

10 March 2017 | Corporate Update

## Hartalega Holdings Berhad

*Expecting a better FY18*

### INVESTMENT HIGHLIGHTS

- **Better revenue expected in FY18**
- **Demand to improve despite increase in ASPs**
- **Capacity expansion on track**
- **Price competition has abated amongst glove producers**
- **Earnings forecasts for FY17-18F lifted by +6.8% and +23%**
- **Maintain NEUTRAL with a revised TP of RM5.07**

**Better revenue expected in FY18.** After going through a period of consolidation and various hikes in production costs last year, we are expecting Hartalega to record better revenue in FY18 when compared against FY17. This improvement is expected to be driven mainly by two factors which are: (i) improvement in demand and; (ii) increase in average selling prices (ASPs). Improvement in demand is following the expected completion of its Plant 3 of NGC which will provide additional 4.7b pieces of annual gloves capacity while the increase in ASPs is due to the strengthening of USD against MYR and fluctuation of raw material prices. Management noted that it has, on average increased ASPs by more than >10% since January 2017 to accommodate rising input prices.

**Demand to improve despite increase in ASPs.** In addition to the increase in capacity, we are also expecting demand to come from the shift in orders from China to Malaysia due to China's recent participation in the Paris Climate Agreement back in November 2016. This resulted in increase in price of gloves produced in China especially vinyl plastic gloves as the factories try to comply with environmental friendly practices as agreed in the Paris Climate Agreement. This has caused the price of vinyl plastic gloves to increase by approximately +30% which drove the switch from vinyl plastic gloves to rubber gloves.

**Capacity expansion well on track.** We understand from the management that the commissioning of the production lines in its Plant 3 of the NGC is well on track with more than one line commissioned per month. Hence, we expect the full-commissioning of Plant 3 to be completed on schedule which is slated to be in the 2H17. In addition, due to the expected improvement in demand, we are expecting the utilization rate after taking into consideration new production capacity to stabilise at around 85% throughout the year.

**Maintain NEUTRAL**


**Revised Target Price (TP): RM5.07**  
(Previously RM4.48)

RETURN STATS	
Price (9 March 2017)	RM4.80
Target Price	RM5.07
Expected Share Price Return	+5.6%
Expected Dividend Yield	+1.4%
<b>Expected Total Return</b>	<b>+7.0%</b>

STOCK INFO	
KLCI	1,717.42
Bursa / Bloomberg	5168 / HART MK
Board / Sector	Main / Trading Services
Syariah Compliant	YES
Issued shares (mil)	1,641.47
Par Value (RM)	1.00
Market cap. (RM'm)	7,883.86
Price over NA	4.88
52-wk price Range	RM3.81 – RM5.03
Beta (against KLCI)	0.56
3-mth Avg Daily Vol	0.65m
3-mth Avg Daily Value	RM3.13m
Major Shareholders (%)	
Hartalega Industries	49.27
EPF	7.60
BNP Paribas Wealth Mgmt	4.82

**Price competition has abated, it is now a volume game.** We reiterate our view that it is now a volume game as we think price competition between the glove makers has now abated. This is due to: (i) the increase in production capacity industry-wide; (ii) announcement of gas price hike schedule and; (iii) deferral of foreign worker levy policy which have reduced the uncertainty involving future costs. That said, we are well aware of external factors such as currency movements as well as fluctuating raw material prices that continue to pose as threats to earnings growth.

**Earnings forecast.** We are revising our FY17-18F earnings upwards by +6.8% and +23% respectively after we revised our assumption on the expected utilisation rates as well as 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) adverse fluctuation of USD against MYR; (ii) rising 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 **RM5.07** per share. Our TP is derived via pegging our FY18F EPS of 21.1sen to PER18 of 24x, which is its five-year average PER. Despite the more positive outlook for Hartalega this year, we are still wary on the movements of the currency as well as raw material prices which could potentially hurt earnings. In addition, we think the call is fair given Hartalega's lofty valuation currently at 28.1x FY17PER vs an average of below 20x for its peers. Furthermore, we opine that further significant stock price appreciation is limited as the price has appreciated to lofty levels and has been hovering at a narrow range of between RM4.54-4.94 for the past six months. 

