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**Malaysia
Healthcare**

 Reuters HTHB.KL
 Bloomberg HART MK

Priced on 16 January 2013

KLSE Comp @ 1,681.1

12M hi/lo RM5.10/3.22

12M price target RM5.10
±% potential +3%

Shares in issue 484.5m
Free float (est.) 44.5%

Market cap US\$1,202m

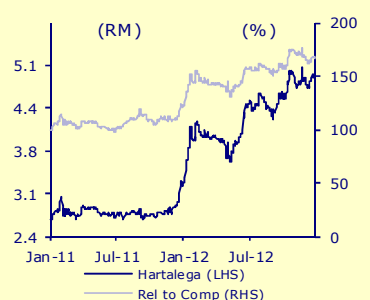
3M average daily volume
 RM1.3m (US\$4m)

Major shareholders

Hartalega Industries 55.5%

Stock performance (%)

| | 1M | 3M | 12M |
|------------|-----|-----|------|
| Absolute | 2.1 | 7.6 | 50.9 |
| Relative | 0.1 | 6.3 | 36.4 |
| Abs (US\$) | 3.3 | 8.8 | 56.9 |



Source: Bloomberg

www.cls.com

A 2014 story

Hartalega is the largest and most profitable nitrile examination glove manufacturer with an installed capacity of 11bn gloves per annum. The company has an impressive track record managing to sustain ROE in excess of 30% but this will come down as increasing competition erodes margins. It is improving efficiencies and adding capacity through the commissioning of its Next Generation Complex (NGC) which will increase capacity 4x to 40bn pieces over the next 8 years. Given its size and leadership in its segment which garners it superior margins to its competition the stock deserves its current multiple which is in-line with Top Glove's. The stock's next leg up will come when NGC starts being commissioned in FY15. Initiate with an U-PF and RM5.10 TP (6% TSR)

Nitrile leader

Hartalega is the most efficient player in the market evidenced by its superior margins it achieves versus its peers. This is due to its production efficiencies which it has achieved through extensive R&D as well as a highly automated production process.

Margins to trend down

Cost pressures are expected given the higher butadiene (feedstock) prices but nitrile glove users are not as sensitive to pricing as latex glove users, so we expect Hartalega to pass on the additional costs to end-users. However, the bigger concern is the other glove manufacturers are expanding production capacity in the nitrile segment, and therefore, pricing pressures will make Hartalega's margins trend downwards.

NGC – the answer

The RM1.5bn Next Generation Complex which will increase production capacity to 40bn pieces over 8 years is expected to reduce cost/unit potentially as much as 5-6ppts assuming constant ASPs. The company intends to focus on increasing its market share by passing on entire savings to the customer reducing ASPs which will reduce margins but kill competition.

One for the future.

The company deserves the re-rating it has gotten over the past year and is now trading in-line with Top Glove's multiples. However, we believe the next leg up for the stock will be when NGC is commissioned. We rate Hartalega an U-PF with an RM5.10 TP implying 7% TSR based on a 15x multiple.

Financials

| Year to 31 March | 11A | 12A | 13CL | 14CL | 15CL |
|--------------------------|--------|--------|--------|-------|-------|
| Revenue (RMm) | 735 | 931 | 1,047 | 1,295 | 1,458 |
| Net profit (RMm) | 190 | 201 | 226 | 257 | 284 |
| EPS (sen) | 26.2 | 27.7 | 31.1 | 33.6 | 37.2 |
| CL/consensus (14) (EPS%) | - | - | 101 | 98 | 98 |
| EPS growth (% YoY) | 33.2 | 5.7 | 12.4 | 7.9 | 10.7 |
| PE (x) | 18.9 | 17.9 | 15.9 | 14.7 | 13.3 |
| Dividend yield (%) | 4.2 | 2.5 | 2.8 | 3.2 | 3.5 |
| FCF yield (%) | 2.8 | 3.8 | 1.9 | 1.9 | 2.6 |
| PB (x) | 7.3 | 5.8 | 4.8 | 4.5 | 3.8 |
| ROE (%) | 44.9 | 36.1 | 33.2 | 31.5 | 29.5 |
| Net debt/equity (%) | (15.8) | (22.3) | (14.1) | (6.8) | (2.9) |

