

## Company Update

# Hartalega

HART MK  
RM4.93

**ADD (maintain)**

**Target Price: RM5.15 (↔)**



## Price Performance

|             | 1M    | 3M    | 12M    |
|-------------|-------|-------|--------|
| Absolute    | +1.6% | +7.4% | +50.1% |
| Rel to KLCI | -0.3% | +5.5% | +35.7% |

## Stock Data

|                               |             |
|-------------------------------|-------------|
| Issued shares (m)             | 732.6       |
| Mkt cap (RMm)                 | 3,611.6     |
| Avg daily vol - 6mth (m)      | 0.27        |
| 52-wk range (RM)              | 3.22 – 5.10 |
| Est free float                | 45%         |
| NTA per share (RM)            | 0.94        |
| P/NTA (x)                     | 5.24        |
| Net cash/ (debt) (RMm) (2Q13) | 147.7       |
| ROE (FY13E)                   | 36%         |
| Derivatives                   | Nil         |

## Key Shareholders

|                         |       |
|-------------------------|-------|
| Hartalega Industries SB | 50.2% |
| Budi Tenggara           | 5.0%  |
| EPF                     | 4.9%  |
| BNP Paribas             | 4.6%  |

## Earnings & Valuation Revisions

|                        | 13E  | 14E  | 15E  |
|------------------------|------|------|------|
| Prev EPS (sen)         | 31.5 | 35.8 | 39.9 |
| Curr EPS (sen)         | 31.5 | 35.8 | 39.9 |
| Chg (%)                | -    | -    | -    |
| Prev target price (RM) | -    | -    | 5.15 |
| Curr target price (RM) | -    | -    | 5.15 |

Mandy Teh  
(603) 2142 5815  
[ssteh@affininvestmentbank.com.my](mailto:ssteh@affininvestmentbank.com.my)

## Efficiency is key

### A visit to Hartalega's newest plant

We recently brought some institutional investors to visit Hartalega's (Harta) newest production facility namely, Plant 6 in Bestari Jaya, Selangor. The level of automation at this plant and the speed of its production line had certainly impressed us. We note that the current level of automation is about 80% and management is targeting a 100% full-automation by end-FY03/14. (The remaining 20%-labor intensive part is in the quality control and packaging line) Furthermore, we also reckon that 4 out of 10 planned production lines in Plant 6 are the most efficient lines in the country, as each line can generate c.45.3k pieces of gloves/hour vis-à-vis the prevailing industry average of c.28k pieces/hour. Management guided that the remaining 6 production lines (running at an average speed of c.45k pieces/hour) will be completed by July 2013 and that they have successfully secured 60% of the total production capacity for Plant 6 from both new and existing customers.

### Expecting a 10-12% growth in 9MFY03/13 earnings

During our plant tour, management guided that the demand for synthetic nitrile gloves from its quality demanding customers in US, Japan and Germany remains resilient. As shown in Figure 3, the company's nitrile sales have grown at a CAGR of 72% from 2004-2012. Given the underlying strength in demand, we expect the group's upcoming 9MFY03/13 results, which will be released on 6 February 2013, to post a healthy net profit growth of 10-12% yoy. Growth will be driven by: 1) the lower nitrile cost of -25% yoy, 2) strong 9MFY03/13 volume sales growth of 20-23% to 7bn-7.3bn pieces (utilization rate at c.90%), and 3) the continued improvement in operating efficiencies underpinned by increased plants automation. All in, we expect Harta's 9MFY03/13 net profit to be around RM170-175m, accounting for 74-76% of our full year FY03/13 forecast.

### Maintain ADD with an unchanged TP of RM5.15

To mitigate the negative impact of minimum wage, management highlighted that they: 1) have removed shift allowance for all the male workers and 2) would raise its ASPs slightly by 2-3% (passing on 100% of the minimum wage increase to customers) All in, we expect the glove sector to remain healthy in 2013 supported by robust gloves demand and improving operating efficiencies. In addition, we also believe the sector's key driver, namely latex and nitrile costs to stay at favorable level at around RM6-7/kg and US\$2.20-2.40/kg respectively. With Harta likely to deliver a healthy 10-12% 9MFY03/13 earnings growth, we maintain our ADD recommendation with an unchanged TP of RM5.15, pegged at 15x CY13 EPS. We believe the group is able to achieve our full FY03/13 net profit target of RM230m, (+11% yoy) with a net profit margin of c.21%.

