

Hartalega Holdings (HART MK)

FY13 Results Preview: Wrapping Up Commendably

We expect a flat quarter in Hartalega's 4QFY13 results, but foresee commendable FY13 results, driven by the recovery period post overstocking issues in 2011. Positively, the margin contraction anticipated could be temporary mitigated by: a) a notable fall in raw material prices and b) slower-than-expected (but still rapid) industry capacity expansion. Maintain SELL with a revised target price of RM4.25 (previously RM4.05).

What's New

- **Another flattish quarter...** Hartalega's 4QFY13 results are expected to be released on 7 May 13. We expect low single-digit qoq growth for both top-line (3QFY13: RM259.6m) and net profit (3QFY13: RM60.5m), backed by a decent <5% volume growth and improved productivity level.
- **...but wrapping up a good FY13.** We expect Hartalega's FY13 results to be slightly ahead our forecast of RM220m, but likely to be within consensus' estimates of RM229m.
- **Pricing pressure continues to hit the nitrile gloves segment...** Hartalega implemented a general +2-3% price hike on its products in Feb 13 to address the rising labour cost from the minimum wage policy. However, due to the ongoing intense pricing competition within the nitrile glove segment, we understand that the price hike will not be sustainable, presumably due to buyers' resistance to factor in the notable decline in raw material costs. We expect ASPs to remain soft, and likely to be riding on a downward trend.
- **...but margin compression may temporary ease at this juncture.** Our concern on Hartalega's margin compression may ease in the short term as our channel checks revealed that the actual capacity expansion in nitrile glove production is less rapid as planned by the big industry boys amid the easing raw materials cost trends.

SELL

(Maintained)

Company Update

Share Price	RM5.26
Target Price	RM4.25
Upside	-19.2%
(Previous TP)	RM4.05)

Company Description

Rubber Gloves Manufacturer

Stock Data

GICS sector	Health Care
Bloomberg ticker:	HART MK
Shares issued (m):	733.5
Market cap (RMm):	3,858.2
Market cap (US\$m):	1,272.2
3-mth avg daily t'over (US\$m):	1.1

Price Performance (%)

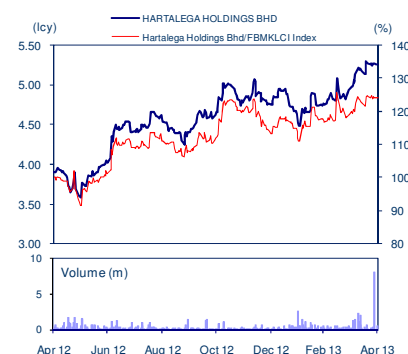
52-week high/low		RM5.29/RM3.58		
1mth	3mth	6mth	1yr	YTD
6.5	13.6	13.9	34.0	10.7

Major Shareholders

	%
Hartalega Industries Sdn Bhd	50.2
Budi Tenggara Sdn Bhd	5.0

FY14 NAV/Share (RM)	1.29
FY14 Net Cash/Share (RM)	0.23

Price Chart



Source: Bloomberg

Analysts

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Key Financials

Year to 31 Mar (RMm)	2011	2012	2013F	2014F	2015F
Net turnover	735	931	1,046	1,215	1,461
EBITDA	274	299	313	375	429
Operating profit	245	260	271	319	358
Net profit (rep./act.)	190	202	220	258	289
Net profit (adj.)	190	202	220	258	289
EPS (sen)	26.1	27.7	30.3	35.5	39.7
PE (x)	20.2	19.0	17.4	14.8	13.2
P/B (x)	7.7	6.2	5.0	4.1	3.4
EV/EBITDA (x)	13.5	12.4	11.8	9.9	8.6
Dividend yield (%)	1.5	1.8	1.9	2.3	2.5
Net margin (%)	25.8	21.7	21.0	21.2	19.8
Net debt/(cash) to equity (%)	(15.8)	(22.4)	(21.7)	(18.2)	(17.2)
Interest cover (x)	111.1	171.9	n.a.	n.a.	n.a.
ROE (%)	44.7	36.2	31.8	30.3	28.0
Consensus net profit	-	-	229	263	295
UOBKH/Consensus (x)	-	-	0.96	0.98	0.98

