

PP14767/09/2012(030761)

Wednesday, May 06, 2015

Hartalega Holdings Berhad

“Hooray on NGC, Nay for ASP”

Results Review

- **Actual vs. expectations.** Hartalega Holding Berhad (Hartalega) posted net profit of RM210 million in FY15 (-10x y-o-y) that came in below ours but in line with consensus estimate respectively, accounting 90% and 97% of ours and consensus full year net profit forecast. Below expectation performance was dragged by high start-up cost for NGC and stiff competition on the selling price. Hartalega FY15 revenue surged to RM1.14 billion (4% y-o-y,) mainly due to the increase in sales volume to RM305 million attributable by the start of NGC facilities and backed by the strengthening of USD as most sales are in USD.
- **Dividend.** Hartalega declared a final interim dividend of 3.0sen/share for the current quarter, bringing a total dividend to 13.0sen/share translating into a dividend payout of 48%, higher than FY14 payout of 46%.
- **Top line.** Hartalega FY15 revenue surged to RM1.14 billion (4% y-o-y) mainly due to the increase in sales volume (11% y-o-y, 9% q-o-q) lifted by the additional lines contributed by the NGC plant of about 180 million pieces, which currently has 8 production lines since the beginning of the year. Furthermore, 4Q15 revenues jumped by 9% y-o-y to RM308 million lifted by the weakening of Ringgit against the USD as most sales are denominated in USD.
- **Bottom line.** 4Q15 net profit surged by 11% y-o-y and q-o-q respectively to RM55 million from RM49 million assisted by the recognition of deferred tax asset adjustment. However, we note that Hartalega incurred higher start-up expenses of the new NGC plant amounting to RM2.26 billion spread up to 8 years, hence weighing down the net profit in FY15. PBT dropped to RM277 million (-2% q-o-q, -10% y-o-y)

HOLD (TP: RM7.40)

Current Price (RM)	RM8.22
New Target Price (RM)	RM7.40
Previous Fair Value (RM)	RM7.20
Previous Recommend.	HOLD
Upside To Fair Value	-9%
Dividend Yield (FY16)	2.43%

Stock Code	
Bloomberg	HART MK

Stock & Market Data	
Listing	MAIN MARKET
Sector	Rubber
Shariah Compliance	Yes
Issued Shares (mn)	802.9
Market Cap (RM mn)	6,552
YTD Chg In Share Price	16.07%
Beta (x)	0.47
52-week Hi/Lo (RM)	8.69 5.72
6M Average Volume (shrs)	0.365mn
Estimated Free Float	30%

Major Shareholders	
Hartalega Industries	50.39%
EPF	7.37%
BNP Paribas Wealth	6.41%

in FY15 due to the increase in maintenance, electricity and natural gas cost from the NGC project.

- Raw Material Prices.** The average rubber latex price has fallen by 18% to RM3.93 per kg in 1Q15 from RM4.81 1Q14 but rise by 4% from RM3.77 in 4Q14. The latex price has dropped significantly due to excessive supply of rubber in the market coupled with the weakening of crude oil prices and the slower-moving tyre industry, which is the largest rubber consumer. In addition, the nitrile price dropped to USD0.92 (RM3.61) per kg in 1Q15 from 4Q14 USD1.09 (RM3.50) per kg. Average selling price (ASP) of latex has dropped 6% y-o-y from RM97 to RM91, whereas nitrile ASP dropped by 8% y-o-y from USD29 to USD 27. Nevertheless, we estimate that the rubber glove industry would expect better earnings, taking advantage of the softening raw material prices and capacity expansion plans from all rubber players. Nonetheless, NR price will not strengthen anytime soon and nitrile price would remain stable in the short to medium term period due to China's economic deceleration and the oversupply of natural rubber.
- Update on NGC.** Currently there are 8 production lines have started commencing as the group aims to commission two production lines per month and would complete the first two plants of 12 lines by 1Q16. With the start of operation, management expects a capacity of approximately 15 billion pieces per annum (p.a.) for FY15. Note that, the company is targeting to achieve of approximately 22 billion pieces capacity p.a. by FY16 and 42 billion pieces p.a. by FY20 (+90% y-o-y). Furthermore, once the two plants are completed, the group would schedule to build another two plants at the corresponding period.
- Outlook.** The group will continue to strengthen its position as the largest nitrile gloves producer driven by steady global demand and expansion plans such as the NGC. Note that, Hartalega product mix has been around 95% nitrile and 5% latex glove. Demand for nitrile rubber gloves is expected to grow at a high rate of over 19% due mainly to the switching from latex to nitrile rubber gloves. Nevertheless, Hartalega's would incur higher capex approximately RM417 million per year in the next three years due to the expansion plans, thus would lead to a higher depreciation cost and higher borrowings that would impact its bottom-line.
- Forecast.** We have done some housekeeping exercise and came out with new FY16 and FY17 earnings forecast of RM298 million and RM388 million respectively. We made adjustments to our earnings due to the lower average selling price in view of the reduction in raw material prices of nitrile and also natural latex along with stiff competitions. Nevertheless, we still optimistic on FY16 and FY17 earnings which are expected to grow by 30% and 13%, boosted by i) the expansion of production line and ii) the resilient demand and consumption of nitrile gloves in the healthcare sector and iii) positive earnings from stronger USD.
- Valuation & recommendation.** We value Hartalega at RM7.40 based on 3 years average PER 20x to FY16 EPS of 37sen and the stock is a **HOLD** underpin by i) continuous expansion in production capacity as NGC project in Sepang couple with the stronger USD against RM and ii) switching momentum of global demand from latex to nitrile rubber gloves.

