

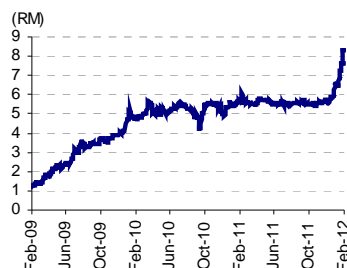
## Company Update

# Hartalega

HART MK  
RM8.26

**BUY (maintain)**

**Target Price: RM9.60 (↑)**



## Price Performance

	1M	3M	12M
Absolute	+25.7%	+47.5%	+45.4%
Rel to KLCI	+22.3%	+39.3%	+39.8%

## Stock Data

Issued shares (m)	364.6
Mkt cap (RMm)	3,012.0
Avg daily vol - 6mth (m)	0.28
52-wk range (RM)	5.00 – 8.35
Est free float	43.4%
NTA per share (RM) (2QFY12)	1.53
P/NTA (x)	5.40
Net cash/ (debt) (RMm) (2QFY12)	112.3
ROE (FY12E)	36.1%
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	65.5	74.3
Chg (%)	-	-	-
Prev target price (RM)		7.33	
Curr target price (RM)		9.60	

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## Room for re-rating

### Share price buoyed by positive sentiment on the rubber gloves sector

Hartalega's share price has spiked up by +41% YTD, after a largely flattish share price performance in 2011. We have long advocated Hartalega for its strong fundamentals, superior EBIT margin of c. 30% as well as its high operating and technological efficiencies. We believe the re-rating has been sparked by several factors. Primarily, natural latex price has plunged by much as -42% from its peak of RM10.93/kg in April 2011, reviving investor interest in the sector. The sharp fall was due to: 1) the end of the wintering period in May 2011, and; 2) significantly weaker growth in China's auto sales (2011 passenger car sales growth of 3% vs. 32% in 2010). Coupled with a visibly stronger sequential earnings growth and margin expansion in the November 2011 round of results, share prices of rubber glove manufacturers have surged by +28-81% from their respective lows - Hartalega surged by +59%.

### Switching to Hartalega to reduce exposure to volatile latex price

Hartalega's forte as a nitrile glove producer has also helped propel share price. Since reaching a low of RM6.30/kg on 10 January 2012, natural latex price has rebounded by +23% to the current RM7.76/kg due to: 1) the start of the wintering period (a seasonal factor), and; 2) the recent US\$477m intervention plan by the Thai government to support rubber prices (the impact of which we believe is temporary given persistent weak global demand for rubber). Meanwhile, the price of nitrile latex has moderated to c. US\$1,400-1,500/mt, down -35% from its high in August 2011. Hartalega's management also indicated that demand for nitrile gloves remains robust. Thus, we believe investors have switched over to Hartalega to maintain exposure to the rubber glove sector, while reducing vulnerability to the volatile natural latex price.

### Room for further re-rating

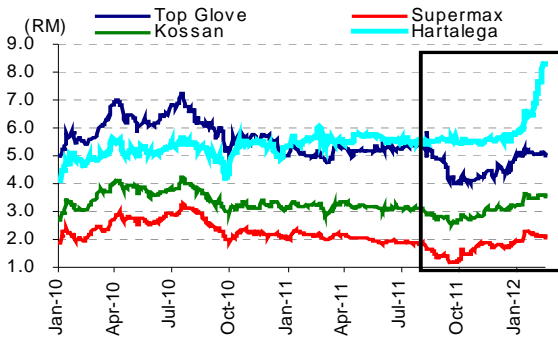
Despite the run-up in share price, we think there is still further upside. Since end-2011, Hartalega's CY12 PE has re-rated by 4x (from 9x to 13x) but is still trading at a 31% discount to Top Glove's 3-year average forward PE of 19x. This is in spite of: 1) its higher average EBIT margin of c. 30% vs. 11% for Top Glove, and; 2) growing share of industry net profit (27% in 2010 vs. 24% in 2008). Furthermore, we forecast Hartalega's absolute CY11 net profit of RM201.1m to not only surpass Top Glove's CY11 net profit (RM123.2m), but also that of Kossan and Supermax. Factor in its substantially higher ROEs (36-45% vs. 10-20% for its peers), we believe the current CY12 PE gap of 7x with Top Glove is unwarranted. Consequently, we reduce our discount to Top Glove's average PE from 37% to 20% (taking into account Top Glove's higher annual production capacity of 37bn pieces vs. 9bn pieces for Hartalega). Our CY12 PE target is raised to 15x (previously, 12x) and in tandem with that, our target price is raised to **RM9.60** (previously, RM7.33). Maintain **BUY**. Key risks to our view are: 1) a surge in nitrile latex price; 2) slower-than-expected demand for nitrile gloves, and; 3) significant margin erosion from increased competition.

