

PP14767/09/2012(030761)

Wednesday, August 05, 2015

Hartalega Holdings Berhad

“Promising Start for FY16”

Results Review

- Actual vs. expectations.** Hartalega Holding Berhad (Hartalega) 1Q16 net profit of RM63 million (10% y-o-y) came in in line with ours and consensus estimate respectively, accounting 23% and 21% of ours and consensus full year net profit forecast. The steady performance was lifted by higher sales volume that jumped by 15% y-o-y from 3.1 million pieces to 3.5 million pieces and the strengthening of the USD.
- Dividend.** Hartalega declared a first interim dividend of 4.0sen/share for the current quarter, translating into a dividend payout of 52%, marginally lower than 1Q15 payout of 53%.
- Top line vs Bottom line.** Hartalega 1Q16 revenue surged to RM321 million (15% y-o-y) mainly due to the increase in sales volume (15% y-o-y) lifted by additional lines contributed by the NGC plant capacity of 180 million pieces, which currently has 11 production lines since the beginning of the year. 1Q16 operating profit margin dropped marginally to 25% against 1Q15 margin of 26% due to the increase in maintenance and natural gas costs. Hartalega’s PBT gained by double digits or 19% q-o-q and 6% y-o-y to RM80 million from RM76 million in the preceding year in line with the strengthening of revenue. Nonetheless, PBT margin dropped to 25% from 27% in the preceding year.
- Raw Material Prices.** The average rubber latex price has fallen by 2% q-o-q to RM3.85 per kg in 2Q15 from RM3.93 1Q15. 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 drop in ringgit against the greenback.

HOLD (TP: RM7.98)

Current Price (RM)	RM8.60
New Target Price (RM)	RM7.98
Previous Fair Value (RM)	RM7.40
Previous Recommend.	HOLD
Upside To Fair Value	-7%
Dividend Yield (FY16)	2.43%

Stock Code

Bloomberg	HART MK
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Stock & Market Data

Listing	MAIN MARKET
Sector	Rubber
Shariah Compliance	Yes
Issued Shares (mn)	820
Market Cap (RM mn)	7,056
YTD Chg In Share Price	22.3%
Beta (x)	0.58
52-week Hi/Lo (RM)	9.05 6.56
6M Average Volume (shrs)	0.459mn
Estimated Free Float	31%

Major Shareholders

Hartalega Industries	49.32%
EPF	7.78%
BNP Paribas Wealth	6.27%

In addition, the nitrile price dropped by 7% y-o-y to USD0.96 per kg in 2Q15 from 2Q14 USD1.03 per kg in the corresponding year.

- **Strong USD Lift Earnings.** As Ringgit continues to weaken against the USD, Hartalega's earnings performance has been favourable as sales are dominated by USD. Note that, Ringgit touched at RM3.66 in 1Q16, dropped 12% y-o-y from RM3.21 in 1Q15. The stronger USD has offset to some extent against the weakening of average selling price due to the downfall of raw material prices coupled with the competitive selling price. Ringgit has so far depreciated to RM3.85 on 4th August, 2015, the lowest in 17 years, down by 8.4% YTD.
- **Update on NGC.** Currently 11 production lines have started commencing at the back of the group aimings to commission two production lines per month. The first two plants of 12 lines would be commissioned by 2Q16. With the start of operation, management expects a capacity of approximately 15 billion pieces per annum (p.a.) for CY15. Note that, the company is targeting to achieve of approximately 22 billion pieces capacity p.a. by CY16 and 42 billion pieces p.a. by CY20 (+90% y-o-y). Furthermore, once the two plants are completed, the group is scheduled 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 plants 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. Note that, Hartalega's would incur higher capex approximately RM417 million per year in the next three years due to the expansion plants, thus would lead to a higher depreciation cost and higher borrowings that would impact its bottom-line.
- **Forecast.** We maintain our FY16 and FY17 forecast. Given that, FY16 and FY17 earnings are expected to grow by 30% and 13% to RM298 million and RM388 million respectively, boosted by i) the expansion of production lines and ii) resilient demand and consumption of nitrile gloves in the healthcare sector and iii) positive earnings from stronger USD.
- **Valuation & recommendation.** We value Hartalega at RM7.98 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	8.60	35	40	25	21	5.4	5.0	19.0	1.5	7.98	Hold
Top Glove	Aug	7.70	39	43	20	18	3.2	2.5	15.9	2.2	7.74	Hold
Supermax	Dec	2.50	19	21	11	10	1.7	1.6	10.8	2.5	2.30	Hold
Kossan	Dec	7.28	30	35	20	17	5.5	4.9	19.0	1.3	4.99	Hold
Average			31	35	20	18	4.0	3.5				

