

Hartalega Holdings – Malaysia

2QFY12: Poorer quarter, impacted by forex losses; we lower our target price

2QFY12 Results

Year to 31 Mar	2QFY12 (RMm)	qoq % chg	yoy % chg	6M11 (RMm)	yoy % chg
Turnover	229.5	4.6	24.5	448.9	26.7
COGS	(164.0)	7.3	31.4	(316.9)	31.6
EBIT	59.1	(15.8)	(2.1)	129.3	13.9
Finance Costs	(0.4)	(10.0)	(2.1)	(0.9)	(26.4)
Pre-Tax Profit	59.6	(15.7)	(2.4)	130.2	13.5
Tax	(13.4)	(16.0)	(3.8)	(29.3)	11.8
Net Profit	46.2	(15.7)	(1.9)	101.9	14.1
Core Profit	54.9	1.5	16.5	108.9	23.0
EPS (sens)	0.0	(15.7)	(1.9)	27.8	14.1
PBT Margins (%)	25.9	+/- ppts (6.3)	+/- ppts (7.2)	29.0	+/- ppts (3.4)
Net Margin (%)	20.1	(4.9)	(5.4)	22.5	(2.5)

Source: Hartalega, UOB Kay Hian

Results

- **2QFY12 net profit dropped** 16% qoq and 2% yoy. Hartalega recorded an exceptional unrealised forex loss of RM8.7m in 2QFY12. Core profit (adjusted for forex losses) of RM54.9m was within our expectation.
- **Pre-tax margin (before forex losses)** contracted by a mere 3ppt from 32.2% to 29.7%.
- **Revenue continued to grow** by 5% qoq to a record RM230m in 2QFY12, a comforting sign that Hartalega is less impacted by the severe oversupply in the natural rubber glove segment. Hartalega is the only glove manufacturer still reporting sequential top-line growth every quarter.
- **Declared dividend of 6 sen/share for 2QFY11.** Hartalega continues to pay out quarterly dividends. It has an annual implied dividend yield of 4.4%.

Key Financials

Year to 31 Mar (RMm)	2010	2011	2012F	2013F	2014F
Net turnover	575	735	899	1,075	1,184
EBITDA	207	275	276	329	363
Operating profit	181	246	248	295	322
Net profit (rep./act.)	143	190	200	240	264
Net profit (adj.)	143	190	200	240	264
EPS (sen)	39.4	52.3	55.1	66.0	72.7
PE (x)	13.9	10.4	9.9	8.3	7.5
P/B (x)	5.6	4.0	3.3	2.6	2.1
EV/EBITDA (x)	9.2	6.9	6.9	5.8	5.3
Dividend yield (%)	3.7	3.8	4.4	4.4	4.6
Net margin (%)	24.9	25.9	22.3	22.3	22.3
Net debt/(cash) to equity (%)	(9.4)	(15.8)	(20.2)	(25.5)	(32.9)
Interest cover (x)	61.4	111.5	n.a.	n.a.	n.a.
ROE (%)	47.1	44.8	36.4	35.1	31.2
Consensus net profit	-	-	209	235	269
UOBKH/Consensus (x)	-	-	0.96	1.02	0.98

Source: Hartalega, Bloomberg, UOB Kay Hian

BUY

(Maintained)

Company Results

Share Price	RM5.46
Target Price	RM6.62
Upside	+21.2%
(Previous TP	RM7.90)

Company Description

A synthetic rubber gloves manufacturer.

Stock Data

GICS sector	Health Care
Bloomberg ticker:	HART MK
Shares issued (m):	364.0
Market cap (RMm):	1,987.5
Market cap (US\$m):	636.1
3-mth avg daily t'over (US\$m):	0.5

Price Performance (%)

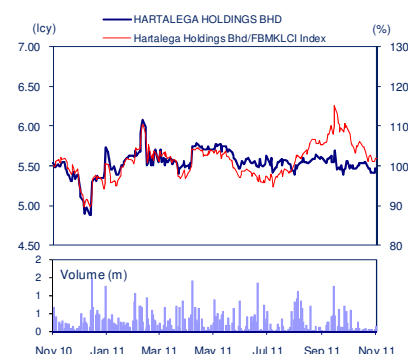
52-week high/low					RM6.07/RM4.88
1mth	3mth	6mth	1yr	YTD	
(1.8)	0.4	(4.2)	(2.2)	2.2	

Major Shareholders

	%
Hartalega Industries Sdn Bhd	50.6
Budi Tenggara Sdn Bhd	5.0

FY12 NAV/Share (RM)	1.67
FY12 Net Cash/Share (RM)	0.34

Price Chart



Source: Bloomberg

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Stock Impact

- **Forex loss arose from forward contracts to hedge receipts.** The sudden appreciation of the US dollar at end-Sep 11 exceeded forward rates locked in earlier. This is a one-off treatment and could be reversed if the US dollar starts to depreciate again.
- **Lower margins going forward.** The entry of other players such as Top Glove and Supermax in the nitrile segment has eroded the exceptional margins that Hartalega enjoyed. We estimate gross margin for synthetic latex gloves could have reached 35% two quarters ago. We think gross margin for nitrile gloves has fallen to just 31-32% now, just a few percentage points above natural gloves'.
- **Cost pressures reducing margins.** Hartalega acknowledged that rising raw material costs are also applying some downward pressure on their margins for the first time. This could reduce some cost advantage Hartalega currently has over the other natural latex players.
- **Strong top-line growth the only consolation.** Hartalega's utilisation rate of 82% in the quarter was an improvement from a quarter ago, and still the highest in the industry.
- **Hartalega's outlook is still very positive.** Management expects another 30% demand growth for nitrile gloves for the rest of the year. Unlike other glove makers who have delayed their production plans for 3-6 months, Hartalega is continuing with the plant 5 expansion.