Source: Hartalega, Bloomberg, UOB Kay Hian

Stock Impact

- H7N9 avian flu virus continues to spread.** The number of H7N9 cases and deaths are still climbing. Based on the latest statistics released by Chinese health officials on Tuesday, 23 Apr 13, there were 108 confirmed cases and 22 confirmed deaths. The H7N9 avian flu virus, which started from Shanghai and Anhui, has spread to Shandong's Zaozhuang city.
- Minimal upside in the event of deteriorating H7N9 avian flu condition**
 Given that the China market is predominantly plastic and natural rubber glove users, we foresee any upsurge in demand for rubber gloves will benefit the natural rubber gloves producers, thus, benefitting Hartalega least within the sector. We also note that Hartalega is currently operating at its optimum utilisation rate (close to 90%), thus there is minimal room to capitalise any increase in demand.
- Raw material price trading on the softer end.** Nitrile butadiene (NBR) prices continue to head south, trading at an average price of US\$1,373/tonne in 3M13 (-16% vs 3M12) alongside with the sliding latex prices (-17% vs 3M12). We expect raw material prices to remain soft, especially entering into 2H13, driven by ample supply in the market and weak demand from the global market. Hence, we have tweaked our NBR cost assumption to an average of RM4.00/kg for 2013 (previously RM4.50/kg).
- Seeing production capacity capped in FY14-15.** While we note that the capacity expansion in Plant 6 is well executed, (expecting the 10 double former production lines to be fully ready by Jul 13) we maintain our conservative view that capacity expansion may be stalled in FY14-15 due to the delay in the commencement of Next Generation Integrated Glove Manufacturing Complex (NGC), which is targeted to commence construction in 2H13. We understand that the construction period of a manufacturing plant would generally require 1-1.5 years. This raises our concern on the company's prospective earnings post FY14, as there will be no additional capacity kicking in after the completion of Plant 6 by Jul 13. We foresee potential low growth visibility in FY14/15.

Earnings Revision/Risk

- We have tweaked our FY14-15 earnings forecasts by +6% and +5% respectively to factor in our new NBR price assumption of an average price of RM4.00/kg.

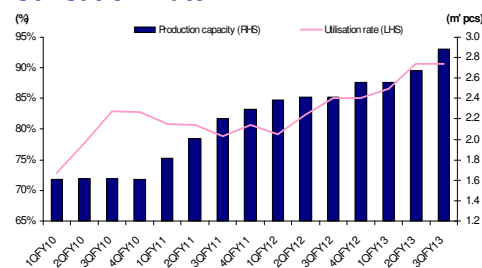
Valuation/Recommendation

- Maintain SELL with a slightly higher target price of RM4.25** (previously RM4.05) based on 12x FY14F PE (based on fully diluted EPS), which is close to 1SD above its historical mean PE.
- Margin compression remains as a concern.** The margin compression anticipated could be temporary mitigated by a) slower-than-expected industry capacity expansion as part of the aggressive nitrile glove capacity expansion projected in 2013 are likely to be delayed to 1H14 and b) we foresee a last run in the substitution effect of nitrile glove demand in the US market (current product mix of nitrile vs latex gloves stands at 74:26).

Share Price Catalyst

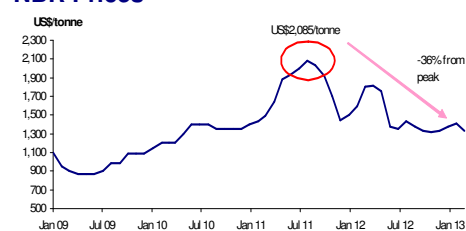
- Slowing capacity expansion in the nitrile glove production among the other manufacturers within the industry.

