Hartalega

Hartalega Holdings Berhad (741883-X)

Notes to the Interim financial report for the Second Quarter ended 30 September 2014

A. NOTES PURSUANT TO THE MALAYSIAN FINANCIAL REPORTING STANDARD 134 (MFRS 134): INTERIM FINANCIAL REPORTING

A1. Basis of Preparation

The interim financial report is unaudited and has been prepared in accordance with requirement of Malaysian Financial Reporting Standard 134 (MFRS 134): Interim Financial Reporting issued by the Malaysian Accounting Standards Board ("MASB"), International Accounting Standard ("IAS") 34: Interim Financial Reporting issued by the International Accounting Standards Board ("IASB") and paragraph 9.22 (Appendix 9B part A) of the Main Market Listing Requirements ("Listing Requirements") of the Bursa Malaysia Securities Berhad ("Bursa Securities").

The significant accounting policies and methods of computation adopted in the preparation of this interim financial report are consistent with those adopted in the audited financial statements of the Group for the financial year ended 31 March 2014 except for the adoption of the following new Malaysian Financial Reporting Standards ("MFRS") and IC Interpretations ("IC Int."):

MFRSs/IC Interpretations

IC Interpretation 21	Levies
Amendments to MFRS 10, MFRS 12 and MFRS 127	Investment Entities
Amendments to MFRS 119	Employee Benefits (Amendments relating to Defined Benefit Plans: Employee Contributions)
Amendments to MFRS 132	Financial Instruments: Presentation (Amendments relating to Offsetting Financial Assets and Financial Liabilities)[2]
Amendments to MFRS 136	Impairment of Assets (Amendments relating to Recoverable Amounts Disclosures for Non-Financial Assets)
Amendments to MFRS 139	Financial Instruments: Recognition and Measurement (Amendments relating to Novation of Derivatives and Continuation of Hedge Accounting)

The Group has not applied in advance the following MFRSs, Amendments to MFRSs and IC Interpretations that have been issued by MASB but not yet effective for the current financial year:

MFRS 9	Financial Instruments (IFRS 9 issued by IASB in November 2009)[1]
MFRS 9	Financial Instruments (IFRS 9 issued by IASB in October 2010)[1]
MFRS 9	Financial Instruments (Hedge Accounting and amendments relating to MFRS 9, MFRS 7 and MFRS 139)[1]
Amendments to MFRS 9 and MFRS 7	Mandatory Effective Date of MFRS 9 (IFRS 9 issued by IASB in November 2009 and October 2010 respectively) and Transition Disclosures[1]
Amendments to MFRS 11	Accounting for Acquisitions of Interests in Joint Operations[3]
MFRS 14	Regulatory Deferral Accounts[3]
MFRS 15	Revenue from Contracts with Customers[4]

Amendments to MFRS 116 and MFRS 138	Clarification of Acceptable Methods of Depreciation and Amortisation[3]
Amendments to MFRS 119	Employee Benefits (Amendments relating to Defined Benefit Plans: Employee Contributions)[2]

Annual Improvements to MFRSs 2010 – 2012 cycle[2]
Annual Improvements to MFRSs 2011 – 2013 cycle[2]

1 The mandatory effective date of MFRS 9 (IFRS 9 issued by IASB in November 2009 and October 2010 respectively) which was for annual period beginning on or after 1 January 2015 has been removed with the issuance of MFRS 9 Financial Instruments: Hedge Accounting and amendments to MFRS 9, MFRS 7 and MFRS 139. The effective date of MFRS 9 will be decided when IASB's IFRS 9 project is closer to completion. However, each version of the MFRS 9 is available for early adoption

2 Effective for annual periods beginning on or after 1 July 2014

3 Effective for annual periods beginning on or after 1 January 2016

4 Effective for annual periods beginning on or after 1 January 2017

The Directors anticipate that the adoption of the abovementioned standards and interpretations, when they become effective, are not expected to have material impact on the financial statements of the Group in the period of initial application.

