13 June 2013

AFFIN INVESTMENT BANK
KDN: PP 10251/07/2013(032736)

Company Update

Hartalega

HART MK
RM6.30

ADD (maintain)

Target Price: RM6.69 (↑)

Price Performance

	1M	3M	12M
Absolute	+10.5%	+31.0%	+64.1%
Rel to KLCI	+10.4%	+22.2%	+45.7%

Stock Data

Issued shares (m)	733.9
Mkt cap (RMm)	4,624.1
Avg daily vol - 6mth (m)	0.57
52-wk range (RM)	3.80 – 6.40
Est free float	45%
NTA per share (RM)	1.03
P/NTA (x)	6.09
Net cash/ (debt) (RMm) (4Q13)	170.3
ROE (FY13E)	36%
Derivatives	06/15 warrants, SP RM4.14

Key Shareholders

Hartalega Industries SB	50.1%
BNP Paribas Singapore	7.7%
EPF	5.1%
Budi Tenggera	4.9%

Earnings & Valuation Revisions

	14E	15E	16E
Prev EPS (sen)	34.7	37.3	39.0
Curr EPS (sen)	34.7	38.0	41.2
Chg (%)	-	+1.8	+5.6
Prev target price (RM)			5.86
Curr target price (RM)			6.69

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Embark to the next phase of expansion plans

Harta finally sealed the land deal with a price tag of RM96.9m

Hartalega (Harta) announced that its wholly-owned subsidiary Hartalega NGC, which is involve in the Next Generation Integrated Glove Manufacturing (NGC) project, has entered into a sale and purchase agreement with Kumpulan Tanjung Balai Sdn Bhd for the acquisition of a piece of land located in Sepang, Negeri Sembilan. The purchase price for the piece of land, measuring 112 hectares is RM96.9m. The purpose of the land is for Harta to expand its capacity, producing examination and speciality gloves. The purchase will be funded by both internal generated funds and bank borrowings of RM100m.

NGC to kick start by Aug 2013

Post the completion of Plant 6 in July 2013, Harta will then embark to start its 8-year master growth plan. NGC has been accorded an Entry Point Project (EPP) status under the government's ETP. Management guided that the construction of the manufacturing plant will start in September 2013, after the road access clearing and land filling is completed in August 2013. Construction of the plant will take about 11 months and we expect the 1st phase of NGC to commission in August 2014. We believe the group would be able to step up its production capacity to 15.4bn and 17.5bn pieces in FY15-16 respectively.

Annual CAPEX requirement of RM250m – funding is not an issue

Management guided that CAPEX for NGC would be c.RM250 p.a over the next 8 years. These CAPEX will be funded by: 1) the proceeds from the 74.3m warrant conversion with a strike price of RM4.14; and 2) the RM100m revolving credit already secured. With the strike price of RM4.14, we believe its major controlling shareholders (Kuan family) will exercise their 36.8m warrants to help fund the company's NGC programme. The company also had a strong balance sheet with healthy net cash per share of RM0.46 (as of 31 March 2013), and sturdy operating cash flows of c.RM300m/quarter.

Maintain ADD with a higher TP of RM6.69

We remain upbeat on Harta's prospects backed by: 1) resilient demand growth; 2) low and stable key raw material prices; and 3) management's strong commitment on capacity expansion and automations. We raised our TP for Harta to **RM6.69** from RM5.86 as we pegged the stock at a higher PER of 18x CY14 EPS from 16x previously. We believe Harta should trade at premium due to: 1) its solid track record in sustaining premium net profit margins of at least 22% (highest in the industry, despite the potential price competition within the nitrile segment); and 2) its ability to generate c.45k pcs of gloves/hour vs the prevailing industry's average of only 28k pcs/hour.

Earnings and valuation summary

FYE Mar	2012	2013	2014E**	2015E*	2016E*
Revenue (RMm)	931.1	1,032.0	1,197.9	1,311.7	1,401.5
EBITDA (RMm)	295.0	340.9	405.8	458.4	498.2
Pretax profit (RMm)	258.4	305.9	349.3	400.4	437.8
Net profit (RMm)	201.4	234.7	267.1	306.2	332.7
EPS (sen)	27.6	32.1	34.7	38.0	41.2
PER (x)	22.9	19.6	18.1	16.6	15.3
Core net profit (RMm)	207.2	234.7	267.1	306.2	332.7
Core EPS (sen)	28.3	32.1	34.7	38.0	41.2
Core EPS chg (%)	10.7	13.3	8.1	9.3	8.6
Core PER (x)	22.2	19.6	18.1	16.6	15.3
DPS (sen)	12.0	14.5	16.0	18.0	19.0
Dividend Yield (%)	1.9	2.3	2.5	2.9	3.0
EV/EBITDA (x)	15.1	13.0	11.4	10.4	9.4
Consensus profit (RMm)			264.3	292.9	331.6
Affin/Consensus (x)			1.0	1.0	1.0

