

Hartalega Holdings

A heartening 1Q
OUTPERFORM

Maintained

RM5.39

Target: RM7.18

Mkt.Cap: RM1,961m/US\$650m

Rubber Gloves

HART MK / HTHB.KL

Terence Wong CFA +60(3) 20849689 – terence.wong@cimb.com

- **In line, maintain OUTPERFORM.** We consider Hartalega's 1QFY3/12 results to be largely in line even though net profit came in at 28% of our full-year forecast and 26% of consensus estimates. This is because we expect competition to lead to margin erosion in the remaining quarters. The absence of dividends was also in line. We make no changes to our EPS forecasts or target price of RM7.18 as we continue to value the stock at a forward P/E of 11.75x, a 10% discount to Top Glove's target P/E of 13.05x. Hartalega remains an OUTPERFORM as strong sales figures from China and Brazil, the commissioning of Plant 6 and lower input costs could spark a re-rating. Its 5.4% FY12 dividend yield is the highest in the sector.
- **A good 1Q.** 1Q net profit jumped 32% yoy to RM54.7m. Although it is in line with our FY12 forecast as we expect lower margins in the quarters ahead, the reported 1Q numbers exceeded the RM45m-50m we estimated in our preview in Jul due to higher-than-expected nitrile demand. Group revenues increased 29% yoy to RM219m on the back of a 9% qoq rise in glove output to 1.98bn pieces due to strong demand from Europe. Despite higher feedstock costs, sales of nitrile gloves rose 10% qoq to 1.85bn pieces. But sales of natural rubber (NR) gloves fell 5% to 130k pieces, illustrating consumers' continued preference for nitrile. Group utilisation rates remained strong at 80% despite a 4% rise in glove capacity. Balancing the higher revenues was a 2% pt fall in 1Q net margins to 25%, which Hartalega attributed to poor cost pass-through. According to the company, its hands were tied due to higher competition in the nitrile segment.
- **Strong nitrile demand.** Our estimates suggest that nitrile's cost advantage over NR has been squeezed from 40% in Apr 11 to 4% currently. Despite this, nitrile demand remains strong, going by Hartalega's 10% qoq increase in nitrile sales in 1Q.
- **China distribution outfit.** Yesterday, Hartalega announced that it has set up a 70%-owned subsidiary in China to distribute examination gloves. This is a positive surprise as we expected Hartalega to focus on Brazil first before expanding to China. The glove market in China remains untapped with an average usage of 2.2 gloves per person annually compared to 96 in the US, 50 in Europe and 40 in Brazil. Higher sales from China could catalyse earnings.

Results comparison

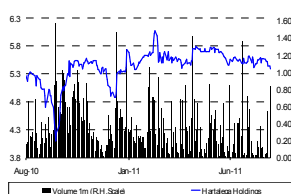
FYE Mar (RM m)	1QFY12	1QFY11	yoy % chg	4QFY11	qoq % chg	Prev. FY12F	Comments
Revenue	219.4	170.0	29.1	192.5	13.9	821.7	Higher due to increased capacity and material cost
Operating costs	(162.0)	(125.4)	29.2	(130.0)	24.6	(550.0)	Higher raw material costs and output
EBITDA	57.3	44.6	28.6	55.1	4.0	271.6	
EBITDA margin (%)	26.1	26.2	(0.3)	28.6	(8.8)	33.1	Lower margins qoq to higher competition
Depn & amort.	9.2	9.4	(1.5)	7.4	25.1	(26.1)	
EBIT	66.5	53.9	23.4	62.5	6.5	245.5	
Interest expense	(0.5)	(0.7)	(24.8)	(0.6)	(11.1)	(1.3)	Borrowings of RM35.4m as at end Jun-11
Interest & invt inc	4.6	0.5	818.7	4.3	6.8	1.7	Cash position of RM135.7m as at Jun-11
Pretax profit	70.7	53.8	31.4	66.3	6.6	245.9	1Q12 accounted to 29% of our FY12 forecast
Tax	(15.9)	(12.3)	29.3	(13.9)	14.9	(49.2)	
Tax rate (%)	22.5	22.9	(1.6)	20.9	7.8	20.0	Lower than statutory tax rate due to allowances
Minority interests	(0.0)	(0.0)	154.5	(0.0)	(22.2)	(0.2)	
Net profit	54.7	41.4	32.0	52.4	4.4	196.6	1Q12 accounted to 28% of our FY12 forecast
Core net profit	54.7	41.4	32.0	52.4	4.5	196.6	
EPS (sen)	15.1	11.4	32.0	14.4	4.4	54.1	
Core EPS (sen)	15.1	11.4	32.0	14.4	4.5	54.1	

Source: Company, CIMB Research

For further information, kindly contact Yeoh Yung Juen, CFA at (603) 2084 9911 or yungjuen.yeoh@cimb.com

Please read carefully the important disclosures at the end of this publication.

