Hartalega Holdings

Land acquisition removes uncertainty

OUTPERFORM ↔

Price: RM6.30

Target Price: RM7.10 ↑

News

- In an announcement to Bursa Malaysia, Hartalega Holdings' (Hartalega) wholly-owned Hartalega NGC Sdn Bhd has entered into an agreement with Kumpulan Tanjung Balai Sdn Bhd to buy three plots of land measuring a total of 112 acres located in Sepang for RM96.9m.
- The acquisition is expected to be completed within three months.

Comments

- We are positive on this latest corporate development by Hartalega, which paved the way for its on-going planned expansion and also removed any uncertainties over its longer-than-expected land acquisition. This piece of land is essential for Hartalega to embark on its long term expansion plan to raise its gloves capacity to meet the rising demand for nitrile gloves.
- The land acquisition will be funded via internally generated funds and borrowings. Hartalega has a net cash of RM170m as at 31 Mar 2013. Additionally, this acquisition could be easily funded from its operating cashflow, which we forecast will average RM280m p.a. over FY14 and FY15. We understand that this acquisition could marginally exceed RM100m due to additional cost incurred for land re-filling.
- Recall that Hartalega is embarking on a massive capacity expansion consisting of 72 new production lines, which we believe will be largely for nitrile gloves. The expansion will cost RM1.9b and will be carried out in two phases over eight years between 2013 and 2021. We understand that the project is expected to commence in 2013 and to gradually start contributing in FY15. The first line is expected to come on-stream in Aug 2014.
- This project will be undertaken by its wholly-owned subsidiary, Hartalega NGC Sdn Bhd. The acronym NGC refers to 'Next Generation Integrated Glove Manufacturing Complex'.
- **Salient points of the project are:** (i) the project will be located at a new site measuring 112 acres, (ii) new plants will be built with several dedicated buildings linked to each other and will include Research & Development Centre, Learning and Development Centre, Renewable Energy plant (which we believe will run on Biomass), workers quarters and sports centre, (iii) the project will be spread over two phases over four years and will require 5,000 workers, (iv) the first phase is scheduled to commence in 2013-2017 comprising 40 production lines (production capacity of 14b p.a.) and (v) the second phase is scheduled to begin in 2018-2021 comprising 32 production lines (production capacity of 14.5b p.a.). When completed, Hartalega's glove production capacity will be more than double from its current 14.0b pieces (once plant 6 is fully commissioned by FY14) to a staggering 42.5b pieces p.a. in 2021. The new lines are expected to boost productivity by an average of 50% or 45,000 pieces/line/hour compared to an average of 30,000 currently. We have factored in RM200m in capex p.a. in our FY14 and FY15 earnings estimates.

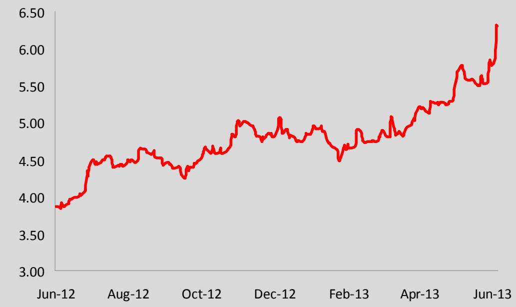
Rating

- **Maintain OUTPERFORM.** The share price of Hartalega has appreciated 20% since our upgrade last month. We are upgrading Hartalega TP from RM5.93 to RM7.10 as we attached a higher PER rating from 15x to 18x CY14 EPS (at +2.0 SD of its historical average). The 18x PER is at a 20% premium to Top Glove's 1-year forward PER target due to its superior margins (Hartalega's pre-tax margins averaged at 29% vs Top Glove at 12% and compared to its industry peers of 13% over the last three years) and better average three years ROE of 33% vs Top Glove at 18%. We like Hartalega for (i) its "highly automated production processes" model, (ii) the solid improvement in its production capacity and a reduction in costs, leading it to achieve better margins compared to its peers, (iii) its superior quality nitrile gloves through product innovation and (iv) its positioning in a booming nitrile segment with a dominant market position.

Risks

- Lower than expected sales volume due to a delay in the commercial production of its future plant expansion.