Source: CLSA Asia-Pacific Markets

Summary financials

| Year to 31 March | 2011A | 2012A | 2013CL | 2014CL | 2015CL |
|---------------------------------------------|-------------|-------------|--------------|--------------|--------------|
| Summary P&L forecast (RMm) | | | | | |
| Revenue | 735 | 931 | 1,047 | 1,295 | 1,458 |
| Op Ebitda | 276 | 289 | 322 | 371 | 417 |
| Op Ebit | 247 | 257 | 291 | 330 | 364 |
| Interest income | (2) | 0 | 0 | 0 | 0 |
| Interest expense | (2) | 2 | (2) | (2) | (2) |
| Other items | 0 | 0 | - | - | - |
| Profit before tax | 243 | 258 | 289 | 328 | 363 |
| Taxation | (53) | (57) | (63) | (71) | (78) |
| Minorities/Pref divs | 0 | 0 | 0 | 0 | 0 |
| Net profit | 190 | 201 | 226 | 257 | 284 |
| Summary cashflow forecast (RMm) | | | | | |
| Operating profit | 247 | 257 | 291 | 330 | 364 |
| Operating adjustments | - | - | - | - | - |
| Depreciation/amortisation | 29 | 33 | 32 | 41 | 52 |
| Working capital changes | (41) | (44) | (2) | (37) | (25) |
| Net interest/taxes/other | (53) | (48) | (64) | (72) | (80) |
| Net operating cashflow | 182 | 197 | 256 | 261 | 312 |
| Capital expenditure | (81) | (60) | (188) | (190) | (214) |
| Free cashflow | 101 | 137 | 68 | 71 | 98 |
| Acq/inv/disposals | 0 | 0 | - | - | - |
| Int, invt & associate div | 2 | 4 | 0 | 0 | 0 |
| Net investing cashflow | (79) | (57) | (188) | (190) | (214) |
| Increase in loans | (2) | (15) | 0 | 0 | 0 |
| Dividends | (57) | (87) | (102) | (115) | (128) |
| Net equity raised/other | 0 | 7 | 0 | 0 | 0 |
| Net financing cashflow | (59) | (95) | (102) | (115) | (128) |
| Incr/(decr) in net cash | 45 | 45 | (34) | (45) | (30) |
| Exch rate movements | (2) | 1 | 1 | 1 | 1 |
| Opening cash | 75 | 117 | 162 | 128 | 84 |
| Closing cash | 117 | 163 | 130 | 85 | 55 |
| Summary balance sheet forecast (RMm) | | | | | |
| Cash & equivalents | 117 | 163 | 130 | 85 | 55 |
| Debtors | 101 | 111 | 144 | 178 | 200 |
| Inventories | 65 | 98 | 103 | 132 | 149 |
| Other current assets | 3 | 0 | 0 | 0 | 0 |
| Fixed assets | 349 | 380 | 536 | 685 | 847 |
| Intangible assets | 0 | 0 | 0 | 0 | 0 |
| Other term assets | 0 | 0 | 0 | 0 | 0 |
| Total assets | 635 | 752 | 913 | 1,080 | 1,252 |
| Short-term debt | 15 | 13 | 13 | 13 | 13 |
| Creditors | 57 | 55 | 91 | 117 | 132 |
| Other current liabs | 7 | 13 | 13 | 13 | 13 |
| Long-term debt/CBs | 24 | 12 | 12 | 12 | 12 |
| Provisions/other LT liabs | 37 | 40 | 40 | 40 | 40 |
| Minorities/other equity | 0 | 1 | 1 | 1 | 1 |
| Shareholder funds | 494 | 620 | 744 | 885 | 1,042 |
| Total liabs & equity | 635 | 752 | 913 | 1,080 | 1,252 |
| Ratio analysis | | | | | |
| Revenue growth (% YoY) | 28.5 | 26.7 | 12.4 | 23.7 | 12.6 |
| Ebitda growth (% YoY) | 38.2 | 4.8 | 11.4 | 15.1 | 12.3 |
| Ebitda margin (%) | 37.6 | 31.1 | 30.8 | 28.7 | 28.6 |
| Net profit margin (%) | 25.9 | 21.6 | 21.6 | 19.8 | 19.5 |
| Dividend payout (%) | 80.2 | 45.0 | 45.0 | 47.3 | 47.3 |
| Effective tax rate (%) | 21.6 | 22.0 | 21.6 | 21.6 | 21.6 |
| Ebitda/net int exp (x) | 60.8 | - | 212.0 | 184.8 | 256.5 |
| Net debt/equity (%) | (15.8) | (22.3) | (14.1) | (6.8) | (2.9) |
| ROE (%) | 44.9 | 36.1 | 33.2 | 31.5 | 29.5 |
| ROIC (%) | 48.3 | 41.0 | 37.9 | 33.4 | 29.8 |
| EVA@/IC (%) | 38.1 | 30.8 | 27.7 | 23.2 | 19.6 |