## Earnings and valuation summary

| FYE Mar                | 2011  | 2012  | 2013E   | 2014E   | 2015E   |
|------------------------|-------|-------|---------|---------|---------|
| Revenue (RMm)          | 734.9 | 931.1 | 1,093.8 | 1,258.0 | 1,392.1 |
| EBITDA (RMm)           | 267.2 | 295.0 | 336.6   | 392.1   | 436.7   |
| Pretax profit (RMm)    | 242.8 | 258.4 | 287.9   | 335.8   | 373.9   |
| Net profit (RMm)       | 190.3 | 201.4 | 230.3   | 261.9   | 291.6   |
| EPS (sen)              | 26.0  | 27.6  | 31.5    | 35.8    | 39.9    |
| PER (x)                | 18.9  | 17.9  | 15.6    | 13.8    | 12.4    |
| Core net profit (RMm)  | 187.2 | 207.2 | 230.3   | 261.9   | 291.6   |
| Core EPS (sen)         | 25.6  | 28.3  | 31.5    | 35.8    | 39.9    |
| Core EPS chg (%)       | 31.0  | 10.7  | 11.1    | 13.7    | 11.3    |
| Core PER (x)           | 19.2  | 17.4  | 15.6    | 13.8    | 12.4    |
| DPS (sen)              | 10.5  | 12.0  | 15.0    | 17.0    | 18.0    |
| Dividend Yield (%)     | 2.1   | 2.4   | 3.0     | 3.4     | 3.7     |
| EV/EBITDA (x)          | 13.2  | 11.7  | 10.9    | 9.3     | 8.3     |
| Consensus profit (RMm) |       |       | 228.3   | 262.1   | 295.6   |
| Affin/Consensus (x)    |       |       | 1.0     | 1.0     | 1.0     |

## Other Updates

### Rubber gloves demand outlook is in the pink of health

We remain upbeat on the rubber gloves sector due to: 1) the robust gloves demand brought by better healthcare awareness and more stringent health regulations from both developed and emerging economies. (note that Malaysia's glove exports have grown at a CAGR from 12% from 2008 to 2011, *please see Figure 1 overleaf*), 2) better operating efficiencies due to continuing plant automation, which helps to mitigate the effect of rising labor cost, and 3) relatively low and stable raw material cost.

### Speculation activities to stay relatively benign in 2013

While latex prices will pace up in 1H13 due to the wintering period from Feb-April (low latex supply), we do not expect speculation activities to intensify this time around that will lead to a spike up in latex price to the levels seen in 1H12 of RM7.92/kg. (1H11: RM10.93/kg). Instead, we believe latex and nitrile prices will likely rise to around RM6-7.50/kg and US\$2.20-2.40/kg vs their respective current price of RM6.24/kg and US\$2.05/kg. This is mainly attributed to: 1) the soft China auto industry which would curtail the rise in demand for latex (used in tyres), and 2) a potential supply glut of latex from Cambodia and Vietnam. In view of a more favorable latex price environment, we assume an average latex cost of RM7.15/kg in 2013 vs RM7.20/kg in 2012, (a key earnings driver in the glove sector as it accounts for c.55%-58% of glove manufacturers' total cost of production) we believe glove makers' earnings and operating margins will remain healthy in 2013.

### Believe gas price hike to resume post the 13<sup>th</sup> GE

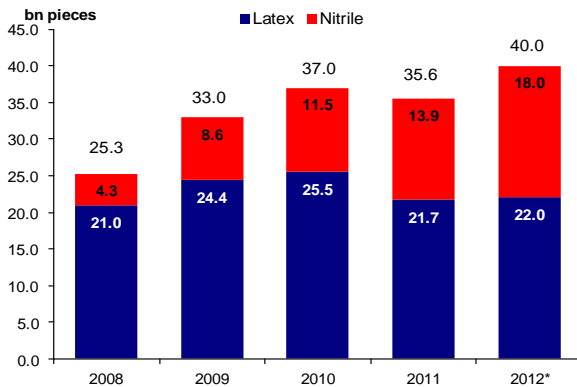
Although Malaysia has delayed three scheduled bi-annual gas tariff hikes, (currently at RM18/mmbtu), we believe the government will likely implement a price hike after the 13th General Election. Our sensitivity analysis indicates that for every 10% increase in gas tariff, rubber gloves manufacturer net profit could be dampened by 2-5%. Gas cost accounts for roughly 8-9% of production cost. Nonetheless, we are confident that the higher gas cost could be passed on to customers as happened in the past. Margins will however contract initially due to time lag of 1-3 months.

