

Kossan Rubber Industries

Solid 1H19, A Few Wrinkles in 2Q19

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1H19 PATAMI of RM114.6m (+30% YoY) came in within expectations at 46%/48% of our/consensus full-year forecasts. Subsequent quarter earnings growth to be driven by Plant 16, 17 and 18. Volume sales from new capacity coupled with better efficiency from new plants are expected to offset any ASPs pressure. Stock under-appreciated, unwarranted PER discount valuation to peers. Our TP of RM5.25 is based on 25.5x FY20E EPS. Maintain Outperform.

1H19 PATAMI of RM114.6m (+30% YoY) came in within expectations at 46%/48% of our/consensus full-year forecasts. No dividend was declared in this quarter as expected.

Key result highlights. QoQ, 2Q19 revenue fell 2% due to lower contribution from rubber gloves (-4%) on lower volume sales (-5%) but negated by higher ASP (+3-5%). The lower volume sales were largely due to a revamp and upgrading works across the Group's plants for efficiency improvements and energy savings. The Technical Rubber Product (TRP) division revenue decreased 9%, while PBT rose 9% due to was mainly attributable to sales of higher margin products. Overall, PBT margin lowered marginally by 0.7ppt to 12.7% compared to 13.4% in 1Q19 due to revamp and upgrading works. This brings 2Q19 net profit to RM56m (-5% QoQ).

YoY, 1H19 revenue rose 13% due to higher contribution from the Gloves division (+15%), underpinned by higher volume sales (+15%) which more than offset lower ASP (-4-6%). The TRP division's revenue rose 2% while PBT soared 8% attributable to sales of higher margin products. Overall 1H19 PBT margin improved to 13% compared to 11% in 1H18 due to manufacturing efficiency and effective cost savings initiatives, including save heating and electricity cost. This brings 1H19 PATAMI to RM114.6m (+30%) despite a higher effective tax rate of 20% compared to 17% in 1H18.

Plant 16,17,18 and 19 to boost earnings over next two years.

Following the revamp works in 2Q19, we expect subsequent quarters results to pick up underpin by Plant 16 and Plant 17 and contribution from Plant 18. Construction works for Plant 18 (2.5bn pieces) and Plant 19 (3.0bn pieces) are currently on track, with expected full commissioning by Oct 2019 (Plant 18 - two lines expected to be commission in Sept and Oct 2019) and end 4Q 2019, respectively. Upon completion, these two new plants will add an additional 5.5b pieces of gloves per annum, bringing the group's total installed capacity to 35bn (+19%) pieces of gloves per annum by end-FY19. The Group expects construction, which will start somewhere in 2019, to take eight years to complete, costing RM1.5b (works out to RM190m capex per annum) for an integrated glove manufacturing project in Bidor, subject to all relevant approvals being obtained. The expected capacity at the Bidor plant is estimated at 34bn pieces per annum, which will more than double from 35b pieces currently (once Plant 18 and Plant 19 are fully commissioned).

Stock under-appreciated, unwarranted PER discount valuation to peers, Maintain Outperform. We maintain our FY19E/FY20E earnings forecasts. Our TP of RM5.25 is based on 25.5x FY20E EPS (+1.0SD above 5-year historical forward mean). We like Kossan because it is trading at an unwarranted 25% discount to peers' PER average considering that its net profit growth is the highest at 23.7% compared to peers average at 7%. Reiterate Outperform.

Key risk to our call is slower-than-expected commissioning of the new plants.

OUTPERFORM ↔

Price : RM4.18
Target Price : RM5.25 ↔

Share Price Performance



KLCI	1,602.47
YTD KLCI chg	-5.2%
YTD stock price chg	-3.7%

Stock Information

Shariah Compliant	Yes
Bloomberg Ticker	KRI MK Equity
Market Cap (RM m)	5,346.0
Shares Outstanding	1,278.9
52-week range (H)	4.60
52-week range (L)	3.44
3-mth avg daily vol:	1,357,213
Free Float	40%
Beta	0.6

Major Shareholders

Kossan Holdings Sdn Bhd	51.1%
Employees Provident Fund	7.0%
KWAP	2.2%

Summary Earnings Table

FY Dec (RM'm)	2018A	2019E	2020E
Turnover	2144.2	2324.1	2425.5
PBT	249.3	316.6	335.5
Net Profit (NP)	200.8	248.4	263.3
Consensus (NP)	-	237.7	269.4
Earnings Revision	-	-	-
Core EPS (sen)	15.7	19.4	20.6
Core EPS growth (%)	10.3	23.7	6.0
NDPS (sen)	6.0	6.0	6.0
BVPS (RM)	1.03	1.16	1.31
Core PER (x)	26.6	21.5	20.3
Price/Bv (x)	4.1	3.6	3.2
Net Gearing (%)	27.6	19.2	10.4
Net Div. Yield (%)	1.4	1.4	1.4