### Earnings and valuation summary

FYE Mar	2010	2011	2012E	2013E	2014E
Revenue (RMm)	571.9	734.9	887.1	1,071.2	1,207.1
EBITDA (RMm)	201.0	267.2	291.9	332.2	372.6
Pretax profit (RMm)	177.8	242.8	254.7	304.3	345.3
Net profit (RMm)	142.9	190.3	197.2	238.0	270.2
EPS (sen)	39.3	52.4	54.3	65.5	74.3
PER (x)	21.0	15.8	15.2	12.6	11.1
Core net profit (RMm)	142.9	187.2	205.9	238.0	270.2
Core EPS (sen)	39.3	51.5	56.6	65.5	74.3
Core EPS chg (%)	69.1	31.0	9.9	15.6	13.5
Core PER (x)	21.0	16.0	14.6	12.6	11.1
DPS (sen)	13.3	21.0	25.0	30.0	34.0
Dividend Yield (%)	1.6	2.5	3.0	3.6	4.1
EV/EBITDA (x)	14.8	10.9	9.6	8.1	6.8
Consensus profit (RMm)			205.9	236.8	271.3
Affin/Consensus (x)			1.0	1.0	1.0

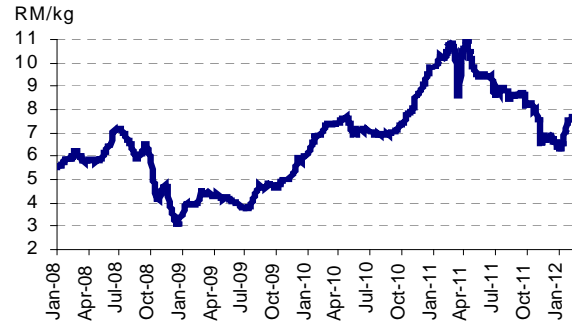
## Focus Charts

**Fig 1: Share price performance**



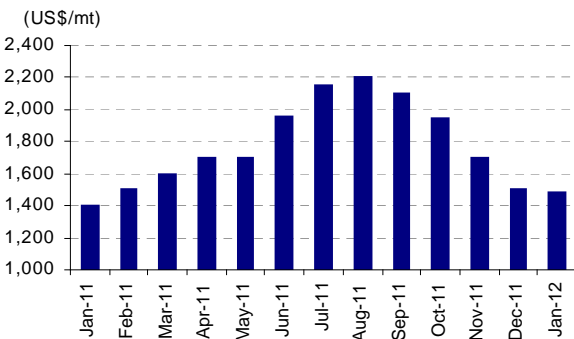
Source: Bloomberg

**Fig 2: Natural latex price**



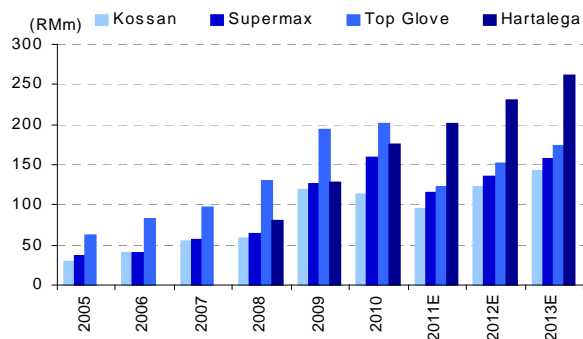
Source: Bloomberg

**Fig 3: Nitrile latex price**



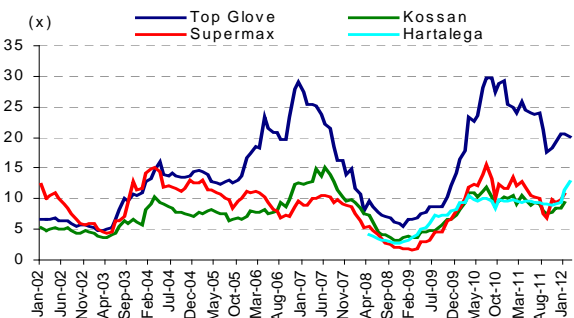
Source: Affin, industry data

