Hartalega Holdings Berhad

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

***Maintain* NEUTRAL**

Cautious outlook

***Revised* Target Price: RM1.60**

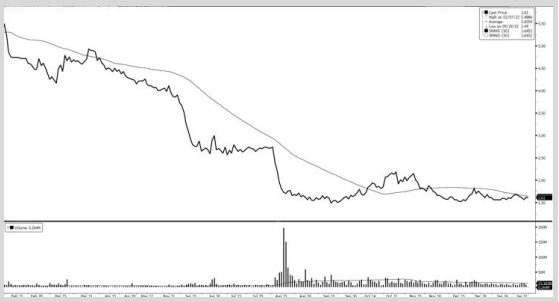
(Previously RM1.68)

KEY INVESTMENT HIGHLIGHTS

- **9MFY23's earnings exceeded expectations**
- **Earnings turned red in 3QFY23**
- **Lower revenue and core earnings in 9MFY23**
- **Declining ASP and utilisation**
- **Revised FY23F–25F earnings projection**
- **Maintain NEUTRAL with a revised TP of RM1.60 (previously RM1.68)**

RETURN STATISTICS	
Price @ 7th February 2023	1.58
Expected share price return (%)	+1.1
Expected dividend yield (%)	1.8
Expected total return (%)	+2.85

SHARE PRICE CHART



Share price performance (%)	Absolute	Relative
1 month	0.6	0.7
3 months	-4.1	-19.5
12 months	-72.0	-71.2

KEY STATISTICS	
FBM KLCI	1,476.38
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)	5,570.46
52-wk price range	RM1.46 - RM5.97
Beta vs FBM KLCI (x)	1.01
3-mth average daily volume (m)	13.83
3-mth average daily value (RM'm)	24.17
Top Shareholders (%)	
Hartalega Industries Sdn Bhd	34.39
BUDI TENGGARA SDN BHD	8.63
Employees Provident Fund Board	4.97

9MFY23's earnings exceeded expectations. Hartalega Holdings Berhad (Hartalega) reported a core PATANCI of RM154.2m in 9MFY23, after subtracting a one-time-off item of RM52.3m. The result was better than expected accounting for 82.6% of our full-year FY23F projection and 97.6% of streets. This was mainly due to slightly better-than-expected ASP of USD23/1,000 pieces instead of our projected ASP of USD20/1,000 pieces. No dividend was declared during the quarter.

Earnings turned red in 3QFY23. The group's 3QFY23 revenue decreased by -21%qoq to RM461.8m, primarily due to lower average selling prices (ASP) and lower sales volume (-5%qoq). The core earnings dropped from a net profit of RM43.8m in the previous quarter to a net loss of -RM22.9m in 3QFY23. This was due to reduced revenue and higher energy costs. On yearly basis, the core earnings plunged -152.3%yoy to a net loss of -RM22.9m in 3QFY23. This was primarily caused by reduced revenue as well as higher input expenses because of increasing natural gas prices and minimum wage.

Lower revenue and core earnings in 9MFY23. Cumulatively, the group's revenue for 9MFY23 plunged -72.7%yoy to RM1.89b due to falling ASP and decreased sales volume. The core PATANCI declined significantly, going from RM3.4b in 9MFY22 to RM154.2m in 9MFY23. This was mostly caused by fewer sales, and increased energy and labour costs.

Declining ASP and utilisation. In 3QFY23, the blended ASP and utilisation continued to be on a downward trend. In particular, the blended ASP fell -12.2%qoq to USD23/1,000 pieces in 3QFY23, while the utilisation rate reduced from 49% in 2QFY23 to 42% in 3QFY23. This was caused by continued intense market competition, excessive stockpiling during the pandemic, and surplus capacity, which resulted in an oversupply of gloves. Moving forward, the group targets to pass on a portion of the additional cost by implementing an ASP increase.

Revised FY23F–25F earnings projection. We reduced our earnings forecasts for FY23F by -15.2%, FY24F by -13.8% and FY25F by -9.9% to reflect challenging outlooks ahead. This is after factoring in a lower utilization rate due to continued oversupply in the glove sector. We also increased the input cost to reflect higher energy and labour costs.

Analyst(s)
Genevieve Ng Pei Fen
Genevieve.ng@midf.com.my
03-2173 1678

Maintain NEUTRAL with a revised TP of RM1.60 (previously RM1.68). We changed our valuation method to the dividend discount model (DDM) to better reflect the mid-to-long-term outlook. Note that Hartalega has a dividend policy of at least 60% of the payout ratio. Our TP of RM1.60 (from RM1.68) is based on a WACC of 9.3% and a sustainable growth rate of 2.0%. We are cautious about Hartalega because we believe that the glove's oversupply will persist in FY24F, resulting in a low ASP and utilisation rate. Furthermore, escalating energy and labour costs will continue to exert pressure on the operating margin, resulting in lower earnings. Hence, we are aware that the upcoming earning for 4QFY23F could remain challenging due to the low ASP, utilization rate and higher input costs. However, the group's net cash position of RM1.76b can protect against potential downside risk in the near term. Taking all into consideration, we are maintaining our **NEUTRAL** call. Hartalega is currently trading at a PE of 22.7x, which is lower than its 3-year historical mean PE of 26x.

