

## Hartalega Holdings

**Buy** (Unchanged)

Share price: RM5.44  
Target price: RM6.80 (Unchanged)

Lee Yen Ling  
lee.yl@maybank-ib.com  
(603) 2297 8691



**Description:** OEM gloves manufacturer.

**Information:**

Ticker:	HART MK
Shares Issued (m):	363.8
Market Cap (RM m):	1,979.1
3-mth Avg Daily Volume (m):	0.23
KLCI:	1,524.43

**Major Shareholders:**

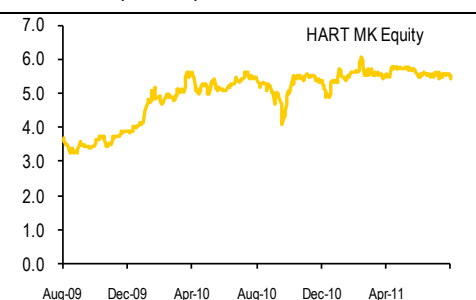
	%
Hartalega Industries SB	50.6
Budi Tenggara SB	5.0

**Price Performance:**

52-week High/Low RM6.08/RM4.04

1-mth	3-mth	6-mth	1-yr	YTD
(1.4)	(1.6)	8.8	-	1.9

Price Chart (RM5.44)



## Gross injustice to sector's leader

**Earnings outperformance unappreciated.** Upcoming 1QFY12 results are likely to outperform its peers again but share price has been flattish YTD due to the overall sector's weakness. Hartalega is now the new bellwether of the sector, with its profitability double of Top Glove's, yet PER is 40% below Top Glove's 5-year average. In our view, Hartalega is not only a high quality stock within the sector (27% PAT margin, net cash, 5% dividend yield, 39% ROE), but also on Bursa. Hartalega remains our top pick with DCF-based TP of RM6.80 (11x CY12 PER).

**Expect EPS growth in 1QFY12.** Results is due to release tomorrow (9<sup>th</sup> Aug). We expect the company to post net profit of around RM55m (+5% QoQ, +33% YoY) on stronger sales volume (+4% QoQ, +27% YoY). Though NBR cost has gone up 27% QoQ, margin may only see minor contraction of around 1-ppt as: (i) management partially passed on the higher cost; and (ii) the company reaps efficiency gains from its new Plant 5. Additionally, earnings may also appear unscathed by the weaker USD due to its favorable hedging policy.

**Strong nitrile demand in Europe.** The ongoing ASP-led demand switch to nitrile glove (from latex) in Europe is aggressive. Europe now accounts for 21% of Hartalega's overall sales (from 15% in 2HFY11). Although NBR price is at its high of USD2.08/kg (+54% YTD), Hartalega's nitrile glove ASP remains very competitive at around 30% discount to the latex powder free. Concern over US' slowdown affecting its sales to US is also unwarranted as glove is a necessity consumable.

**Flattish sequential earnings ahead.** Earnings momentum may slow in the coming quarters as: (i) the company may absorb some of the cost inflation to keep its ASP competitive; and (ii) little sales volume upside (plants are close to full utilization level). Our earnings model has already incorporated for a 4-5-ppt EBITDA margin contraction (from FY11) in FY12-13. Nevertheless, YoY earnings growth of 9-15% in FY12-13 is still remarkable, despite coming from a high base.

**Severely penalized over lower liquidity.** Though stock liquidity (6-mth average daily volume: 350,000) is relatively lower than peers, it is still acceptable for most of the local funds. Moreover, its potential dividend yield of 4.7% (FY12) is the highest amongst its peers and we see room for higher payout given its high ROE and FCF yield. Maintain forecasts, DCF-derived TP of RM6.80, which indicates a CY12 PER of 11x (vs. Top Glove's 5-year average of 15x and current CY12 PER of 20x).