**Fig 4: Comparative core net profit (CY)**



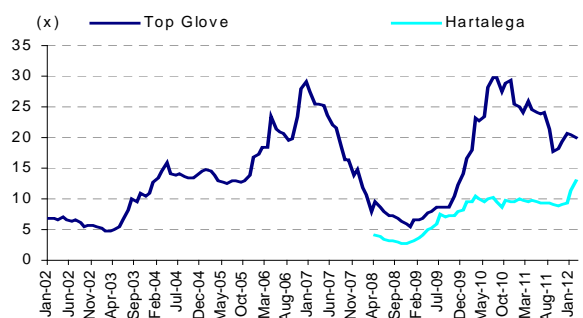
Source: Company, Affin

**Fig 5: 1-year forward rolling PE (peers)**



Source: Bloomberg, Affin

**Fig 6: 1-year forward rolling PE (Hartalega & Top Glove)**



Source: Bloomberg, Affin

**Fig 7: Peers comparison**

Stock	Rating	Sh Pr (RM)	TP (RM)	Mkt Cap (RM m)	Core PE (x) CY11	Core PE (x) CY12	EPS growth (%) CY11	EPS growth (%) CY12	EV/EBITDA (x)	P/B (x)	ROE (%) FY11	ROE (%) FY12	Net Div Yield (%) FY11	Net Div Yield (%) FY12
Kossan	BUY	3.55	4.04	1,135	12.0	9.3	-16.6	29.4	7.0	1.9	19.8	21.8	2.0	2.5
Top Glove	REDUCE	5.01	4.55	3,099	25.2	20.4	-38.8	23.5	15.6	2.6	10.2	12.4	2.2	2.8
Supermax	BUY	2.08	2.60	1,415	12.3	10.5	-27.4	16.8	11.6	0.9	14.8	16.0	1.9	2.9
Hartalega	BUY	8.26	9.60	3,012	15.0	13.1	14.2	14.3	9.6	4.0	44.9	36.1	2.5	3.0
Adventa**	NR	1.65	na	252	9.7	8.6	-22.1	12.5	6.2	1.2	12.9	n.a.	4.1	4.3
Latexx**	NR	1.89	na	421	7.2	6.6	-11.2	9.8	4.5	1.8	20.5	19.6	2.8	3.1
<b>Simple average</b>					<b>13.6</b>	<b>11.4</b>	<b>-17.0</b>	<b>17.7</b>	<b>9.1</b>	<b>2.1</b>	<b>20.5</b>	<b>21.2</b>	<b>2.6</b>	<b>3.1</b>