Upside risk is supply-demand equilibrium with small players leaving the market or existing players ceasing some production lines.

INVESTMENT STATISTICS

FYE MAR (RM'm)	2021A	2022A	2023E	2024E	2025E
Revenue	6,703.5	7,888.3	2,294.6	2,275.0	3,125.3
Cost of Sales	(2,605.5)	(3,093.1)	(1,994.7)	(1,899.3)	(2,582.6)
Gross Profit	**4,098.0**	**4,795.1**	**299.9**	**375.7**	**542.7**
Other Income	8.2	3.4	11.6	12.1	20.1
Distribution expenses	(44.4)	(65.3)	(22.6)	(24.7)	(33.5)
Administrative expenses	(249.3)	(159.8)	(90.2)	(100.1)	(145.8)
Other operating expenses	(37.8)	(23.7)	(20.3)	(22.2)	(35.0)
EBITDA	**3,636.7**	**4,397.9**	**1.9**	**151.9**	**236.1**
EBIT	**3,774.8**	**4,549.7**	**178.4**	**240.8**	**348.3**
Profit before tax (PBT)	**3,773.9**	**4,555.5**	**193.5**	**256.4**	**367.4**
Tax expense	(909.6)	(1,394.6)	(35.1)	(46.5)	(66.6)
Profit After tax (PAT)	**2,864.2**	**3,160.9**	**158.4**	**209.9**	**300.7**
Core PATANCI	**2,845.9**	**3,123.5**	**158.4**	**209.9**	**300.7**
Basic EPS (sen)	84.4	94.3	4.6	6.1	8.8
DPS (sen)	51.0	53.5	2.8	3.7	5.5
Growth & Valuation (%)					
Revenue Growth (%)	129.2	17.7	(70.9)	(0.9)	37.4
Gross Profit Growth (%)	452.6	17.0	(93.7)	25.3	44.4
Core PATANCI Growth (%)	496.1	9.8	(94.9)	32.5	43.3
Gross Profit Margin (%)	61.1	60.8	13.1	16.5	17.4
Core PATANCI Margin (%)	42.5	39.6	6.9	9.2	9.6
Ratios & Valuation					
Effective tax rate (%)	24.1	30.6	18.1	18.1	18.1
Dividend Yield (%)	32.2	33.9	1.8	2.3	3.5
PER (x)	1.9	1.7	34.1	25.7	18.0
Cash/Market Capitalisation (sen)	49.4	44.0	38.4	32.0	37.4
Cash/share (sen)	78.1	69.6	60.7	50.6	59.0

