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

Results Note

Hartalega

HART MK
Sector: Rubber Products

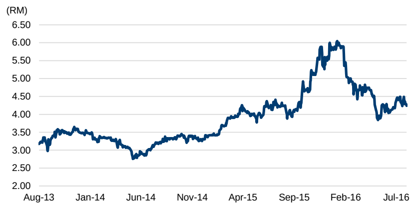
RM4.24 @ 2 August 2016

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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