**based on enlarged share base after the exercise of 36.8 free warrants*
***based on full conversion of free warrants with enlarged share base of 806.9m*

Other Updates

Plant 6's expansion is well on track

We understand that demand for nitrile gloves from its 45 major customers (mainly from the USA's renowned hospitals) remain strong. Coupled with the appreciation of US$ against the RM, we are positive on the company's volume sales growth moving forward. To meet the strong demand, Harta has actually fast tracked the commission of its production lines in Plant 6 and management is confident its remaining 2 production lines will come on time next month. This will help Harta to generate an additional 3.9bn piece of gloves, bringing its total capacity to14bn pieces, an increase of 27% yoy from 11bn in FY13.

Land filling and road excess for NGC will take c.2months to complete

Post the full commissioning of Plant 6, Harta will then start the 1st phase of NGC. We gathered that the company will take c.2 months from now to carry out land filling and road access clearing. It is expected that Harta would be able to start building the manufacturing plant in September 2013 for completion by August 2014. Hence, the first 8 production lines will be commission in September 2014. (We have factored in a total production capacity assumption of 15.4bn and 17.5bn pieces of gloves for FY15-16 respectively into our earnings forecasts)

Valuation & Recommendation

Lifting our FY15-16 EPS forecast by 1.3-5.6%

In view of management's strong commitment on capacity ramp-up and high conviction on the NGC's expansion, we are upgrading our actual sales volume capacity growth assumption by 5% to 13.5bn and 14.3bn pieces for FY03/15-16 respectively. Notwithstanding the capacity ramp-up, plant utilization rate will be sustained at 88%. As a result, our FY03/15-16 net profit forecast is lifted by 1.3-5.6% respectively.

Our positive view on Hartalega is valid

Backed by: 1) the resilient growth in volume demand; 2) low and stable key raw material prices; 3) Harta's pushed towards greater plant automation to boost operating efficiencies; and 4) management's efforts in ramping up capacity, we are positive on Harta's prospects going forward. In addition, we believe its major controlling shareholders (Kuan family) will exercise their 55% share of the warrants (36.8m units) to help fund the NGC. In that sense, this clearly shows their high conviction on the NGC project, and in a way, it also helps to reaffirm our positive view on the company.

Maintain ADD with a higher TP of RM6.62

We raised our TP for Harta to **RM6.69** from RM5.86, as we pegged the stock at a higher PER of 18x CY14 EPS from 16x previously. We believe Harta should trade at a premium PER of 18x, (on par with Top Glove) in view of the company's solid track record in sustaining premium net profit margins of at least 22%, (highest in the industry). Furthermore, we reckon that Harta's production plants are equipped with most efficient production lines in the world as each line in Plant 6 can generate up to c.45k pcs of gloves/hour vis-à-vis the prevailing industry's average of 28k pcs per hour. Key risks to our view are: 1) a delay in NGC plant construction and completion; 2) strong rebound in raw material prices; and 3) strong appreciation of RM against the greenback, dampening topline revenue growth.

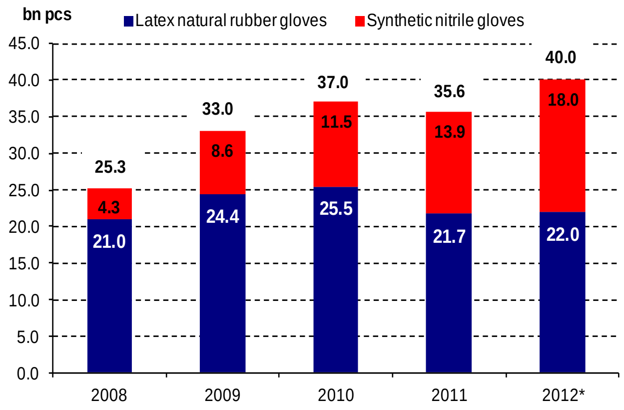
Table 1: Issued and paid-up share capital and diluted EPS