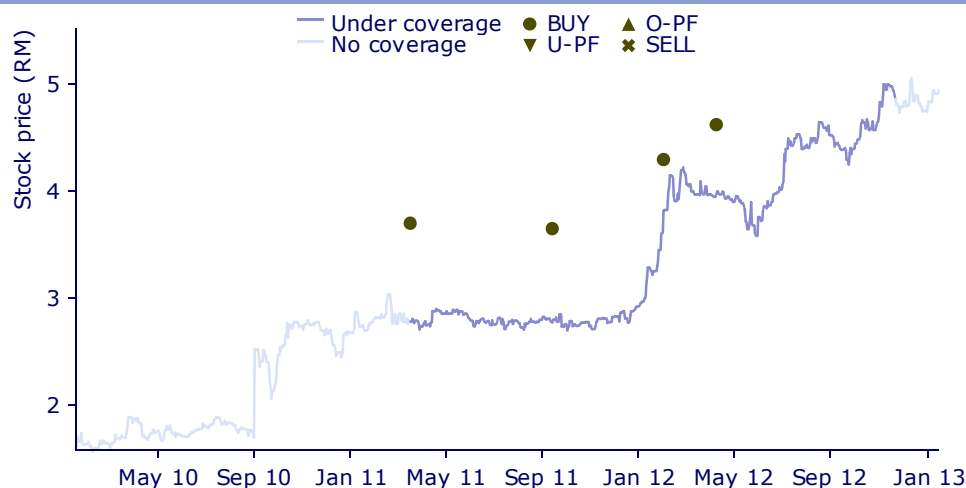
Source: CLSA Asia-Pacific Markets

Steady EBITDA growth
until FY15 when NGC is
commissionedCapex picks up in FY13
when NGC is being builtMargins to come off as
competition erodes
profitability

Companies mentioned

Hartalega (HART - RM4.95 - UNDERPERFORM)

Recommendation history of Hartalega HART MK



| Date | Rec | Target | Date | Rec | Target |
|------------------|------------------|--------|-------------------|-----|--------|
| 22 November 2012 | Dropped Coverage | | 14 September 2011 | BUY | 3.65 |
| 09 April 2012 | BUY | 4.63 | 18 March 2011 | BUY | 3.70 |
| 02 February 2012 | BUY | 4.30 | | | |

Source: CLSA Asia-Pacific Markets

Key to CLSA investment rankings: **BUY:** Total return expected to exceed market return AND provide 20% or greater absolute return; **O-PF:** Total return expected to be greater than market return but less than 20% absolute return; **U-PF:** Total return expected to be less than market return but expected to provide a positive absolute return; **SELL:** Total return expected to be less than market return AND to provide a negative absolute return. For relative performance, we benchmark the 12-month total return (including dividends) for the stock against the 12-month forecast return (including dividends) for the local market where the stock is traded.

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Note: In the interests of timeliness, this document has not been edited.

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