\*\*based on consensus estimates

Source: Affin, Bloomberg

## Hartalega – FINANCIAL SUMMARY

### Profit & Loss Statement

FYE Mar (RMm)	2010	2011	2012E	2013E	2014E
Total revenue	571.9	734.9	887.1	1,071.2	1,207.1
Operating expenses	(370.9)	(467.7)	(595.1)	(739.0)	(834.5)
EBITDA	201.0	267.2	291.9	332.2	372.6
Depreciation	(19.8)	(24.9)	(26.4)	(25.9)	(25.5)
Amortisation	(0.0)	(0.0)	(0.0)	(0.0)	(0.0)
EBIT	181.2	242.3	265.5	306.3	347.1
Net interest income/(expense)	(3.4)	(2.5)	(2.2)	(2.0)	(1.8)
Associates' contribution	0.0	0.0	0.0	0.0	0.0
Others	0.0	0.0	0.0	0.0	0.0
Pretax profit	177.8	242.8	254.7	304.3	345.3
Tax	(34.7)	(52.5)	(57.4)	(66.2)	(75.1)
Minority interest	(0.1)	(0.0)	(0.0)	(0.0)	(0.0)
Net profit	142.9	190.3	197.2	238.0	270.2

### Balance Sheet Statement

FYE Mar (RMm)	2010	2011	2012E	2013E	2014E
Fixed assets	284.4	348.6	342.2	336.3	330.8
Other long term assets	8.6	0.3	0.3	0.3	0.3
<b>Total non-current assets</b>	<b>293.0</b>	<b>348.9</b>	<b>342.5</b>	<b>336.6</b>	<b>331.1</b>
Cash and equivalents	74.7	117.0	234.7	357.7	499.2
Stocks	28.1	64.7	43.4	53.5	60.1
Debtors	83.0	101.0	121.3	146.5	165.1
Other current assets	0.1	3.4	3.4	3.4	3.4
<b>Total current assets</b>	<b>185.8</b>	<b>286.1</b>	<b>402.7</b>	<b>561.1</b>	<b>727.8</b>
Creditors	44.4	57.2	68.6	84.6	95.1
Short term borrowings	13.7	14.5	13.1	11.8	10.6
Other current liabilities	10.9	7.2	7.2	7.2	7.2
<b>Total current liabilities</b>	<b>69.0</b>	<b>78.9</b>	<b>88.8</b>	<b>103.6</b>	<b>112.9</b>
Long term borrowings	27.7	24.5	22.0	19.8	17.8
Other long term liabilities	27.8	36.9	36.9	36.9	36.9
<b>Total long term liabilities</b>	<b>55.5</b>	<b>61.3</b>	<b>58.9</b>	<b>56.7</b>	<b>54.7</b>
<b>Shareholders' Funds</b>	<b>354.1</b>	<b>494.4</b>	<b>597.2</b>	<b>737.0</b>	<b>890.9</b>

### Cash Flow Statement

FYE Mar (RMm)	2010	2011	2012E	2013E	2014E
EBIT	181.2	242.3	265.5	306.3	347.1
Depreciation & amortisation	19.8	25.0	26.4	25.9	25.5
Working capital changes	(4.8)	(44.8)	11.0	(20.6)	(15.9)
Cash tax paid	(34.7)	(52.5)	(57.4)	(66.2)	(75.1)
Others	2.4	14.9	(7.2)	1.3	1.2
<b>Cashflow from operations</b>	<b>163.9</b>	<b>184.8</b>	<b>238.3</b>	<b>246.7</b>	<b>282.8</b>
Capex	(17.1)	(21.7)	(20.0)	(20.0)	(20.0)
Disposal/(purchases)	0.3	0.2	0.0	0.0	0.0
Others	(50.0)	(59.5)	0.0	0.0	0.0
<b>Cash flow from investing</b>	<b>(66.7)</b>	<b>(81.0)</b>	<b>(20.0)</b>	<b>(20.0)</b>	<b>(20.0)</b>
Debt raised/(repaid)	(14.7)	(2.4)	(3.9)	(3.5)	(3.2)
Equity raised/(repaid)	99.7	64.8	0.0	0.0	0.0
Net interest income/(expense)	(3.4)	(2.5)	(2.2)	(2.0)	(1.8)
Dividends paid	(44.8)	(56.9)	(94.5)	(98.1)	(116.3)
Others	(96.3)	(62.1)	0.0	0.0	0.0
<b>Cash flow from financing</b>	<b>(59.5)</b>	<b>(59.1)</b>	<b>(100.6)</b>	<b>(103.6)</b>	<b>(121.3)</b>
<b>Free Cash Flow</b>	<b>146.8</b>	<b>163.2</b>	<b>218.3</b>	<b>226.7</b>	<b>262.8</b>

