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COMPANY UPDATE
Thursday, June 13, 2013
FBM KLCI: 1,775.12
Sector: Manufacturing

Hartalega Holdings Berhad

Prepare for Takeoff

TP: RM7.15 *(+13.5%)*

Last traded: RM6.30

BUY

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In the past week, shares of Hartalega saw a 9.8% jump in prices to RM6.30. We opine that this may be due to two reasons:

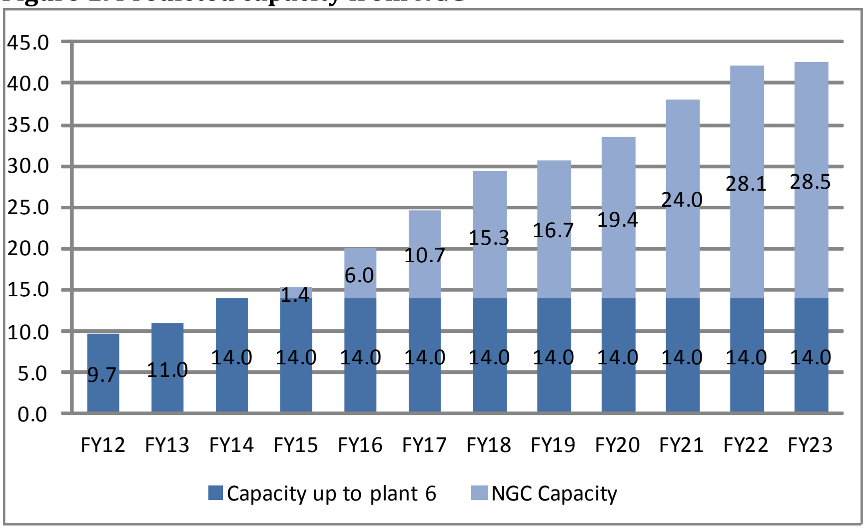
1) Next Generation Integrated Glove Manufacturing Complex (NGC)

Hartalega announced the acquisition of a land in Sepang measuring 120 ha for a total cash consideration of RM97mn (or around RM7.50 per sq. ft.), which we think is reasonable compared to average land price of between RM20.50 and RM31.00 per sq. ft. within the area. Hartalega intends to utilize the land for their NGC project, subject to approvals by relevant authorities for the Company's factory layout plan. The NGC will house six plants of 12 lines each running at a capacity of 45,000 gloves/hour. Together, these plants will propel total installed capacity to 42.5bn gloves/annum.

The estimated size of the workforce required for operation of the NGC is 5,000 workers. As a signal of intent, Hartalega has already increased its factory workforce to 3,900 workers compared to 2,900 workers a year ago. CAPEX is estimated to be between RM1.5bn to RM1.9bn. Individually, the estimated cost for each plant will be approximately RM210mn. This will be funded by a combination of internally generated funds, bank borrowings and proceeds from the issued warrants. The project will be spread over two 4-year phases with expected completion in 2021.

We recap that the above expansions have already been accounted for in our previous reports.

Figure 1: Predicted capacity from NGC



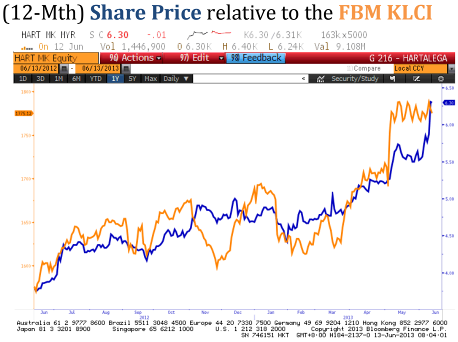
Share Information	
Bloomberg Code	HART MK
Stock Code	5168
Listing	Main Market
Share Cap (mn)	734.0
Market Cap (RMmn)	4624.1
Par Value	0.50
52-wk Hi/Lo (RM)	6.40/3.83
12-mth Avg Daily Vol ('000 shrs)	4376.9
Estimated Free Float (%)	32.2
Beta	0.8
Major Shareholders (%)	
	Hartalega Industries Sdn Bhd - 50.11%
	Budi Tenggara Sdn Bhd - 4.94%
	BNP Paribas Wealth Management - 7.7%
	EPF - 5.1%

Forecast Revision	FY14	FY15
Forecast Revision (%)	0.6	3.0
Net profit (RMm)	267.0	282.1
Consensus	264.8	292.9
TA's / Consensus (%)	100.8	96.3
Previous Rating	Buy (Maintained)	

Financial Indicators	FY14	FY15
Net gearing (x)	(0.1)	(0.1)
CFPS (RM)	0.4	0.5
P/CFPS (x)	15.8	13.5
ROAA (%)	25.4	22.9
ROAE (%)	31.8	28.5
NTA/Share (RM)	1.2	1.4
Price/ NTA (x)	5.1	4.4

Share Performance (%)		
Price Change	**HART**	**FBM KLCI**
1 mth	14.1%	0.3%
3 mth	28.3%	6.2%
6 mth	34.5%	5.1%
12 mth	61.2%	11.0%