The interim financial report should be read in conjunction with the audited financial statements of the Group for the financial year ended 31 March 2014 and the accompanying explanatory notes attached to this interim financial report.

A2. Auditors' Report

The auditors' report for the immediate preceding annual financial statements of the Group for the financial year ended 31 March 2014 is not subject to any qualification.

A3. Seasonal and Cyclical Factors

The principal business operations of the Group were not affected by any seasonal and cyclical factors.

A4. Items of Unusual Nature and Amount

There were no items affecting the assets, liabilities, equity, net income or cash flow of the Group that are unusual because of their nature, size or incidence for the current quarter and financial year-to-date.

A5. Changes in Estimates

There were no changes in the estimates of amounts reported in the prior interim period of the current financial year or changes in the estimates of amounts reported in the prior financial years that have a material effect in the current quarter or financial year-to-date.

A6. Issues, Repurchases and Repayments of Debt and Equity Securities

(a) During the current quarter ended 30 September 2014, a total of 1,577,500 new ordinary shares of RM0.50 each were allotted and issued pursuant to the Company's Executive Share Option Scheme.
(b) For the financial year-to-date ended 30 September 2014, a total of 1,851,800 new ordinary shares of RM0.50 each were allotted and issued pursuant to the Company's Executive Share Option Scheme.
(c) During the current quarter ended 30 September 2014, a total of 20,772,497 new ordinary shares of RM0.50 each were allotted and issued pursuant to the Company's Warrants.
(d) For the financial year-to-date ended 30 September 2014, a total of 30,860,467 new ordinary shares of RM0.50 each were allotted and issued pursuant to the Company's Warrants.

Other than the above, there were no issuance and repayments of debt and equity securities, share buy-backs, share cancellations and shares held as treasury shares for the current quarter and financial year-to-date.

A7. Dividend Paid

Dividends paid by the Company during the financial year were as follows:
(a) Third interim single tier exempt dividend of 3.5 sen per share amounting to RM26,155,733 in respect of the financial year ended 31 March 2014, declared on 6 May 2014 and paid on 18 June 2014.
(b) Final single tier exempt dividend of 4 sen per share amounting to RM31,172,932 in respect of the financial year ended 31 March 2014, proposed on 8 July 2014 and approved on 26 August 2014 and paid on 24 September 2014.

A8. Segment Information

The Group's business mainly comprises the manufacturing and sale of latex gloves and its manufacturing activities are operated solely in Malaysia. On this basis, the Group Managing Director reviews the operating results of the Group as a whole. Accordingly, no reportable operating segment is presented.

A9. Valuation of property, plant and equipment

The valuations of property plant and equipment have been brought forward without amendment from the previous annual financial statements.

A10. Capital Commitments

Capital commitment in respect of Property, Plant and Equipment as at end of the current quarter and financial year-to-date are as follows:-

	30 September 2014
	RM'000
Approved and contracted for	320,412
Approved but not contracted for	1,611,247
Total	1,931,659

A11. Material Events Subsequent to the End of Period Reported

There were no material events subsequent to 30 September 2014 up to latest practicable date 12 November 2014 that have not been reflected in the financial statements for the current quarter and financial year-to-date.

A12. Changes in the Composition of the Group

There were no changes in the composition of the Group in the current quarter and financial year-to-date.

A13. Contingent liabilities and Contingent Assets

There were no contingent liabilities or contingent assets that had arisen since the last annual statement of financial position date except as disclosed in the material litigation under Section B11.