Share Price Performance



KLCI	1,775.12
YTD KLCI chg	5.1%
YTD stock price chg	32.6%

Stock Information

Bloomberg Ticker	HART MK Equity
Market Cap (RM m)	4,624.1
Issued shares	734.0
52-week range (H)	6.40
52-week range (L)	3.80
3-mth avg daily vol:	712,580
Free Float	67%
Beta	0.8

Major Shareholders

HARTALEGA INDUSTRIES SDN BHD	50.2%
BUDI TENGGARA	5.0%
BNP Paribas Wealth Management (Singapore)	7.7%
EPF	5.1%

Summary Earnings Table

FY Mar (RM'm)	2013A	2014E	2015E
Turnover	1,032.0	1347.7	1592.6
EBIT	305.6	333.2	389.3
PBT	305.5	334.9	390.7
Net Profit (NP)	234.7	256.2	298.8
Consensus (NP)	-	264.8	292.9
Earnings Revision	-	-	-
EPS (sen)	32.1	35.1	41.0
CY EPS (sen)	34.4	39.5	45.0
EPS growth (%)	16.2	9.5	16.6
NDPS (sen)	13.7	15.3	17.8
BVPS (RM)	1.05	1.23	1.46
PER (x)	19.6	17.9	15.4
CY PER (x)	18.3	15.9	14.0
PBV (x)	6.1	5.1	4.3
Net Gearing (x)	Net Cash	Net Cash	Net Cash
Dividend Yield (%)	2.2	2.4	2.8

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Income Statement

FY Mar (RM m)	2011A	2012A	2013E	2014E	2015E
Revenue	734.9	931.1	1032.0	1351.0	1590.8
EBITDA	267.9	288.2	338.2	371.5	437.5
Depreciation	-25.0	-29.0	-31.9	-37.3	-47.6
Operating Profit	242.9	259.2	306.3	334.3	389.9
Other Income	2.4	0.9	0.8	2.6	2.4
Interest Exp	-2.5	-1.7	-0.9	-0.8	-0.8
Associate	0.0	0.0	0.0	0.0	0.0
Exceptional Items	0.0	0.0	0.0	0.0	0.0
PBT	242.9	258.4	306.2	336.1	391.5
Taxation	-52.5	-57.0	-70.8	-79.0	-92.0
Minority Interest	0.0	-0.1	-0.4	-0.6	-0.7
Net Profit	190.3	201.4	235.0	256.5	298.8
Core Net Profit	190.3	201.4	235.0	256.5	298.8

Balance Sheet

FY Mar (RM m)	2011A	2012A	2013E	2014E	2015E
Fixed Assets	348.6	370.3	485.8	648.5	800.9
Intangible Assets	0.1	0.0	6.9	6.9	6.9
Other FA	0.2	9.9	49.8	53.2	53.2
Inventories	64.7	97.5	86.6	113.3	133.5
Receivables	101.0	117.1	124.7	163.3	192.2
Other CA	3.4	0.1	0.1	0.1	0.1
Cash	117.0	163.2	182.4	125.1	114.7
Total Assets	634.9	758.1	936.3	1110.5	1301.5
Payables	57.2	60.4	56.2	73.6	86.6
ST Borrowings	14.5	12.6	7.7	7.7	7.7
Other ST Liability	7.2	12.5	51.2	62.5	71.0
LT Borrowings	24.5	12.1	4.5	4.5	4.5
Other LT Liability	36.9	40.5	50.3	50.3	50.3
Minorities Int.	0.4	0.6	1.0	1.5	2.2
Net Assets	**494.4**	**619.5**	**765.5**	**910.5**	**1079.3**
Share Capital	181.8	182.5	366.7	366.7	366.7
Reserves	312.7	437.0	398.9	543.8	712.6
Equity	**494.4**	**619.5**	**765.5**	**910.5**	**1079.3**

Cashflow Statement

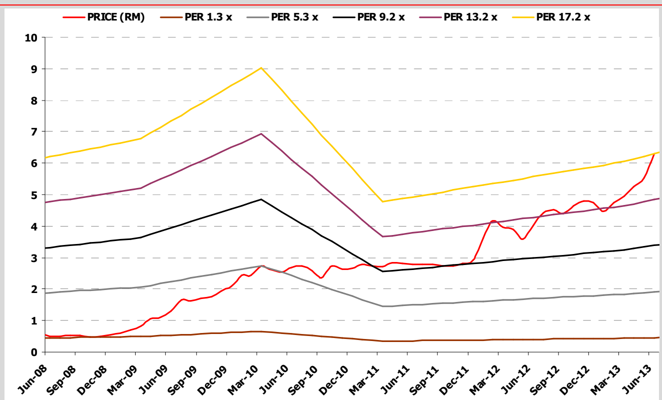
FY Dec (RM m)	2011A	2012A	2013E	2014E	2015E
Operating CF	184.8	200.3	317.2	257.7	319.5
Investing CF	(81.0)	(60.1)	(194.0)	(200.0)	(200.0)
Financing CF	(59.1)	(95.0)	(104.0)	(115.0)	(130.0)
Change In Cash	44.7	45.2	19.2	(57.3)	(10.4)
Free CF	163.2	164.9	217.2	57.7	119.5

