

25 May 2018 | 1QFY18 Results Review

Kossan Rubber Industries

Earnings hit by higher natural gas tariff

INVESTMENT HIGHLIGHTS

- **1QFY18 earnings below expectations at RM44.5m**
- **Higher revenue contribution across business segments**
- **New capacity expansion timeline**
- **FY18-19F earnings forecasts revised down by -12.1% and -20% respectively**
- **Maintain NEUTRAL with a revised TP of RM7.55 per share**

Within expectations. Kossan's 1QFY18 earnings came in at RM44.5m which is below our and consensus' full-year earnings expectation at 19.0% and 20% of full year forecasts respectively. Against last year, revenue and earnings were down marginally by -3.2% and -4.3% respectively. However, on a quarterly sequential basis, it recorded a marginal increase in revenue by +1.3% and -3.0% in earnings respectively. No dividend was declared for the quarter under review.

Higher revenue contribution across business segments. In 1QFY18, the lower revenue year-over-year was mainly attributable to the lag effect in transferring the +23% increase in natural gas tariff earlier this year. Due to this, its gloves division recorded a marginal decline in revenue by -3.2%yoy. Meanwhile, its technical rubber products (TRP) as well as Cleanroom division recorded a -9.4% and +28.7% in revenue respectively vs 1QFY17. That said, efficient manufacturing processes, increased automation as well as higher sales deliveries were among the factors contributing to the higher revenue quarter-over-quarter. Volume sold also increased by +2.7%yoy and +3.4%qoq due to the continued strong demand for gloves.

New capacity expansion timeline. Management disclosed that Kossan's Plant 16 that will contribute +3.0b new capacity has been fully-commissioned last December 2017. However, due to an issue involving the plant's glove formers; production has been halted and no contribution came from this plant in 1QFY18. Plant 16 will only begin to fully contribute to Kossan's revenue in 2HFY18. Meanwhile, the other two plants to be built along Jalan Meru (Plant 17 and 18) are now currently under construction. Plant 17 and 18 are expected to be completed in 3QFY18 and 1QFY19 respectively and will start contributing to Kossan's revenue thereafter. These two new plants will add +4.5b of new production capacity going forward.

Maintain NEUTRAL

Revised Target Price (TP): RM7.55
(Previously RM8.78)

RETURN STATS

Price (24 May 2018)	RM7.07
Target Price	RM7.55
Expected Share Price Return	+6.8%
Expected Dividend Yield	+1.5%
Expected Total Return	+8.3%

STOCK INFO

KLCI	1,775.66
Bursa / Bloomberg	7153 / KRI MK
Board / Sector	Main / Trading Services
Syariah Compliant	YES
Issued shares (mil)	639.47
Market cap. (RM'm)	4,521.04
Price over NA	3.91
52-wk price Range	RM6.05 – RM8.79
Beta (against KLCI)	0.7
3-mth Avg Daily Vol	0.49m
3-mth Avg Daily Value	RM3.79m
Major Shareholders (%)	
Kossan Holdings Sdn Bhd	51.06
EPF	8.43
Citibank New York	1.95

Earnings forecast. Post earnings announcement, we are revising our FY18-19F earnings forecasts down by -12.1% and -20% as we adjust our capacity expansion assumption due to the delay of Plant 16 and recognising that Plant 17's contribution to come in only later in the year. Key risks to our earnings would most likely be: (i) sudden jump in raw materials prices i.e latex and nitrile and; (ii) delay in expansion plans.


Maintain NEUTRAL with a revised Target Price (TP) of RM7.55. Post earnings announcement and adjustment, we are maintaining our **NEUTRAL** recommendation on Kossan with a revised TP of **RM7.55** per share after we roll forward our valuation base period to FY19. Our TP is derived via pegging our FY19F EPS of 34.4sen to a revised PER19 of 22x, representing the average PER across five years. We believe that despite the high demand for gloves, earnings growth for this year will continue to be constrained as currently Kossan is already operating at full capacity with its latest Plant 16's capacity being held back due to the issue with its gloves formers and new capacity of +4.5b will only be contributing next year. 

Table 1: Kossan's quarterly earnings review

FYE Dec (RM'm)	Quarterly results				
	1QFY17	4QFY17	1QFY18	QoQ (%)	YoY (%)
Revenue	500.0	477.8	484.2	1.3	(3.2)
Operating expenses	(442.3)	(416.3)	(428.1)	2.8	(3.2)
Other operating income	1.1	0.8	0.9	16.8	(18.1)
Finance costs	(2.4)	(3.3)	(3.9)	20.5	64.2
Profit Before Tax	56.3	59.0	53.0	(10.1)	(5.9)
Taxation	(9.1)	(12.5)	(7.7)	(38.2)	(14.7)
Profit After Tax	47.3	46.5	45.3	(2.5)	(4.2)
Non-controlling interest	0.7	0.6	0.8	39.1	8.1
PATANCI	46.5	45.9	44.5	(3.0)	(4.3)
Basic EPS (sen)	7.3	7.2	7.0	(3.0)	(4.3)
PBT margin (%)	11.3	12.3	11.0	(11.3)	(0.3)
PAT margin (%)	9.5	9.7	9.4	(3.8)	(0.1)
PATANCI margin (%)	9.3	9.6	9.2	(4.3)	(0.1)
Tax rate (%)	16.1	21.2	14.6	(31.3)	(1.5)
Segments					
Revenue					
Technical Rubber Division	48.1	42.2	43.6	3.3	(9.4)
Gloves Division	433.4	414.3	419.3	1.2	(3.2)
Clean Room Division	18.2	20.2	20.4	0.7	11.8
PBT					
Technical Rubber	5.4	4.4	5.0	14.0	(6.3)
Gloves	50.1	53.5	47.5	(11.4)	(5.2)
Clean Room	0.9	0.6	0.4	(35.4)	(51.2)