B. ADDITIONAL INFORMATION REQUIRED BY BURSA MALAYSIA'S LISTING REQUIREMENTS

B1. Review of Performance of the Company and its Subsidiaries

	2nd Quarter Ended 30 Sep 2014	2nd Quarter Ended 30 Sep 2013	Variance		Year-To-Date 30 Sep 2014	Year-To-Date 30 Sep 2013	Variance	
	RM'000	RM'000	RM'000	%	RM’000	RM’000	RM’000	%
Revenue	275,238	280,953	(5,715)	(2.0)	554,436	558,967	(4,531)	(0.8)
Profit before tax	64,902	82,300	(17,398)	(21.1)	140,553	164,217	(23,664)	(14.4)

The Group's performance for the quarter under review and year-to-date versus the corresponding quarter and year-to-date of the previous financial year is as follows:

(a) For the 2nd quarter year-on-year basis, the Group’s revenue decreased by 2.0% and profit before tax decreased by 21.1%. Although there is an increase of 6% in sales volume, the revenue had declined due to lower average selling price from declining raw material prices and more competitive selling price.

(b) The operating profit margin reduced from 31.0% to 23.7% due to reduction in average selling price, more competitive pricing, pre-operating expenses from NGC project, increase in electricity and natural gas cost.

The Group’s performance for the year-to-date versus the corresponding year-to-date of the previous financial year is as follows:

(a) The Group’s sales revenue decreased by 0.8%. The decrease in revenue is due to lower average selling price from declining raw material prices and more competitive selling price.

(b) The operating profit margin reduced from 31.0% to 24.8% for the current year-to-date compared with the corresponding year-to-date of the preceding year. This is due to easing in raw material prices of nitrile and natural latex but also offset by more competitive sales pricing, increase in energy and increase in maintenance cost.

B2. Material Changes in the Quarterly Results Compared to the Results of the Preceding Quarter

	Current Quarter ended 30 Sep 2014	Preceding Quarter ended 30 Jun 2014	Variance	
	RM'000	RM'000	RM'000	%
Revenue	275,238	279,198	(3,960)	(1.4)
Profit before tax	64,902	75,651	(10,749)	(14.2)

In the current quarter, the Group's revenue was 1.4% lower and the profit before tax was 14.2% lower when compared to the preceding quarter.

The operating profit margin decreased from 25.9% to 23.7% for the current quarter compared with the preceding quarter basically due to increase in price of nitrile material, increase in natural gas cost and increase in pre-operating expenses for NGC project.

B3. Commentary on Prospects and Targets

The global demand for nitrile rubber gloves continued to grow at a high rate of over 19% due mainly to switching momentum from latex to nitrile rubber gloves. This has spurred an increase of nitrile capacity by the industry which we are confident would be more than matched by strong nitrile glove demand. Furthermore, we do not expect price war as claimed by certain quarters as global demand growth continues to be strong. However, average selling price will be lower from declining raw material price and more competitive product selling price. The lower selling price and sustaining demand will support efforts to open new markets.

We have embarked on a new stage of progress with our Next Generation Integrated Glove Manufacturing Complex (NGC). Hartalega NGC Sdn Bhd, a wholly-owned subsidiary of the Company, has completed the acquisition of land for the NGC project. The major portion of this land will be used to build six high capacity manufacturing plants that will house 72 production lines. Hartalega targets to add another 28.5 billion pieces aggregating to total installed capacity of over 42 billion pieces per year upon completion of the NGC project. The total budgeted project cost including land cost about RM2.26 billion. The project expected to take 8 years to complete. The Group will finance the NGC project via a combination of internal funds, conversion of portion of its warrants and bank borrowings. We have started the construction of plant 1 and 2 and supporting facilities in the 4th quarter of calendar year 2013 and we target to commission some of the production lines in the 4th quarter of calendar year 2014 and other production lines will come on stream progressively.

In view of current and anticipated conducive market conditions, we are making strenuous efforts to put in place the foundation for long term sustainable growth. On this note, we have already made concerted effort in improving our human resource in areas of training and development and man power numbers and have adjusted our salary structure in line with the minimum wage ruling effective January 2013.

