

8 November 2023

Consumer Cyclical | Rubber Products

Hartalega (HART MK)

Neutral (Maintained)

Cost Pass-Through Still Challenging

Target Price (Return): MYR2.22 (-4.6%)
Price (Market Cap): MYR2.33 (USD1,703m)
ESG score: 2.9 (out of 4)
Avg Daily Turnover (MYR/USD) 12.3m/2.63m

- **Still NEUTRAL, with DCF-derived TP of MYR2.22 from MYR1.94.** Hartalega's 2QFY24 core earnings leaped 20x to MYR27.4m from MYR1.2m in 1QFY24, bringing its 1HFY24 earnings to account for 34% and 21% of ours and Street's expectations. Sequential earnings recovery were driven by higher volume sold and lower raw material costs – offset by softer ASP. We expect a favourable cost outlook, improvement in operating efficiencies (post the full completion of its decommissioning exercise), and sequential pick-up in sales volume to produce better profits in 2024.
- **2QFY24 results overview.** HART reported sequential improvement during 2QFY24 underpinned by 8% QoQ growth in volume sold (4.6bn pieces) offset by 7% QoQ decrease in ASP to c.USD21.20 per thousand pieces. It's worth noting that the softer ASPs were mainly attributed to the easing of raw materials and fuel prices.
- **Cost.** Natural gas tariff was lowered 10% QoQ in 2QFY24. Raw material prices were lowered 12% QoQ in view of the easing of global commodity prices as a result of subdued demand.
- **Outlook.** Moving forward, we expect the favourable cost outlook and decommissioning exercise to result in margins expansion. Management expects the full decommissioning exercise to be completed in 4QFY24 as it is currently still running two production lines at the Bestari Jaya facility. Although cost pass-through remains challenging in the near-term, its ASP is holding up at c.USD20 per thousand. Stock replenishment remains erratic in the near-term as customers remain price sensitive. We hold our view that demand for gloves will pick up gradually in the coming quarters, as client inventory levels continue to deplete, on top of the glove inventories (stockpiled since 2020) approaching expirations (typical shelf life for gloves is 3-5 years). Glove makers' profitability is expected to recover YoY in 2024, with our base case global glove demand assumption to pick up 4% YoY in 2024 (vs -7% in 2023). This should be underpinned by the resumption of customers order by 2H24 as the industry's excess capacity continues to be phased out, resulting in a demand-supply equilibrium.
- **Earnings adjustment.** We lowered our earnings estimate by 4% for both FY24 and FY25, after factoring challenges in cost pass-through exercise and gradual pick-up in sales volume.
- **Maintain NEUTRAL.** We lowered our required return assumptions to reflect improved risk sentiment towards the glove sector. We derived a higher TP of MYR2.22. Our DCF derived-TP implies CY24 ex-cash P/E of 38x, 0.9SD above its pre-COVID-19's 5-year historical mean of 27x. Key risks include higher/lower-than-expected sales volume, stronger/weaker-than-expected USD against MYR, and lower/higher-than-expected raw material price.

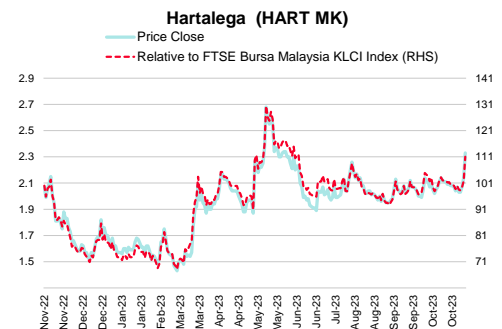
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Share Performance (%)

	YTD	1m	3m	6m	12m
Absolute	37.1	12.6	9.9	18.3	18.3
Relative	39.3	9.3	8.7	16.0	16.8
52-wk Price low/high (MYR)				1.43 – 2.68	



Source: Bloomberg

Overall ESG Score: 2.9 (out of 4)

E: GOOD

Hartalega has pledged to reduce its carbon emission intensity by 45% by 2030 through the installation various production related equipment and advanced technologies to optimise equipment efficiency and further reduce the Group energy consumption and carbon emissions. More than 90% of product packaging are made from recyclable materials.

S: GOOD

The Group has invested more than RM98 million in providing first-rate workers' accommodation, which complies with the ILO's 11 Indicators of Forced Labour and exceeds the requirements of the Workers' Minimum Standards of Housing and Amenities (Amendment) Act 2019 (Act 446) specified under the Malaysian law.

