can fund the construction of Plant 6 without incurring additional borrowings or raising new equity.
- **Higher dividends likely** after paying quarterly dividends of 5 sen/share for the past five quarters. Management indicated it could increase quarterly dividend to 6 sen/share, which translates into a current net yield of 4.3%.
- **An interesting play if the US dollar and economy regain their strength.** Hartalega's sales are entirely denominated in the US dollar. The US remains its biggest export market, accounting for more than 70% of its total sales. Earnings could rise by 11% if the US dollar strengthens by 10% against the ringgit.
- **Expect another strong showing next quarter** after rolling out its final and last few lines in Plant 5 which had added 10% to its sales volume in 4QFY11. As of now, Hartalega has a gloves manufacturing capacity of 9.7b pieces. The significant addition to its capacity during the quarter will herald another quarter of record earnings for Hartalega.

Stock Impact

- **Substitution effect from natural gloves to synthetic gloves.** Input prices to manufacture synthetic glove are less elastic to higher rubber prices. Synthetic gloves can be priced more attractively than natural gloves, driving demand growth. Synthetic gloves which sell at a 20% premium are selling at the same prices as natural gloves.
- **Purely synthetic.** Among glove makers, Hartalega has the highest concentration in synthetic gloves (90% of its product mix).

BUY

(Maintained)

Company Update

Share Price	RM5.53
Target Price	RM8.12
Upside	+46.8%
(Previous TP	RM7.58)

Company Description

Rubber gloves manufacturer.

Stock Data

GICS sector	Health Care
Bloomberg ticker:	HART MK
Shares issued (m):	363.6
Market cap (RMm):	2,010.5
Market cap (US\$m):	664.8
3-mth avg daily t'over (US\$m):	0.6

Price Performance (%)

52-week high/low		RM6.07/RM4.10		
1mth	3mth	6mth	1yr	YTD
(0.2)	1.5	0.0	9.1	3.6

Major Shareholders

	%
Hartalega Industries Sdn Bhd	51

FY12 NAV/Share (RM)	1.67
FY12 Net Cash/Share (RM)	0.10

Price Chart



Source: Bloomberg

Analyst

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Key Financials

Year to 31 Mar (RMm)	2009	2010	2011F	2012F	2013F
Net turnover	443.2	574.9	727.2	963.5	1,107.0
EBITDA	113.5	207.1	258.1	313.9	360.6
Operating profit	97.9	181.3	232.1	283.4	319.0
Net profit (rep./act.)	84.5	143.3	186.2	227.3	256.7
Net profit (adj.)	84.5	143.3	186.2	227.3	256.7
EPS (sen)	23.3	39.4	51.2	62.5	70.6
P/E (x)	23.8	14.0	10.8	8.8	7.8
P/BV (x)	7.9	5.7	4.3	3.3	2.6
EV/EBITDA (x)	17.1	9.4	7.5	6.2	5.4
Dividend yield (%)	1.7	3.6	3.6	4.3	4.3
Net margin (%)	19.1	24.9	25.6	23.6	23.2
Net debt/(cash) to equity (%)	7.7	(9.4)	(14.9)	(5.8)	(18.5)
Interest cover (x)	46.7	61.4	n.a.	n.a.	n.a.
ROE (%)	39.0	47.1	45.3	42.3	37.1
Consensus net profit	-	-	185.1	207.8	242.8
UOBKH/Consensus (x)	-	-	1.01	1.09	1.06

Source: Hartalega Holdings, Bloomberg, UOB Kay Hian

- **Even if rubber prices fall back to historical levels**, demand for synthetic gloves will not experience a sharp pull back. Synthetic gloves have a captive market. Oil-based synthetic gloves are free of protein allergens and this is universally preferred by the medical fraternity which is the biggest group of users for gloves. Changing to synthetic gloves would only accelerate the adoption rate from natural gloves to synthetic gloves in the long run.
- **New entrants will only erode Hartalega's margins slightly.** Natural gloves manufacturers like Top Glove, Supermax and Kossan are all converting their production from natural gloves to synthetic gloves. These players do not have market recognition in this niche market, and it may take a while before any one can replicate Hartalega's margins and challenge Hartalega's market share.
- **Operational efficiencies also give rise to superior margins.** Hartalega's output per line is at least twice as fast the industry's and is less labour intensive compared with peers. Technological leadership (some of its equipment designs are proprietary) and cost advantages enjoyed will sustain Hartalega's above-industry margins.