We view that the concerted long term planning and efforts should bear fruit due to productivity gains and benefits of economies of scale derived from building capacity and leveraging on in-house technological competencies to mitigate the potential margin compression arising from greater competition. Although we are concerned that lower average selling price continues to impact Hartalega's top and bottom line, the timing of the incoming NGC capacity should sustain the group's earnings. On the back of strong demand for nitrile gloves, we are confident that Hartalega's profit margins will remain above the industry average.

The Board of Directors is optimistic that the Group will achieve the internal target growth for the financial year ending 31 March 2015.

B4. Variance of Profit Forecast/Profit Guarantee

Not applicable as no profit forecast/profit guarantee was issued.

B5. Profit For The Period

Profit for the period is arrived at after charging/(crediting):

	2nd Quarter Ended 30 Sep 2014	2nd Quarter Ended 30 Sep 2013	Year-To-Date 30 Sep 2014	Year-To-Date 30 Sep 2013
	RM'000	RM'000	RM'000	RM'000
Interest income	(356)	(222)	(618)	(512)
Other income including investment income	(1,690)	(1,523)	(4,100)	(3,416)
Interest expense	27	93	58	220
Depreciation and amortisation	11,016	11,303	21,833	21,805
Provision and write off of bad debts	88	-	88	-
Foreign exchange (gain)/loss-realised	(1,604)	5,077	(3,306)	2,922
Foreign exchange (gain)/loss-unrealised	(3,082)	501	(2,203)	18
Fair value loss on derivatives	6,922	899	7,128	9,752

B6. Taxation

	Current quarter	Current year-to-date
	RM'000	RM'000
Current tax expense	15,152	31,865
Deferred tax expense	1,436	3,133
	16,588	34,998

B7. Status of Corporate Proposal

As at the latest practicable date, 12 November 2014, the outstanding corporate proposals announced but not completed are as follows:

(a) On 8 July 2014, it was announced that the Company proposed purchase of its own ordinary shares of up to ten per centum (10%) of its issued and paid-up share capital ("Proposed Share Buy-Back"). The proposed share buy-back are subject to the approval of the shareholders of the Company at the forthcoming Annual General Meeting schedule on 26 August 2014.

The above proposals have been approved by shareholders at the AGM held on 26 August 2014.

(b) On 9 July 2014, it was announced that the Company proposed establishment of a new employees' share option scheme ("New ESOS") for the eligible person(s) of the company and its subsidiaries (excluding dormant subsidiaries). Bursa Malaysia Securities Berhad has approved the listing with conditions on 23 July 2014. The proposed new ESOS are subject to the approval of the shareholders of the Company at the forthcoming Extraordinary General Meeting schedule on 26 August 2014.

The above proposals have been approved by shareholders at the EGM held on 26 August 2014.

B8. Group Borrowings and Debt Securities

Total Group borrowings as at 30 September 2014 are as follows:

	Secured RM'000	Unsecured RM'000	Total RM'000
Short term borrowings			
Term Loans (USD denominated)	2,762	-	2,762
Term Loans(RM denominated)	136	-	136
Finance Lease (USD denominated)	24	-	24
	2,922	-	2,922
Long term borrowings			
Term Loans (USD denominated)	-	-	-
Term Loans (RM denominated)	344	-	344
Finance Lease (USD denominated)	68	-	68
	412	-	412

B9. Financial Derivative Instruments

As at 30 September 2014, the outstanding foreign currency forward contracts are as follows:

Type of Derivatives	Contract/Notional Value (RM'000)	Fair Value (RM'000)
Foreign Exchange Contracts		
Less than 1 year		
-USD denominated	343,649	338,293
-AUD denominated	7,296	7,469

The Group enters into foreign currency forward contracts to hedge its estimated net exposure to movements in exchange rates arising mainly from sales and purchases.

As foreign currencies contracts are hedged with creditworthy financial institutions in line with the Group's policy, the Group does not foresee any significant credit risks.

