

07 February 2018 | 3QFY18 Results Review

Hartalega Holdings Berhad

Revenue boosted by increase in volume sold

INVESTMENT HIGHLIGHTS

- **3QFY18 earnings slightly above expectations**
- **Revenue boosted by increase in sales volume**
- **Higher contribution from NGC going forward**
- **Proposed 1-for-1 bonus issue**
- **FY18-19F earnings forecasts lifted by +9.8% and +11.4%**
- **Maintain NEUTRAL (negative bias) with revised TP of RM9.68**

Above expectations. Hartalega's 3QFY18 earnings came in at RM113m which is slightly above our and consensus expectations, representing 79% and 78% of full-year earnings forecasts respectively. On a quarterly sequential basis, revenue increased by +3.2%qoq however, earnings was flat at -0.3%qoq respectively. As for yoy, revenue and earnings surged by +32.2% and +70.7% respectively. A second interim dividend of 4.0sen was also declared for the quarter under review which brings the total dividend declared to date to 7.5sen or 0.7% yield to yesterday's closing price.

Earnings boosted by increase in sales volume. In 3QFY18, sales volume for nitrile gloves increased by +36.2%yoy while on a sequential basis, volume increased by +4.0%qoq. The improved sales volume during the quarter was mainly attributable to: (i) better demand; (ii) increase in average selling prices (ASPs); (iii) higher utilisation rate of above 90% and; (iv) improvement in internal processes. It is also worth noting that the more stable condition of USD vs MYR which traded at an average of RM4.16 per USD during the quarter assisted in boosting both the revenue and earnings.

Higher contribution from NGC going forward. Management disclosed that the commissioning of Plant 4 of NGC is well on track and is expected to be completed in 1HCY18. We also understand that the capacity from Plant 4 is fully sold out as with the rest of the NGC plants despite the expected increase in ASP. Meanwhile, its Plant 5 is currently under construction and is expected to start commissioning in 2HCY18. Currently, the NGC plants are contributing about 52% of Hartalega's total revenue with the balance contributed by plants in Bestari Jaya. Post the complete commissioning of NGC (Plant 1-6), the revenue contribution from NGC will increase to >70%. This in return will boost the net margin of Hartalega as the net margin from NGC-produced gloves is higher at around 20% vs 10-15% net margin from gloves produced at Bestari Jaya. Therefore, we opine that post-complete commissioning of NGC, the net margins of Hartalega will be hovering above at 20%.

Maintain NEUTRAL

Revised Target Price (TP): RM9.68
(Previously RM7.30)

RETURN STATS	
Price (6 February 2018)	RM10.84
Target Price	RM9.68
Expected Share Price Return	-10.7%
Expected Dividend Yield	+0.7%
Expected Total Return	-10.0%

STOCK INFO	
KLCI	1,812.45
Bursa / Bloomberg	5168 / HART MK
Board / Sector	Main / Trading Services
Syariah Compliant	YES
Issued shares (mil)	1,645.10
Market cap. (RM'm)	17,935.96
Price over NA	9.62
52-wk price Range	RM4.67 – RM12.10
Beta (against KLCI)	1.11
3-mth Avg Daily Vol	2.13m
3-mth Avg Daily Value	RM21.0m
Major Shareholders (%)	
Hartalega Industries	48.91
EPF	6.38
Budi Tenggara Sdn Bhd	3.01

Proposed 1 for 1 bonus issue. Hartalega has also announced a proposed 1-for-1 bonus issue yesterday. The bonus issue which is slated to be completed by end of March 2018, is expected to boost the trading liquidity of its shares as well as encourage participation from new investors in the company's growth. It is also to reflect the current scale of operations and assets employed by Hartalega. Post the bonus issue which will be allotted on a pro-rata basis to all shareholders of Hartalega, its fully-diluted share base will increase to 3,428.6m from the current 1,714.3m. We are neutral on this announcement as despite the increase in number of shares allocated to investors, there will be dilution in earnings per share (EPS) from the current FY19F EPS of 29.9sen to 15.0sen. Subsequently, our **TP will be revised to RM4.84** to reflect the enlarged share based once the exercise is completed in March.

