

20 August 2018 | 2QFY18 Results Review

## Kossan Rubber Industries Bhd

*Higher production output to boost 2HFY18 performance*

### INVESTMENT HIGHLIGHTS

- **2QFY18 earnings broadly within expectations at RM43.4m**
- **Weaker revenue contribution in view of capacity constraint**
- **Plant 16 has been fully commissioned in August 2018**
- **FY19F earnings forecasts revised upward by +8.6%**
- **Maintain NEUTRAL with a revised TP of RM4.09 per share**

**Within expectations.** Kossan Rubber Industries Bhd's (Kossan) 2QFY18 earnings came in at RM43.4m. As a result, 1HFY18 earnings were broadly within our and consensus' full-year earnings expectation at 43% and 40% of FY18 earnings forecasts respectively. Against last year, 2QFY18 revenue rose marginally by +1.3%yoy while earnings dropped by -4.5%yoy. However, we are anticipating a stronger 2HFY18 performance due to the additional contribution from plants that are going to be commissioned during the period. No dividend was declared for the quarter under review.

**Capacity constraint.** In 2QFY18, the lower year-over-year earnings was mainly attributable to the decline in the profit before tax (PBT) of glove division by -11.9%yoy. Apart from capacity constraint, the earnings was negatively impacted by lag effect in cost-pass-through arising from the increase in prices of Nitrile Butadiene Rubber (NBR) and natural gas by +13.2%yoy and +21.9%yoy respectively. However, the weaker PBT of glove division was mitigated by the stronger performance of Kossan's two smaller segments namely the technical rubber products (TRP) as well as Cleanroom division. These divisions recorded increase in PBT by +190.4%yoy and +71.0%yoy respectively driven by the increased sales of higher margin products.

**Plant 16 has been fully commissioned.** The management disclosed that Kossan's Plant 16, which is expected to contribute additional three billion production capacity, has been fully-commissioned in August 2018. Hence, we believe that the plant will strongly contribute to Kossan's revenue in 2HFY18 driven by the robust demand for glove product. Volume sold in the 2QFY18 increased by +8.9%yoy as compared to +2.7%yoy in the previous year corresponding quarter. Meanwhile, the three other plants (Plant 17, 18 and 19) are currently under construction. Plant 17, 18 and 19 are expected to be completed in the 4QFY18, 2QFY19 and 4QFY19 respectively. These three new plants will add another seven billion of new production capacity going forward.

**Maintain NEUTRAL**

**Revised Target Price (TP): RM4.09**  
(Previously RM3.78)


### RETURN STATS

|                                      |              |
|--------------------------------------|--------------|
| Price (17 <sup>th</sup> August 2018) | RM4.43       |
| Target Price                         | RM4.09       |
| Expected Share Price Return          | -7.7%        |
| Expected Dividend Yield              | +1.3%        |
| <b>Expected Total Return</b>         | <b>-6.4%</b> |

### STOCK INFO

|                         |                         |
|-------------------------|-------------------------|
| KLCI                    | 1,783.47                |
| Bursa / Bloomberg       | 7153 / KRI MK           |
| Board / Sector          | Main / Trading Services |
| Syariah Compliant       | YES                     |
| Issued shares (mil)     | 1,278.94                |
| Market cap. (RM'm)      | 5,665.69                |
| Price over NA           | 4.72                    |
| 52-wk price Range       | RM3.19 – RM4.72         |
| Beta (against KLCI)     | 0.57                    |
| 3-mth Avg Daily Vol     | 1.37m                   |
| 3-mth Avg Daily Value   | RM5.82m                 |
| Major Shareholders (%)  |                         |
| Kossan Holdings Sdn Bhd | 51.06                   |
| EPF                     | 7.71                    |
| Citibank New York       | 1.95                    |

**Earnings forecast.** We are maintaining our FY18 earnings forecast. However, we are revising our FY19F earnings forecasts higher by +8.6%, driven by continued stronger demand for glove products. Key risks to our earnings would be: (i) sudden increase in raw materials prices i.e. latex and nitrile and; (ii) delay in expansion plans.

**Maintain NEUTRAL.** We are maintaining our **NEUTRAL** recommendation on Kossan with a revised TP of **RM4.09** per share (previously RM3.78). Our TP is derived via pegging our FY19F EPS of 18.6sen to PER19 of 22x, representing the average PER for the past five years. We believe that earnings growth for Kossan will remain supported due to the high demand for glove as well as the expected commissioning of three additional plants. Nevertheless, we opine that all positives have been priced in at this juncture. 