Results Review - Hartalega Holdings Berhad

Table 1: Peers comparison (Calenderised)

Company	Year Ended	Price (RM)	EPS (sen)		P/E (X)		P/B (X)		ROE (%)	Div Yield (%)	Target Price	Call
			FY15	FY16	FY15	FY16	FY15	FY16				
Hartalega	Mar	8.22	28	35	29	23	5	6	19.3	1.7	7.40	Hold
Top Glove	Aug	5.60	34	36	16	16	2	2	13.8	2.9	4.62	Hold
Supermax	Dec	2.00	19	21	11	10	1	2	10.8	2.5	2.30	Hold
Kossan	Dec	6.00	30	35	20	17	5	4	19.0	1.3	4.99	Hold
Average			28	32	19	17	3	4				

Table 2: Results Analysis

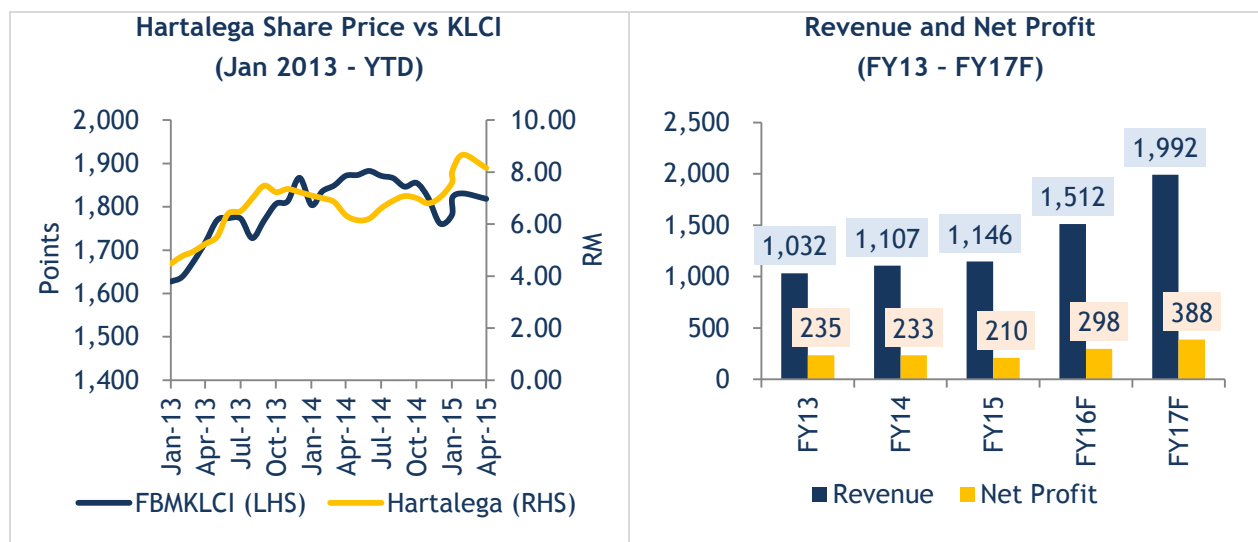
YE: Mar (RM million)	4Q15	4Q14	3Q15	q-o-q	y-o-y	12M15	12M14	y-o-y
Revenue	305	280	286	7%	9%	1,146	1,107	4%
Opex	(237)	(213)	(215)	10%	11%	(869)	(796)	9%
Interest	(0)	(0)	(0)	8%	-28%	(0)	(0)	-65%
Pre-tax profit	67	70	69	-2%	-4%	277	309	-10%
Taxation	(12)	(21)	(19)	-36%	-41%	(67)	(76)	-12%
Net profit	55	49	50	11%	11%	210	233	-10%
EPS (sen)	7	7	6	11%	7%	27	31	-14%
Pre-tax margin	22%	25%	24%			24%	28%	
Effective tax rate	-18%	-30%	-28%			-24%	-24%	

Source: Bursa Malaysia, M&A Securities

Table 3: Financial Forecast

YE: March (RM million)	FY13	FY14	FY15	FY16F	FY17F
Revenue	1,032	1,107	1,146	1,512	1,992
EBIT	305	309	277	398	520
Pretax Profit	306	309	277	392	510
Net Profit	235	233	210	298	388
EPS	32	31	27	37	49
PAT Margin	23%	21%	18%	20%	19%
PBT Margin	30%	28%	24%	26%	26%
PER	23	23	26	19	15
P/BV	7.5	6.1	4.8	4.0	3.3

Source: Bursa Malaysia, M&A Securities



Source: Bloomberg, M&A Securities

M&A Securities

STOCK RECOMMENDATIONS

BUY	Share price is expected to be $\geq +10\%$ over the next 12 months.
TRADING BUY	Share price is expected to be $\geq +10\%$ within 3-months due to positive newsflow.
HOLD	Share price is expected to be between -10% and $+10\%$ over the next 12 months.
SELL	Share price is expected to be $\geq -10\%$ over the next 12 months.

SECTOR RECOMMENDATIONS

OVERWEIGHT	The sector is expected to outperform the FBM KLCI over the next 12 months.
NEUTRAL	The sector is expected to perform in line with the FBM KLCI over the next 12 months.
UNDERWEIGHT	The sector is expected to underperform the FBM KLCI over the next 12 months.

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