Hartalega Holdings Berhad

(5168 | HART MK) Health Care| Health Care Equipment & Services

***Maintain* NEUTRAL**

Sluggish capacity expansion in the near term

***Revised* Target Price: RM2.58**

(from RM3.09)

KEY INVESTMENT HIGHLIGHTS

- **Missed expectations**
- **Weaker earnings and revenue**
- **Blended ASPs bottoming at a slower pace**
- **Utilisation rate improved +1%qoq to 70% during the quarter**
- **Revised FY23-24 earnings estimate**
- **Maintain NEUTRAL with a lower TP of RM2.58 *(from RM3.09)***

Missed expectations. Hartalega Holdings Berhad (Hartalega) reported a core PATANCI of RM110.1m (excluding a one-time off an item of +RM29.1m) in 1QFY22. It came in below our and streets' estimation, accounting for 17.4% and 18.8% of the full-year FY23 earnings projection respectively. The negative deviation was mainly due to lower-than-expected ASPs and a higher-than-anticipated rise in energy costs. There was no dividend announced this quarter.

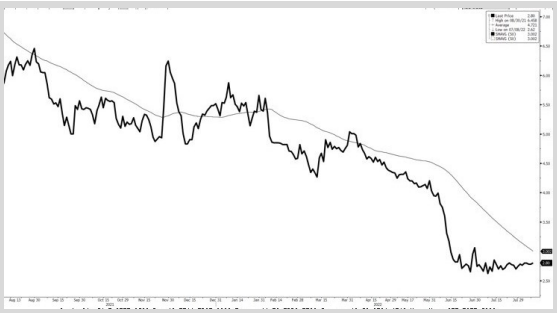
Weaker earnings and revenue. Hartalega's 1QFY23 revenue plunged by -78.3%yoy to RM845.7m. The lower revenue was owing to normalizing of the ASPs of gloves (USD/1000pcs) (-70.6%yoy) along with a lower sales volume (-27.2%yoy). Similarly, core PATANCI shrunk to RM110.1m (-95.1%yoy), due to higher energy (+15.3%yoy) and labour cost (+5.4%yoy). This was following increase in natural gas tariffs and a minimum wage hike to RM1,500. Operating profit margin decreased by -55ppt to 18% due to higher input cost. On a sequential basis, the group's 1QFY23 topline and operating profit were lower at RM845.7m (-12.7%qoq) and RM152.6 (-26.2%qoq). The operating margin narrowed by -3ppt to 18.0%.

Blended ASPs declining at a slower pace. During the quarter, blended ASPs decrease -12.9%qoq to around USD27/1000pcs following -27.6%qoq and -39.8%qoq declines in 4QFY22 and 3QFY22 respectively (Chart 1). Looking ahead, management expects that ASPs will continue to drop in FY23 until supply and demand meet. This is mainly due to the overstock situation in the sector, which is characterized by decreased customer demand due to overstocking and subsequent inventory adjustment. We are aware that the ASPs for gloves would drop to pre-covid levels before the unbalanced demand-supply dynamics reverted to normal.

The utilization rate improved marginally (+1%qoq) to 70% (Chart 2). Hartalega alludes that increasing the utilization rate is the top priority in the near term, with a target of 75% in FY23. Note that the industry average utilization rate is at 50%. Moving forward, we think that the higher utilization rate and higher gloves production would further weigh on ASPs.

RETURN STATISTICS	
Price @ 9th August 2022	2.80
Expected share price return (%)	-7.73
Expected dividend yield (%)	2.84
Expected total return (%)	-4.89

SHARE PRICE CHART



Share price performance (%)	Absolute	Relative
1 month	6.9	1.7
3 months	-8.5	-32.3
12 months	-58.3	-58.3

KEY STATISTICS	
FBM KLCI	1,497.68
Syariah compliant	Yes
Issue shares (m)	3427.61
F4BGM Index	Yes
ESG Grading Band (Star rating)	☆☆☆
Estimated free float (%)	35.89
Market Capitalisation (RM'm)	9,568.89
52-wk price range	RM2.56–RM7.45
Beta vs FBM KLCI (x)	0.85
Monthly velocity (%)	0.19
Monthly volatility (%)	32.04
3-mth average daily volume (m)	6.61
3-mth average daily value (RM'm)	20.60
Top Shareholders (%)	
Hartalega Industries Sdn Bhd	34.39
BUDI TENGGARA SDN BHD	8.63
Employees Provident Fund Board	7.22

MIDF research
research@midf.com.my

Shutdown of the manufacturing plant. The group dismantled plant 2 (Bestari Jaya) for cost savings purposes due to its massive workforce. Note that Plant 2 has five production lines and produces 1.2b gloves annually. Hartalega plans to cease Plant 3 (Bestari Jaya), which has 8 production lines and produces 3.3b gloves annually, to increase cost-effectiveness.

