Shifting into high gear

Results Note

Hartalega

HART MK
Sector: Rubber Products

RM5.39 @ 9 May 2017

BUY (upgrade)
Upside: +17%

Price Target: RM6.30
Previous Target: RM4.50

Price Performance

	1M	3M	12M
Absolute	+8.9%	+13.5%	+39.6%
Rel to KLCI	+7.4%	+8.5%	+29.0%

Stock Data

Issued shares (m)	1,643.6
Mkt cap (RMm)/(US$m)	8,858.8/2,038.0
Avg daily vol - 6mth (m)	0.8
52-wk range (RM)	3.81-5.47
Est free float	29.9%
BV per share (RM)	0.98
P/BV (x)	5.48
Net cash/ (debt) (RMm)	(230.4)
ROE (2017E)	20.3%
Derivatives	Nil
Shariah Compliant	Yes

Key Shareholders

Hartalega Industries	49.2%
EPF	7.5%
BNP Paribas	4.8%

Source: Affin Hwang, Bloomberg

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Hartalega's 4QFY17 core net profit rose by a strong 35% qoq to RM89m, underpinned by firmer sales volume, tailwinds from the weak Ringgit, and improved operational efficiencies in spite of higher raw material prices. We are upgrading Hartalega to BUY as we believe its margin decline is nearing a trough on normalising competition and improvements in operational efficiencies. We forecast an FY18-20 earnings CAGR of 19%, underpinned by capacity expansion and strong emphasis on cost management. We lift our 12M TP to RM6.30, after rolling forward valuations to CY18 and raising our target PER to 24x (from 22x), in line with the 3-year mean.

Volume sales boost revenue growth

Hartalega's 4Q revenue rose 16% qoq to RM527m on a 14% qoq surge in total sales volume, bolstered by a 3% weakening of the Ringgit. Overall the US$ ASP was marginally lower by 1% qoq, but the strong increase in sales volume was more than enough to compensate for the decline in pricing. Hartalega added 6% qoq in capacity during the quarter with the gradual commissioning of the NGC Phase 2, which has seen 10 out of 12 lines at Plant 3 already operational. The remaining lines at Plant 3 and another 12 lines at Plant 4 are expected to be operational by end-2017.

4Q earnings rise 35% qoq

Hartalega booked core net profit of RM89m in 4QFY17, up 35% qoq and in line with the higher-volume sales. This brings FY17 total core net profit to RM283m, which was within our expectation but above consensus estimates. The higher earnings were bolstered by overall operational efficiencies, resulting in lower labour and packaging costs, as well as a general decline in overhead and fuel/electricity expenses. This has resulted in the EBITDA margin increasing 5ppts to a strong 26%. Hartalega's strict cost management, operational improvement initiatives and economies of scale continue to underpin underlying margin expansion and earnings growth, negating the impact of the higher raw material costs due to rally in commodity prices.

Upgrade to BUY on improved prospects; TP: RM6.30

We upgrade Hartalega to **BUY** from Hold, as we believe the margin decline has troughed and earnings growth should trend higher with robust sales growth. We raise our 2017-18 earnings estimates by 8-18%, after imputing for higher capacity expansion and reduced cost assumptions. We lift our 12M TP to RM6.30 from RM4.50, after raising our PER assumption to 24x (from 22x), in line with its 3-year mean, on stabilising margin and improved prospects.