**Table 1: Kossan's quarterly earnings review**

| FYE Dec (RM'm)            | Quarterly results |              |              |         |         | Cumulative results |              |              |
|---------------------------|-------------------|--------------|--------------|---------|---------|--------------------|--------------|--------------|
|                           | 2QFY17            | 1QFY18       | 2QFY18       | QoQ (%) | YoY (%) | 1HFY17             | 1HFY18       | YoY (%)      |
| <b>Revenue</b>            | <b>490.5</b>      | <b>484.2</b> | <b>496.8</b> | 2.6     | 1.3     | <b>990.5</b>       | <b>981.0</b> | <b>(1.0)</b> |
| Operating expenses        | (432.7)           | (428.1)      | (438.9)      | 2.5     | 1.4     | (875.0)            | (867.0)      | (0.9)        |
| Other operating income    | 0.8               | 0.9          | 1.1          | 26.6    | 38.1    | 1.9                | 2.0          | 6.0          |
| Finance costs             | (2.6)             | (3.9)        | (4.1)        | 3.6     | 57.9    | (5.0)              | (8.0)        | 60.9         |
| <b>Profit Before Tax</b>  | <b>56.1</b>       | <b>53.0</b>  | <b>54.9</b>  | 3.5     | (2.1)   | <b>112.4</b>       | <b>107.9</b> | <b>(4.0)</b> |
| Taxation                  | (10.2)            | (7.7)        | (10.2)       | 31.7    | (0.4)   | (19.3)             | (17.9)       | (7.1)        |
| <b>Profit After Tax</b>   | <b>45.8</b>       | <b>45.3</b>  | <b>44.7</b>  | (1.3)   | (2.5)   | <b>93.1</b>        | <b>90.0</b>  | <b>(3.3)</b> |
| Non-controlling interest  | 0.3               | 0.8          | 1.3          | 62.6    | 280.7   | 1.0                | 2.0          | 94.2         |
| <b>PATANCI</b>            | <b>45.5</b>       | <b>44.5</b>  | <b>43.4</b>  | (2.4)   | (4.5)   | <b>92.0</b>        | <b>88.0</b>  | <b>(4.4)</b> |
| Basic EPS (sen)           | 7.1               | 7.0          | 6.8          | (2.4)   | (4.5)   | 14.4               | 13.8         | (4.4)        |
| PBT margin (%)            | 11.4              | 11.0         | 11.1         | 0.9     | (0.4)   | 11.3               | 11.0         | (0.3)        |
| PAT margin (%)            | 9.3               | 9.4          | 9.0          | (3.8)   | (0.3)   | 9.4                | 9.2          | (0.2)        |
| PATANCI margin (%)        | 9.3               | 9.2          | 8.7          | (4.9)   | (0.5)   | 9.3                | 9.0          | (0.3)        |
| Tax rate (%)              | 18.3              | 14.6         | 18.6         | 27.3    | 0.3     | 17.2               | 16.6         | (0.6)        |
| <b>Segments</b>           |                   |              |              |         |         |                    |              |              |
| <b>Revenue</b>            |                   |              |              |         |         |                    |              |              |
| Technical Rubber Division | 33.7              | 43.6         | 44.5         | 2.2     | 32.1    | 81.8               | 88.1         | 7.7          |
| Gloves Division           | 442.8             | 419.3        | 432.4        | 3.1     | (2.4)   | 876.2              | 851.7        | (2.8)        |
| Clean Room Division       | 13.1              | 20.4         | 19.3         | (5.3)   | 47.2    | 31.3               | 39.7         | 26.6         |
| <b>PBT</b>                |                   |              |              |         |         |                    |              |              |
| Technical Rubber          | 2.8               | 5.0          | 8.1          | 60.8    | 190.4   | 8.2                | 13.2         | 60.9         |
| Gloves                    | 52.6              | 47.5         | 46.3         | (2.4)   | (11.9)  | 102.7              | 93.8         | (8.7)        |
| Clean Room                | 0.7               | 0.4          | 1.1          | 170.4   | 71.0    | 1.5                | 1.5          | 2.0          |

