Hartalega Holdings Berhad

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

Unpredictable Demand

***Downgrade to* TRADING SELL**

(previously NEUTRAL)

***Unchanged* Target Price: RM1.75**

KEY INVESTMENT HIGHLIGHTS

- **Improved sales volume and lower costs drive sequential earnings growth**
- **Decreased revenue and core PATANCI in FY23**
- **Demand for gloves remains uncertain in the near term**
- **More updates about the decommissioning of manufacturing plant**
- **Downgrade to TRADING SELL with an unchanged TP of RM1.75**

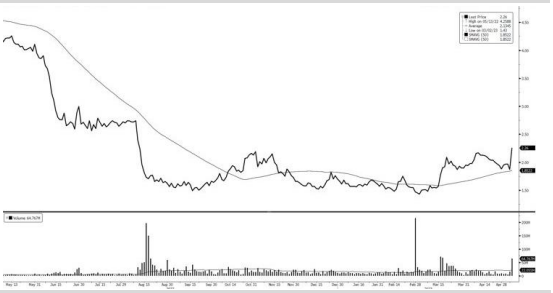
Above expectations. Hartalega Holdings ("Harta") reported a core PATANCI of RM177.8m for 12MFY23, after excluding a one-time off item of RM396m. The results outperformed our and the consensus full-year FY23 estimates, accounting for 172% of ours and 298% of the street's. The upward trajectory was mostly due to higher-than-expected sales volume on the back of some buying activities that increased the utilization rate. This has resulted in lower-than-expected production cost per unit. No dividend was declared for FY23.

Improved sales volume and lower costs drive sequential earnings growth. On sequential basis, the group reported higher revenue of RM515.7m in 4QFY23 as compared to RM461.8m in the previous quarter. This was supported by an improved sales volume (+24%qoq) on the back of customer buying activity throughout the quarter, which more than offset reduced ASP (-13.5%qoq). Despite higher energy and labor costs, the improved utilization rate resulting in lower production costs per unit. Combined with some reversal in provision of costs, the COG per 1000 units of gloves decreased by 22%qoq to RM87/1000pcs of gloves. After excluding a one-time item of RM346.9m, the group reported a net profit of RM44.1m compared to a net loss of -RM21.4m in the previous quarter. On a yearly basis, the core earnings returned to profit with a core PATANCI of RM44.1m in 4QFY23 as against a net loss of RM199.7m in 4QFY22. This improvement in earnings was primarily due to the absence of a prosperity tax provision in 4QFY23 that more than offset the decreased revenue of -46.8%yoy to RM515.7m combined with higher production costs.

Decreased revenue and core PATANCI in 12MFY23. Harta's revenue for FY23 decreased by -69.5%yoy to RM2.4b mainly mostly owing to a persisting oversupply situation and supply chain inventory adjustment, which reduced the ASP (-59.9%yoy) and sales volume (-23.8%yoy). As such, the group recorded a core PATANCI of RM177.8m as compared to RM3.21b in 12MFY22, after excluding a one-off item. This was due to lower revenue, lower plant utilization as well as greater operating cost that eroded the profit margin.

RETURN STATISTICS	
Price @ 9th May 2023 (RM)	2.26
Expected share price return (%)	-22.70
Expected dividend yield (%)	0.00
Expected total return (%)	**-22.70**

SHARE PRICE CHART



Price performance (%)	Absolute	Relative
1 month	10.2	9.9
3 months	18.9	50.1
12 months	-47.2	-42.7

INVESTMENT STATISTICS

FYE Mar	2023A	2024F	2025F
Revenue	2,407.8	1,805.9	1,943.1
EBITDA	326.8	107.5	271.5
Profit before tax (PBT)	(190.8)	(64.9)	107.3
Core PATANCI	177.8	(66.0)	87.8
Core EPS (sen)	5.2	(1.9)	2.6
DPS (sen)	0.0	0.0	1.6
Dividend Yield (%)	0.0	0.0	0.9