### Key Financial Ratios and Margins

FYE Mar (RMm)	2010	2011	2012E	2013E	2014E
<b>Growth</b>					
Revenue (%)	29.0	28.5	20.7	20.8	12.7
EBITDA (%)	77.1	32.9	9.3	13.8	12.2
Core net profit (%)	69.1	33.2	3.6	20.7	13.5
<b>Profitability</b>					
EBITDA margin (%)	35.1	36.4	32.9	31.0	30.9
PBT margin (%)	31.1	33.0	28.7	28.4	28.6
Net profit margin (%)	25.0	25.9	22.2	22.2	22.4
Effective tax rate (%)	19.5	21.6	22.5	21.8	21.7
ROA (%)	29.8	30.0	26.5	26.5	25.5
Core ROE (%)	47.0	44.1	37.7	35.7	33.2
ROCE (%)	51.2	52.2	45.6	43.7	41.1
Dividend payout ratio (%)	34	40	45	45	45

### Liquidity

Current ratio (x)	2.7	3.6	4.5	5.4	6.4
Op. cash flow (RMm)	163.9	184.8	238.3	246.7	282.8
Free cashflow (RMm)	146.8	163.2	218.3	226.7	262.8
FCF/share (sen)	40.4	44.9	60.1	62.4	72.3

### Asset management

Debtors turnover (days)	53	50	50	50	50
Stock turnover (days)	28	51	28	28	28
Creditors turnover (days)	45	45	45	45	45

### Capital structure

Core ROA (%)	29.8	29.5	27.6	26.5	25.5
ROCE (%)	51.2	52.2	45.6	43.7	41.1

### Quarterly Profit & Loss

FYE Mar (RMm)	2Q11	3Q11	4Q11	1Q12	2Q12
Revenue	184.3	188.1	192.5	219.4	229.5
Operating expenses	(124.3)	(125.3)	(125.7)	(148.2)	(160.9)
EBIT	60.1	62.8	66.9	71.2	68.7
Net int income/(expense)	(0.6)	(0.6)	(0.6)	(0.5)	(0.4)
Associates' contribution	0.0	0.0	0.0	0.0	0.0
Exceptional Items	1.6	0.0	0.0	0.0	(8.7)
Pretax profit	61.0	62.2	66.3	70.7	59.6
Tax	(13.9)	(13.0)	(13.9)	(15.9)	(13.4)
Minority interest	(0.1)	(0.0)	(0.0)	0.0	(0.0)
Net profit	47.0	49.2	52.4	54.8	46.1
Core net profit	45.4	49.2	52.4	54.8	54.8

### Margins (%)

EBIT	32.6	33.4	34.7	32.4	29.9
PBT	33.1	33.1	34.4	32.2	25.9
Net profit	25.5	26.2	27.2	25.0	20.1

## Equity Rating Structure and Definitions

<b>BUY</b>	Total return is expected to exceed +15% over a 12-month period
<b>TRADING BUY (TR BUY)</b>	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
<b>ADD</b>	Total return is expected to be between 0% to +15% over a 12-month period
<b>REDUCE</b>	Total return is expected to be between 0% to -15% over a 12-month period
<b>TRADING SELL (TR SELL)</b>	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
<b>SELL</b>	Total return is expected to be below -15% over a 12-month period
<b>NOT RATED</b>	Affin Investment Bank does not provide research coverage or rating for this company. Report is intended as information only and not as a recommendation
<b>OVERWEIGHT</b>	Industry, as defined by the analyst's coverage universe, is expected to outperform the KLCI benchmark over the next 12 months
<b>NEUTRAL</b>	Industry, as defined by the analyst's coverage universe, is expected to perform inline with the KLCI benchmark over the next 12 months
<b>UNDERWEIGHT</b>	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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