Source: Bloomberg, M&A Securities

Table 2: Results Analysis

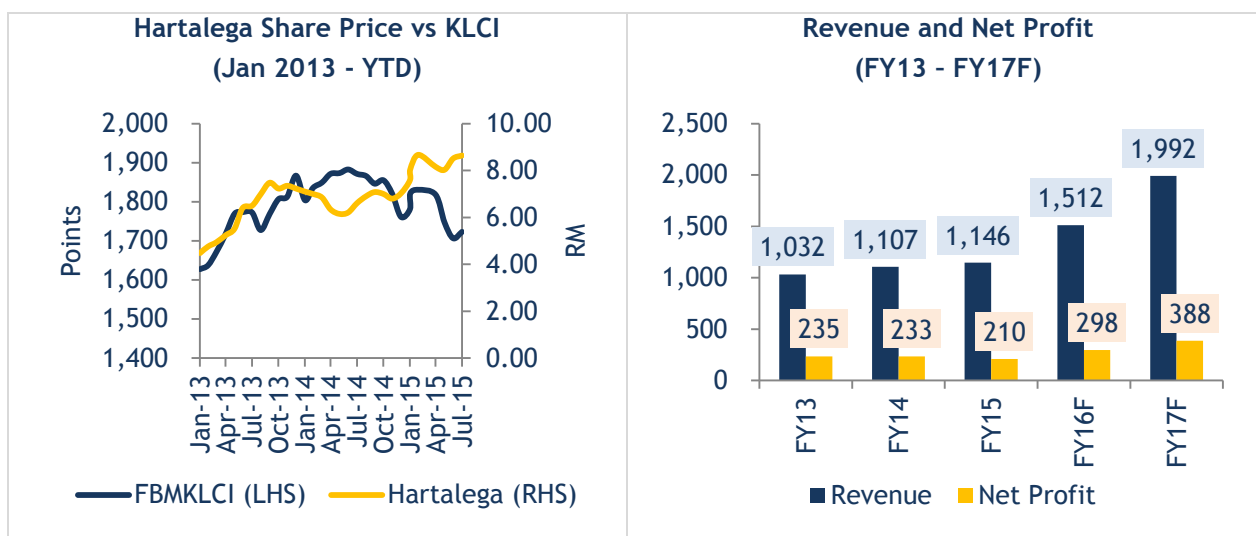
YE: Mar (RM million)	1Q16	1Q15	4Q15	q-o-q	y-o-y	3M16	3M15	y-o-y
Revenue	321	279	305	5%	15%	321	279	15%
Opex	(240)	(207)	(237)	1%	16%	(240)	(207)	16%
Interest	(0)	(0)	(0)	62%	35%	(0)	(0)	35%
Pre-tax profit	80	76	67	19%	6%	80	76	6%
Taxation	(17)	(18)	(12)	39%	-7%	(17)	(18)	-7%
Net profit	63	57	55	14%	10%	63	57	10%
EPS (sen)	8	8	7	8%	1%	8	8	1%
Pre-tax margin	25%	27%	22%			25%	27%	
Effective tax rate	-21%	-24%	-18%			-21%	-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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Results Review - Hartalega Holdings Berhad

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