### Hartalega – Summary Earnings Table

Source: Maybank-IB

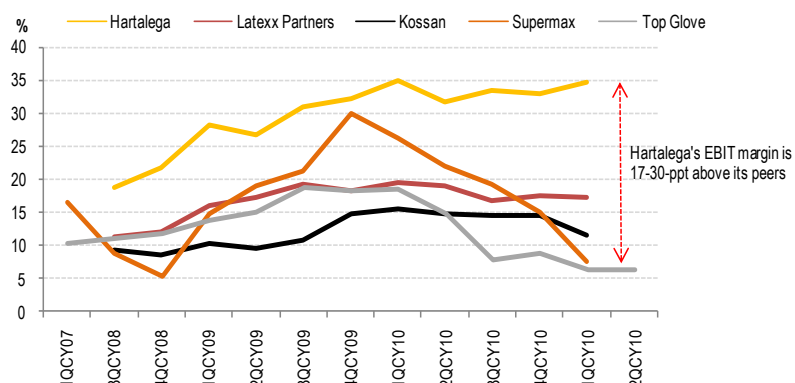
FYE Mar (RM m)	2010A	2011A	2012F	2013F	2014F
Revenue	571.9	734.9	924.0	1,073.9	1,306.6
EBITDA	199.9	267.9	296.6	339.4	412.9
Recurring Net Profit	142.9	190.3	207.9	235.7	290.9
Recurring Basic EPS (Sen)	39.3	52.3	57.2	64.8	80.0
EPS growth (%)	69.1	33.1	9.2	13.4	23.4
DPS (Sen)	13.3	21.0	25.7	29.2	36.0
PER	14.0	10.5	9.7	8.5	6.9
EV/EBITDA (x)	9.9	7.2	6.4	5.5	4.3
Div Yield (%)	2.4	3.8	4.7	5.3	6.5
P/BV(x)	5.7	4.1	3.3	2.7	2.2
Net Gearing (%)	Cash	Cash	Cash	Cash	Cash
ROE (%)	40.3	38.5	34.2	31.9	32.4
ROA (%)	30.0	30.1	27.5	26.6	28.7
Consensus Net Profit (RM m)	-	-	209.3	237.1	283.2

## Other updates: ASP, cost, capacity

**ASP competitive despite higher NBR cost.** Though NBR-to-latex cost gap has narrowed substantially, we note that Hartalega's nitrile glove ASP remain competitive, at around 30% cheaper than powder free latex gloves offered by its competitors. Given its superior EBIT margins of 35% (+17-30-ppt to peers), we believe Hartalega will be able to defend its market share easily by giving up a few ppt margins. Note that its peers' overall EBIT margins are much lower, ranging from 6-17%, with the 2 biggest glove-makers on the lowest end.

We have already incorporated for a 4-5-ppt EBITDA margin contraction (from FY11) in our FY12-14 forecasts.

### Sector: EBIT margins; Hartalega has ample of flexibility in terms of ASP

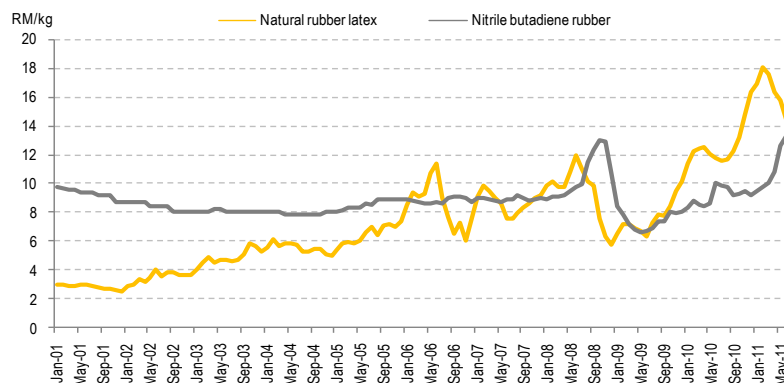


Sources: Companies, Maybank-IB

**NBR-to-latex price gap to widen again.** The NBR-to-latex price gap has narrowed substantially to 8% (from a high of 46% in Feb '11), and we expect the gap to widen again by end-4Q CY11 as: (i) seasonal factors will lower latex production (i.e. flood, wintering season); and (ii) latex is on a long-term supply deficit predicament.

Latex cost is stubbornly high at RM8.90/kg currently (-18% from peak in Apr '11) and is still 27% away from latex-focused players' expectation of RM7/kg. Though production yield of rubber trees has improved since May '11, it still falls short of the global demand. According to RCMA Commodities Asia, the current global rubber stocks-to-use ratio has plunged to the lowest level ever as expanding demand shrinks inventories in China. This should lend support for higher prices.

### NBR-to-latex price gap: Narrowed substantially but to widen again by 4Q



Note: NR and NBR costs are adjusted for respective rubber conversion ratios

Sources: Company, Bloomberg, Maybank-IB

**Near-term new capacity.** Plant 4 is currently undergoing retrofitting works which will see the productivity rising by 6%. The company is also adding 2 lines at its Plant 5 (for latex glove demand in Brazil) as it positions itself in Brazil for any change in future regulations to allow the sale of thinner nitrile gloves. We estimate new capacity totaling 750m pcs p.a. (+8% to 10.4b pcs p.a.) from the retrofitted Plant 4 and 2 new lines at Plant 5 by end-FY12.