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Result Highlight								
	2Q	1Q	Q-o-Q	2Q	Y-o-Y	6M	6M	Y-o-Y
FY Dec (RM'm)	FY19	FY19	Chg	FY18	Chg	FY18	FY19	Chg %
Turnover	550.5	561.5	(1.9)	496.8	10.8	981.0	1,112.0	13.4
EBITDA	96.9	102.6	(5.5)	76.3	27.0	150.6	199.6	32.5
PBT	70.0	75.1	(6.8)	54.9	27.5	107.9	145.1	34.4
PATAMI (NP)	55.9	58.7	(4.8)	43.4	28.6	88.0	114.6	30.3
Core EPS (sen)	4.4	4.6	(4.8)	3.4	28.7	6.9	9.0	30.2
EBITDA margin (%)	17.6	18.3		15.4		15.3	17.9	
PBT margin (%)	12.7	13.4		11.1		11.0	13.0	
NP margin (%)	10.2	10.5		8.7		9.0	10.3	
Effective tax rate (%)	19.0	20.8		18.6		16.6	19.9	

Source: Kenanga Research, Bursa Malaysia

Quarterly segmental breakdown								
	2Q18	1Q19	2Q19	Chg %	Chg %	6M	6M	Chg %
				q-o-q	y-o-y	FY18	FY19	y-o-y
Revenue (RM'm)								
Gloves division	432.4	497.0	478.0	(3.8)	10.6	851.7	975.0	14.5
Technical rubber products (TRP) division	44.5	46.7	42.7	(8.5)	(4.1)	88.1	89.4	1.5
Cleanroom products division	19.3	17.1	29.1	70.1	50.8	39.7	46.2	16.5
Investment Holding	0.6	0.7	0.7	1.4	19.2	1.5	1.4	(7.6)
Total	496.8	561.5	550.5	(1.9)	10.8	981.0	1,112.0	13.4
Pre-tax profit (RM'm)								
Gloves division	46.3	68.0	61.9	(8.9)	33.6	93.8	129.9	38.4
Technical rubber products (TRP) division	8.1	6.8	7.5	9.4	(8.1)	13.2	14.3	8.4
Cleanroom products division	1.1	0.6	0.6	9.6	(44.0)	1.5	1.2	(21.8)
Investment Holding	(0.7)	(0.3)	(0.0)	(97.0)	(98.8)	(0.6)	(0.3)	(50.5)
Total	54.9	75.1	70.0	(6.8)	27.5	107.9	145.1	34.4
Pre-tax profit margin (%)								
Gloves division	11	14	13			11	13	
Technical rubber products division	18	15	17			15	16	
Cleanroom products division	6	3	2			4	3	

Source: Kenanga Research, Bursa Malaysia

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Peer Comparison

Name	Last Price (RM)	Market Cap (RM'm)	Shariah Compliant	Current FYE	Revenue Growth		Core Earnings Growth		PER (x) - Core Earnings			PBV (x)		ROE (%)	Net Div Yld (%)	Target Price (RM)	Rating
					1-Yr. Fwd.	2-Yr. Fwd.	1-Yr. Fwd.	2-Yr. Fwd.	Hist.	1-Yr. Fwd.	2-Yr. Fwd.	Hist.	1-Yr. Fwd.	1-Yr. Fwd.			
RUBBER GLOVES																	
HARTALEGA HOLDINGS BHD	5.04	16925.5	Y	03/2020	3.7	6.2	11.6	6.7	36.5	32.7	30.6	7.4	6.6	20.3	1.4	5.85	OP
KOSSAN RUBBER INDUSTRIES	4.18	5346.0	Y	12/2019	8.4	4.4	23.7	6.0	26.6	21.5	20.3	4.1	3.6	16.7	1.4	5.25	OP
SUPERMAX CORP BHD	1.47	1920.3	Y	06/2019	11.9	4.9	19.1	4.0	18.7	15.7	15.1	1.9	1.8	11.4	2.7	1.70	MP
TOP GLOVE CORP BHD	4.58	11723.9	Y	08/2019	4.5	4.6	-9.0	14.4	26.9	29.6	25.8	4.9	4.5	15.3	1.9	4.50	MP

Source: Bloomberg, Kenanga Research

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Stock Ratings are defined as follows:**Stock Recommendations**

OUTPERFORM	: A particular stock's Expected Total Return is MORE than 10%
MARKET PERFORM	: A particular stock's Expected Total Return is WITHIN the range of -5% to 10%
UNDERPERFORM	: A particular stock's Expected Total Return is LESS than -5%

Sector Recommendations***

OVERWEIGHT	: A particular sector's Expected Total Return is MORE than 10%
NEUTRAL	: A particular sector's Expected Total Return is WITHIN the range of -5% to 10%
UNDERWEIGHT	: A particular sector's Expected Total Return is LESS than -5%

*****Sector recommendations are defined based on market capitalisation weighted average expected total return for stocks under our coverage.**

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