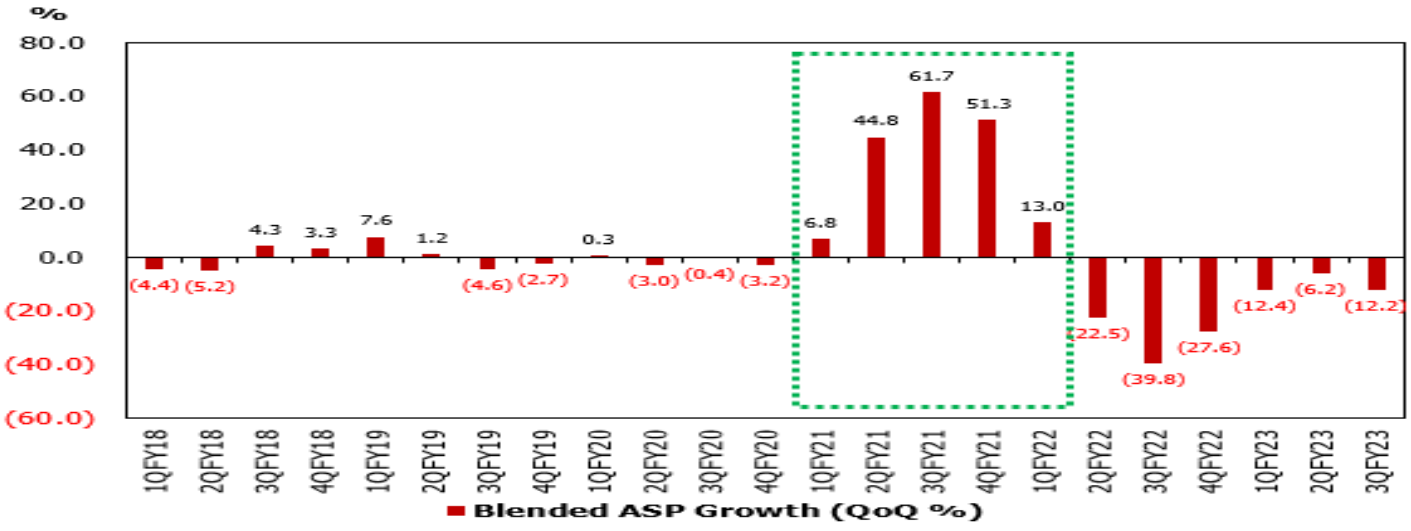
Source: Company, MIDFR

Table 1: Hartalega's 3QFY23 earnings review

FYE MAR (RM'm)	Quarterly results					Cumulatively results		
	3QFY23	2QFY23	3QFY22	YoY (%)	QoQ (%)	9MFY23	9MFY22	YoY (%)
Revenue	461.8	584.6	1,005.4	(54.1)	(21.0)	1,892.1	6,919.6	(72.7)
Cost of Sales	(492.4)	(541.0)	(678.3)	(27.4)	(9.0)	(1,726.5)	(2,563.2)	(32.6)
Gross Profit	**(30.5)**	**43.6**	**327.1**	**(109.3)**	**(170.1)**	**165.6**	**4,356.4**	**(96.2)**
Other operating (expenses)/income	2.1	(4.5)	22.2	(90.7)	(146.1)	(19.7)	58.8	(133.5)
Operating profit (EBIT)	**(28.5)**	**39.1**	**349.3**	**(108.2)**	**(172.9)**	**145.9**	**4,415.2**	**(96.7)**
Net finance income/(cost)	(2.2)	(1.7)	(1.1)	100.4	31.5	(5.1)	(3.8)	36.2
Profit before tax (PBT)	(30.7)	37.4	348.2	(108.8)	(182.2)	140.7	4,411.5	(96.8)
Taxation	(0.4)	(7.9)	(96.3)	(99.6)	(95.0)	(51.6)	(986.5)	(94.8)
Profit After tax (PAT)	**(31.1)**	**29.5**	**251.9**	**(112.4)**	**(205.6)**	**89.1**	**3,425.0**	**(97.4)**
Non-controlling interests	0.8	1.0	(2.9)	(128.0)	(19.3)	11.7	(1.1)	(1,165.9)
PATANCI	(31.9)	28.5	254.7	(112.5)	(212.1)	100.8	3,423.9	(97.1)
Core PATANCI	**(22.9)**	**43.8**	**250.5**	**(109.1)**	**(152.3)**	**154.2**	**3,404.5**	**(95.5)**
Basic EPS (sen)	(0.9)	0.8	7.6	(112.3)	(212.0)	2.5	100.4	(97.5)
DPS (sen)	0.0	0.0	14.8	(100.0)	n.m.	0.0	50.0	(100.0)
Growth & Margin (%)				***+/(-) ppts***	***+/(-) ppts***			***+/(-) ppts***
Revenue Growth	(21.0)	(30.9)	(50.0)	29.0	9.9	32.3	17.0	15.3
Operating Profit Growth	(172.9)	(71.1)	(70.5)	(102.4)	(101.8)	(16.3)	8.6	(24.9)
Core PATANCI Growth	(152.3)	(60.2)	(72.7)	(79.6)	(92.1)	(12.1)	7.7	(19.9)
Operating Profit Margin	(6.2)	6.7	34.7	(40.9)	(12.8)	7.7	63.8	(56.1)
PBT Margin	(6.6)	6.4	34.6	(41.3)	(13.0)	7.4	63.8	(56.3)
Core PATANCI Margin	(5.0)	7.5	24.9	(29.9)	(12.5)	8.2	49.2	(41.1)
Ratios & Valuation				*+/(-) ppts*	*+/(-) ppts*			*+/(-) ppts*
Net cash/market cap (%)	32.5	32.9	51.6	(19.0)	(0.4)	#DIV/0!	#DIV/0!	n.m.
Effective tax rate (%)	(1.3)	21.1	27.7	(29.0)	(22.4)	36.7	22.4	14.3
Inventories (Days)	188.1	189.6	277.3	(32.2)	(0.8)	53.6	73.4	(26.9)
Account receivables (Days)	116.0	43.6	37.1	212.7	166.3	28.3	5.4	425.3
Account payable (Days)	42.4	47.1	55.0	(22.9)	(10.0)	12.1	14.5	(17.0)

Source: Company, MIDFR

CHART 1: Hartalega's Blended ASP Growth (%)



Source: 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