KEY STATISTICS	
FBM KLCI	1,432.63
Issue shares (m)	3427.61
Estimated free float (%)	38.13
Market Capitalisation (RM'm)	6,390.65
52-wk price range	RM1.4 – RM4.5
3-mth average daily volume (m)	21.26
3-mth average daily value (RM'm)	37.19
Top Shareholders (%)	
Hartalega Industries Sdn Bhd	34.39
BUDI TENGGARA SDN BHD	8.63
Employees Provident Fund Board	4.97

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Bottoming ASP. In 4QFY23, the group recorded a lower blended ASP (-13.5%qoq; -32%yoy) mainly attributed to the ongoing oversupply of gloves situation. Despite the group's efforts to raise ASP during this period, the initiative was unsuccessful due to intense competition from Chinese glovemakers offering relatively lower prices and the excessive production capacity from both existing and new entrants. Going forward, the group anticipates that the ASP will remain in the current range due to the persistent oversupply situation and the competitive pricing from Chinese glovemakers.

Demand for gloves remains uncertain in the near term. Harta reported higher sales volume (+25%qoq) on a sequential basis in 4QFY23, driven mainly by restocking activities from food-related buyers after the holiday season. However, demand from healthcare-related buyers remained subdued due to excessive inventory buildup during the pandemic. Moving forward, the group anticipates that demand for gloves will be unpredictable, with certain quarters experiencing buying activity while others may experience a dip owing to continuous oversupply. While the glove sector may experience gradual annual growth, excessive capacity expansion by existing players and new entrants has resulted in a massive total production capacity, making it unlikely that utilization rates for industry players will recover to pre-pandemic levels of above 80% in the near-to-midterm.

More updates about the decommissioning of manufacturing plant. The group alludes that the recent decision to decommission its Bestari Jaya plants is a challenging one in the short term but expected to yield long-term benefits by enhancing production efficiency and reducing costs. The decommissioning process will take around six months, impacting 2.9k employees at the Bestari Jaya plant, while also potentially filling some vacancies at NGC. Production will gradually shift to NGC, which features advanced automation technology that increases productivity and lowers costs. This move aims to enhance Hartalega's competitiveness with Chinese glovemakers, who have significantly expanded their production facilities during the pandemic, resulting in newer and more efficient plants. By consolidating production at NGC, Hartalega aims to remain cost-competitive in the industry. The management expects NGC's production capacity to be sufficient to capture the order book, given its current blended utilization rate of only half.

Downgrade to TRADING SELL with an unchanged TP of RM1.75. Given that persistent oversupply of glove situation, we make no changes to our earnings estimation post result and analyst briefing. Our **TP** of **RM1.75** is based on its 2-year historical -1SD P/BV of 1.2x multiplied by an unchanged FY24F BVPS of 145.5sen. Given the recent share price rally, we are downgrading our recommendation to **TRADING SELL** as the total return has fallen below -10%. We remain a cautious outlook on the company due to the anticipated 1–2-year timeline for the normalization of supply-demand dynamics in the industry. This is expected to result in soft average selling prices (ASPs) and demand for gloves. Additionally, production costs are likely to remain elevated in the near term due to low utilization rates and decommissioning of the manufacturing plant will increase production costs per unit, which could compress profit margins. As a result, we caution that the group may report net losses for FY24F. However, the group's solid net cash position of RM1.57b as of 4QFY23 provides some protection against potential downside risks in the long run. **Upside risks** are: (1) further exits of new and existing players from the market, (2) fluctuations in raw material prices and currency exchange rates, and (3) potential increased demand due to the emergence of new variants or diseases.