**Construction of Plant 6 commencing soon.** Regulatory approvals for the construction of its Plant 6 should be granted soon. We think Plant 6 will be the major earnings kicker for Hartalega, with planned capacity of 3.5b pcs (+33% to 13.9b pcs p.a.), to run at industry's highest efficiency level of 40,000 pcs/hr (industry: 23,000 pcs/hr). The plant will have a total of 10 lines, coming on stream progressively. Hence, earnings contribution should kick-in progressively from 1HFY13 onwards. We have yet to factor this into our forecasts. Capex is estimated at RM170m over 2 years.

**Hartalega: Capacity expansion (billion pieces p.a.)**

Timeline	1QFY12 (Apr-Jun 2012)	4QFY12 (Jan-Mar 2012)	End-FY14
	Plants 1-5	Plant 4 (retrofit) + Plant 5 (2 new lines)	Plant 6
Total capacity	9.6	10.4	13.9
New capacity	-	+0.75	+3.5

Sources: Company, Maybank-IB

**Expect higher dividend payout in FY12-13.** Hartalega's net profit payout ratio was 29-40% during FY09-11. Nevertheless, we forecast a higher payout of 45% over FY12-13 (or 26-29sen/sh, total dividend payout of RM93-107m), given: (i) strong cashflow potential – even after including capex of RM170m for Plant 6 (over 2 years), we still forecast FCF of RM120-130m p.a. in FY12-13; and (ii) it is in a net cash position of RM78m (as of Mar '11); and (iii) capital management purpose as its ROE is high at 39%.

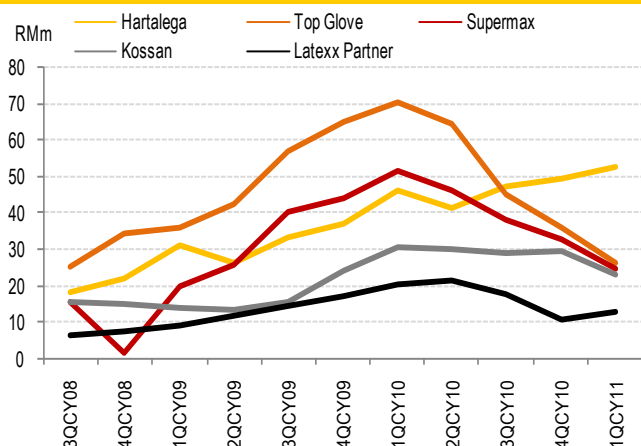
**Highest dividend yield glove stock.** Based on our 45% payout assumption, net dividend yield is 4.7% and 5.3% in FY12 and FY13 respectively, highest in the glove sector (3-4%). Additionally, the company has been paying quarterly dividend (during 2Q-4Q) and this should provide assurance/earlier cashflow to investors.

## Valuation: Steeply severely undervalued

**Earnings outperformed peers.** Ever since global glove demand normalized after the H1N1 hype in 3QCY10, the sector has seen its earnings collapse, with the exception of Hartalega. Hartalega has been consistently growing by 5-14% QoQ in the last 3 quarters while its peers fell by 5-40% QoQ.

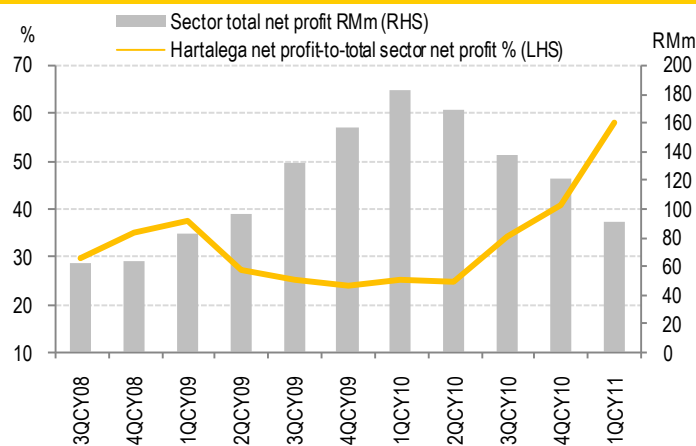
**Leader in profitability.** Hartalega has overtaken Top Glove, in terms of net profit, since a year ago and it is now the most profitable glove manufacturer. Hartalega's latest reported 4QFY11 (ended-Mar '11) net profit of RM52m is double of Top Glove's RM26m in 3QFY11 (ended-May '11). This was achieved inspite of its much smaller size (9.6b pcs vs. Top Glove's 35b pcs). In our view, Hartalega is now the bellwether of the sector, accounting for 58% of the sector's total net profit (from 30% in 2008). It is also worth noting that Hartalega's tax rate is the highest in the sector at 22% while its peers' tax rates are 5-20%.