	No. of shares (m)
Issued and paid-up share capital	732.6
To be issued assuming shareholders exercise half of the Free Warrants	36.8
Enlarged issued and paid-up share capital after the free warrants	769.4
CY14 EPS (RM sen) post-exercise of warrants	37.1
TP (RM) pegged to unchanged 18x PER	**6.69**

Source: Affin

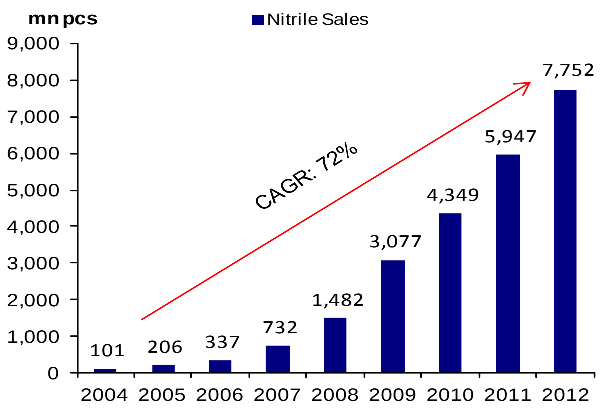
FOCUS CHART

Fig 1: Growth in gloves export



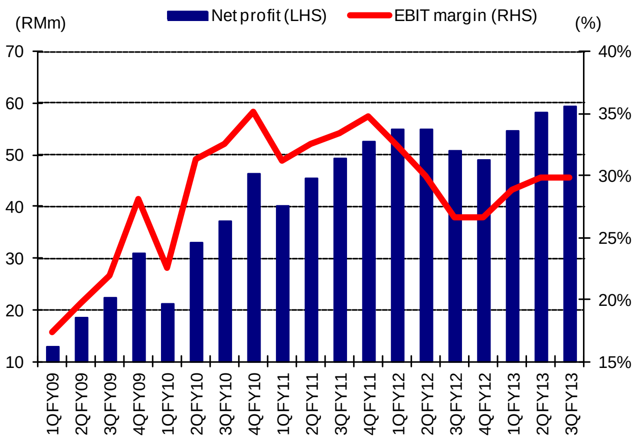
Source: MRPEC, Affin

Fig 2: Nitrile sales volume (million pieces)



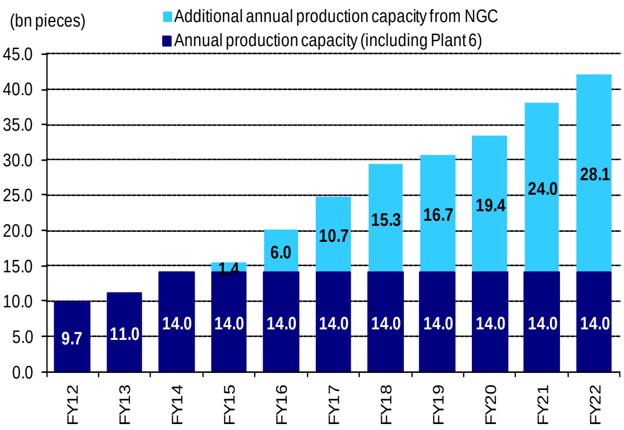
Source: Company, Affin

Fig 3: Hartalega's net profit (LHS) and EBIT margin (RHS)



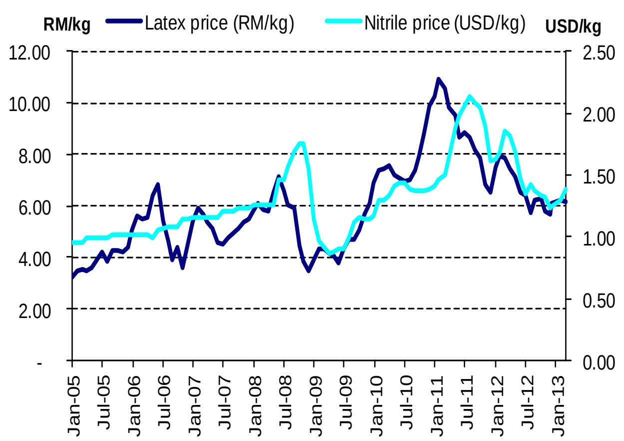
Source: Affin

Fig 4: Hartalega's capacity expansion plans



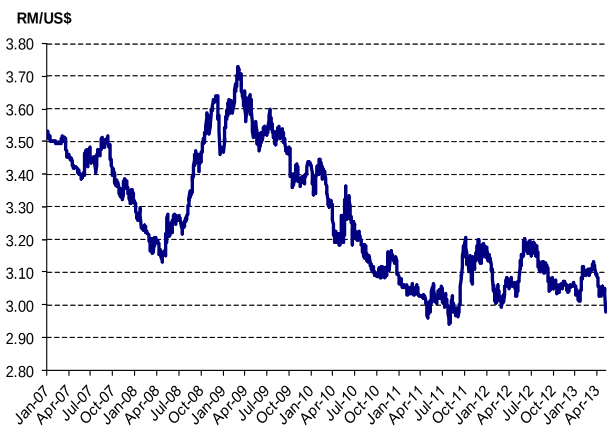
Source: Bloomberg, Affin

Fig 5: Latex price (LHS) vs Nitrile price (RHS)