G: EXCELLENT

56% of its board members are independent, and 33% are women, exceeding the Malaysian Code on Corporate Governance's requirement of 30%. Additionally, Hartalega provides full disclosure on its directors' remuneration, including salaries and bonuses. The company holds investor briefings regularly, embodying good transparency and disclosure practices.

Forecasts and Valuation	Mar-22	Mar-23	Mar-24F	Mar-25F	Mar-26F
Total turnover (MYRm)	7,888	2,410	2,190	2,228	2,402
Recurring net profit (MYRm)	3,180	118	147	191	293
Recurring net profit growth (%)	7.8	(96.3)	25.4	29.5	53.2
Recurring P/E (x)	2.51	67.80	54.06	41.73	27.25
P/B (x)	1.6	1.7	1.7	1.6	1.5
P/CF (x)	2.15	na	58.02	25.75	19.49
Dividend Yield (%)	24.5	1.5	na	na	na
EV/EBITDA (x)	1.22	na	20.69	15.89	11.60
Return on average equity (%)	64.1	(4.8)	3.2	4.0	5.8
Net debt to equity (%)	net cash	net cash	net cash	net cash	net cash

Source: Company data, RHB

See important disclosures at the end of this report

Market Dateline / PP 19489/05/2019 (035080)

Financial Exhibits

Asia	Financial summary (MYR)	Mar-22	Mar-23	Mar-24F	Mar-25F	Mar-26F
Malaysia	Recurring EPS	0.93	0.03	0.04	0.06	0.09
Consumer Cyclical	DPS	0.57	0.03	-	-	-
Hartalega	BVPS	1.50	1.36	1.38	1.43	1.52
HART MK	Return on average equity (%)	64.1	(4.8)	3.2	4.0	5.8
Neutral						
	Valuation metrics	Mar-22	Mar-23	Mar-24F	Mar-25F	Mar-26F
Valuation basis	Recurring P/E (x)	2.51	67.80	54.06	41.73	27.25
We adopt DCF valuation methodology	P/B (x)	1.6	1.7	1.7	1.6	1.5
	FCF Yield (%)	36.0	(4.3)	(1.4)	0.7	2.0
Key drivers	Dividend Yield (%)	24.5	1.5	-	-	-
Sales volume growth, appreciation of USD against MYR, lower-than-expected raw material prices	EV/EBITDA (x)	1.22	na	20.69	15.89	11.60
	EV/EBIT (x)	1.26	na	37.93	25.47	16.29
Key risks	Income statement (MYRm)	Mar-22	Mar-23	Mar-24F	Mar-25F	Mar-26F
Increase/decrease in gloves ASP, slower/faster-than-expected capacity expansion, higher/lower-than-expected utilisation rate, and lower/higher-than-expected raw material price.	Total turnover	7,888	2,410	2,190	2,228	2,402
	Gross profit	4,795	319	401	490	647
	EBITDA	4,794	(55)	315	406	541
	Depreciation and amortisation	(152)	(152)	(143)	(153)	(156)
	Operating profit	4,642	(207)	172	253	385
	Net interest	(5)	(8)	(5)	(4)	(4)
	Pre-tax profit	4,637	(214)	167	249	381
	Taxation	(1,395)	(24)	(19)	(57)	(88)
	Reported net profit	3,234	(235)	147	191	293
	Recurring net profit	3,180	118	147	191	293
Company Profile	Cash flow (MYRm)	Mar-22	Mar-23	Mar-24F	Mar-25F	Mar-26F
Hartalega is the second world's largest glove producer by market cap	Change in working capital	182	119	(71)	(23)	(24)
	Cash flow from operations	3,716	(38)	137	310	409
	Capex	(847)	(307)	(250)	(250)	(250)
	Cash flow from investing activities	(810)	(266)	(233)	(234)	(230)
	Cash flow from financing activities	(3,210)	(352)	(15)	(14)	(14)
	Cash at beginning of period	2,669	2,378	1,724	1,614	1,676
	Net change in cash	(304)	(657)	(110)	61	165
	Ending balance cash	2,378	1,723	1,614	1,676	1,841
	Balance sheet (MYRm)	Mar-22	Mar-23	Mar-24F	Mar-25F	Mar-26F
	Total cash and equivalents	2,378	1,724	1,614	1,676	1,841
	Tangible fixed assets	2,372	1,943	1,856	1,760	1,663
	Total assets	6,347	5,305	5,479	5,618	5,892
	Short-term debt	104	87	87	87	87
	Total long-term debt	140	64	54	44	34
	Total liabilities	1,203	647	743	690	671
	Total equity	5,145	4,658	4,736	4,928	5,221
	Total liabilities & equity	6,347	5,305	5,479	5,618	5,892
	Key metrics	Mar-22	Mar-23	Mar-24F	Mar-25F	Mar-26F
	Revenue growth (%)	17.7	(69.5)	(9.1)	1.7	7.8
	Recurrent EPS growth (%)	7.8	(96.3)	25.4	29.5	53.2
	Gross margin (%)	60.8	13.2	18.3	22.0	26.9
	Operating EBITDA margin (%)	60.8	(2.3)	14.4	18.2	22.5
	Net profit margin (%)	41.0	(9.8)	6.7	8.6	12.2
	Dividend payout ratio (%)	60.4	(50.9)	0.0	0.0	0.0
	Capex/sales (%)	10.7	12.8	11.4	11.2	10.4
	Interest cover (x)	972	(27)	36	57	93