Hartalega Holdings: 4QFY23 Results Summary

FYE Mar (RM'm)	Quarterly results					Cumulative results		
	4QFY23	3QFY23	4QFY22	YoY (%)	QoQ (%)	12MFY23	12MFY22	YoY (%)
Revenue	515.7	461.8	968.7	(46.8)	11.7	2,407.8	7,888.3	(69.5)
Cost of Sales	(500.5)	(492.4)	(762.0)	(34.3)	1.7	(2,227.0)	(3,325.2)	(33.0)
Gross Profit	**15.2**	**(30.5)**	**206.7**	**(92.6)**	**(149.8)**	**180.8**	**4,563.1**	**(96.0)**
Other operating (expenses)/income	(344.2)	2.1	12.7	(2,807.6)	(16,703.5)	(363.9)	71.5	(608.6)
Operating profit (EBIT)	**(329.0)**	**(28.5)**	**219.4**	**(249.9)**	**1,055.3**	**(183.1)**	**4,634.6**	**(104.0)**
Net finance income/(cost)	(2.5)	(2.2)	(1.0)	144.4	10.2	(7.6)	(4.8)	59.0
Profit before tax (PBT)	(331.4)	(30.7)	218.4	(251.8)	979.3	(190.7)	4,629.9	(104.1)
Taxation	21.8	(0.4)	(408.1)	(105.3)	(5,583.4)	(29.8)	(1,394.6)	(97.9)
Profit After tax (PAT)	**(309.7)**	**(31.1)**	**(189.7)**	**63.2**	**895.5**	**(220.5)**	**3,235.3**	**(106.8)**
PATANCI	(302.8)	(31.9)	(198.4)	52.6	848.8	(218.1)	3,227.6	(106.8)
Core PATANCI	**44.1**	**(21.4)**	**(199.7)**	**(122.1)**	**(306.2)**	**177.8**	**3,211.9**	**(94.5)**
Basic EPS (sen)	(8.9)	(0.9)	(5.8)	53.0	852.7	(6.4)	94.6	(106.7)
DPS (sen)	0.0	0.0	3.5	(100.0)	n.m.	0.0	53.5	(100.0)
Growth & Margin (%)				*+/(-) ppts*	*+/(-) ppts*			*+/(-) ppts*
Revenue Growth	11.7	(21.0)	(3.7)	15.3	32.7	244.0	1,322.8	(1,078.7)
Core PATANCI Growth	(306.2)	(148.3)	(179.9)	(126.3)	(158.0)	44.6	2,949.8	(2,905.1)
Operating Profit Margin	(63.8)	(6.2)	22.6	(86.4)	(57.6)	(7.6)	58.8	(66.4)
Core PATANCI Margin	8.6	(4.6)	(20.6)	29.2	13.2	7.4	40.7	(33.3)
Ratios & Valuation				*+/(-) ppts*	*+/(-) ppts*			*+/(-) ppts*
Net cash/market cap (%)	24.6	27.5	33.4	(8.7)	(2.8)	(24.6)	(33.4)	8.7
Effective tax rate (%)	6.6	(1.3)	186.9	(180.3)	7.9	(15.6)	30.1	(45.8)

Source: Company, MIDFR

FINANCIAL SUMMARY

Income Statement (RM'm)	2021A	2022A	2023A	2024F	2025F
Revenue	6,703.5	7,888.3	2,407.8	1,805.9	1,943.1
Cost of Sales	(2,605.5)	(3,093.1)	(2,227.0)	(1,524.3)	(1,571.6)
Gross Profit	**4,098.0**	**4,795.1**	**180.8**	**281.6**	**371.5**
EBITDA	**3,912.8**	**4,701.6**	**326.8**	**107.5**	**271.5**
EBIT	**3,774.8**	**4,549.7**	**(183.2)**	**(60.9)**	**111.4**
Profit before tax (PBT)	**3,773.9**	**4,555.5**	**(190.8)**	**(64.9)**	**107.3**
Tax expense	(909.6)	(1,394.6)	(29.8)	(10.1)	(19.4)
Profit After tax (PAT)	**2,864.2**	**3,160.9**	**(220.6)**	**(75.0)**	**87.8**
Core PATANCI	**2,845.9**	**3,123.5**	**177.8**	**(66.0)**	**87.8**
Basic EPS (sen)	84.4	94.3	(6.4)	(2.2)	2.6
Core EPS (sen)	83.3	91.4	5.2	(1.9)	2.6
DPS (sen)	51.0	53.5	0.0	0.0	1.6