**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	2H17
Plant 4 of NGC		12	4.7bn	2018
Plant 5 of NGC	3	12	4.7bn	2019
Plant 6 of NGC		12	4.7bn	2020
			<b>28.2bn</b>	
<b>Capacity by 2020</b>			<b>41.5bn</b>	

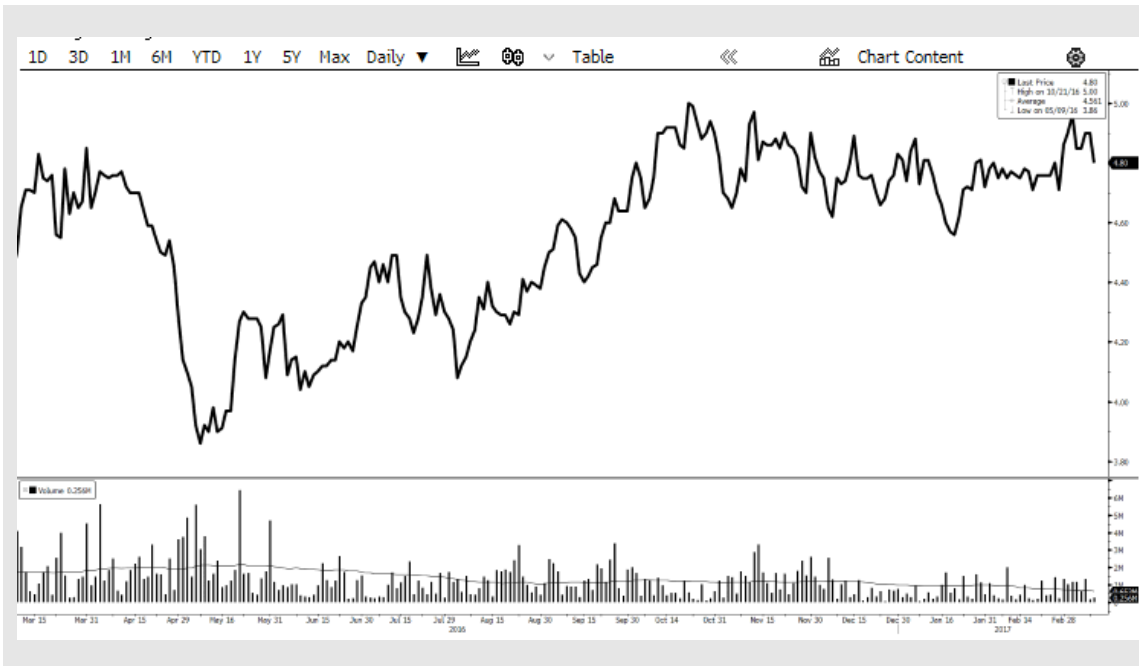
Source: Company, MIDFR

## INVESTMENT STATISTICS

FYE Mar (RM'm)	FY2014	FY2015	FY2016	FY2017F	FY2018F
Revenue	1,107.1	1,146.0	1,498.3	1,878.6	2,202.0
Cost of goods sold	(739.2)	(869.1)	(1,181.9)	(1,445.6)	(1,656.9)
<b>Gross profit</b>	367.8	276.8	316.4	433.0	545.1
Finance costs	(0.3)	(0.1)	(0.4)	(0.2)	(0.1)
<b>Profit before tax</b>	<b>367.5</b>	<b>276.7</b>	<b>317.3</b>	<b>333.3</b>	<b>412.8</b>
Income tax expense	(75.7)	(66.7)	(59.4)	(53.3)	(66.0)
<b>Net Profit (RM'm)</b>	<b>291.4</b>	<b>209.5</b>	<b>257.7</b>	<b>280.0</b>	<b>346.8</b>
EPS (sen)	27.0	13.1	15.7	17.1	21.1
EPS Growth (%)	-15.3	-51.3	19.6	8.6	23.9
PER (x)	17.8	36.5	30.5	28.1	22.7
Dividend Per Share (sen)	7.3	6.5	6.3	6.5	7.0
Dividend yield (%)	1.5	1.4	1.3	1.4	1.5

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 <i>rise</i> 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 <i>fall</i> 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.