(12-Mth) **Share Price** relative to the **FBM KLCI**



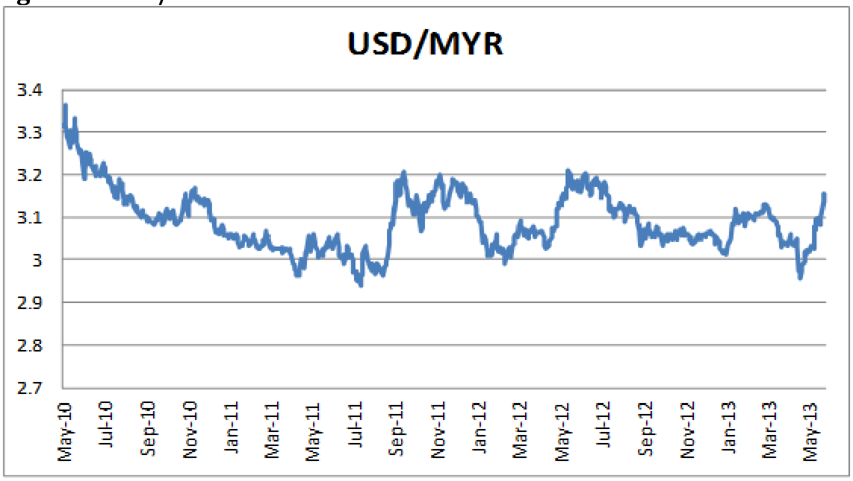
Source: Bloomberg

Figure 2: The NGC

2) USD/MYR appreciation

The USD/MYR rate rebounded from its 52 week low of 2.96 to 3.15 on Tuesday. To recap, glove manufacturers benefit from an appreciation in the USD/MYR rate due to time lags in passing back cost savings to customers. Hence, this may contribute positively to earnings in the current quarter. Conducting a sensitivity analysis on the USD/MYR rate, a 10 sen appreciation/depreciation in the USD/MYR rate will increase/decrease earnings by approximately 5% to 7%, ceteris paribus. We note however that this does not include the passing back of cost savings to consumers.

Figure 3: USD/MYR rate



Meanwhile…

Overcapacity unlikely in the next two years

Opposed to rumors of an impending price war, management believes current and future demand in the market will remain plentiful to accommodate for incoming capacity, in the near future. In CY12, the global demand for nitrile gloves was 56bn pieces per annum. This figure is expected to grow at a rate of 20% per annum in the near future. Accounting for the inflow of nitrile capacity of approximately 20bn gloves per annum, over the next two years, demand is projected to outstrip foreseen supply. Indicating strong demand, the average utilization rate of nitrile production lines in the industry remains high at an estimated rate of 80%. Hartalega expects the price floor for their average ASPs to be around the RM95 (per thousand gloves) mark. That being said, we are already predicting ASPs of between RM94 to RM100 for the coming years. We also note that, Hartalega's high net profit margin (FY13: 22.8%) will provide them with an added advantage in the event of a price war.

Material prices to remain soft

Echoing the market's view, Hartalega expects the prices of natural rubber and synthetic latex to remain soft in the coming quarters. Higher natural rubber yields are expected due to the maturing of rubber trees planted in Thailand, Cambodia and Vietnam. For synthetic latex, 16 crude oil based naphtha crackers are expected within the next two years. Butadiene, the material used to make nitrile gloves, stems from the cracking of naphtha. Hence, the price of synthetic latex is expected to remain soft due to expanding supply.

Taking a breather

Management intends to bring the utilization rate down to 88% from 90% currently. The excess time will be used to facilitate maintenance activities on current machinery. If the machines are not well maintained, they may be susceptible to breakdowns which may be more damaging in the long run. However, if push comes to shove, in order to capitalize on strong short term demand, management will be prepared to incur higher utilization rates for events such as pandemic outbreaks. Once again, this is in line with our utilization rate estimate of 88% for the coming year.

Plant 6

The construction of Plant 6 is on schedule as the last line is expected to be commissioned by the end of this month. To recap, Plant 6 will accommodate 10 lines for nitrile gloves production. With the capability of producing 45,000 gloves per hour, these lines will provide an additional capacity of 3.9bn gloves a year.

Estimates

Incorporating a stronger utilization rate for future years and softer material prices, we adjust our earnings estimates for FY14/FY15/FY16 upwards to RM267.0mn/RM282.1mn/RM347.0mn from RM265.4mn/RM273.8mn/ RM338.7mn. We are now assuming a utilization rate of 88% for FY15 and 86% for FY16. Also, we predict the material price of latex and synthetic latex to be at around RM6.00/kg and RM5.60/kg respectively.

Valuation

We increase our targeted industry premium for Hartalega to 40% from 20% based on a better outlook for the nitrile segment and the concreteness of the NGC project. Factoring in higher earnings and our increased premium, we raise our TP for Hartalega to RM7.15 from RM6.15. This is based on a 40% premium to our targeted industry PE ratio of 14x, providing a total potential upside of 15.9%. Maintain BUY on Hartalega.

Table 1: Earnings Summary

FYE Mar 31		2012	2013	2014f	2015f	2016f
Revenue		931.1	1,032.0	1,232.2	1,333.1	1,657.5
Other income		6.4	6.1	4.6	11.5	11.7
Total Cost		(679.1)	(732.2)	(894.2)	(982.7)	(1,224.0)
PBT		258.4	305.9	342.6	362.0	445.2
Taxation		(57.0)	(70.8)	(75.5)	(79.8)	(98.2)
Net profit		201.4	234.6	267.0	282.1	347.0
EPS	(sen)	55.2	32.0	36.4	38.5	43.0
EPS Growth	(%)	5.4	(42.0)	13.8	5.7	11.8
DPS	(sen)	23.9	13.5	16.4	17.3	19.4
Div Yield	(%)	3.8	2.1	2.6	2.7	3.1
PER	(x)	11.4	19.7	17.3	16.4	14.6

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for TA SECURITIES HOLDINGS BERHAD(14948-M)

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