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12 July 2017 | Corporate Update

Hartalega Holdings Berhad

Demand to remain resilient in FY18

***Maintain* NEUTRAL**

***Revised* Target Price (TP): RM6.99**
(*Previously* RM5.07)

INVESTMENT HIGHLIGHTS

- **Revenue to be supported by resilient demand**
- **Higher capacity to offset lower ASPs**
- **Capacity expansion well on track**
- **1QFY18 earnings to imitate previous quarter's earnings**
- **Earnings forecasts for FY18-19F lifted by +10.3% and +19.3%**
- **Maintain NEUTRAL with a revised TP of RM6.99**

Revenue to be supported by resilient demand. We opine that Hartalega's earnings will remain resilient in FY18 as we are expecting new demand to come from China due to the switch from vinyl gloves to rubber gloves. In addition, the continuous switch in demand for powdered gloves to non-powdered gloves and nitrile gloves has allowed demand to remain resilient. Furthermore, we opine that revenue will also continue to be supported by the slower growth in the glove industry's capacity expansion which has provided Hartalega with a more conducive environment to price its product. This is as opposed to the intense pricing competition last year which caused the glove manufacturers to reduce prices in order to compete for orders.

Increasing capacity to offset lower ASP. From our observation, we note that natural rubber price have been steadily coming down from its peak of RM8.16 per kg back in February. As of 30 June, the average price of natural rubber stands at RM5.73 per kg. This means that Hartalega would have to adjust its ASPs lower to accommodate for lower raw materials price. However, despite the expected lower ASPs, we think that the new capacity from Plant 3 will assist to offset the lower ASPs going forward as demand is expected to remain resilient.

Capacity expansion well on track. We understand from the management that the commissioning of the production lines in its Plant 3 of the NGC has now been fully-completed. It will now move on to the production lines in Plant 4 which will begin commissioning in late July. There will be 12 production lines in Plant 4 and Hartalega expects to commission one production line per month. Management expects to complete the full-commissioning of Plant 4 by middle of 2018.

RETURN STATS	
Price (11 July 2017)	RM6.80
Target Price	RM6.99
Expected Share Price Return	+2.75%
Expected Dividend Yield	+1.10%
Expected Total Return	**+3.85%**

STOCK INFO	
KLCI	1,755.03
Bursa / Bloomberg	5168 / HART MK
Board / Sector	Main / Trading Services
Syariah Compliant	YES
Issued shares (mil)	1,645.10
Market cap. (RM'm)	11,186.66
Price over NA	6.69
52-wk price Range	RM4.06 – RM7.40
Beta (against KLCI)	0.58
3-mth Avg Daily Vol	1.17m
3-mth Avg Daily Value	RM7.28m
Major Shareholders (%)	
Hartalega Industries	49.19
EPF	7.28
BNP Paribas Wealth Mgmt	4.81

1QFY18 earnings to imitate previous quarter's earnings. With the complete commissioning of Plant 3 of the NGC, we opine that Hartalega's 1QFY18 earnings will replicate its 4QFY17 earnings of about RM85-90m. This is due to the fact that we believe that Ringgit will continue to trade at current level and revenue will continue to be driven by the 24b of annual glove production capacity. We are also expecting Hartalega to maintain its net margin in the mid-teens in FY18 premised on the abovementioned factors.

Earnings forecast. We are revising our FY18-19F earnings upwards by +10.3% and +19.3% respectively after we revised our assumption on: (i) the expected utilisation rates to 88% (from 85% previously); (ii) ASPs for both financial years and; (iii) USD vs Ringgit exchange rate to RM4.10 per USD for FY18F and RM4.00 per USD for FY19F - 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.

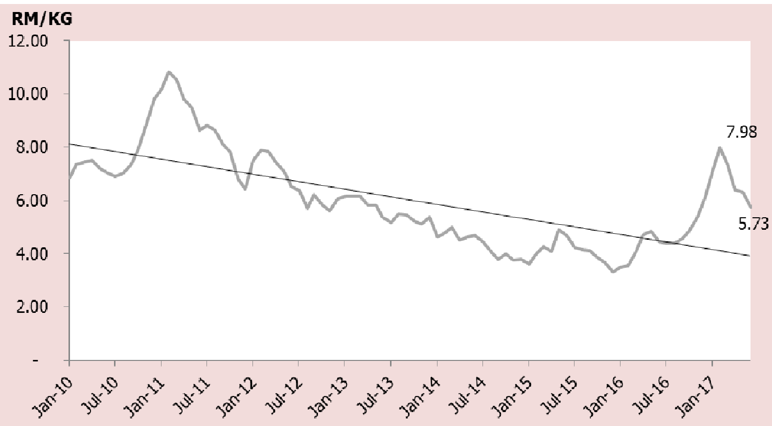
Recommendation. Post earnings revision, we are maintaining our **NEUTRAL** call on Hartalega with a revised TP of RM6.99 per share (from RM5.07 per share previously) as we roll forward our valuation base year to FY19. Our TP is derived via pegging our FY19F EPS of 26.9sen to an unchanged PER19 of 26x, which is its three-year average PER. We believe the call is fair given Hartalega's lofty valuation currently when compared against its peers at 26.9x FY19PER vs an average of 19x for its peers. In addition, we continue to be wary of the ongoing strengthening of Ringgit against USD as well as the drop in raw materials price which could distort its revenue. Furthermore, its share price has gone up by +44% YTD which limits further share price appreciation in our opinion.