Earnings forecasts. As we are expecting contribution coming From NGC to increase in the coming months, we are revising our FY18-19F earnings upwards by +9.8% and +11.4% respectively after we revised our assumption on: (i) the expected utilisation rates to above 90% and; (ii) ASPs for both financial years - given the recent developments in the company and the glove industry. The key risks to our earnings are the: (i) fluctuation of USD vs MYR; (ii) lower than expected raw material prices; and (iii) lower demand from customers.

Recommendation. Aside from the upcoming new capacity coming on board in the next few months coupled with the strong overall demand for gloves, we opine that all the positives have been priced in at this juncture. In addition, Hartalega's share price has surged by +51.6% since its last earnings announcement back in November 2017 which leaves limited room for future share price appreciation in our view. Valuation also remains lofty at 35.5x FY19PER vs an average of 20x for its peers which remains unattractive.


Hence, we are maintaining our **Neutral** (negative bias) recommendation on Hartalega with a revised TP of **RM9.68** (from RM7.30) per share post earnings revision. Our negative bias is premised on the fact that we believe Hartalega's share price will retrace further in the coming three months to trade closer to its fundamentals as what we have observed happening to its listed peers post the share price rally which affected all the glove counters for the past two months. Our TP is derived via pegging our CY19F EPS of 34.6sen to a PER19 of 28x, which is its five-year average PER. 

Table 1: Hartalega's quarterly earnings review

FYE Mar (RM'm)	Quarterly results					Cumulative results		
	3QFY17	2QFY18	3QFY18	QoQ (%)	YoY (%)	1HFY17	9MFY18	YoY (%)
Revenue	456.3	584.6	603.1	3.2	32.2	1,295.1	1,788.8	38.1
Operating expenses	(348.5)	(454.6)	(470.5)	3.5	35.0	(1,024.6)	(1,417.6)	38.4
Other operating income	(29.2)	9.1	8.3	(9.3)	(128.3)	(39.7)	26.3	nm
Finance costs	(0.3)	(1.9)	(2.0)	8.6	650.0	(0.6)	(5.6)	815.7
Profit Before Tax	78.3	137.2	138.9	1.2	77.3	230.2	391.8	70.2
Taxation	(11.9)	(23.5)	(25.7)	9.5	115.8	(36.2)	(68.5)	89.2
Profit After Tax	66.4	113.7	113.1	(0.5)	70.4	194.0	323.3	66.7
Non-controlling interest	0.2	0.4	0.1	nm	nm	0.4	0.5	51.1
PATANCI	66.2	113.3	113.0	(0.3)	70.7	193.6	322.7	66.7
Basic EPS (sen)	4.0	6.9	6.9	(0.3)	69.3	11.8	19.6	65.8
FD EPS (sen)	4.0	6.8	6.8	(0.6)	68.2	11.7	19.4	65.2
PBT margin (%)	17.2	23.5	9.3	(60.5)	(46.0)	17.8	26.2	8.4
PAT margin (%)	14.6	19.5	7.6	(61.2)	(48.1)	15.0	21.6	6.6
PATANCI margin (%)	14.5	19.4	18.7	(3.3)	29.1	15.0	18.0	3.1
Tax rate (%)	15.2	17.1	18.5	8.2	21.7	15.7	17.5	1.8

Source: Company, MIDFR

Table 2: Hartalega's NGC capacity expansion timeline

Plants	Phase	Production Lines	Capacity (pcs per annum)	Expected full commissioning
5 plants at Bestari Jaya		45	13.5bn	-
Plant 1 of NGC	1	12	4.7bn	Fully Commissioned
Plant 2 of NGC		12	4.7bn	Fully Commissioned
Plant 3 of NGC	2	12	4.7bn	Fully Commissioned
Plant 4 of NGC		12	4.7bn	1HCY18
Plant 5 of NGC	3	12	4.7bn	1HCY19
Plant 6 of NGC		12	4.7bn	1HCY20
Current capacity			28.2bn	
Capacity by 2020			41.5bn	

