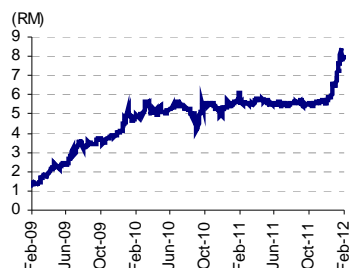


Results Note

Hartalega

 HART MK
 RM7.97

BUY (maintain)
Target Price: RM9.20 (↓)

Price Performance

	1M	3M	12M
Absolute	+22.6%	+44.4%	+44.6%
Rel to KLCI	+19.6%	+32.6%	+40.1%

Stock Data

Issued shares (m)	364.6
Mkt cap (RMm)	2,906.2
Avg daily vol - 6mth (m)	0.28
52-wk range (RM)	5.00 – 8.35
Est free float	43.4%
NTA per share (RM) (3QFY12)	1.61
P/NTA (x)	4.95
Net cash/ (debt) (RMm) (3QFY12)	136.1
ROE (FY12E)	36.4%
Derivatives	Nil

Key Shareholders

Hartalega Industries	55.1%
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Earnings & Valuation Revisions

	12E	13E	14E
Prev EPS (sen)	56.6	65.5	74.3
Curr EPS (sen)	56.6	61.3	69.1
Chg (%)	-	-6.4	-7.0
Prev target price (RM)		9.60	
Curr target price (RM)		9.20	

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Price competition heats up
Within expectations

Hartalega reported a 9MFY03/12 revenue growth of 27.4% yoy to RM690.9m, driven primarily by volume sales growth of +23.6% yoy. EBIT margin was lower at 29.3% vs. 32.4% due to higher nitrile latex prices, but was largely in line with our forecast of 29.5%. Overall, 9MFY03/12 headline net profit grew by +10% yoy to RM151.6m. Excluding the impact of foreign exchange losses, 9MFY03/12 core net profit would have increased by a sharper +17.6% yoy to RM158.4m. Results were within expectations, accounting for 77% and 78% of our and consensus full year estimates. Hartalega also declared a second interim dividend of 6 sen/share, bringing YTD DPS to 12 sen.

3QFY03/12 core net profit slips -3.5% qoq

Sequentially, 3QFY03/12 revenue grew by +5.4% to RM242m, primarily due to a +4.1% qoq increase in glove volume sales. Although nitrile latex prices fell from an average of US\$2,005/mt in 2QFY03/12 to US\$1,650/mt in 3QFY03/12, weaker pricing power from higher price competition had caused EBIT margin to slip by -2.3-ppt qoq to 26.7% (2QFY03/12: 29%). 3QFY03/12 net profit grew by +9.9% to RM50.7m – however, excluding the net losses in foreign exchange, 3QFY03/12 core net profit would have fallen by -3.5% qoq.

Declared a 1-for-1 bonus issue with free warrants

Hartalega has proposed to undertake a 1-for-1 bonus issue, primarily to improve its stock trading liquidity and better reflect the company's scale of operations. Upon completion, Hartalega's share base would be enlarged from 364.6m shares to 729.3m shares. As a sweetener, Hartalega also proposed the issuance of up to 74.3m free warrants on the basis of 1 free warrant for every 5 shares held on the same entitlement date as the bonus issue. The exercise price is to be determined later. Assuming full conversion of the warrants at an exercise price of RM4.15 (representing a 5% premium to the theoretical ex-price of RM3.95), proceeds would be RM308.5m. We believe the future proceeds would likely be used to fund production capacity expansion beyond Plant 6 (yet to be disclosed). Dilution to FY03/13-14 EPS is estimated at 9%, assuming full conversion.

Implementing a more aggressive pricing strategy

Management indicated that they would be more aggressive in competitively pricing their nitrile gloves once the additional capacity from Plant 6 comes onstream (due to commence in September 2012). This implies that margins will be sacrificed in order to maintain competitiveness. We now estimate FY03/13-14 EBIT margin to fall to c. 26% from 29% in FY03/12 - consequently, our FY03/13-14 net earnings forecasts are cut by -6-7%.