Table 1: 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	1H18
Plant 5 of NGC	3	12	4.7bn	2019
Plant 6 of NGC		12	4.7bn	2020
			28.2bn	
Capacity by 2020			**41.5bn**	

Source: Company, MIDFR

Chart 1: Natural rubber monthly average historical price trend



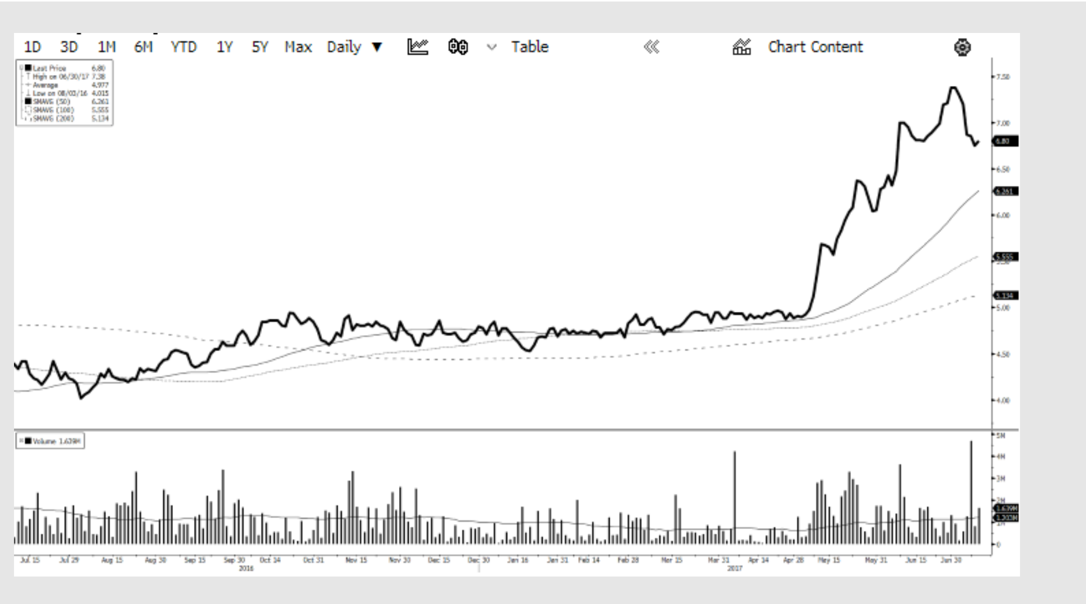
Source: Malaysian Rubber Board (MRB), MIDFR

INVESTMENT STATISTICS

FYE Mar (RM'm)	FY2015	FY2016	FY2017	FY2018F	FY2019F
Revenue	1,146.0	1,498.3	1,822.1	2,254.4	2,593.4
Cost of goods sold	(869.1)	(1,181.9)	(1,435.2)	(1,645.9)	(1,923.3)
Gross profit	276.8	316.4	386.9	608.5	670.1
Finance costs	(0.1)	(0.4)	(1.0)	(15.5)	(15.5)
Profit before tax	**276.7**	**317.3**	**348.7**	**457.7**	**525.0**
Income tax expense	(66.7)	(59.4)	(65.3)	(73.2)	(84.0)
Net Profit (RM'm)	**209.5**	**257.7**	**283.4**	**384.5**	**441.0**
EPS (sen)	13.1	15.7	17.2	23.4	26.9
EPS Growth (%)	-51.3	19.6	9.8	35.8	14.7
PER (x)	51.4	42.9	39.1	28.8	0.0
Dividend Per Share (sen)	6.5	6.3	6.0	7.0	7.5
Dividend yield (%)	1.0	0.9	0.9	1.0	1.1

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 >15% over the next 12 months.
TRADING BUY	Stock price is expected to *rise* by >15% within 3-months after a Trading Buy rating has been assigned due to positive newsflow.
NEUTRAL	Total return is expected to be between -15% and +15% over the next 12 months.
SELL	Total return is expected to be <15% over the next 12 months.
TRADING SELL	Stock price is expected to *fall* by >15% 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.