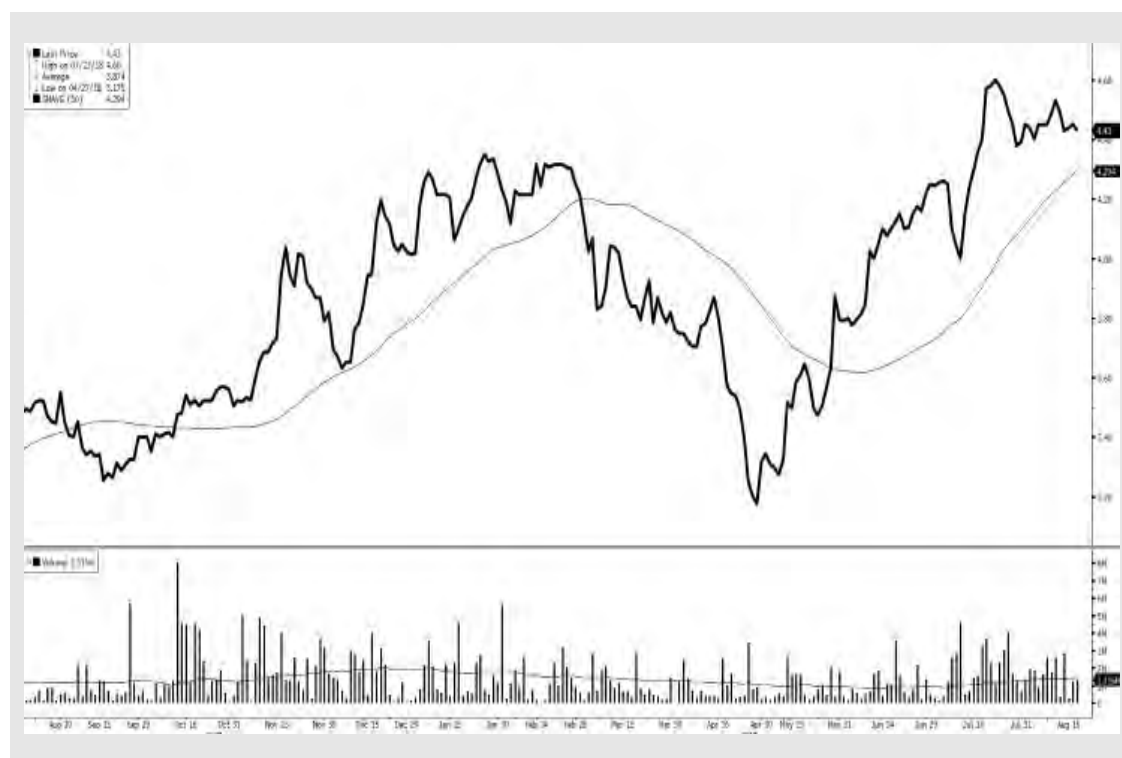
Source: Company, MIDFR

## INVESTMENT STATISTICS

| FYE Dec (RMm)               | FY2015        | FY2016        | FY2017        | FY2018F       | FY2019F       |
|-----------------------------|---------------|---------------|---------------|---------------|---------------|
| <b>Revenue</b>              | <b>1635.9</b> | <b>1668.3</b> | <b>1957.4</b> | <b>2024.1</b> | <b>2264.5</b> |
| Operating Profit            | 278.6         | 223.4         | 240.9         | 288.7         | 331.7         |
| PBT                         | 268.5         | 213.4         | 229.6         | 274.7         | 317.8         |
| <b>PATANCI</b>              | <b>207.1</b>  | <b>174.2</b>  | <b>185.6</b>  | <b>206.0</b>  | <b>238.3</b>  |
| Operating Profit margin (%) | 17.0          | 13.4          | 12.3          | 14.3          | 14.6          |
| PBT margin (%)              | 16.4          | 12.8          | 11.7          | 13.6          | 14.0          |
| PATAMI margin (%)           | 12.7          | 10.4          | 9.5           | 10.2          | 10.5          |
| EPS (sen)                   | 15.9          | 13.4          | 14.4          | 16.1          | 18.6          |
| EPS Growth (%)              | 42.3          | -15.9         | 7.6           | 12.0          | 15.7          |
| PER (x)                     | 28.0          | 33.3          | 30.9          | 27.6          | 23.9          |
| Dividend per share (sen)    | 5.5           | 5.0           | 0.0           | 4.8           | 5.7           |
| Dividend yield (%)          | 1.2           | 1.1           | 0.0           | 1.1           | 1.3           |

Source: Company, MIDFR

## DAILY PRICE CHART



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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 <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. |