CLSA
ASIA-PACIFIC MARKETS

Hartalega

RM4.95 - UNDERPERFORM

Initiating coverage

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Malaysia
Healthcare

Reuters	HTHB.KL
Bloomberg	HART MK

Priced on 16 January 2013
KLSE Comp @ 1,681.1

12M hi/lo RM5.10/3.22

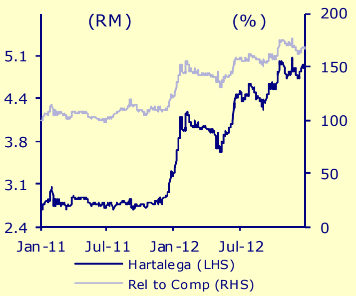
12M price target	RM5.10
±% potential	+3%
Shares in issue	484.5m
Free float (est.)	44.5%
Market cap	US$1,202m

3M average daily volume
RM1.3m (US$.4m)

Major shareholders
Hartalega Industries 55.5%

Stock performance (%)

	1M	3M	12M
Absolute	2.1	7.6	50.9
Relative	0.1	6.3	36.4
Abs (US$)	3.3	8.8	56.9



Source: Bloomberg

www.clsa.com

A 2014 story

Hartalega is the largest and most profitable nitrile examination glove manufacturer with an installed capacity of 11bn gloves per annum. The company has an impressive track record managing to sustain ROE in excess of 30% but this will come down as increasing competition erodes margins. It is improving efficiencies and adding capacity through the commissioning of its Next Generation Complex (NGC) which will increase capacity 4x to 40bn pieces over the next 8 years. Given its size and leadership in its segment which garners it superior margins to its competition the stock deserves its current multiple which is in-line with Top Glove's. The stock's next leg up will come when NGC starts being commissioned in FY15. Initiate with an U-PF and RM5.10 TP (6% TSR)

Nitrile leader
Hartalega is the most efficient player in the market evidenced by its superior margins it achieves versus its peers. This is due to its production efficiencies which it has achieved through extensive R&D as well as a highly automated production process.

Margins to trend down
Cost pressures are expected given the higher butadiene (feedstock) prices but nitrile glove users are not as sensitive to pricing as latex glove users, so we expect Hartalega to pass on the additional costs to end-users. However, the bigger concern is the other glove manufacturers are expanding production capacity in the nitrile segment, and therefore, pricing pressures will make Hartalega's margins trend downwards.

NGC – the answer
The RM1.5bn Next Generation Complex which will increase production capacity to 40bn pieces over 8 years is expected to reduce cost/unit potentially as much as 5-6ppts assuming constant ASPs. The company intends to focus on increasing its market share by passing on entire savings to the customer reducing ASPs which will reduce margins but kill competition.

One for the future.
The company deserves the re-rating it has gotten over the past year and is now trading in-line with Top Glove's multiples. However, we believe the next leg up for the stock will be when NGC is commissioned. We rate Hartalega an U-PF with an RM5.10 TP implying 7% TSR based on a 15x multiple.

Financials

Year to 31 March	11A	12A	13CL	14CL	15CL
Revenue (RMm)	735	931	1,047	1,295	1,458
Net profit (RMm)	190	201	226	257	284
EPS (sen)	26.2	27.7	31.1	33.6	37.2
CL/consensus (14) (EPS%)	-	-	101	98	98
EPS growth (% YoY)	33.2	5.7	12.4	7.9	10.7
PE (x)	18.9	17.9	15.9	14.7	13.3
Dividend yield (%)	4.2	2.5	2.8	3.2	3.5
FCF yield (%)	2.8	3.8	1.9	1.9	2.6
PB (x)	7.3	5.8	4.8	4.5	3.8
ROE (%)	44.9	36.1	33.2	31.5	29.5
Net debt/equity (%)	(15.8)	(22.3)	(14.1)	(6.8)	(2.9)