Source: Bloomberg

Fig 6: RM/US$ exchange rate



Source: Bloomberg

Hartalega - FINANCIAL SUMMARY

Profit & Loss Statement

FYE Mar (RMm)	2012	2013	2014E**	2015E*	2016E*
Total revenue	931.1	1,032.0	1,197.9	1,311.7	1,401.5
Operating expenses	(636.1)	(691.1)	(792.1)	(853.3)	(903.3)
EBITDA	295.0	340.9	405.8	458.4	498.2
Depreciation	(29.0)	(34.1)	(44.5)	(51.8)	(58.6)
Amortisation	(0.0)	(0.0)	(6.9)	(1.2)	(1.2)
EBIT	266.0	306.8	354.3	405.4	438.4
Net interest income/(expense)	(1.7)	(0.9)	(2.2)	(0.4)	(0.6)
Associates' contribution	0.0	0.0	(2.9)	(4.6)	0.0
Others	0.0	0.0	0.0	0.0	0.0
Pretax profit	258.4	305.9	349.3	400.4	437.8
Tax	(57.0)	(70.8)	(82.1)	(94.1)	(105.1)
Minority interest	(0.1)	(0.3)	(0.1)	(0.1)	(0.1)
Net profit	201.4	234.7	267.1	306.2	332.7

Balance Sheet Statement

FYE Mar (RMm)	2012	2013	2014E**	2015E*	2016E*
Fixed assets	370.3	485.8	591.3	688.4	777.9
Other long term assets	9.9	56.8	56.8	56.8	56.8
Total non-current assets	**380.2**	**542.5**	**648.0**	**745.2**	**834.7**
Cash and equivalents	163.2	182.4	244.8	311.1	394.7
Stocks	97.5	86.6	124.2	132.3	139.7
Debtors	117.1	124.7	150.7	165.0	176.3
Other current assets	0.1	0.1	0.1	0.1	0.1
Total current assets	**377.9**	**393.8**	**519.8**	**608.4**	**710.8**
Creditors	60.4	92.8	76.9	82.0	86.5
Short term borrowings	12.6	7.7	9.2	8.3	7.5
Other current liabilities	12.5	14.5	14.5	14.5	14.5
Total current liabilities	**85.5**	**115.0**	**100.7**	**104.8**	**108.5**
Long term borrowings	12.1	4.5	5.5	5.0	4.5
Other long term liabilities	40.5	50.3	50.3	50.3	50.3
Total long term liabilities	**52.6**	**54.8**	**55.8**	**55.2**	**54.8**
Shareholders' Funds	**619.5**	**765.5**	**1017.1**	**1193.5**	**1380.7**

Cash Flow Statement

FYE Mar (RMm)	2012	2013	2014E**	2015E*	2016E*
EBIT	266.0	306.8	354.3	405.4	438.4
Depreciation & amortisation	29.0	34.1	51.4	53.0	59.8
Working capital changes	(41.1)	37.7	(79.4)	(17.4)	(14.1)
Cash tax paid	(57.0)	(70.8)	(82.1)	(94.1)	(105.1)
Others	3.5	0.0	0.0	0.0	0.0
Cashflow from operations	**200.3**	**307.8**	**244.3**	**346.9**	**379.0**
Capex	(35.4)	(250.0)	(150.0)	(149.0)	(148.0)
Disposal/(purchases)	0.1	46.9	0.0	0.0	0.0
Others	(24.8)	0.0	0.0	0.0	0.0
Cash flow from investing	**(60.1)**	**(203.1)**	**(150.0)**	**(149.0)**	**(148.0)**
Debt raised/(repaid)	(14.3)	(12.5)	2.6	(1.5)	(1.3)
Equity raised/(repaid)	10.8	184.1	0.0	0.0	0.0
Net interest income/(expense)	(1.7)	(0.9)	(2.2)	(0.4)	(0.6)
Dividends paid	(87.4)	(95.0)	(193.3)	(129.9)	(145.4)
Others	(2.4)	0.0	0.0	0.0	0.0
Cash flow from financing	**(95.0)**	**75.7**	**(193.0)**	**(131.7)**	**(147.4)**
Free Cash Flow	**164.9**	**57.8**	**94.3**	**197.9**	**231.0**