Earnings and valuation summary

FYE Mar	2010	2011	2012E	2013E	2014E
Revenue (RMm)	571.9	734.9	887.1	1,064.2	1,199.7
EBITDA (RMm)	201.0	267.2	293.0	313.2	349.9
Pretax profit (RMm)	177.8	242.8	256.5	283.2	319.6
Net profit (RMm)	142.9	190.3	199.1	222.7	251.3
EPS (sen)	39.3	52.4	54.8	61.3	69.1
PER (x)	20.3	15.2	14.6	13.0	11.5
Core net profit (RMm)	142.9	187.2	205.9	222.7	251.3
Core EPS (sen)	39.3	51.5	56.6	61.3	69.1
Core EPS chg (%)	69.1	31.0	10.0	8.2	12.8
Core PER (x)	20.3	15.5	14.1	13.0	11.5
DPS (sen)	13.3	21.0	25.0	28.0	32.0
Dividend Yield (%)	1.7	2.6	3.1	3.5	4.0
EV/EBITDA (x)	14.2	10.5	9.2	8.3	7.1
Consensus profit (RMm)			204.4	233.0	266.8
Affin/Consensus (x)			1.0	1.0	0.9

Maintain BUY with a lower target price of RM9.20

Notwithstanding our earnings downgrade, we continue to like Hartalega for its attractive valuations. Despite having a higher earnings base, Hartalega is trading at a significant 32% discount to perceived market leader Top Glove's CY12 PE of 19.5x. The stock also offers higher ROEs (c. 35%) and decent dividend yields of 3-4% (market: 3%). Furthermore, the bonus issue may boost the re-rating process – recall that Supermax's share price surged by as much as +23% after its bonus issue was declared on 2 November 2011. Maintain BUY, with lower target price of RM9.20, pegged to an unchanged PE target of 15x on CY12 EPS. Key risk to our view is a sharper-than-expected surge in nitrile latex price.

Fig 1: Quarterly results comparison

FYE Mar (RMm)	3QFY11	2QFY12	3QFY12	QoQ % chg	YoY % chg	Comment
Revenue	188.1	229.5	242.0	5.4	28.6	Qoq revenue growth attributed to a +4.1% increase in sales volume
Operating cost	(125.3)	(162.9)	(177.4)	8.9	41.6	
EBIT	62.8	66.6	64.5	(3.2)	2.7	
EBIT margin (%)	33.4	29.0	26.7	Nm	Nm	Impacted by increased price competition
Int expense	(0.6)	(0.4)	(0.4)	(10.7)	(35.5)	
Int and other inc	0.0	0.0	0.0	nm	nm	
Associates	0.0	0.0	0.0	nm	nm	
Exceptional items	0.0	(6.6)	(0.2)	nm	nm	Net loss in foreign exchange
Pretax profit	62.2	59.6	63.9	7.3	2.7	
Tax	(13.0)	(13.4)	(13.2)	(1.1)	(1.9)	
Tax rate (%)	20.9	22.5	20.7	Nm	Nm	
MI	(0.0)	(0.0)	0.0	0.0	0.0	
Net profit	49.2	46.1	50.7	9.9	3.0	
EPS (sen)	13.5	12.7	13.9	9.9	3.0	
Core net profit	49.2	52.7	50.9	(3.5)	3.5	Accounts for 25% of our and consensus estimates

Source: Company, Affin

Fig 2: Cumulative results comparison

FYE Dec (RMm)	9MFY11	9MFY12	YTD % chg	Comment
Revenue	542.4	690.9	27.4	Higher revenue due to increased sales volume (+26.3% yoy)
Operating cost	(366.6)	(488.6)	33.3	
EBIT	175.8	202.3	15.0	
EBIT margin (%)	32.4	29.3	Nm	Inline with our forecasts
Int expense	(1.9)	(1.3)	(29.3)	
Int and other inc	0.0	0.0	nm	
Associates	0.0	0.0	nm	
Exceptional items	3.1	(6.8)	nm	Net gain/loss in foreign exchange
Pretax profit	177.0	194.1	9.7	
Tax	(39.2)	(42.5)	8.5	
Tax rate (%)	22.2	21.9	Nm	
MI	(0.0)	0.0	0.0	
Net profit	137.8	151.6	10.0	
EPS (sen)	37.9	41.7	10.0	
Core net profit	134.7	158.4	17.6	Accounts for 77% and 78% of our and consensus estimates

Source: Company, 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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