There are also no cash requirement risks as the Group only uses forward foreign currencies contracts as its hedging instruments.

The fair value derivative liabilities amounting to RM5,183,000 has been recognised in the financial statements.

B10. Realised and Unrealised Profits/Losses Disclosure

	As at 30/09/2014 RM'000	As at 31/03/2014 RM'000
Total retained profits of Hartalega Holdings Berhad and its subsidiaries:		
- Realised	720,234	664,562
- Unrealised	(65,783)	(57,029)
	654,451	607,533
Less: Consolidation adjustments	(97,140)	(98,141)
Total group retained profits as per consolidated accounts	557,311	509,392

B11. Material Litigation

As at the latest practicable date, 12 November 2014, there are no material litigations against the Group or taken by the Group saved as disclosed below:

Mr. Seow Hoon Hin (the "Plaintiff"), a shareholder of the Company and a former shareholder of Hartalega Sdn. Bhd. ("HSB") vs Hartalega Holdings Berhad ("the Company" or "1st Defendant"), HSB ("2nd Defendant") and three (3) individuals (3rd, 4th and 5th defendant") (collectively "the Defendants") (Kuala Lumpur High Court Writ and Statement of Claim).

The Plaintiff has instituted legal proceedings against the Defendants by filing a Writ of Summons and a Statement of Claim in the High Court of Malaya at Kuala Lumpur (the "Action"). The Writ of Summons and Statement of Claim were served on the Company on 24 March 2011.

The Plaintiff claims against the Defendants for the following:

(i) he had delivered to the 3rd Defendant, acting on behalf of the 2nd Defendant substantial part of another two (2) assembly lines for the manufacture of gloves for storage at the 2nd Defendant's factory to which he purportedly intended to be reimbursed for. The Plantiff contends that the 3rd Defendant (whom the Plaintiff contends is the controlling mind and person behind the 2nd Defendant) has represented to him that the said parts would be kept in the possession of the 2nd Defendant as a trustee for the Plaintiff;

(ii) the Plaintiff contends that the 2nd Defendant had in flagrant breach of trust utilised the said parts to assemble another 2 assembly lines for the manufacture of latex gloves and that the 2nd Defendant had in breach of trust converted the same for its use and acquired proceeds and/or profits from the assembly of the said parts and as a consequence thereof has purportedly been unjustly enriched;

(iii) the Plaintiff further claims that there was a conspiracy to injure the Plaintiff by the 3rd, 4th and 5th Defendant culminating in the share allotment on 4 April 2005. The Plaintiff states that 3rd, 4th and 5th Defendant had agreed to use the said allotment of shares for the predominant purpose of injuring the Plaintiff and that the said allotment was done pursuant to a purported agreement between the 3rd, 4th and 5th Defendants to injure the Plaintiff resulting in damage and loss to him;

(iv) that the 2nd Defendant is a trustee for the unpaid dividends amounting to RM488,765.25 due and owing to the Plaintiff; and

(v) that the Company is guilty of negligent misstatement or alternatively in breach of statutory duty pursuant to Section 357 of the Capital Markets and Services Act, 2007 ("CMSA") read together with, inter alia, Section 214 of the CMSA and/or tort of breach of statutory duty pursuant to Section 177 and/or Section 179 of the CMSA.

The Plaintiff claims against the Company for the following:

(i) damages for negligent misstatement or alternatively of breach of statutory duty pursuant to Section 357 of the CMSA read together with, inter alia, Section 214 of the CMSA and/or tort of breach of statutory duty pursuant to Section 177 and/or Section 179 of the CMSA;

(ii) interest on the said damages at the rate of 8% per annum or any other rate deemed appropriate from 7 April 2008 or such other date deemed appropriate until full satisfaction thereof;

(iii) such further or other relief the Court deems fit; and

(iv) costs.

