

**AmResearch****Company report****Cheryl Tan**

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HARTALEGA HOLDINGS

(HART MK, HTHB.KL)

25 June 2013

*Consensus downgrades on weakening earnings momentum?***HOLD**

(Maintained)

Rationale for report: Company Update

Price RM6.56
 Fair Value RM6.00
 52-week High/Low RM6.80/RM3.99

Key Changes

Fair value 
 EPS 

YE to Mar	FY13	FY14F	FY15F	FY16F
Revenue (RMmil)	1,032.0	1,213.5	1,336.7	1,646.5
Core net profit (RMmil)	234.7	257.4	280.1	350.8
FD EPS (Sen)	31.7	32.0	34.8	43.6
FD EPS growth (%)	16.1	10.1	8.9	25.2
Consensus EPS (Sen)	n/a	n/a	n/a	n/a
DPS (Sen)	14.3	15.0	16.0	21.5
FD PE (x)	20.4	18.6	17.1	13.6
EV/EBITDA (x)	15.1	14.3	12.2	10.2
Div yield (%)	2.2	2.3	2.4	3.3
ROE (%)	33.9	33.6	33.2	34.5
Net Gearing (%)	n/a	18.4	8.1	21.5

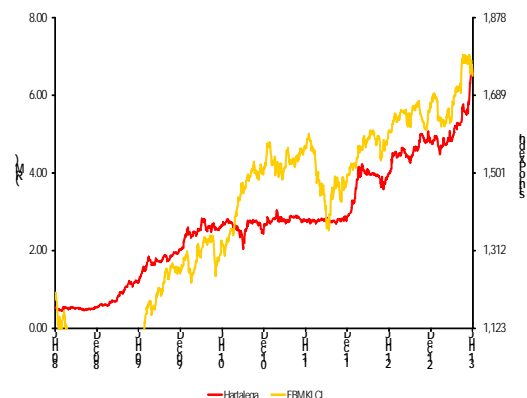
Stock and Financial Data

Shares Outstanding (million) 734.2
 Market Cap (RMmil) 4,816.2
 Book value (RM/share) 0.95
 P/BV (x) 6.9
 ROE (%) 33.9
 Net Gearing (%) n/a

Major Shareholders Hartalega Industries Sdn Bhd (50.1%)
 Budi Tenggara (4.9%)

Free Float (%) 44.8
 Avg Daily Value (RMmil) 5.3

Price performance	3mth	6mth	12mth
Absolute (%)	39.5	40.9	70.0
Relative (%)	31.5	35.4	59.5

**Investment Highlights**

- We maintain our HOLD recommendation on Hartalega Holdings but trim our fair value to RM6.00/share. This is premised on an unchanged target PE of 17x.
- We have reduced our FY14F-FY15F earnings by a further 2%-4% in view of the earlier-than-expected onset of price competition. We now anticipate ASP to decline by an additional 2% for nitrile gloves (93% of sales volume) and 6% for latex gloves.
- Albeit at a smaller quantum, this represents our second earnings downgrade in a month following a revision in May when we clipped Hartalega's FY14F-FY15F earnings by 9%-21%. Back then, we had cautioned that the group's earnings would be capped by capacity constraints (CY13-14: +2% vs peers' 3%) as well as an 8% ASP decline in FY14F-FY15F.
- Despite the healthy global demand for rubber gloves (FY14F: +10%-15%), the group's delays in its capacity expansion plans and current oversold position place it at a disadvantage to its peers. This is more pressing given that nitrile gloves (of which it is the market leader at 19%) remain the key growth segment.
- We also take stock of Hartalega's concentrated customer base. Its top three customers contribute ~45% to total sales, making the group more sensitive to pricing pressures. We gather that one of its major customers had recently reduced its orders.
- As such, we foresee some earnings headwinds seeping through from 2QFY14F onwards. We anticipate some consensus earnings downgrades amid weakness in its sequential earnings momentum. Our forecasts now stand at 3%-4% below consensus.
- YTD, Hartalega's share price has appreciated by 16%, extending its 2012 rally in which it outperformed the FBM KLCI by 52ppts. While this can be in part attributed to the recent re-rating of the rubber glove sector, we believe it is priced to perfection and a pullback may be imminent.
- We opine that at current price levels, Hartalega's valuations are expensive. It is trading at a PE of 19x-21x its fully-diluted FY14F-FY15F EPS. This is close to 3SD above its 3-year trend average of 12x.
- No change to our FY14F-FY15F gross DPS forecasts which are in line with management's minimum payout ratio of 45%. With the recent run-up in its share price, yields have however compressed to an average of 2.2%.