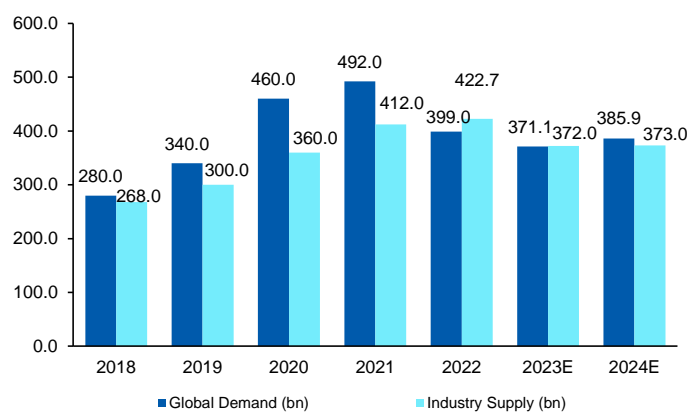
Source: Company data, RHB

Figure 1: 1HFY24 results snapshot

FYE 31 March (MYR m)	2QFY23	1QFY24	2QFY24	QoQ (%)	YoY (%)	1HFY23	1HFY24	YoY (%)	Comments
Revenue	584.6	440.0	452.1	2.7	(22.7)	1,430.2	892.1	(37.6)	Revenue improve QoQ due to improved volume sold +8% QoQ, offset by weaker ASP -7% QoQ
EBITDA	79.3	(10.0)	70.5	(806.9)	(11.2)	255.2	60.5	(76.3)	
EBITDA margin (%)	13.6	(2.3)	15.6			17.8	6.8		
Depreciation	40.3	32.6	32.7	0.4	(18.9)	80.9	65.3	(19.3)	
EBIT	39.0	(42.5)	37.8	(188.8)	(3.3)	174.3	(4.8)	(102.7)	
EBIT margin (%)	6.7	(9.7)	8.4			12.2	(0.5)		
Interest expense	(1.7)	(2.2)	(2.2)	1.0	28.7	(2.9)	(4.4)	53.4	
PBT	37.3	(44.7)	35.5	(179.5)	(4.7)	171.5	(9.2)	(105.4)	
Pretax margin (%)	6.4	(10.2)	7.9			12.0	(1.0)		
Tax	(7.9)	(6.4)	(6.7)	3.6	(15.3)	(51.1)	(13.1)	(74.4)	
Effective tax rate (%)	(21.1)	14.4	(18.8)			(29.8)	142.6		
Minority interest	(1.1)	(1.3)	(1.2)	(8.5)	8.4	(3.7)	(2.5)	(32.8)	
Net profit	28.3	(52.5)	27.7	(152.8)	(2.3)	116.6	(24.8)	(121.2)	
Net margin (%)	4.8	(11.9)	6.1			8.2	(2.8)		
Core NP	25.8	1.2	27.4	2,099.8	6.1	141.4	28.6	(79.8)	1HFY24 earnings were below ours and consensus expectations.
Core NP margin (%)	4.4	0.3	6.1			9.9	3.2		

Source: Company data, RHB

Figure 2: Global demand & supply overview



Source: MARGMA, RHB

Figure 3: Key assumptions

	FY2024F	FY2025F	FY2026F
Blended (ASP, USD per 1,000)	23.5	24.0	24.4
Total production (per m pieces)	20,703	21,129	22,679
Utilisation	56%	68%	73%

Source: RHB

Emissions And ESG

Trend analysis
Lower Scope 1 and 2 emissions in FY23 due to lower natural gas and electricity consumption.