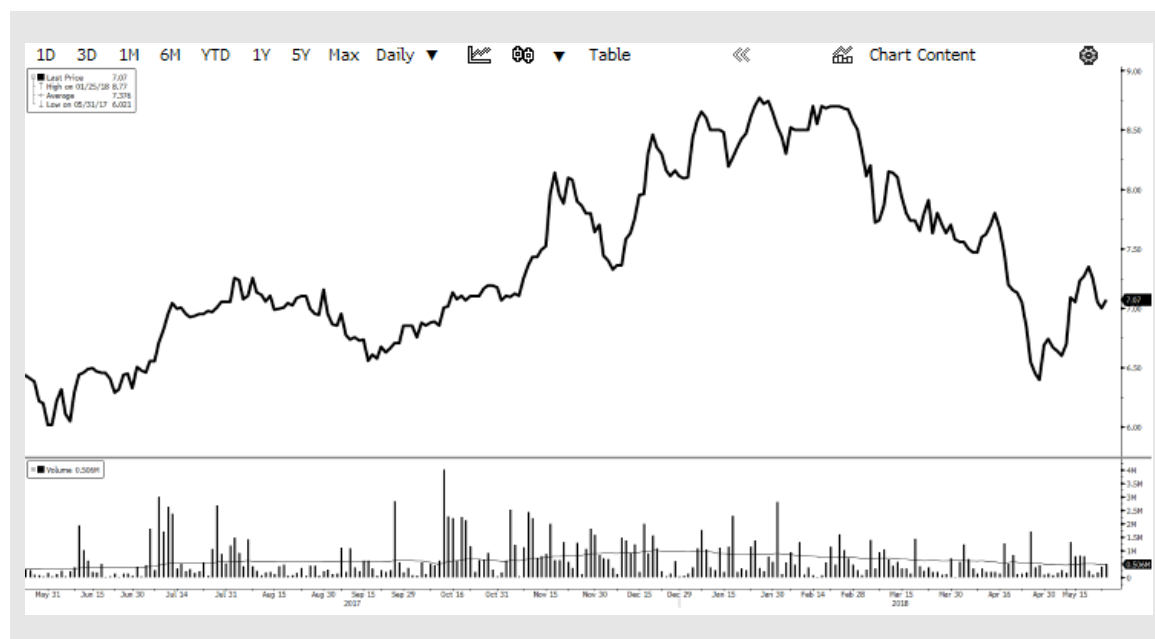
Source: Company

INVESTMENT STATISTICS

FYE Dec (RMm)	FY2015	FY2016	FY2017	FY2018F	FY2019F
Revenue	1635.9	1668.3	1957.4	2024.1	2212.4
Operating Profit	278.6	223.4	240.9	288.7	306.6
PBT	268.5	213.4	229.6	274.7	292.7
PATANCI	207.1	174.2	185.6	206.0	219.5
Operating Profit margin (%)	17.0	13.4	12.3	14.3	13.9
PBT margin (%)	16.4	12.8	11.7	13.6	13.2
PATAMI margin (%)	12.7	10.4	9.5	10.2	9.9
EPS (sen)	31.8	26.7	28.8	32.2	34.3
EPS Growth (%)	42.3	-15.9	7.6	12.0	6.6
PER (x)	22.2	26.4	24.6	21.9	20.6
Dividend per share (sen)	5.5	5.0	0.0	9.5	10.5
Dividend yield (%)	0.8	0.7	0.0	1.3	1.5

Source: Company, Forecasts by MIDFR

DAILY PRICE CHART



Noor Athila Mohd Razali
 noor.athila@midf.com.my
 03-2772 1679

MIDF RESEARCH is part of MIDF Amanah Investment Bank Berhad (23878 - X).
(Bank Pelaburan)
(A Participating Organisation of Bursa Malaysia Securities Berhad)

DISCLOSURES AND DISCLAIMER

This report has been prepared by MIDF AMANAH INVESTMENT BANK BERHAD (23878-X). It is for distribution only under such circumstances as may be permitted by applicable law.

Readers should be fully aware that this report is for information purposes only. The opinions contained in this report are based on information obtained or derived from sources that we believe are reliable. MIDF AMANAH INVESTMENT BANK BERHAD makes no representation or warranty, expressed or implied, as to the accuracy, completeness or reliability of the information contained therein and it should not be relied upon as such.

This report is not, and should not be construed as, an offer to buy or sell any securities or other financial instruments. The analysis contained herein is based on numerous assumptions. Different assumptions could result in materially different results. All opinions and estimates are subject to change without notice. The research analysts will initiate, update and cease coverage solely at the discretion of MIDF AMANAH INVESTMENT BANK BERHAD.

The directors, employees and representatives of MIDF AMANAH INVESTMENT BANK BERHAD may have interest in any of the securities mentioned and may benefit from the information herein. Members of the MIDF Group and their affiliates may provide services to any company and affiliates of such companies whose securities are mentioned herein. This document may not be reproduced, distributed or published in any form or for any purpose.

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 <i>rise</i> 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 <i>fall</i> 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.