**Sector: Net profit trend; Hartalega has overtaken sector's leader Top Glove since a year ago**



Sources: Companies, Maybank-IB

**Hartalega: Accounts for 58% of sector's total net profit**

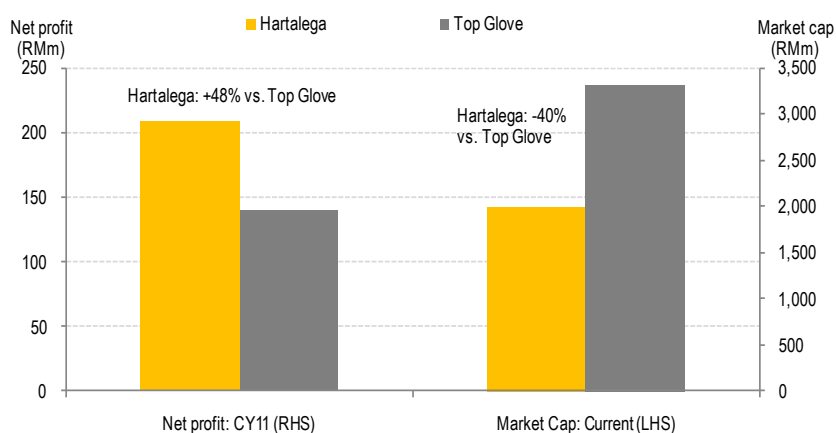


Note: Sector is made up by Top Glove, Supermax, Kossan, Hartalega and Latexx Partner

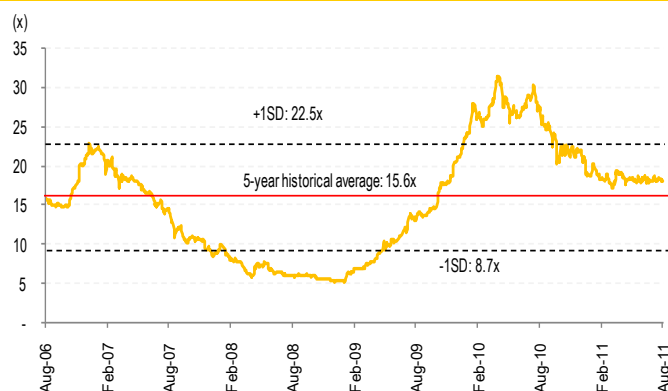
Sources: Bloomberg, Maybank-IB

**Steeply undervalued.** Although Hartalega's earnings have surpassed that of Top Glove, its valuation is nowhere near Top Glove's. Hartalega currently trades at 9x forward PER, compared to Top Glove's forward PER of 20x and 5-year historical average of 15x. We believe it is just a matter of time before market comes to the realization that Hartalega is the new bellwether of the sector and value it accordingly.

**Hartalega vs. Top Glove: Hartalega's profit is 48% higher but market cap is 40% lower**



Sources: Bloomberg, Maybank-IB

**Top Glove: Biggest capacity player at 20x forward PER**

Sources: Bloomberg, Maybank-IB

**Hartalega: Highest profitability player at 9x forward PER**

Sources: Bloomberg, Maybank-IB

**Share price will only go higher.** We think market may also be waiting for a better entry level as stock is close to its historical high levels. However, we believe share price is unlikely to come off as valuation is very undemanding at 9x forward PER. If we were to take a step back and look at the big picture, we argue that Hartalega's valuation is also undemanding on Bursa, given its superior profitability/return metrics.

**Glove sales is recession proof.** Concern over slowdown in the US affecting Hartalega's sales to the US (accounting for 70% of total sales) is also unwarranted. Hartalega's gloves are of medical grade, which is primarily used by the medical practitioners. Medical gloves are necessity/irreplaceable consumables to the medical practitioners and have to be used irrespective of the economic cycles because: (i) it serves as a barrier of protection to both the medical practitioners and patients from infection risk; and (ii) cost of glove to hospitals is minimal, consisting around 3% of hospitals' total costs.

