Hartalega Holdings Berhad

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

Downgrade to SELL

Low utilization rate

Revised Target Price: RM1.78

(Previously RM2.58)

KEY INVESTMENT HIGHLIGHTS

- **1HFY23 earnings below expectations**
- **Poor 2QFY23 revenue and earnings**
- **1HFY23 core earnings tumbled by -95%yoy to RM158.4m**
- **Slashed FY23F/24F/25F earnings estimate by -58.3%/-55.7%/48.2% respectively**
- **Downgrade to SELL with a lower TP of RM1.78 (previously RM2.58)**

RETURN STATISTICS	
Price @ 8th November 2022	2.07
Expected share price return (%)	-13.9
Expected dividend yield (%)	1.6
Expected total return (%)	-12.3

SHARE PRICE CHART



Share price performance (%)	Absolute	Relative
1 month	18.9	16.4
3 months	21.1	-24.7
12 months	-65.5	-63.2

KEY STATISTICS	
FBM KLCI	1,441.35
Syariah compliant	Yes
Issue shares (m)	3427.61
F4BGM Index	Yes
ESG Grading Band (Star rating)	☆☆☆
Estimated free float (%)	38.13
Market Capitalisation (RM'm)	6,869.10
52-wk price range	RM1.46 - RM7.01
Beta vs FBM KLCI (x)	0.83
3-mth average daily volume (m)	26.45
3-mth average daily value (RM'm)	47.16
Top Shareholders (%)	
Hartalega Industries Sdn Bhd	34.39
BUDI TENGGARA SDN BHD	8.63
Employees Provident Fund Board	4.97

1HFY23 earnings below expectations. Hartalega Holdings Berhad ("Hartalega")'s 1HFY23 core PATANCI of RM158.4m came in below ours and the streets' full-year estimation. It accounted for 35.3% of our forecast for FY23 and 27% of the consensus'. This was after eliminating an RM41.8m one-time item. The negative variance was mainly due to lower-than-expected sales volume and higher-than-expected operating costs. No dividend was declared for 2QFY23 as management anticipates that dividends will only be declared at the end of the year moving forward given the current difficult market conditions.

Poor 2QFY23 revenue and earnings. In 2QFY23, the group reported lower revenue of RM584.6m (vs. RM845.7m in 1QFY23). This was primarily due to lower average selling prices (ASP) and lower sales volume. Margin compression persisted as increasing operating costs pushed the operating profit margin down from 18% in the previous quarter to 7.5% this quarter. The core PATANCI decreased -62.3%qoq to RM44.2m. On yearly basis, the group's core earnings slumped -95.2%yoy to RM44.2m. This was due to lower revenue and higher energy costs which were partially cushioned by lower raw material costs.

1HFY23 core earnings tumbled by -95%yoy to RM158.4m in line with lower revenue of RM1.4b (-75.8%yoy). This was mainly due to the following factors: (1) bottoming ASP; (2) reduced sales volume due to lower demand; and (3) higher operating costs driven by a hike in the natural gas tariff and the minimum wage.

Demand remained low. ASP continued to be on a downward trend in 2QFY23, but the reduction slowed down more gradually. Note that the blended ASP for 2QFY23 fell by -1.7%qoq to around USD24-25 per 1000pcs as compared to decline of -12.3%qoq in 1QFY23 and -27.5%qoq declines in 4QFY22. Meanwhile, the 2QFY23 utilization rate was lower at 49% compared to 69.6% in 1QFY23. Looking ahead, management expects that ASPs will drop to USD 20 per 1000 items, while the utilization rate will stay constant at 50%. This is mostly because of the oversupply situation in the sector, which is characterized by low customer demand coupled with aggressive capacity expansion by both existing and new entry players during the pandemic.

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Slashed FY23F/24F/25F earnings estimate by -58.3%/-55.7%/48.2% respectively. Given earnings below expectation, we slashed our earnings estimate for FY23F-25F. This is after factoring in a lower utilization rate and higher production cost.

Downgrade to SELL with a lower TP of RM1.78 (previously RM2.58). Our target price is based on a revised PER of 25x (previously PER of 16.1x), which is close to its 3-years historical average, pegging FY24F EPS of 7.13sen. We turned cautious that the oversupply of the glove would persist for at least the next 1-years. This is mainly due to the: (1) aggressive capacity installation from both existing and new entrants during the pandemic, (2) overstock conditions in the industry, as well as (3) subsequent inventory adjustment that result in uneven demand-supply dynamics. We are also wary that the margin compression will continue in the near term due to lower sales volume ahead coupled with increasing energy costs, both of which might worsen the margin. **Upside risks** are (1) industry consolidation due to recent share price declines that have resulted in a low valuation, (2) rising demand as big buyers replenish their inventories, (3) supply-demand equilibrium with small players leaving the market or existing players ceasing some production lines.