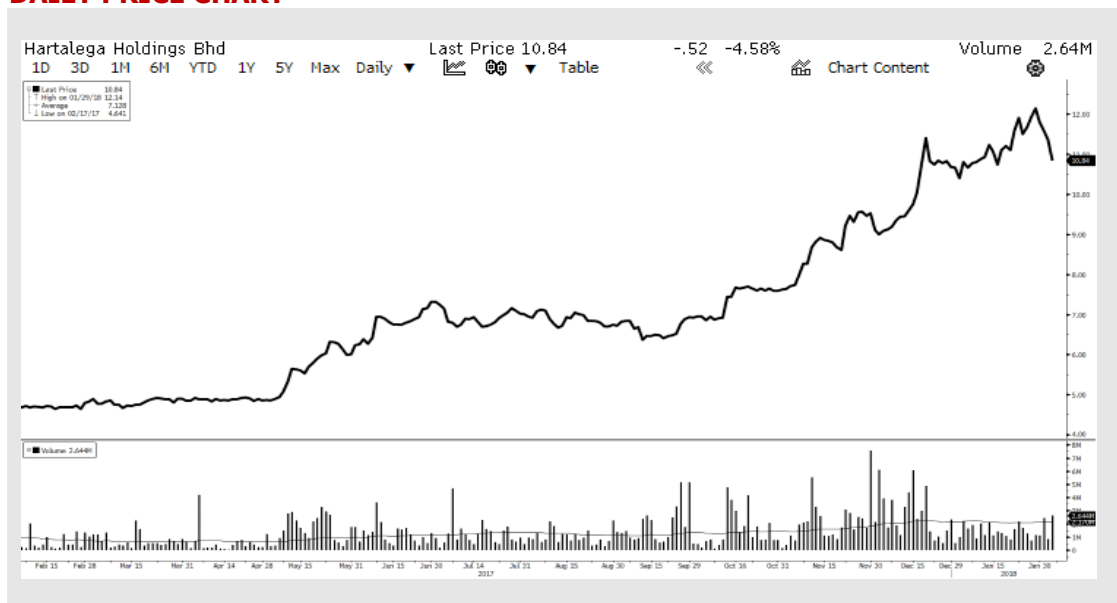
Source: Company, MIDFR

INVESTMENT STATISTICS

FYE Mar (RM'm)	2015	2016	2017	2018F	2019F
Revenue	1,146.0	1,498.3	1,822.1	2,524.5	3,005.5
Cost of goods sold	(869.1)	(1,181.9)	(1,435.2)	(1,843.2)	(2,228.9)
Gross profit	276.8	316.4	386.9	681.4	776.6
Finance costs	(0.1)	(0.4)	(1.0)	(15.5)	(15.5)
Profit before tax	276.7	317.3	348.7	514.4	610.9
Income tax expense	(66.7)	(59.4)	(65.3)	(82.3)	(97.7)
Net Profit (RM'm)	209.5	257.7	283.4	432.1	513.1
EPS (sen)	13.1	15.7	17.2	25.2	29.9
EPS Growth (%)	-51.3	19.6	9.8	46.1	18.7
PER (x)	82.5	69.0	62.8	43.0	36.2
Dividend Per Share (sen)	6.5	6.3	6.0	7.0	7.5
Dividend yield (%)	0.6	0.6	0.6	0.6	0.7

Source: Company, Forecasts by MIDFR

DAILY PRICE CHART



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MIDF AMANAH INVESTMENT BANK : GUIDE TO RECOMMENDATIONS

STOCK RECOMMENDATIONS

BUY	Total return is expected to be >10% over the next 12 months.
TRADING BUY	Stock price is expected to <i>rise</i> by >10% within 3-months after a Trading Buy rating has been assigned due to positive newsflow.
NEUTRAL	Total return is expected to be between -10% and +10% over the next 12 months.
SELL	Total return is expected to be <10% over the next 12 months.
TRADING SELL	Stock price is expected to <i>fall</i> by >10% within 3-months after a Trading Sell rating has been assigned due to negative newsflow.

SECTOR RECOMMENDATIONS

POSITIVE	The sector is expected to outperform the overall market over the next 12 months.
NEUTRAL	The sector is to perform in line with the overall market over the next 12 months.
NEGATIVE	The sector is expected to underperform the overall market over the next 12 months.