**Sector comparison table**

Stock	Rec	Shr px	Mkt cap	TP	PER (x)		3-yr EPS	Net yield (%)		P/B (x)
		(RM)			CY11	CY12		CY11	CY12	
Top Glove	Sell	5.35	3,303.7	4.40	23.5	19.6	(10.0)	2.2	2.4	2.8
Hartalega	Buy	5.45	1,980.9	6.80	9.8	8.7	18.1	4.4	5.1	3.4
Supermax *	NR	3.70	1,256.0	NR	6.9	6.3	10.6	2.8	3.2	1.5
Kossan	Buy	3.07	981.6	3.60	7.2	6.6	6.7	3.1	3.3	1.7
Latexx Partner *	NR	1.91	417.2	NR	6.3	5.8	16.4	4.5	6.0	NA
<b>Average</b>					<b>10.8</b>	<b>9.4</b>	<b>8.3</b>	<b>3.4</b>	<b>4.0</b>	<b>2.4</b>

Source: Maybank-IB, Consensus (\*)

## INCOME STATEMENT (RM m)

FYE Mar	2011A	2012F	2013F	2014F
Revenue	734.9	924.0	1,073.9	1,306.6
EBITDA	267.9	296.6	339.4	412.9
Depreciation & Amortisation	(25.0)	(31.0)	(39.0)	(44.3)
<b>Operating Profit (EBIT)</b>	<b>242.9</b>	<b>265.6</b>	<b>300.4</b>	<b>368.6</b>
Interest (Exp)/Inc	(0.1)	0.9	1.7	4.3
Associates	0.0	0.0	0.0	0.0
One-offs	0.0	0.0	0.0	0.0
<b>Pre-Tax Profit</b>	<b>242.8</b>	<b>266.5</b>	<b>302.2</b>	<b>372.9</b>
Tax	(52.5)	(58.6)	(66.5)	(82.0)
Minority Interest	(0.0)	0.0	0.0	0.0
<b>Net Profit</b>	<b>190.3</b>	<b>207.9</b>	<b>235.7</b>	<b>290.9</b>
<b>Recurring Net Profit</b>	<b>190.3</b>	<b>207.9</b>	<b>235.7</b>	<b>290.9</b>
Revenue Growth %	28.5	25.7	16.2	21.7
EBITDA Growth (%)	34.0	10.7	14.4	21.7
EBIT Growth (%)	34.9	9.4	13.1	22.7
Net Profit Growth (%)	33.2	9.2	13.4	23.4
Recurring Net Profit Growth (%)	33.2	9.2	13.4	23.4
Tax Rate %	21.6	22.0	22.0	22.0

## BALANCE SHEET (RM m)

FYE Mar	2011A	2012F	2013F	2014F
Fixed Assets	348.6	407.7	488.7	524.4
Other LT Assets	0.2	0.2	0.2	0.2
Cash/ST Investments	117.0	144.4	160.9	200.8
Other Current Assets	165.4	203.8	236.9	288.2
<b>Total Assets</b>	<b>631.3</b>	<b>756.1</b>	<b>886.7</b>	<b>1,013.7</b>
ST Debt	14.5	14.5	14.5	14.5
Other Current Liabilities	60.9	71.4	82.3	99.3
LT Debt	24.4	24.4	14.4	(35.6)
Other LT Liabilities	36.8	36.8	36.8	36.8
Minority Interest	0.4	0.4	0.4	0.4
Shareholders' Equity	494.3	608.6	738.3	898.3
<b>Total Liabilities-Capital</b>	<b>631.3</b>	<b>756.2</b>	<b>886.8</b>	<b>1,013.7</b>
Share Capital (m)	363.6	363.6	363.6	363.6
Net Debt/(Cash)	Cash	Cash	Cash	Cash
Working capital	108.3	136.2	158.3	192.6