Balance Sheet (RM'm)	2021A	2022A	2023A	2024F	2025F
Property,plant and equipment	2,156.4	2,367.0	1,942.8	2,045.1	2,176.3
Intangible assets	32.6	30.8	42.6	54.2	52.5
Total Non-current assets	**2,451.8**	**3,150.1**	**2,944.7**	**3,067.1**	**3,206.3**
Inventories	633.5	396.9	253.5	334.8	310.7
ST - Trade and other receivables	1,110.7	418.6	324.1	432.9	442.5
Cash and cash equivalents	2,668.7	2,378.1	1,724.5	1,750.4	1,776.6
Total current assets	**4,414.2**	**3,197.3**	**2,382.2**	**2,572.1**	**2,582.1**
Total Assets	**6,866.0**	**6,347.4**	**5,326.9**	**5,639.2**	**5,788.4**
Total Equity	**4,999.1**	**5,124.6**	**4,676.7**	**4,969.4**	**5,123.4**
LT Lease Liabiltiies	2.1	3.2	2.0	1.3	1.3
LT Loans and borrowings	250.1	136.7	63.2	66.4	68.4
Total Non-current liabilities	**450.3**	**385.7**	**298.7**	**320.5**	**322.3**
ST Trade and other payables	1,091.3	378.2	250.2	254.4	241.4
ST Loans and borrowings	92.9	102.1	87.3	91.6	94.4
Total Current Liabilities	**1,416.6**	**816.8**	**352.4**	**349.3**	**342.7**
Total Liabilities	**1,866.9**	**1,202.5**	**651.1**	**669.8**	**665.0**

Cash Flow (RM'm)	2021A	2022A	2023A	2024F	2025F
Pretax profit	3,773.9	4,555.5	(190.8)	(64.9)	107.3
Cash flow from operations	3,088.2	3,716.4	(38.1)	134.0	220.8
Cash flow from investing	(345.7)	(810.0)	(262.7)	(107.3)	(136.2)
Cash flow from financing	(384.7)	(3,210.3)	(351.5)	(0.8)	(58.3)
Net cash flow	**2,357.8**	**(303.9)**	**(652.3)**	**25.8**	**26.3**
(+/-) Adjustments	5.8	13.3	(1.3)	0.0	0.0
Net cash/(debt) b/f	**305.2**	**2,668.8**	**2,378.1**	**1,724.5**	**1,750.4**
Net cash/(debt) c/f	**2,668.8**	**2,378.1**	**1,724.5**	**1,750.4**	**1,776.6**

Key Metrics	2021A	2022A	2023A	2024F	2025F
Inventories (Days)	63.6	60.8	53.5	80.2	72.2
Cash/Market Capitalisation (sen)	41.8	37.2	27.0	27.4	27.8
Cash/share (sen)	78.1	69.6	50.5	51.2	52.0
P/BV ratio (x)	1.28	1.25	1.37	1.29	1.25

Profitability Margins	2021A	2022A	2023A	2024F	2025F
Revenue Growth (%)	129.2	17.7	(69.5)	(25.0)	7.6
Gross Profit Growth (%)	452.6	17.0	(96.2)	55.7	31.9
Core PATANCI Growth (%)	496.1	9.8	(94.3)	(137.1)	(233.0)
Gross Profit Margin (%)	61.1	60.8	7.5	15.6	19.1
Core PATANCI Margin (%)	42.5	39.6	7.4	(3.7)	4.5

Source: Bloomberg, 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