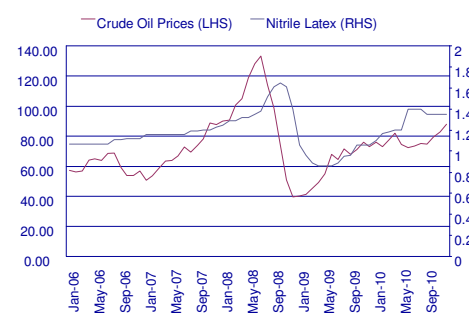
Earnings Revision/Risk

- We are reducing our FY12 to FY14 net profit forecasts by 10% after factoring in lower gross margin from the nitrile latex segment of 32% (previously 36%). Average selling price for nitrile gloves has only risen 8.5% qoq, much slower than the spike in raw material costs which have risen 13% qoq.

Valuation/Recommendation

- **Maintain BUY but we lower our target price from RM7.90 to RM6.62,** based on 12x 2012F PE, in line with the PE multiple we have for Top Glove. As a nitrile glove specialist, Hartalega deserves to trade on a par with the industry leader. Its 6 sen quarterly dividend, which implies a 4.4% annual gross yield, also limits share price downside. It has a net cash of 35 sen/share, enough to cover dividends for the next 18 months.

Rising Synthetic Latex Costs



Source: Hartalega, Bloomberg

Profit & Loss

Year to 31 Mar (RMm)	2011	2012F	2013F	2014F
Net turnover	735	899	1,075	1,184
EBITDA	275	276	329	363
Deprec. & amort.	29	28	35	41
EBIT	246	248	295	322
Net interest income/(expense)	(2)	3	5	9
Pre-tax profit	243	251	300	330
Tax	(53)	(50)	(60)	(66)
Net profit	190	200	240	264
Net profit (adj.)	190	200	240	264

Balance Sheet

Year to 31 Mar (RMm)	2011	2012F	2013F	2014F
Other LT assets	349	443	543	636
Cash/ST investment	117	161	233	346
Other current assets	165	169	202	218
Total assets	631	774	978	1,200
ST debt	15	15	15	15
Other current liabilities	61	91	142	190
LT debt	24	24	24	24
Other LT liabilities	37	37	37	37
Shareholders' equity	494	607	760	934
Minority interest	0	0	0	0
Total liabilities & equity	631	774	978	1,200

Cash Flow

Year to 31 Mar (RMm)	2011	2012F	2013F	2014F
Operating	182	217	243	287
Pre-tax profit	243	251	300	330
Tax	(48)	(50)	(60)	(66)
Deprec. & amort.	29	28	35	41
Working capital changes	(43)	(9)	(26)	(11)
Other operating cashflows	1	(3)	(5)	(8)
Investing	(81)	(85)	(85)	(85)
Capex (growth)	(81)	(85)	(85)	(85)
Investments	0	0	0	0
Proceeds from sale of assets	0	0	0	0
Others	0	0	0	0
Financing	(59)	(87)	(87)	(89)
Dividend payments	(57)	(87)	(87)	(91)
Issue of shares	0	0	0	1
Proceeds from borrowings	14	0	0	0
Loan repayment	(17)	0	0	0
Others/interest paid	1	0	0	1
Net cash inflow (outflow)	42	44	71	113
Beginning cash & cash equivalent	75	117	161	233
Changes due to forex impact	0	0	0	0
Ending cash & cash equivalent	117	161	233	346

Key Metrics

Year to 31 Mar (%)	2011	2012F	2013F	2014F
Profitability				
EBITDA margin	37.4	30.7	30.7	30.7
Pre-tax margin	33.1	27.9	27.9	27.9
Net margin	25.9	22.3	22.3	22.3
ROA	34.3	28.5	27.4	24.3
ROE	44.8	36.4	35.1	31.2
Growth				
Turnover	27.8	22.4	19.5	10.2
EBITDA	32.7	0.3	19.5	10.2
Pre-tax profit	36.7	3.0	19.7	10.2
Net profit	32.8	5.4	19.7	10.2
Net profit (adj.)	32.8	5.4	19.7	10.2
EPS	32.8	5.4	19.7	10.2
Leverage				
Debt to total capital	7.3	6.0	4.9	4.0
Debt to equity	7.9	6.4	5.1	4.2
Net debt/(cash) to equity	(15.8)	(20.2)	(25.5)	(32.9)
Interest cover (x)	111.5	n.a.	n.a.	n.a.

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