CHART 1 : PB BAND CHART



CHART 2 : PE BAND CHART

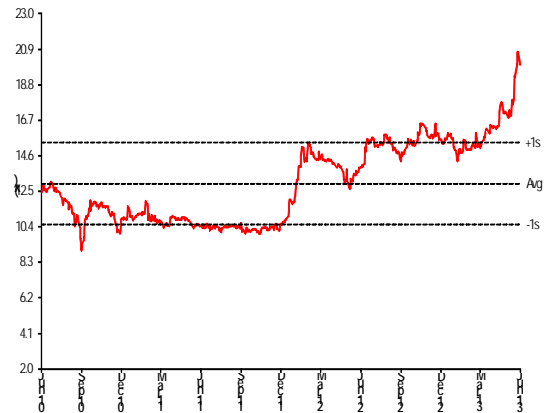


TABLE 1 : FINANCIAL DATA

Income Statement (RMmil, YE 31 Mar)	2012	2013	2014F	2015F	2016F
Revenue	931.1	1,032.0	1,213.5	1,336.7	1,646.5
EBITDA	288.2	337.9	382.5	437.7	546.0
Depreciation	(29.0)	(31.9)	(43.2)	(59.8)	(75.0)
Operating income (EBIT)	259.2	305.9	339.4	378	470.9
Other income & associates	0.0	0.0	0.0	0.0	0.0
Net interest	(0.8)	(0.1)	(4.0)	(11.2)	(17.9)
Exceptional items	0.0	0.0	0.0	0.0	0.0
Pretax profit	258.4	305.9	335.3	366.6	453.1
Taxation	(57.0)	(70.8)	(77.6)	(86.2)	(101.9)
Minorities/pref dividends	(0.1)	(0.3)	(0.3)	(0.3)	(0.3)
Net profit	201.4	234.7	257.4	280.1	350.8
Core net profit	201.4	234.7	257.4	280.1	350.8
Balance Sheet (RMmil, YE 31 Mar)	2012	2013	2014F	2015F	2016F
Fixed assets	370.3	485.8	670.6	839.6	1,044.3
Intangible assets	0.0	6.9	0.0	0.0	0.0
Other long-term assets	9.9	49.8	49.6	49.6	49.6
Total non-current assets	380.2	542.5	720.3	889.2	1,093.9
Cash & equivalent	163.2	182.4	56.1	266.8	163.7
Stock	97.5	86.6	141.1	95.4	194.1
Trade debtors	107.7	119.9	172.6	149.6	247.3
Other current assets	9.5	4.8	9.5	9.5	9.5
Total current assets	377.9	393.8	379.4	521.4	614.7
Trade creditors	29.5	56.2	26.7	63.0	46.8
Short-term borrowings	12.6	7.7	84.3	128.2	172.4
Other current liabilities	43.4	51.2	42.7	42.7	42.7
Total current liabilities	85.5	115.0	153.6	233.8	261.8
Long-term borrowings	12.1	4.5	144.3	219.5	296.2
Other long-term liabilities	40.5	50.3	35.6	35.9	35.2
Total long-term liabilities	52.6	54.8	179.9	255.3	331.4
Shareholders' funds	619.5	765.5	765.5	920.9	1,114.8
Minority interests	0.6	1.0	0.6	0.6	0.6
BV/share (RM)	0.77	0.95	0.95	1.14	1.39
Cash Flow (RMmil, YE 31 Mar)	2012	2013	2014F	2015F	2016F
Pretax profit	258.4	305.9	335.3	366.6	453.1
Depreciation	29.0	31.9	43.2	59.8	75.0
Net change in working capital	(44.5)	35.7	(136.7)	105.0	(212.5)
Others	(42.6)	(56.3)	(77.6)	(86.2)	(101.9)
Cash flow from operations	200.3	317.2	164.2	445.3	213.6
Capital expenditure	(35.4)	(18.2)	(300.0)	(200.0)	(250.0)
Net investments & sale of fixed assets	0.1	0.0	0.1	0.1	0.1
Others	(24.8)	(175.9)	(30.0)	(30.0)	(30.0)
Cash flow from investing	(60.1)	(194.0)	(329.9)	(229.9)	(279.9)
Debt raised/(repaid)	(14.6)	(12.5)	114.0	119.0	119.0
Equity raised/(repaid)	0.0	0.0	0.0	0.0	0.0
Dividends paid	(87.4)	(98.8)	(111.2)	(124.7)	(156.9)
Others	6.9	7.3	0.0	0.0	0.0
Cash flow from financing	(95.0)	(104.0)	2.8	(5.7)	(37.9)
Net cash flow	45.2	19.2	(162.9)	209.7	(104.1)
Net cash/(debt) b/f	117.0	163.2	218.0	56.1	266.8
Net cash/(debt) c/f	163.2	182.4	56.1	266.8	163.7
Key Ratios (YE 31 Mar)	2012	2013	2014F	2015F	2016F
Revenue growth (%)	26.7	10.8	17.6	10.2	23.2
EBITDA growth (%)	7.5	17.2	13.2	14.4	24.7
Pretax margins (%)	27.8	29.6	27.6	27.4	27.5
Net profit margins (%)	21.6	22.7	21.2	21.0	21.3
Interest cover (x)	149.3	338.8	56.4	26.2	23.1
Effective tax rate (%)	22.0	23.2	23.2	23.5	22.5
Net dividend payout (%)	45.3	45.2	46.9	46.0	49.3
Debtors turnover (days)	40	40	44	44	44
Stock turnover (days)	32	33	34	32	32
Creditors turnover (days)	13	15	12	12	12

Source: Company, AmResearch estimates

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