Source: CLSA Asia-Pacific Markets

evalu@tor The Asia-Pacific Market Database

Summary financials

Steady EBITDA growth until FY15 when NGC is commissioned

Capex picks up in FY13 when NGC is being built

Margins to come off as competition erodes profitability

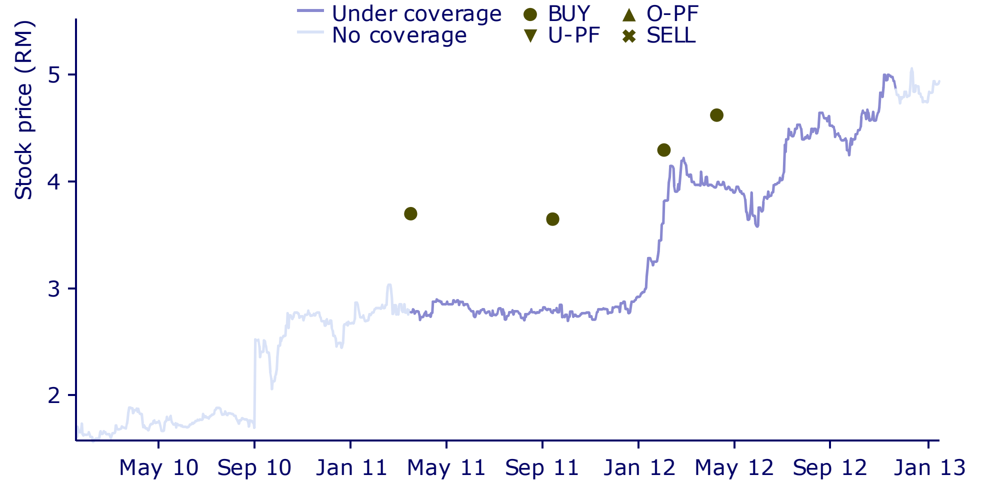
Year to 31 March	2011A	2012A	2013CL	2014CL	2015CL
Summary P&L forecast (RMm)					
Revenue	**735**	**931**	**1,047**	**1,295**	**1,458**
Op Ebitda	276	289	322	371	417
Op Ebit	247	257	291	330	364
Interest income	(2)	0	0	0	0
Interest expense	(2)	2	(2)	(2)	(2)
Other items	0	0	-	-	-
Profit before tax	**243**	**258**	**289**	**328**	**363**
Taxation	(53)	(57)	(63)	(71)	(78)
Minorities/Pref divs	0	0	0	0	0
Net profit	**190**	**201**	**226**	**257**	**284**
Summary cashflow forecast (RMm)					
Operating profit	**247**	**257**	**291**	**330**	**364**
Operating adjustments	-	-	-	-	-
Depreciation/amortisation	29	33	32	41	52
Working capital changes	(41)	(44)	(2)	(37)	(25)
Net interest/taxes/other	(53)	(48)	(64)	(72)	(80)
Net operating cashflow	**182**	**197**	**256**	**261**	**312**
Capital expenditure	(81)	(60)	(188)	(190)	(214)
Free cashflow	**101**	**137**	**68**	**71**	**98**
Acq/inv/disposals	0	0	-	-	-
Int, invt & associate div	2	4	0	0	0
Net investing cashflow	**(79)**	**(57)**	**(188)**	**(190)**	**(214)**
Increase in loans	(2)	(15)	0	0	0
Dividends	(57)	(87)	(102)	(115)	(128)
Net equity raised/other	0	7	0	0	0
Net financing cashflow	**(59)**	**(95)**	**(102)**	**(115)**	**(128)**
Incr/(decr) in net cash	**45**	**45**	**(34)**	**(45)**	**(30)**
Exch rate movements	(2)	1	1	1	1
Opening cash	**75**	**117**	**162**	**128**	**84**
Closing cash	**117**	**163**	**130**	**85**	**55**
Summary balance sheet forecast (RMm)					
Cash & equivalents	117	163	130	85	55
Debtors	101	111	144	178	200
Inventories	65	98	103	132	149
Other current assets	3	0	0	0	0
Fixed assets	349	380	536	685	847
Intangible assets	0	0	0	0	0
Other term assets	0	0	0	0	0
Total assets	**635**	**752**	**913**	**1,080**	**1,252**
Short-term debt	15	13	13	13	13
Creditors	57	55	91	117	132
Other current liabs	7	13	13	13	13
Long-term debt/CBs	24	12	12	12	12
Provisions/other LT liabs	37	40	40	40	40
Minorities/other equity	0	1	1	1	1
Shareholder funds	494	620	744	885	1,042
Total liabs & equity	**635**	**752**	**913**	**1,080**	**1,252**
Ratio analysis					
Revenue growth (% YoY)	28.5	26.7	12.4	23.7	12.6
Ebitda growth (% YoY)	38.2	4.8	11.4	15.1	12.3
Ebitda margin (%)	37.6	31.1	30.8	28.7	28.6
Net profit margin (%)	25.9	21.6	21.6	19.8	19.5
Dividend payout (%)	80.2	45.0	45.0	47.3	47.3
Effective tax rate (%)	21.6	22.0	21.6	21.6	21.6
Ebitda/net int exp (x)	60.8	-	212.0	184.8	256.5
Net debt/equity (%)	(15.8)	(22.3)	(14.1)	(6.8)	(2.9)
ROE (%)	44.9	36.1	33.2	31.5	29.5
ROIC (%)	48.3	41.0	37.9	33.4	29.8
EVA®/IC (%)	38.1	30.8	27.7	23.2	19.6

Source: CLSA Asia-Pacific Markets

Companies mentioned

Hartalega (HART - RM4.95 - UNDERPERFORM)

Recommendation history of Hartalega HART MK



Date	Rec	Target	Date	Rec	Target
22 November 2012	Dropped Coverage		14 September 2011	BUY	3.65
09 April 2012	BUY	4.63	18 March 2011	BUY	3.70
02 February 2012	BUY	4.30			

Source: CLSA Asia-Pacific Markets