



Weak start

1QFY17 came in weaker than expected despite higher volume sales growth, dragged down by lower margins on higher raw material costs and start-up losses in NGC. Sequential recovery is expected on volume growth but margins should stay weak amid ongoing ASP pressure. Maintain HOLD with unchanged TP at RM4.00.

Weaker-than-expected 1Q

1QFY17 revenue was flat at RM402m (+0.3% qoq; but +25% yoy) on the back of flat volume growth on a lower utilisation rate, likely due to production bottlenecks in NGC. Core net profit fell to RM56m (-9% qoq; -11% yoy) on lower margins due to higher raw material costs and overheads, while the effective tax rate spiked on lower tax incentives available. Overall, 1QFY17 was weaker than expected, missing both our estimates and consensus expectations.

Sequential recovery likely in 2Q

Hartalega was plagued by ongoing production issues at some of its plants, which led to a below-average utilisation rate. We understand that most bottlenecks have been resolved in June and the utilisation rate should normalise at above 85% (vs 81% in 1Q). Volume growth should resume in 2Q on the higher utilisation rate and bolstered by the higher US\$ ASP, which will lead to a stronger 2Q. Our channel checks also indicate a slight recovery in nitrile gloves' US\$ ASP by up to 5% across the sector in 2Q, mostly to account for the higher raw material prices, and this should alleviate the margin pressure.

Competition still lurking

Despite our expectation of sequential recovery in 2Q, which is mostly volume-driven, there is little room for margin expansion in the near term on limited efficiency gains from NGC and ongoing ASP pressure. 1Q EBITDA margin fell sharply to 21% (-2ppts qoq; -9% yoy), one of its lowest on record, likely driven by intense competition in nitrile gloves. While capacity growth has slowed down in recent quarters, it could heat up again in CY17 as we expect total gloves supply to grow by 12%.

Maintain HOLD with unchanged TP at RM4.00

There is no change to our earnings forecasts despite the weak 1Q results, largely on expected sequential recovery. We maintain our 12-month target price at RM4.00, with an unchanged target PER of 22x CY17E. Our **HOLD** rating is premised on its: (i) eroding valuation premium vis-à-vis its peers; and (ii) declining profitability profile due to pricing competition.

Earnings & Valuation Summary

| FYE Mar (RM'm) | 2015A | 2016A | 2017E | 2018E | 2019E |
|-----------------------|---------|---------|---------|---------|---------|
| Revenue (RMm) | 1,146.0 | 1,498.3 | 1,685.0 | 1,901.9 | 2,114.4 |
| EBITDA (RMm) | 322.2 | 388.4 | 438.4 | 480.6 | 518.4 |
| Pretax profit (RMm) | 276.8 | 317.4 | 353.0 | 385.6 | 413.7 |
| Net profit (RMm) | 209.6 | 257.6 | 281.9 | 308.0 | 330.5 |
| EPS (sen) | 12.8 | 15.7 | 17.2 | 18.8 | 20.1 |
| PER (x) | 33.2 | 27.0 | 24.7 | 22.6 | 21.1 |
| Core net profit (RMm) | 209.6 | 257.6 | 281.9 | 308.0 | 330.5 |
| Core EPS (sen) | 12.8 | 15.7 | 17.2 | 18.8 | 20.1 |
| Core EPS chg (%) | (10.0) | 22.9 | 9.4 | 9.3 | 7.3 |
| Core PER (x) | 33.2 | 27.0 | 24.7 | 22.6 | 21.1 |
| DPS (sen) | 6.4 | 6.3 | 6.9 | 7.5 | 8.1 |
| Dividend Yield (%) | 1.5 | 1.5 | 1.6 | 1.8 | 1.9 |
| EV/EBITDA (x) | 21.4 | 18.1 | 16.4 | 15.2 | 14.2 |

| | | | |
|---------------------|-----|-----|-----|
| Chg in EPS (%) | - | - | - |
| Affin/Consensus (x) | 0.9 | 0.8 | 0.6 |

Source: Company, Affin Hwang estimates

Affin Hwang Investment Bank Bhd (14389-U)
(Formerly known as HwangDBS Investment Bank Bhd)