The High Court had, on 26 August 2011, dismissed the Plaintiff's application to disqualify Messrs. Cheah Teh & Su from acting for the defendants. Subsequently, the Plaintiff appealed against the High Court's decision but was dismissed by the Court of Appeal. The Plaintiff filed an amendment and a discovery application against defendants which the High Court had allowed with no objections from all the defendants on 16 May 2012. The Plaintiff then filed their Amended Statement of Claim on 25 May 2012 and the Group had correspondingly filed the 1st, 2nd and 3rd Defendants' Re-Amended Defence on 29 June 2012. The 1st to 3rd Defendants then had on 2 August 2012 and 29 August 2012 filed two applications to strike out the Plaintiff's claim on the dividends and the conspiracy to injure.

With regards to the Plaintiff's discovery application and the 1st to 3rd Defendants' striking out applications, all the applications were dismissed by the High Court and parties' appeals were subsequently dismissed by the Court of Appeal on 3 September 2013. The matter has since gone for trial on 5, 6, 7 December 2012, 29 and 30 January 2013, 1 and 2 April 2013 where the trial has been concluded. The Judge heard parties' oral submissions on 19 March 2014, 2 May 2014, 5 May 2014, 9, 10, 11 and 13 June 2014. Although initially fixed for decision on 5 August 2014, the matter was subsequently postponed and now fixed for decision on 12 December 2014 at 3.30 pm.

The Plaintiff had also issued a *subpoena duces tecum* to Mr. Wong Maw Chuan, the 2nd Defendant's Company Secretary. The said subpoena has since been set aside and the Plaintiff filed an appeal towards the setting aside of the subpoena. The hearing of the appeal was heard together will all the above mentioned appeals on 3 September 2013 where all the appeals were dismissed by the Court of Appeal.

The directors of the Company, in consultation with the solicitors, are of the opinion that the Group has a valid defence against the Plaintiff's claim. Accordingly, the Group has not made any provision on the financial statements.

B12. Dividend

On 18 November 2014, the board has declared a first interim dividend of 3.0 sen per share single tier in respect of the financial year ending 31 March 2015 and payable on 24 December 2014. The entitlement date has been fixed on 5 December 2014.

A depositor shall qualify for the entitlement only in respect of:

(a) Shares transferred to the Depositor's Securities Account before 4.00 p.m. on 5 December 2014 in respect of ordinary transfers.

(b) Shares bought on Bursa Malaysia Securities Berhad ("BMSB") on a cum entitlement basis according to the rules of BMSB.

B13. Earnings per Share

Basic Earnings Per Share	Current Quarter Ended 30/09/2014	Corresponding Quarter Ended 30/09/2013	Current Year-To-Date 30/09/2014	Corresponding Year-To-Date 30/09/2013
Profit attributable to owners of the parent (RM'000)	48,160	63,273	105,247	126,185
Number of shares in issue as at beginning of the year ('000)	747,032	733,308	747,032	733,308
Effect of exercise of ESOS ('000)	1,284	1,577	1,284	1,577
Effect of exercise of Warrants ('000)	21,221	5,383	21,221	5,383
Weighted average number of ordinary shares in issue ('000)	769,537	740,268	769,537	740,268
Basic earnings per share (sen)	6.26	8.55	13.68	17.05

Diluted Earnings Per Share	Current Quarter Ended 30/09/2014	Corresponding Quarter Ended 30/09/2013	Current Year-To-Date 30/09/2014	Corresponding Year-To-Date 30/09/2013
Profit attributable to owners of the parent (RM'000)	48,160	63,273	105,247	126,185
Weighted average number of ordinary shares in issue ('000)	769,537	740,268	769,537	740,268
Effect of dilution : share options ('000)	3,406	5,077	3,406	5,077
Effect of dilution : warrants ('000)	13,396	16,610	13,396	16,610
Adjusted weighted average number of ordinary shares in issue and issuable('000)	786,339	761,955	786,339	761,955
Diluted earnings per share (sen)	6.12	8.30	13.38	16.56