Earnings & Valuation Summary

FYE 31 March	2016A	2017A	2018E	2019E	2020E
Revenue (RMm)	1,498.3	1,822.1	2,265.4	2,626.5	3,051.0
EBITDA (RMm)	386.0	420.4	573.1	656.1	811.1
Pretax profit (RMm)	316.8	348.7	476.3	542.6	678.4
Net profit (RMm)	257.4	283.0	390.0	444.4	555.7
EPS (sen)	15.7	17.2	23.7	27.0	33.8
PER (x)	34.5	31.4	22.8	20.0	16.0
Core net profit (RMm)	257.4	283.0	390.0	444.4	555.7
Core EPS (sen)	15.7	17.2	23.7	27.0	33.8
Core EPS chg (%)	22.8	10.0	37.8	13.9	25.1
Core PER (x)	34.5	31.4	22.8	20.0	16.0
DPS (sen)	7.5	8.0	9.5	10.8	13.5
Dividend Yield (%)	1.4	1.5	1.8	2.0	2.5
EV/EBITDA (x)	23.4	21.6	15.8	13.9	11.3
Chg in EPS (%)			7.9	18.1	-
Affin/Consensus (x)			1.1	1.2	-

Source: Company, Affin Hwang forecasts, Bloomberg

Fig 1: Results Comparison

FYE March (RMm)	4QFY17	QoQ % chg	YoY % chg	FY17 % chg	YoY % chg	4Q comments
Revenue	527.0	15.5	31.6	1,822.1	21.6	4Q revenue rose 16% qoq, largely underpinned by a 14% increase in volume sales, and bolstered by the Ringgit as the US$ strengthened 3% qoq in 4QFY17. Stripping off the US$ factor, US$ ASP actually fell marginally by 1% qoq, largely due to the huge capacity added. Total production capacity grew by 6% qoq, due to the gradual commissioning of the NGC Phase II. Segment-wise, nitrile glove sales rose a strong 14% qoq, bringing the product mix contribution to 94%. On the other hand, latex glove sales rose 8%, with a product mix contribution of 6%.
Op costs	(388.9)	8.0	26.1	(1,401.7)	26.3	Operational costs rose 8% despite a 16% increase in sales, primarily due to the increase in efficiencies in the production process. Breaking it down to details, raw materials generally saw an increase between 8% and 13%, in line with the higher commodity prices. This was however, negated by lower labour costs, packaging costs, as well as lower fuel and overhead due to improved efficiencies and economies of scale.
EBITDA	138.1	43.8	49.9	420.4	8.2	
EBITDA margin (%)	*26.2*	*+5.2ppts*	*+3.2ppts*	*23.1*	*-2.8ppts*	EBITDA margin rose 5ppts qoq, primarily due to lower operational expenses, as well as favourable tailwinds from the weaker Ringgit.
Depn and amort	(19.2)	10.0	(8.7)	(70.6)	(0.0)	Depreciation charges rose 10% qoq due to the higher number of production lines installed.
EBIT	118.9	51.3	67.3	349.7	10.1	
EBIT margin (%)	*22.6*	*+5.3ppts*	*+4.8ppts*	*19.2*	*-2.0ppts*	EBIT margin rose 5ppts, in line with the higher sales price and lower operational costs.
Int expense	(0.4)	48.9	nm	(1.0)	>100	
Int and other inc	-	na	na	-	na	
EI	-	na	na	-	na	No EI was recorded during the quarter.
Pretax profit	**118.5**	51.3	66.4	348.7	9.9	
Core pretax	118.5	51.3	66.4	348.7	9.9	
Tax	(29.1)	>100	>100	(65.3)	10.1	
Tax rate (%)	*24.5*	*+9.3ppts*	*+11.3ppts*	*18.7*	-	Effective tax rate rose 9ppts due to the additional RM8.7m deferred tax recognized. Full year effective tax rate lower than statutory income tax rate due to the availability of investment tax allowance.
Net profit to company	89.4	34.7	44.7	283.4	9.8	
MI	(0.0)	(93.1)	(75.0)	(0.4)	6.3	
Net profit	**89.4**	35.0	44.8	283.0	9.8	
EPS (sen)	5.4	35.0	44.8	17.2	9.8	
Core net profit	**89.4**	35.0	44.8	283.0	9.8	Core net profit came in within our expectations but above consensus 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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This report is printed and published by:
Affin Hwang Investment Bank Berhad (14389-U)
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