## CASH FLOW (RM m)

FYE Mar	2011A	2012F	2013F	2014F
Profit before taxation	242.8	266.5	302.2	372.4
Depreciation	25.0	31.0	39.0	44.3
Net interest receipts/(payments)	0.1	(0.9)	(1.7)	(3.7)
Working capital change	(41.7)	(27.9)	(22.1)	(34.3)
Cash tax paid	(47.8)	(58.6)	(66.5)	(81.9)
Others (incl'd exceptional items)	4.2	0.0	0.0	0.0
<b>Cash flow from operations</b>	<b>182.5</b>	<b>210.1</b>	<b>250.8</b>	<b>296.7</b>
Capex	(81.3)	(90.0)	(120.0)	(80.0)
Disposal/(purchase)	0.2	0.0	0.0	0.0
Others	0.0	0.0	0.0	0.0
<b>Cash flow from investing</b>	<b>(81.1)</b>	<b>(90.0)</b>	<b>(120.0)</b>	<b>(80.0)</b>
Debt raised/(repaid)	0.3	0.0	(10.0)	(20.0)
Equity raised/(repaid)	1.0	2.0	3.0	4.0
Dividends (paid)	(56.9)	(93.6)	(106.1)	(130.7)
Interest payments	(0.1)	0.9	1.7	3.7
Others	(1.0)	(2.0)	(3.0)	(4.0)
<b>Cash flow from financing</b>	<b>(56.8)</b>	<b>(92.7)</b>	<b>(114.3)</b>	<b>(146.9)</b>
Change in cash	44.7	27.4	16.5	69.7

## RATES &amp; RATIOS

FYE Mar	2011A	2012F	2013F	2014F
EBITDA Margin %	36.4	32.1	31.6	31.6
Op. Profit Margin %	33.1	28.8	28.0	28.2
Net Profit Margin %	25.9	22.5	21.9	22.2
ROE %	38.5	34.2	31.9	32.3
ROA %	30.1	27.5	26.6	27.8
Net Margin Ex. EI %	25.9	22.5	21.9	22.2
Dividend Cover (x)	2.5	2.2	2.2	2.2
Interest Cover (x)	77.0	86.8	112.8	249.0
Asset Turnover (x)	1.2	1.2	1.2	1.3
Asset/Debt (x)	16.2	19.4	30.6	116.2
Debtors Turn (days)	48.1	48.1	48.1	48.1
Creditors Turn (days)	26.7	26.7	26.7	26.7
Inventory Turn (days)	32.3	32.3	32.3	32.3
Net Gearing %	Cash	Cash	Cash	Cash
Debt/EBITDA (x)	0.1	0.1	0.1	0.0
Debt/Market Cap (x)	0.0	0.0	0.0	0.0

Sources: Company, Maybank IB



## Definition of Ratings

Maybank Investment Bank Research uses the following rating system:

- BUY** Total return is expected to be above 10% in the next 12 months  
**HOLD** Total return is expected to be between -5% to 10% in the next 12 months  
**SELL** Total return is expected to be below -5% in the next 12 months

## Applicability of Ratings

The respective analyst maintains a coverage universe of stocks, the list of which may be adjusted according to needs. Investment ratings are only applicable to the stocks which form part of the coverage universe. Reports on companies which are not part of the coverage do not carry investment ratings as we do not actively follow developments in these companies.

## Some common terms abbreviated in this report (where they appear):

Adex = Advertising Expenditure	FCF = Free Cashflow	PE = Price Earnings
BV = Book Value	FV = Fair Value	PEG = PE Ratio To Growth
CAGR = Compounded Annual Growth Rate	FY = Financial Year	PER = PE Ratio
Capex = Capital Expenditure	FYE = Financial Year End	QoQ = Quarter-On-Quarter
CY = Calendar Year	MoM = Month-On-Month	ROA = Return On Asset
DCF = Discounted Cashflow	NAV = Net Asset Value	ROE = Return On Equity
DPS = Dividend Per Share	NTA = Net Tangible Asset	ROSF = Return On Shareholders' Funds
EBIT = Earnings Before Interest And Tax	P = Price	WACC = Weighted Average Cost Of Capital
EBITDA = EBIT, Depreciation And Amortisation	P.A. = Per Annum	YoY = Year-On-Year
EPS = Earnings Per Share	PAT = Profit After Tax	YTD = Year-To-Date
EV = Enterprise Value	PBT = Profit Before Tax	

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Maybank Investment Bank Berhad (15938-H)

(A Participating Organisation of Bursa Malaysia Securities Berhad)

33rd Floor, Menara Maybank, 100 Jalan Tun Perak, 50050 Kuala Lumpur

Tel: (603) 2059 1888; Fax: (603) 2078 4194

Stockbroking Business:

Level 8, MaybanLife Tower, Dataran Maybank, No.1, Jalan Maarof 59000 Kuala Lumpur

Tel: (603) 2297 8888; Fax: (603) 2282 5136

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