Quarterly Production Capacity And Utilisation Rate



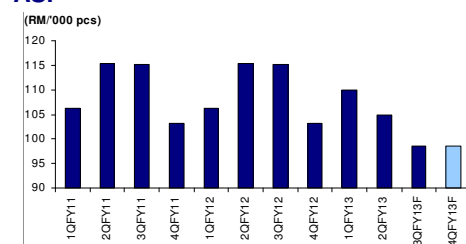
Source: Hartalega

NBR Prices



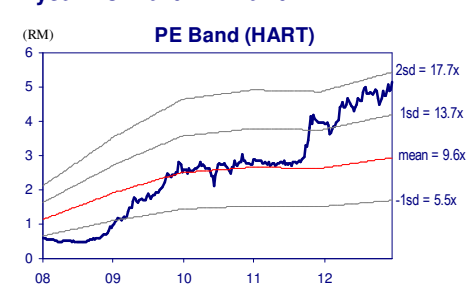
Source: Hartalega

ASP



Source: Hartalega, UOB Kay Hian

1-year Forward PE Band



Source: Bloomberg, UOB Kay Hian

Profit & Loss

Year to 31 Mar (RMm)	2012	2013F	2014F	2015F
Net turnover	931	1,046	1,215	1,461
EBITDA	299	313	375	429
Deprec. & amort.	38	43	56	71
EBIT	260	271	319	358
Net interest income/(expense)	(2)	4	4	3
Pre-tax profit	259	275	322	361
Tax	(57)	(55)	(64)	(72)
Net profit	202	220	258	289
Net profit (adj.)	202	220	258	289

Balance Sheet

Year to 31 Mar (RMm)	2012	2013F	2014F	2015F
Other LT assets	380	487	647	783
Cash/ST investment	163	191	295	319
Other current assets	209	198	223	268
Total assets	752	876	1,165	1,370
ST debt	13	13	113	113
Other current liabilities	67	47	64	78
LT debt	12	12	12	12
Other LT liabilities	40	40	40	40
Shareholders' equity	620	765	936	1,128
Minority interest	1	0	0	0
Total liabilities & equity	752	876	1,165	1,370

Cash Flow

Year to 31 Mar (RMm)	2012	2013F	2014F	2015F
Operating	201	252	291	321
Pre-tax profit	259	275	322	361
Tax	(49)	(55)	(64)	(72)
Deprec. & amort.	38	43	56	71
Working capital changes	(25)	(6)	(19)	(36)
Other operating cashflows	(22)	(4)	(4)	(3)
Investing	(60)	(150)	(200)	(200)
Capex (growth)	(35)	(150)	(200)	(200)
Investments	0	0	0	0
Proceeds from sale of assets	0	0	0	0
Others	(25)	0	0	0
Financing	(95)	(74)	13	(97)
Dividend payments	(87)	(74)	(87)	(97)
Issue of shares	0	0	0	0
Proceeds from borrowings	0	0	100	0
Loan repayment	(14)	0	0	0
Others/interest paid	7	0	0	0
Net cash inflow (outflow)	46	28	104	24
Beginning cash & cash equivalent	117	163	191	295
Changes due to forex impact	0	0	0	0
Ending cash & cash equivalent	163	191	295	319

Key Metrics

Year to 31 Mar (%)	2012	2013F	2014F	2015F
Profitability				
EBITDA margin	32.1	30.0	30.8	29.4
Pre-tax margin	27.8	26.3	26.5	24.7
Net margin	21.7	21.0	21.2	19.8
ROA	29.2	27.0	25.3	22.8
ROE	36.2	31.8	30.3	28.0
Growth				
Turnover	26.7	12.3	16.2	20.3
EBITDA	8.9	4.9	19.6	14.4
Pre-tax profit	6.5	6.4	17.2	12.0
Net profit	6.3	9.1	17.2	12.0
Net profit (adj.)	6.3	9.1	17.2	12.0
EPS	6.3	9.1	17.2	12.0
Leverage				
Debt to total capital	3.8	3.1	11.7	10.0
Debt to equity	4.0	3.2	13.3	11.1
Net debt/(cash) to equity	(22.4)	(21.7)	(18.2)	(17.2)
Interest cover (x)	171.9	n.a.	n.a.	n.a.

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