### Key risk to the sector

Key risks to the sector are: 1) a sudden spike in latex price should China's auto sales industry stage a strong recovery, 2) margin erosion from stiffer-than-expected price competition within the nitrile gloves segment, and; 3) a significant appreciation in the RM/US\$ exchange rate, which would dampen our topline revenue growth. (Our house view is for the RM/US\$ to appreciate to 2.95-3.00 in end 2013)

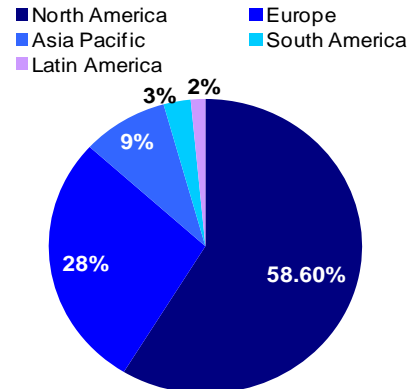
## FOCUS CHART

**Fig 1: Growth in gloves' export**



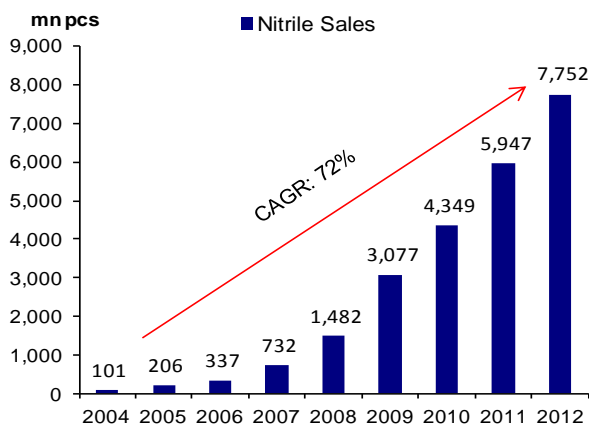
Source: MREPC

**Fig 2: Hartalega's main export markets**



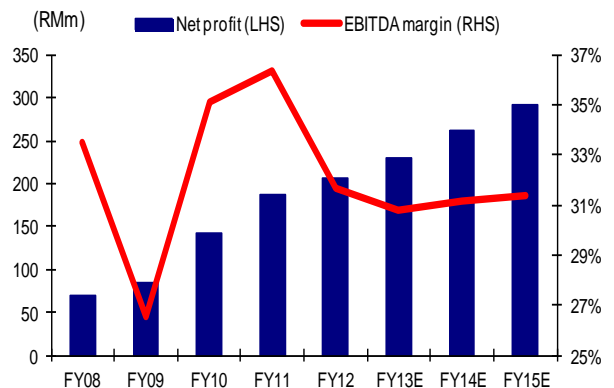
Source: Company, Affin

**Fig 3: Nitrile sales volume (million pieces)**



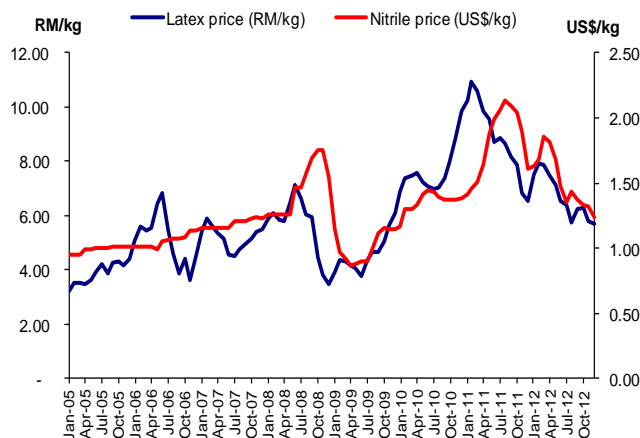
Source: Company, Affin

**Fig 4: Hartalega's net profit and EBITDA margin**



Source: Affin estimates

**Fig 5: Latex price (LHS) vs Nitrile price (RHS)**



Source: Bloomberg

**Fig 6: RM/US\$ exchange rate**



Source: Bloomberg

## Hartalega – FINANCIAL SUMMARY

### Profit & Loss Statement

| FYE Mar (RMm)                 | 2011    | 2012    | 2013E   | 2014E   | 2015E   |
|-------------------------------|---------|---------|---------|---------|---------|
| Total revenue                 | 734.9   | 931.1   | 1,093.8 | 1,258.0 | 1,392.1 |
| Operating expenses            | (467.7) | (636.1) | (757.1) | (865.9) | (955.3) |
| EBITDA                        | 267.2   | 295.0   | 336.6   | 392.1   | 436.7   |
| Depreciation                  | (24.9)  | (29.0)  | (42.6)  | (50.9)  | (57.8)  |
| Amortisation                  | (0.0)   | (0.0)   | (0.0)   | (0.0)   | (0.0)   |
| EBIT                          | 242.3   | 266.0   | 294.0   | 341.2   | 378.9   |
| Net interest income/(expense) | (2.5)   | (1.7)   | (6.1)   | (5.4)   | (5.0)   |
| 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                 | 242.8   | 258.4   | 287.9   | 335.8   | 373.9   |
| Tax                           | (52.5)  | (57.0)  | (57.6)  | (73.9)  | (82.3)  |
| Minority interest             | (0.0)   | (0.1)   | (0.1)   | (0.1)   | (0.1)   |