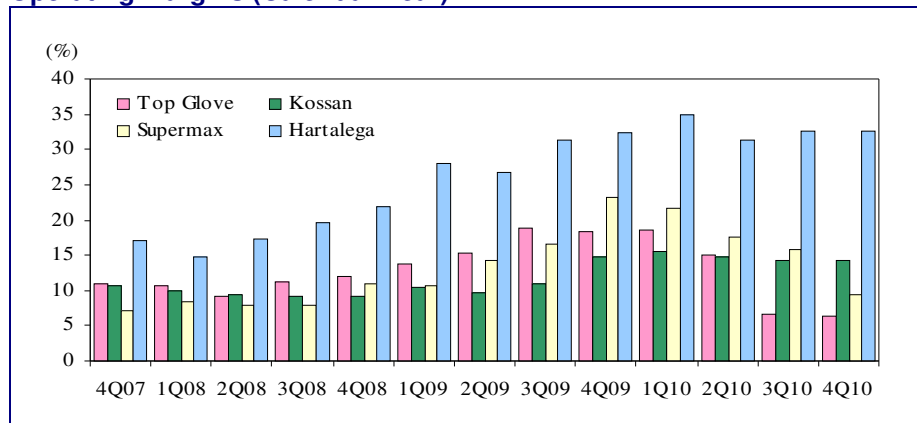
Earnings Revision/Risk

- We increase our net profit forecast for 2011 by 3.5% and 2012 by 9%, after factoring in its new expansion plans, higher gross margins assumptions for synthetic gloves, and lower average selling prices (a result of the strengthening Ringgit against the US dollar).

Valuation/Recommendation

- **Reiterate BUY.** We raise target price from RM7.58 to RM8.12, pegged at 13x FY12F PE (equivalent to Top Glove's long-term mean).
- Hartalega's earnings base has already surpassed Top Glove's, the market leader in gloves manufacturing, and its margins are defensible. We believe the markets will, in time, accord and reward Hartalega with similar valuations.

Operating Margins (Calendar Year)



Source: UOB Kay Hian

Peer Comparison

Company	Ticker	Rec	Price 13 Apr 11 (RM)	Target Price (RM)	Market Cap (US\$m)	FYE	-----PE-----			P/B 2010 (x)	Curr ROE (%)
							Curr (x)	+1 yr (x)	+2 yr (x)		
Top Glove	TOPG MK	SELL	4.96	4.02	992.9	Aug	24.0	14.8	12.1	2.5	25.6
Hartalega	HART MK	BUY	5.53	8.12	650.9	Mar	10.8	8.8	7.8	4.2	47.0
Kossan	KRI MK	HOLD	3.20	2.97	330.3	Dec	8.6	7.3	6.9	1.9	29.4

Source: UOB Kay Hian

Expansion Plans

	2011F	2012F	2013F
Installed Capacity ('m)	8,250.0	11,750.0	13,500.0
Production Capacity ('m)	6,765.0	9,635.0	11,070.0
Utilisation Rate	82%	82%	82%

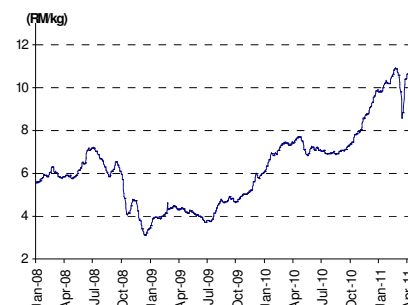
Source: UOB Kay Hian

Key Assumptions

	2011F	2012F	2013F
ASP (RM/'000 piece)	107.5	100.0	100.0
GP Margins			
Nitrile Latex	38%	35%	35%
Natural Latex	28%	25%	25%