Results Note

Hartalega

HART MK

Sector: Rubber Products

RM4.24 @ 2 August 2016

HOLD (maintain)

Downside: 6%

Price Target: RM4.00

Previous Target: RM4.00



Price Performance

| | 1M | 3M | 12M |
|-------------|-------|-------|-------|
| Absolute | -2.5% | -1.2% | -1.9% |
| Rel to KLCI | -3.4% | -0.4% | +1.9% |

Stock Data

| | |
|--------------------------|-------------|
| Issued shares (m) | 1,641.1 |
| Mkt cap (RMm)/(US\$m) | 6,958/1,720 |
| Avg daily vol - 6mth (m) | 1.7 |
| 52-wk range (RM) | 3.85-6.15 |
| Est free float | 28.8% |
| BV per share (RM) | 0.92 |
| P/BV (x) | 4.63 |
| Net cash/ (debt) (RMm) | (164) |
| ROE (2017E) | 17.7% |
| Derivatives | Nil |
| Shariah Compliant | Yes |

Key Shareholders

| | |
|----------------------|-------|
| Hartalega Industries | 49.3% |
| EPF | 7.3% |
| Budi Tenggara | 3.0% |

Source: Affin Hwang, Bloomberg

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Fig 1: Results Comparison

| FYE Mar (RMm) | 1QFY17 | QoQ % chg | YoY % chg | Comments |
|------------------------|-------------|--------------|--------------|---|
| Revenue | 401.8 | 0.3 | 25.4 | Low utilization rate and lower ASP |
| Op costs | 316.4 | 2.6 | 40.4 | Higher operating costs due to spike in raw material prices and overheads from NGC |
| EBITDA | 85.4 | (7.3) | (10.3) | |
| EBITDA margin (%) | 21.3 | -1.8ppts | -8.5ppts | |
| Depn and amort | (17.1) | (18.9) | 12.3 | Higher depreciation charges from installation of new lines |
| EBIT | 68.3 | (3.9) | (14.6) | |
| EBIT margin (%) | 17.0 | -0.7ppts | -8.0ppts | Lower operating margins due to pricing pressure and higher raw material prices |
| Int expense | (0.2) | >(100) | na | |
| Int and other inc | - | na | na | |
| EI | - | na | na | |
| Pretax profit | 68.1 | (4.3) | (14.8) | |
| Core pretax | 68.1 | (4.3) | (14.8) | |
| Tax | (11.7) | 24.5 | (31.4) | |
| Tax rate (%) | 17.2 | +4.0ppts | -4.2ppts | Higher tax rate due to lower tax incentives |
| Net profit to company | 56.4 | (8.7) | (10.3) | |
| MI | (0.2) | >100 | >100 | |
| Net profit | 56.2 | (9.0) | (10.5) | |
| EPS (sen) | 3.4 | (9.0) | (10.5) | |
| Core net profit | 56.2 | (9.0) | (10.5) | Results missed expectations at 20%/19% of our/consensus full-year estimates |

Source: Affin Hwang, Company data

Key risks to our view include: i) sudden movements in the US\$ against the RM, ii) sharp changes in raw material prices, and iii) greater or lesser-than-expected pricing competition among glove players.

Equity Rating Structure and Definitions

| | |
|------------------|--|
| BUY | Total return is expected to exceed +10% over a 12-month period |
| HOLD | Total return is expected to be between -5% and +10% over a 12-month period |
| SELL | Total return is expected to be below -5% over a 12-month period |
| NOT RATED | Affin Hwang Investment Bank Berhad does not provide research coverage or rating for this company. Report is intended as information only and not as a recommendation |

The total expected return is defined as the percentage upside/downside to our target price plus the net dividend yield over the next 12 months.

| | |
|--------------------|--|
| OVERWEIGHT | Industry, as defined by the analyst's coverage universe, is expected to outperform the KLCI benchmark over the next 12 months |
| NEUTRAL | Industry, as defined by the analyst's coverage universe, is expected to perform inline with the KLCI benchmark over the next 12 months |
| UNDERWEIGHT | Industry, as defined by the analyst's coverage universe is expected to under-perform the KLCI benchmark over the next 12 months |

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