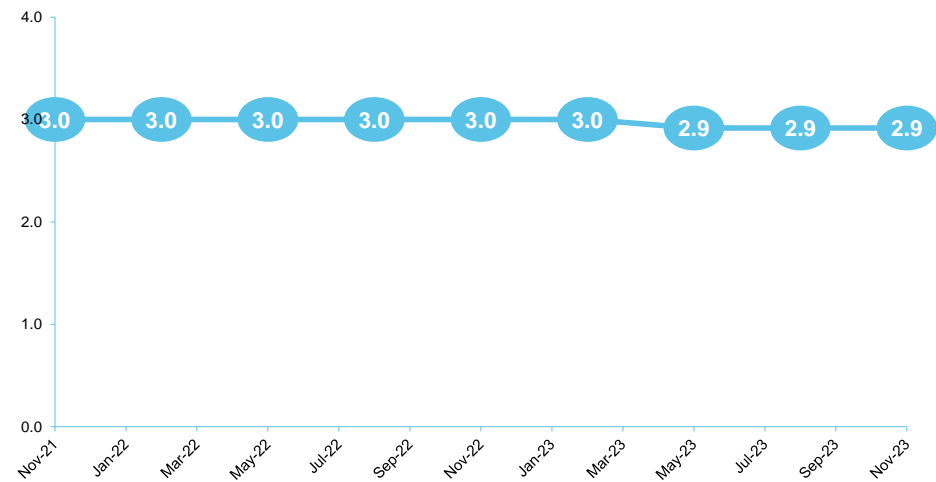
Emissions (tCO2e)	Mar-21	Mar-22	Mar-23
Scope 1	626,972	521,681	378,118
Scope 2	183,460	136,705	114,517
Scope 3	-	-	5,383
Total emissions	810,432	658,386	498,018

Source: Company data, RHB

Latest ESG-Related Developments

- Invested more than MYR90m in strengthening wastewater systems at its manufacturing plants

ESG Rating History



Source: RHB

Figure 4: DCF Valuation

FYE 31 March (MYR m)	FY24F	FY25F	FY26F	FY27F	FY28F	FY29F	FY30F	FY31F	FY32F	FY33F	FY34F	Terminal
NOPAT	131	192	293	397	499	614	652	659	679	737	762	
+ D&A	143	153	156	159	162	166	169	172	176	179	183	
- Change in NWC	(71)	(23)	(24)	(73)	(94)	(108)	(53)	(23)	(20)	(19)	(19)	
- CAPEX	(250)	(250)	(250)	(250)	(250)	(250)	(250)	(250)	(250)	(250)	(250)	
Free cash flow to firm (FCFF)	-47	72	174	233	317	421	518	558	584	647	675	10,729
Discount factor	0.89	0.82	0.76	0.70	0.65	0.60	0.55	0.51	0.47	0.43	0.40	0.40
PV of FCFF	(42)	60	133	163	205	251	285	283	273	279	269	4,270
Risk-free	4%											
WACC	8%											
Terminal growth	2%											
Enterprise value (MYR m)	6,420											
- Minority	(0)											
Cash	1,495											
- Debt	(142)											
Equity value (MYR m)	7,773											
No of shares (m)	3,422											
Intrinsic value (MYR)	2.26											
ESG discount/premium	(0.04)											
Target price (MYR)	2.22											

Source: RHB

Recommendation Chart



Source: RHB, Bloomberg

Date	Recommendation	Target Price	Price
2023-08-10	Neutral	1.9	2.1
2023-06-28	Neutral	2.0	1.9
2023-05-10	Neutral	2.4	2.3
2023-03-27	Neutral	2.1	1.9
2023-02-08	Neutral	1.6	1.5
2022-11-09	Sell	1.5	2.0
2022-09-27	Sell	1.4	1.6
2022-05-11	Neutral	5.0	4.4
2022-02-08	Neutral	5.1	5.6
2021-12-26	Neutral	5.1	5.5
2021-11-03	Neutral	5.9	5.7
2021-09-27	Neutral	5.6	5.5
2021-01-26	Buy	23.9	12.4
2020-10-27	Buy	23.5	18.3
2020-07-14	Buy	21.6	17.0

Source: RHB, Bloomberg

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