INVESTMENT STATISTICS

FYE MAR (RM'm)	FY2021	FY2022	FY2023F	FY2024F	FY2025F
Revenue	**6,695.7**	**7,888.3**	**2,280.2**	**2,819.1**	**3,357.1**
Operating expenses	(3,036.4)	(3,487.5)	(2,031.1)	(2,494.5)	(2,914.5)
Operating profit	**3,659.3**	**4,400.7**	**249.1**	**324.6**	**442.6**
Profit Before Tax (PBT)	**3,813.4**	**4,636.9**	**239.5**	**312.4**	**428.1**
Income Tax Expenses	(909.6)	(1,394.6)	(52.7)	(68.7)	(94.2)
Profit After Tax (PAT)	**2,903.7**	**3,242.3**	**186.8**	**243.7**	**333.9**
PATANCI	**2,879.5**	**3,218.7**	**186.8**	**243.7**	**333.9**
CORE PATANCI	**2,885.2**	**3,224.1**	**186.8**	**243.7**	**333.9**
EPS (sen)	84.0	94.2	5.5	7.1	9.8
Dividend per share (sen)	51.0	53.5	3.3	4.3	5.9
Growth & Valuation (%)					
Revenue Growth	129.0	17.8	(71.1)	23.6	19.1
Operating Profit Growth	564.2	20.3	(94.3)	30.3	36.4
Core PATANCI Growth	565.3	11.7	(94.2)	30.4	37.0
Operating Profit Margin	54.7	55.8	10.9	11.5	13.2
PBT Margin	57.0	58.8	10.5	11.1	12.8
Core Patanci Margin	43.1	40.9	8.2	8.6	9.9
Effective tax rate	23.9	30.1	22.0	22.0	22.0
Ratios & Valuation					
Adj. PER (x)	2.5	2.2	37.9	29.0	21.2
Dividend yield (%)	24.6	25.8	1.6	2.1	2.8
Net debt/Total Equity (%)	Net cash	Net cash	Net cash	Net cash	Net cash
Dividend payout (%)	60.6	56.8	60.0	60.0	60.0
Cash/Mkt Cap (x)	37.6	33.6	28.2	29.0	29.9

Source: Company, MIDFR

Table 1: Hartalega's 2QFY23 earnings review

FYE MAR (RM'm)	Quarterly results					Cumulatively results		
	2QFY23	1QFY23	2QFY22	YoY (%)	QoQ (%)	1HFY23	1HFY22	YoY (%)
Revenue	584.6	845.7	2,011.3	(70.9)	(30.9)	1,430.2	5,914.2	(75.8)
Operating expenses	(541.0)	(693.1)	(833.2)	(35.1)	(21.9)	(1,234.1)	(1,881.7)	(34.4)
Operating Profit	**43.6**	**152.6**	**1,178.2**	**(96.3)**	**(71.5)**	**196.2**	**4,032.4**	**(95.1)**
Other operating (expenses)/income	(4.5)	(17.3)	7.3	(161.6)	(73.9)	(21.8)	36.7	(159.5)
EBIT	**39.0**	**135.3**	**1,185.5**	**(96.7)**	**(71.1)**	**174.3**	**4,069.1**	**(95.7)**
Finance costs	(1.7)	(1.2)	(1.3)	35.0	49.2	(2.9)	(2.7)	8.5
PBT	**37.3**	**134.1**	**1,187.4**	**(96.9)**	**(72.2)**	**171.5**	**4,066.4**	**(95.8)**
Taxation	(7.9)	(43.3)	(273.3)	(97.1)	(81.8)	(51.1)	(890.1)	(94.3)
PAT	**29.4**	**90.9**	**914.0**	**(96.8)**	**(67.6)**	**120.3**	**3,176.3**	**(96.2)**
PATANCI	28.3	88.3	914.0	(96.9)	(67.9)	116.6	3,173.5	(96.3)
One-time off	15.9	29.1	8.4	88.4	(45.4)	41.8	(9.6)	(534.7)
Core PATANCI	**44.2**	**117.3**	**922.4**	**(95.2)**	**(62.3)**	**158.4**	**3,163.9**	**(95.0)**
Basic EPS (sen)	0.8	2.6	26.7	(96.9)	(67.8)	4.6	92.6	(95.0)
DPS (sen)	0.0	0.0	0.0	n.m.	n.m.	0.0	0.0	n.m.
				+/(-) ppts	*+/(-) ppts*			*+/(-) ppts*
Operating profit margin (%)	7.5	18.0	58.6	(51.1)	(10.6)	13.7	68.2	(54.5)
EBIT margin (%)	6.7	16.0	58.9	(52.3)	(9.3)	12.2	68.8	(56.6)
PBT margin (%)	6.4	15.9	59.0	(52.6)	(9.5)	12.0	68.8	(56.8)
PAT margin (%)	5.0	10.7	45.4	(40.4)	(5.7)	8.4	53.7	(45.3)
Core PATANCI margin (%)	7.6	13.9	45.9	(38.3)	(6.3)	11.1	53.5	(42.4)
Effective Tax rate (%)	21.1	32.2	23.0	(1.9)	(11.1)	29.8	21.9	7.9
Net cash/mkt cap (%)	25.2	25.6	66.5	(41.3)	(0.4)	25.2	66.5	(41.3)

Source: Company, MIDFR

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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