Source: UOB Kay Hian

Latex Prices



Source: UOB Kay Hian

Ringgit/US\$



Source: UOB Kay Hian

Profit & Loss

Year to 31 Mar (RMm)	2010	2011F	2012F	2013F
Net turnover	574.9	727.2	963.5	1,107.0
EBITDA	207.1	258.1	313.9	360.6
Deprec. & amort.	25.8	26.0	30.4	41.6
EBIT	181.3	232.1	283.4	319.0
Net interest income/(expense)	(3.4)	0.6	0.7	1.9
Pre-tax profit	177.9	232.8	284.1	320.9
Tax	(34.7)	(46.6)	(56.8)	(64.2)
Net profit	143.3	186.2	227.3	256.7
Net profit (adj.)	143.3	186.2	227.3	256.7

Cash Flow

Year to 31 Mar (RMm)	2010	2011F	2012F	2013F
Operating	163.0	189.0	223.1	275.8
Pre-tax profit	177.9	232.8	284.1	320.9
Tax	(22.5)	(46.6)	(56.8)	(64.2)
Deprec. & amort.	25.8	26.0	30.4	41.6
Working capital changes	(28.2)	(22.5)	(34.0)	(20.7)
Other operating cashflows	9.9	(0.6)	(0.7)	(1.9)
Investing	(66.6)	(80.0)	(170.0)	(80.0)
Capex (growth)	(66.9)	(80.0)	(170.0)	(80.0)
Investments	0.0	0.0	0.0	0.0
Proceeds from sale of assets	0.0	0.0	0.0	0.0
Others	0.3	0.0	0.0	0.0
Financing	(60.0)	(72.7)	(87.2)	(87.2)
Dividend payments	(43.6)	(72.7)	(87.2)	(87.2)
Issue of shares	0.0	0.0	0.0	0.0
Proceeds from borrowings	0.0	0.0	0.0	0.0
Loan repayment	(16.3)	0.0	0.0	0.0
Others/interest paid	(0.0)	0.0	0.0	0.0
Net cash inflow (outflow)	36.5	36.3	(34.2)	108.6
Beginning cash & cash equivalent	38.3	74.7	111.0	76.9
Changes due to forex impact	(0.0)	0.0	0.0	0.0
Ending cash & cash equivalent	74.7	111.0	76.9	185.4

Balance Sheet

Year to 31 Mar (RMm)	2010	2011F	2012F	2013F
Other LT assets	292.9	365.3	504.3	683.9
Cash/ST investment	74.7	111.0	76.9	185.4
Other current assets	108.8	142.5	188.8	216.9
Total assets	476.5	618.8	770.0	1,086.3
ST debt	13.7	13.7	13.7	13.7
Other current liabilities	52.7	81.9	93.0	239.7
LT debt	27.7	27.7	27.7	27.7
Other LT liabilities	27.8	27.8	27.8	27.8
Shareholders' equity	354.3	467.8	607.8	777.3
Minority interest	0.3	0.0	0.0	0.0
Total liabilities & equity	476.5	618.8	770.0	1,086.3

Key Metrics

Year to 31 Mar (%)	2010	2011F	2012F	2013F
Profitability				
EBITDA margin	36.0	35.5	32.6	32.6
Pre-tax margin	31.0	32.0	29.5	29.0
Net margin	24.9	25.6	23.6	23.2
ROA	33.7	34.0	32.7	27.7
ROE	47.1	45.3	42.3	37.1
Growth				
Turnover	29.7	26.5	32.5	14.9
EBITDA	82.6	24.6	21.6	14.9
Pre-tax profit	86.4	30.8	22.1	12.9
Net profit	69.5	30.0	22.1	12.9
Net profit (adj.)	69.5	30.0	22.1	12.9
EPS	69.5	30.0	22.1	12.9
Leverage				
Debt to total capital	11.7	8.9	6.8	5.3
Debt to equity	11.7	8.9	6.8	5.3
Net debt/(cash) to equity	(9.4)	(14.9)	(5.8)	(18.5)
Interest cover (x)	61.4	n.a.	n.a.	n.a.

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