Capacity expansion. The group completed the construction of the four manufacturing plants under the NGC 1.5 (Sepang) expansion plan. Management highlighted that the plant's commissioning will be on a staggered basis, but the timing will depend on the supply and demand dynamics in the market. Based on the NGC 1.5 (Sepang), the 4 production plants will increase installed annual capacity by 19 billion gloves. The decommissioning of the manufacturing plants is anticipated to balance out the commissioning of two plants under NGC 1.5 projects, which resulted in a flattish total capacity in CY22–CY23.

Revised FY23-24 earnings estimate. Correspondingly, we slashed our earnings estimate for FY23/24F by -29.1%/-19.6%. This is after factoring in a stagnant total capacity of 42b pieces of gloves for FY23/24F as highlighted by the management. We also cut our ASPs assumptions for FY23/24F to an average of USD23.5/USD24 per 1000 pieces of gloves, slightly above pre-pandemic levels of USD21-23/1000pcs.

Maintain NEUTRAL with a lower TP of RM2.58 (from RM3.09). Our target price is based on 16.1x PER (close to its 2-years historical average) on FY24F EPS of 16.1sen. The dividend yield is estimated at 2.8%. We believe the pricing and margin compression will continue in FY23 due to weaker demand from customers because of overstocking and subsequent inventory modification, as well as intense competition in the global glove industry. The solid balance sheet of Hartalega, which makes up 25.6% of its market capitalization in net cash, could provide a cushion against market volatility.

Downside risks are faster-than-anticipated decrease in ASP to below break-even level, and rapid depreciation in the value of the USD, which might reduce export sales that are denominated in USD. The company's FY23F PER of 13.1x is trading at below its historical 2-year average of 15.3x. We believe the discount is justified given the challenging operating environment and declining ASPs possess a downside risk to its earnings.

INVESTMENT STATISTICS

FYE MAR (RM'm)	FY2021	FY2022	FY2023F	FY2024F	FY2025F
Revenue	**6,695.7**	**7,888.3**	**3,153.9**	**3,586.6**	**4,058.7**
Cost of Sales	(2,605.5)	(3,093.1)	(2,385.3)	(2,658.3)	(2,978.1)
Gross Profit	**4,098.0**	**4,795.1**	**768.6**	**928.3**	**1,080.5**
Profit Before Tax (PBT)	**3,813.4**	**4,636.9**	**597.6**	**733.4**	**860.1**
Income Tax Expenses	(909.6)	(1,394.6)	(149.4)	(183.4)	(215.0)
Profit After Tax (PAT)	**2,903.7**	**3,242.3**	**448.2**	**550.1**	**645.0**
PATANCI	**2,879.5**	**3,218.7**	**448.2**	**550.1**	**645.0**
CORE PATANCI	**2,885.2**	**3,224.1**	**448.2**	**550.1**	**645.0**
EPS (sen)	84.0	94.2	13.1	16.1	18.9
Dividend per share (sen)	51.0	53.5	8.0	9.8	11.5
Growth & Valuation (%)					
Revenue Growth	129.0	17.8	(60.0)	13.7	13.2
Gross Profit Growth	452.6	17.0	(84.0)	20.8	16.4
Core PATANCI Growth	565.3	11.7	(86.1)	22.7	17.3
Gross Profit Margin	61.2	60.8	24.4	25.9	26.6
PBT Margin	57.0	58.8	18.9	20.4	21.2
Core Patanci Margin	43.1	40.9	14.2	15.3	15.9
Effective tax rate	23.9	30.1	25.0	25.0	25.0
Ratios & Valuation					
PER (x)	3.3	3.0	21.3	17.4	14.8
Dividend yield (%)	18.2	19.1	2.8	3.5	4.1
Net debt/Total Equity (%)	Net cash	Net cash	Net cash	Net cash	Net cash
Dividend payout (%)	60.6	56.8	60.7	60.7	60.7
Cash/Mkt Cap (x)	27.8	24.9	25.6	26.4	27.2