Price chart



Source: Bloomberg

Financial summary

FYE Mar	2010	2011	2012F	2013F	2014F
Revenue (RM m)	571.9	734.9	821.7	905.5	1,067.2
EBITDA (RM m)	202.7	266.1	271.6	316.6	372.7
EBITDA margins (%)	35.4%	36.2%	33.1%	35.0%	34.9%
Pretax profit (RM m)	177.8	243.4	245.9	288.5	342.2
Net profit (RM m)	142.9	190.3	196.6	230.6	273.5
EPS (sen)	39.3	52.4	54.1	63.5	75.2
EPS growth (%)	69.1%	33.2%	3.3%	17.3%	18.6%
P/E (x)	13.7	10.3	10.0	8.5	7.2
Core EPS (sen)	40.0	52.4	54.1	63.5	75.2
Core EPS growth (%)	82.2%	31.0%	3.3%	17.3%	18.6%
Core P/E (x)	13.5	10.3	10.0	8.5	7.2
Gross DPS (sen)	13.3	27.0	28.8	33.8	40.1
Dividend yield (%)	2.5%	5.0%	5.4%	6.3%	7.4%
P/BV (x)	5.5	4.0	3.4	2.7	2.2
ROE (%)	47.0%	44.9%	36.5%	35.4%	34.1%
Net cash per share (RM)	0.09	0.21	0.46	0.61	0.97
P/FCFE (x)	23.7	19.8	13.3	16.1	9.1
EV/EBITDA (x)	9.5	7.1	6.6	5.5	4.3
% change in EPS estimates			N/A	N/A	N/A
CIMB/Consensus (x)			0.93	0.97	0.87

Source: Company, CIMB Research, Bloomberg

Figure X: Sector comparisons

	Bloomberg		Price	Target		Core	3-yr EPS	P/BV	ROE	Div
	ticker	Recom.	(Local)	price	Mkt cap	P/E (x)	CAGR	(x)	(%)	yield (%)
				(Local)	(US\$ m)	CY2011	CY2012	(%)	CY2011	CY2011
Hartalega	HART MK	O	5.39	7.18	650	10.0	8.8	12.8	3.5	38.2
Adventa	ADV MK	U	1.66	2.01	84	11.0	7.5	(2.3)	0.9	9.0
Kossan	KRI MK	O	2.86	3.87	303	8.1	6.7	10.5	1.6	22.1
Latexx	LTX MK	N	1.65	2.44	122	5.5	5.3	3.6	1.2	25.0
Supermax	SUCB MK	Buy	3.26	4.75	367	7.2	7.2	1.3	1.3	19.2
Top Glove	TOPG MK	U	4.97	4.76	1,018	21.4	13.6	4.8	2.5	12.3
Simple average						10.5	8.2	5.1	1.8	21.0

O = Outperform, N = Neutral, U = Underperform, TB = Trading Buy and TS = Trading Sell
Source: Company, CIMB Research

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NEUTRAL: The stock's total return is expected to be within +/-5% of a relevant benchmark's total return.

UNDERPERFORM: The stock's total return is expected to be below a relevant benchmark's total return by 5% or more over the next 12 months.

TRADING BUY: The stock's total return is expected to exceed a relevant benchmark's total return by 5% or more over the next 3 months.

TRADING SELL: The stock's total return is expected to be below a relevant benchmark's total return by 5% or more over the next 3 months.

SECTOR RECOMMENDATIONS

OVERWEIGHT: The industry, as defined by the analyst's coverage universe, is expected to outperform the relevant primary market index over the next 12 months.

NEUTRAL: The industry, as defined by the analyst's coverage universe, is expected to perform in line with the relevant primary market index over the next 12 months.

UNDERWEIGHT: The industry, as defined by the analyst's coverage universe, is expected to underperform the relevant primary market index over the next 12 months.

TRADING BUY: The industry, as defined by the analyst's coverage universe, is expected to outperform the relevant primary market index over the next 3 months.

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STOCK RECOMMENDATIONS

OUTPERFORM: Expected positive total returns of 15% or more over the next 12 months.

NEUTRAL: Expected total returns of between -15% and +15% over the next 12 months.

UNDERPERFORM: Expected negative total returns of 15% or more over the next 12 months.

TRADING BUY: Expected positive total returns of 15% or more over the next 3 months.

TRADING SELL: Expected negative total returns of 15% or more over the next 3 months.

SECTOR RECOMMENDATIONS

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