| Net profit                    | 190.3   | 201.4   | 230.3   | 261.9   | 291.6   |

### Balance Sheet Statement

| FYE Mar (RMm)                      | 2011         | 2012         | 2013E        | 2014E        | 2015E        |
|------------------------------------|--------------|--------------|--------------|--------------|--------------|
| Fixed assets                       | 348.6        | 370.3        | 577.7        | 676.7        | 767.9        |
| Other long term assets             | 0.3          | 9.9          | 9.9          | 9.9          | 9.9          |
| <b>Total non-current assets</b>    | <b>348.9</b> | <b>380.2</b> | <b>587.6</b> | <b>686.6</b> | <b>777.8</b> |
| Cash and equivalents               | 117.0        | 163.2        | 51.4         | 50.7         | 93.7         |
| Stocks                             | 64.7         | 97.5         | 116.4        | 133.4        | 147.4        |
| Debtors                            | 101.0        | 117.1        | 137.6        | 158.3        | 175.1        |
| Other current assets               | 3.4          | 0.1          | 0.1          | 0.1          | 0.1          |
| <b>Total current assets</b>        | <b>286.1</b> | <b>377.9</b> | <b>305.4</b> | <b>342.4</b> | <b>416.2</b> |
| Creditors                          | 57.2         | 60.4         | 72.1         | 82.6         | 91.3         |
| Short term borrowings              | 14.5         | 12.6         | 11.3         | 10.2         | 9.2          |
| Other current liabilities          | 7.2          | 12.5         | 12.5         | 12.5         | 12.5         |
| <b>Total current liabilities</b>   | <b>78.9</b>  | <b>85.5</b>  | <b>95.9</b>  | <b>105.3</b> | <b>113.0</b> |
| Long term borrowings               | 24.5         | 12.1         | 110.9        | 99.8         | 89.8         |
| Other long term liabilities        | 36.9         | 40.5         | 40.5         | 40.5         | 40.5         |
| <b>Total long term liabilities</b> | <b>61.3</b>  | <b>52.6</b>  | <b>151.4</b> | <b>140.3</b> | <b>130.3</b> |
| <b>Shareholders' Funds</b>         | <b>494.4</b> | <b>619.5</b> | <b>645.1</b> | <b>782.7</b> | <b>950.0</b> |