Key Financial Ratios and Margins

FYE Mar (RMm)	2012	2013	2014E**	2015E*	2016E*
Growth					
Revenue (%)	26.7	10.8	16.1	9.5	6.8
EBITDA (%)	10.4	15.6	19.0	13.0	8.7
Core net profit (%)	5.8	16.6	13.8	14.6	8.6
Profitability					
EBITDA margin (%)	31.7	33.0	33.9	34.9	35.5
PBT margin (%)	27.8	29.6	29.2	30.5	31.2
Net profit margin (%)	21.6	22.7	22.3	23.3	23.7
Effective tax rate (%)	22.0	23.2	23.5	23.5	24.0
ROA (%)	26.6	25.1	22.9	22.6	21.5
Core ROE (%)	37.2	33.9	30.0	27.7	25.8
ROCE (%)	45.2	43.2	39.2	36.2	33.7
Dividend payout ratio (%)	44	45	45	45	45
Liquidity					
Current ratio (x)	4.4	3.4	5.2	5.8	6.5
Op. cash flow (RMm)	200.3	307.8	244.3	346.9	379.0
Free cashflow (RMm)	164.9	57.8	94.3	197.9	231.0
FCF/share (sen)	22.6	7.9	12.3	24.5	28.6
Asset management					
Debtors turnover (days)	46	44	46	46	46
Stock turnover (days)	56	43	56	56	56
Creditors turnover (days)	35	46	35	35	35
Capital structure					
Core ROA (%)	27.3	25.1	22.9	22.6	21.5
ROCE (%)	45.2	43.2	39.2	36.2	33.7

Quarterly Profit & Loss

FYE Mar (RMm)	4Q12	1Q13	2Q13	3Q13	4Q13
Revenue	240.2	247.7	255.0	259.6	269.8
Operating expenses	(176.3)	(176.1)	(179.0)	(182.2)	(188.3)
EBIT	63.9	71.6	76.0	77.3	81.5
Net int income/(expense)	(0.4)	(0.3)	(0.2)	(0.2)	(0.2)
Associates' contribution	0.0	0.0	0.0	0.0	0.0
Exceptional Items	1.0	(1.3)	0.5	1.2	0.0
Pretax profit	64.5	69.9	76.3	78.4	81.3
Tax	(14.4)	(16.5)	(17.7)	(17.7)	(18.9)
Minority interest	(0.1)	(0.1)	(0.0)	0.0	0.1
Net profit	50.0	53.4	58.5	60.6	62.6
Core net profit	49.0	54.7	58.1	59.4	62.6
Margins (%)					
EBIT	26.6	28.9	29.8	29.8	30.2
PBT	26.8	28.2	29.9	30.2	30.1
Net profit	20.8	21.5	23.0	23.4	23.2

**based on enlarged share base after the exercise of 36.8 free warrants*
***based on full conversion of free warrants with enlarged share base of 806.9m*

Source: Affin

Equity Rating Structure and Definitions

BUY	Total return is expected to exceed +15% over a 12-month period
TRADING BUY (TR BUY)	Total return is expected to exceed +15% over a 3-month period due to short-term positive development, but fundamentals are not strong enough to warrant a Buy call. This is to cater to investors who are willing to take on higher risks
ADD	Total return is expected to be between 0% to +15% over a 12-month period
REDUCE	Total return is expected to be between 0% to -15% over a 12-month period
TRADING SELL (TR SELL)	Total return is expected to exceed -15% over a 3-month period due to short-term negative development, but fundamentals are strong enough to avoid a Sell call. This is to cater to investors who are willing to take on higher risks
SELL	Total return is expected to be below -15% over a 12-month period
NOT RATED	Affin Investment Bank does not provide research coverage or rating for this company. Report is intended as information only and not as a recommendation
OVERWEIGHT	Industry, as defined by the analyst's coverage universe, is expected to outperform the KLCI benchmark over the next 12 months
NEUTRAL	Industry, as defined by the analyst's coverage universe, is expected to perform inline with the KLCI benchmark over the next 12 months
UNDERWEIGHT	Industry, as defined by the analyst's coverage universe is expected to under-perform the KLCI benchmark over the next 12 months

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