Source: Company, MIDFR

Table 1: Hartalega's 1QFY23 earnings review

FYE MAR (RM'm)	Quarterly results					Cumulatively results		
	1QFY23	4QFY22	1QFY22	YoY (%)	QoQ (%)	3MFY23	3MFY22	YoY (%)
Revenue	845.7	968.7	3902.8	(78.3)	(12.7)	845.7	3902.8	(78.3)
Operating expenses	(693.1)	(762.0)	(1051.7)	(34.1)	(9.0)	(693.1)	(1051.7)	(34.1)
Operating Profit	**152.6**	**206.7**	**2851.1**	**(94.6)**	**(26.2)**	**152.6**	**2851.1**	**(94.6)**
Other (expenses)/income	(17.3)	12.7	29.3	(159.0)	(236.2)	(17.3)	29.3	(159.0)
EBIT	**135.3**	**219.4**	**2880.5**	**(95.3)**	**(38.3)**	**135.3**	**2880.5**	**(95.3)**
Finance costs	(1.2)	(1.0)	(1.4)	(16.1)	14.5	(1.2)	(1.4)	(16.1)
PBT	**134.1**	**218.4**	**2879.1**	**(95.3)**	**(38.6)**	**134.1**	**2879.1**	**(95.3)**
Taxation	(43.3)	(408.1)	(616.8)	(93.0)	(89.4)	(43.3)	(616.8)	(93.0)
PAT	**90.9**	**(189.7)**	**2262.3**	**(96.0)**	**(147.9)**	**90.9**	**2262.3**	**(96.0)**
PATANCI	81.0	(198.5)	2259.8	(96.4)	(140.8)	81.0	2259.8	(96.4)
One-time off	29.1	1.8	(19.4)	(249.5)	1525.1	29.1	(19.4)	(249.5)
Core PATANCI	**110.1**	**(196.7)**	**2240.3**	**(95.1)**	**(156.0)**	**110.1**	**2240.3**	**(95.1)**
Basic EPS (sen)	2.6	5.8	66.1	(96.1)	(55.4)	2.6	66.1	(96.1)
DPS (sen)	0.0	3.5	0.0	n.m.	(100.0)	0.0	0.0	n.m.
				+/(-) ppts	*+/(-) ppts*			*+/(-) ppts*
Operating profit margin (%)	18.0	21.3	73.1	(55.0)	(3.3)	18.0	73.1	(55.0)
EBIT margin (%)	16.0	22.6	73.8	(57.8)	(6.6)	16.0	73.8	(57.8)
PBT margin (%)	15.9	22.5	73.8	(57.9)	(6.7)	15.9	73.8	(57.9)
PAT margin (%)	13.0	(20.3)	57.4	(44.4)	33.3	13.0	57.4	(44.4)
Core PATANCI margin (%)	(5.1)	(42.1)	(15.8)	10.7	37.0	(5.1)	(15.8)	10.7
Effective Tax rate (%)	32.2	186.9	21.4	10.8	(154.6)	32.2	21.4	10.8

Source: Company, MIDFR

CHART 1: HISTORICAL BLENDED ASPs (USD/'1000pcs) GROWTH (%)