### Cash Flow Statement

| FYE Mar (RMm)                   | 2011          | 2012          | 2013E          | 2014E          | 2015E          |
|---------------------------------|---------------|---------------|----------------|----------------|----------------|
| EBIT                            | 242.3         | 266.0         | 294.0          | 341.2          | 378.9          |
| Depreciation & amortisation     | 25.0          | 29.0          | 42.6           | 50.9           | 57.8           |
| Working capital changes         | (45.6)        | (41.1)        | (27.6)         | (27.1)         | (22.2)         |
| Cash tax paid                   | (52.5)        | (57.0)        | (57.6)         | (73.9)         | (82.3)         |
| Others                          | 15.7          | 3.5           | 0.0            | 0.0            | 0.0            |
| <b>Cashflow from operations</b> | <b>184.8</b>  | <b>200.3</b>  | <b>251.4</b>   | <b>291.1</b>   | <b>332.3</b>   |
| Capex                           | (21.7)        | (35.4)        | (250.0)        | (150.0)        | (149.0)        |
| Disposal/(purchases)            | 0.2           | 0.1           | 0.0            | 0.0            | 0.0            |
| Others                          | (59.5)        | (24.8)        | 0.0            | 0.0            | 0.0            |
| <b>Cash flow from investing</b> | <b>(81.0)</b> | <b>(60.1)</b> | <b>(250.0)</b> | <b>(150.0)</b> | <b>(149.0)</b> |
| Debt raised/(repaid)            | (2.4)         | (14.3)        | 97.5           | (12.2)         | (11.0)         |
| Equity raised/(repaid)          | 64.8          | 10.8          | 0.0            | 0.0            | 0.0            |
| Net interest income/(expense)   | (2.5)         | (1.7)         | (6.1)          | (5.4)          | (5.0)          |
| Dividends paid                  | (56.9)        | (87.4)        | (204.7)        | (124.3)        | (124.3)        |
| Others                          | (62.1)        | (2.4)         | 0.0            | 0.0            | 0.0            |
| <b>Cash flow from financing</b> | <b>(59.1)</b> | <b>(95.0)</b> | <b>(113.2)</b> | <b>(141.9)</b> | <b>(140.3)</b> |
| <b>Free Cash Flow</b>           | <b>163.2</b>  | <b>164.9</b>  | <b>1.4</b>     | <b>141.1</b>   | <b>183.3</b>   |

### Key Financial Ratios and Margins

| FYE Mar (RMm)             | 2011  | 2012  | 2013E | 2014E | 2015E |
|---------------------------|-------|-------|-------|-------|-------|
| <b>Growth</b>             |       |       |       |       |       |
| Revenue (%)               | 28.5  | 26.7  | 17.5  | 15.0  | 10.7  |
| EBITDA (%)                | 32.9  | 10.4  | 14.1  | 16.5  | 11.4  |
| Core net profit (%)       | 33.2  | 5.8   | 14.3  | 13.7  | 11.3  |
| <b>Profitability</b>      |       |       |       |       |       |
| EBITDA margin (%)         | 36.4  | 31.7  | 30.8  | 31.2  | 31.4  |
| PBT margin (%)            | 33.0  | 27.8  | 26.3  | 26.7  | 26.9  |
| Net profit margin (%)     | 25.9  | 21.6  | 21.1  | 20.8  | 20.9  |
| Effective tax rate (%)    | 21.6  | 22.0  | 20.0  | 22.0  | 22.0  |
| ROA (%)                   | 30.0  | 26.6  | 25.8  | 25.4  | 24.4  |
| Core ROE (%)              | 44.1  | 37.2  | 36.4  | 36.7  | 33.7  |
| ROCE (%)                  | 52.2  | 45.2  | 41.7  | 41.1  | 39.0  |
| Dividend payout ratio (%) | 40    | 44    | 45    | 45    | 45    |
| <b>Liquidity</b>          |       |       |       |       |       |
| Current ratio (x)         | 3.6   | 4.4   | 3.2   | 3.3   | 3.7   |
| Op. cash flow (RMm)       | 184.8 | 200.3 | 251.4 | 291.1 | 332.3 |
| Free cashflow (RMm)       | 163.2 | 164.9 | 1.4   | 141.1 | 183.3 |
| FCF/share (sen)           | 22.3  | 22.6  | 0.2   | 19.3  | 25.1  |
| <b>Asset management</b>   |       |       |       |       |       |
| Debtors turnover (days)   | 50    | 46    | 46    | 46    | 46    |
| Stock turnover (days)     | 51    | 56    | 56    | 56    | 56    |
| Creditors turnover (days) | 45    | 35    | 35    | 35    | 35    |
| <b>Capital structure</b>  |       |       |       |       |       |
| Core ROA (%)              | 29.5  | 27.3  | 25.8  | 25.4  | 24.4  |
| ROCE (%)                  | 52.2  | 45.2  | 41.7  | 41.1  | 39.0  |