Financial Data & Ratios

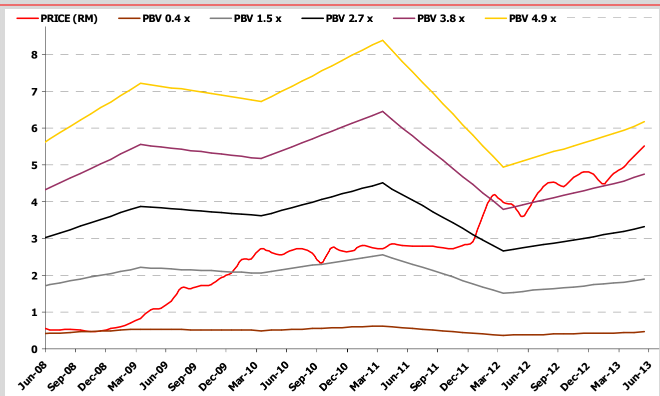
FY Mar (RM m)	2011A	2012A	2013E	2014E	2015E
Growth					
Turnover (%)	28.5	26.7	10.8	30.9	17.8
EBITDA (%)	34.0	7.6	17.3	9.8	17.8
Operating Profit (%)	34.9	6.7	18.2	9.1	16.6
PBT (%)	36.5	6.4	18.5	9.7	16.5
Core Net Profit (%)	33.0	5.8	16.7	9.2	16.5
Profitability (%)					
EBITDA Margin	36.5	31.0	32.8	27.5	27.5
Operating Margin	33.1	27.8	29.7	24.7	24.5
PBT Margin	33.0	27.8	29.7	24.9	24.6
Core Net Margin	25.9	21.6	22.8	19.0	18.8
Effective Tax Rate	21.6	23.0	23.5	23.5	23.5
ROA	30.0	26.6	25.1	23.1	23.0
ROE	38.5	32.5	30.7	28.2	27.7
DuPont Analysis					
Net Margin (%)	25.9	21.6	22.8	19.0	18.8
Assets Turnover (x)	0.9	0.8	0.9	0.8	0.8
Leverage Factor (x)	1.3	1.2	1.2	1.2	1.2
ROE (%)	38.5	32.5	30.7	28.2	27.7
Leverage					
Debt/Asset (x)	0.1	0.0	0.0	0.0	0.0
Debt/Equity (x)	0.1	0.0	0.0	0.0	0.0
Net Cash/(Debt)	78.1	138.6	170.3	112.9	102.5
Net Debt/Equity (x)	Net Cash	Net Cash	Net Cash	Net Cash	Net Cash
Valuations					
EPS (sen)	26.1	27.6	32.1	35.2	41.0
NDPS (sen)	21.0	10.8	14.0	15.3	17.8
NTA (RM)	0.7	0.8	1.0	1.2	1.5
PER (x)	24.1	22.8	19.6	17.9	15.4
Net Div. Yield (%)	3.3	1.7	2.2	2.4	2.8
P/NTA (x)	9.3	7.4	6.1	5.1	4.3
EV/EBITDA (x)	16.8	15.4	13.1	12.1	10.3

Source: Kenanga Research

Fwd PER Band



Fwd PBV Band



Source: Kenanga Research

Stock Ratings are defined as follows:

Stock Recommendations

OUTPERFORM : A particular stock's Expected Total Return is MORE than 10%
(An approximation to the 5-year annualised Total Return of FBMKLCI of 10.2%)
MARKET PERFORM: A particular stock's Expected Total Return is WITHIN the range of 3% to 10%
UNDERPERFORM : A particular stock's Expected Total Return is LESS than 3%
(An approximation to the 12-month Fixed Deposit Rate of 3.15% as a proxy to Risk-Free Rate)

Sector Recommendations***

OVERWEIGHT : A particular stock's Expected Total Return is MORE than 10%
(An approximation to the 5-year annualised Total Return of FBMKLCI of 10.2%)
NEUTRAL : A particular stock's Expected Total Return is WITHIN the range of 3% to 10%
UNDERWEIGHT : A particular stock's Expected Total Return is LESS than 3%
(An approximation to the 12-month Fixed Deposit Rate of 3.15% as a proxy to Risk-Free Rate)

******Sector recommendations are defined based on market capitalisation weighted average expected total return for stocks under our coverage.***

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