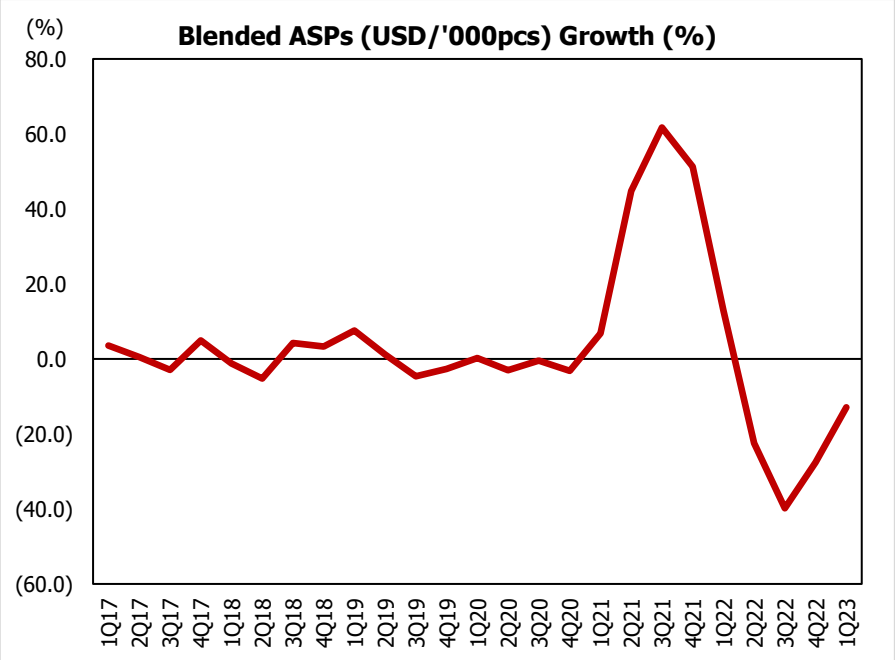
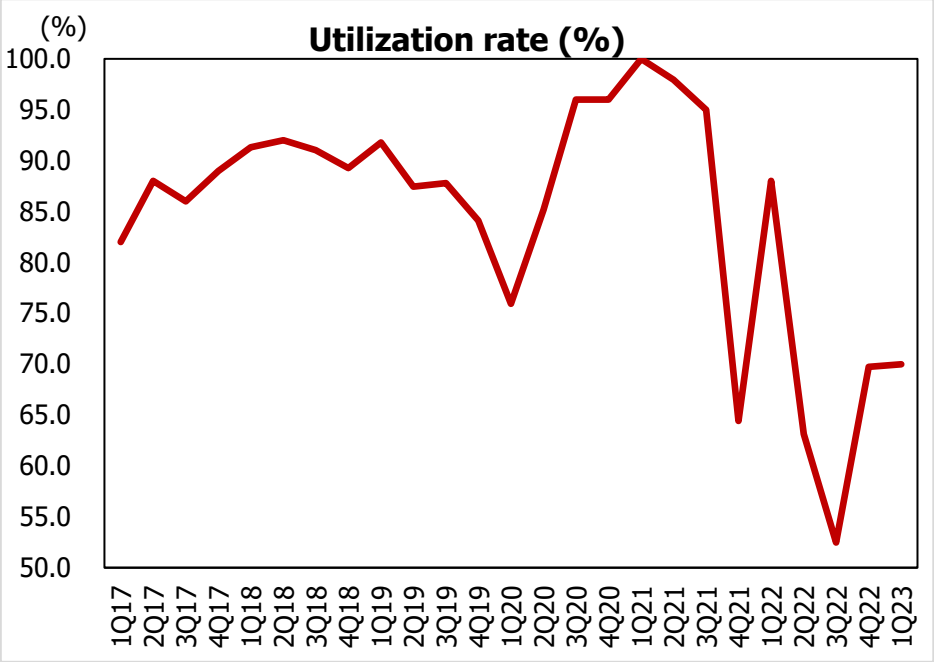


CHART 2: HISTORICAL UTILIZATION RATE (%)



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MIDF AMANAH INVESTMENT BANK : GUIDE TO RECOMMENDATIONS	
STOCK RECOMMENDATIONS	
BUY	Total return is expected to be >10% over the next 12 months.
TRADING BUY	Stock price is expected to *rise* by >10% within 3-months after a Trading Buy rating has been assigned due to positive newsflow.
NEUTRAL	Total return is expected to be between -10% and +10% over the next 12 months.
SELL	Total return is expected to be <-10% over the next 12 months.
TRADING SELL	Stock price is expected to *fall* by >10% 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.
ESG RECOMMENDATIONS* - source Bursa Malaysia and FTSE Russell	
☆☆☆☆	Top 25% by ESG Ratings amongst PLCs in FBM EMAS that have been assessed by FTSE Russell
☆☆☆	Top 26-50% by ESG Ratings amongst PLCs in FBM EMAS that have been assessed by FTSE Russell
☆☆	Top 51%- 75% by ESG Ratings amongst PLCs in FBM EMAS that have been assessed by FTSE Russell
☆	Bottom 25% by ESG Ratings amongst PLCs in FBM EMAS that have been assessed by FTSE Russell

* ESG Ratings of PLCs in FBM EMAS that have been assessed by FTSE Russell in accordance with FTSE Russell ESG Ratings Methodology