### Quarterly Profit & Loss

| FYE Mar (RMm)            | 2Q12    | 3Q12    | 4Q12    | 1Q13    | 2Q13    |
|--------------------------|---------|---------|---------|---------|---------|
| Revenue                  | 192.5   | 219.4   | 229.5   | 242.0   | 240.2   |
| Operating expenses       | (125.7) | (151.7) | (162.9) | (177.4) | (176.3) |
| EBIT                     | 66.9    | 67.6    | 66.6    | 64.5    | 63.9    |
| Net int income/(expense) | (0.6)   | (0.5)   | (0.4)   | (0.4)   | (0.4)   |
| Associates' contribution | 0.0     | 0.0     | 0.0     | 0.0     | 0.0     |
| Exceptional Items        | 0.0     | 3.5     | (6.6)   | (0.2)   | 1.0     |
| Pretax profit            | 66.3    | 70.7    | 59.6    | 63.9    | 64.5    |
| Tax                      | (13.9)  | (15.9)  | (13.4)  | (13.2)  | (14.4)  |
| Minority interest        | (0.0)   | 0.0     | (0.0)   | 0.0     | (0.1)   |
| Net profit               | 52.4    | 54.8    | 46.1    | 50.7    | 50.0    |
| Core net profit          | 52.4    | 51.2    | 52.7    | 50.9    | 49.0    |
| <b>Margins (%)</b>       |         |         |         |         |         |
| EBIT                     | 34.7    | 30.8    | 29.0    | 26.7    | 26.6    |
| PBT                      | 34.4    | 32.2    | 25.9    | 26.4    | 26.8    |
| Net profit               | 27.2    | 25.0    | 20.1    | 21.0    | 20.8    |

## 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   |

This report is intended for information purposes only and has been prepared by Affin Investment Bank Berhad ("Affin Investment Bank") based on sources believed to be reliable. However, such sources have not been independently verified by Affin Investment Bank, and as such, Affin Investment Bank does not give any guarantee, representation or warranty (express or implied) as to the adequacy, accuracy, reliability or completeness of the information and/or opinion provided or rendered in this report. Facts, information, views and/or opinions presented in this report have not been reviewed by, may not reflect information known to, and may present a differing view expressed by other business units within Affin Investment Bank, including investment banking personnel. Reports issued by Affin Investment Bank are prepared in accordance with Affin Investment Bank's policies for managing conflicts of interest arising as a result of publication and distribution of investment research reports. Under no circumstances shall Affin Investment Bank, its affiliates and related companies, their directors, associates, connected parties and/or employees be liable in any manner whatsoever for any consequences (including but are not limited to any direct, indirect or consequential losses, loss of profit and damages) arising from the use of or reliance on the information and/or opinion provided or rendered in this report. Any opinions or estimates in this report are that of Affin Investment Bank as of this date and subject to change without prior notice. Under no circumstances shall this report be construed as an offer to sell or a solicitation of an offer to buy any securities.

Affin Investment Bank and/or any of its directors and/or employees may have an interest in the securities mentioned therein. Affin Investment Bank may also make investment decisions or take proprietary positions that are inconsistent with the recommendations or views in this report. Further, Affin Investment Bank, its affiliates and its related companies may do and seek to do business with the company(ies) covered in this research report and may from time to time assume an underwriting commitment in securities of such company(ies), may sell them to or buy them from customers on a principal basis and may also perform or seek to perform significant investment banking, advisory or underwriting services for or relating to such company(ies) as well as solicit such investment, advisory or other services from any entities mentioned in this report.

Comments and recommendations stated here rely on the individual opinions of the ones providing these comments and recommendations. These opinions may not fit to your financial status, risk and return preferences and hence, an independent evaluation is essential. In addition, this report is general in nature and it is intended for circulation for Affin Investment Bank and its affiliates' clients generally and does not have regard to the specific investment objectives, financial situations and the particular needs of any specific person who may receive this report. Investors are advised to independently evaluate particular investments and strategies and to seek independent financial, legal and other advice on the information and/or opinion contained in this report before investing or participating in any of the securities or investment strategies or transactions discussed in this report.

Simulations or model portfolio are prepared on a hypothetical basis and are for illustrations only.

Third-party data providers make no warranties or representations of any kind relating to the accuracy, completeness, or timeliness of the data they provide and shall not have liability for any damages of any kind relating to such data.

Affin Investment Bank's research, or any portion thereof may not be reprinted, transmitted to, photocopied or reproduced in any form - sold or redistributed, directly or indirectly in whole or in part without the prior written express consent of Affin Investment Bank.

This report is printed and published by:  
**Affin Investment Bank Bhd (9999-V)**  
 A Participating Organisation of Bursa Malaysia Securities Bhd  
 Chulan Tower Branch,  
 3rd Floor, Chulan Tower,  
 No 3, Jalan Conlay,  
 50450 Kuala Lumpur.

[www.affininvestmentbank.com.my](http://www.affininvestmentbank.com.my)  
 Email: [research@affininvestmentbank.com.my](mailto:research@affininvestmentbank.com.my)  
 Tel : + 603 2143 8668  
 Fax : + 603 2145 3005