

19 November 2018 | 3QFY18 Results Review

## Kossan Rubber Industries Bhd

*Capacity expansion on track*

### INVESTMENT HIGHLIGHTS

- **3QFY18 earnings recovery came in broadly in-line within our expectation at RM55.1m (+26.9%yooy)**
- **Higher production capacity and improvement in profit margin led to the earnings recovery**
- **Plant 17 fully commissioned in November 2018 with another two plants expected to come on stream in 2019**
- **Earnings recovery is expected to be seen in 4QFY18**
- **Maintain NEUTRAL with an unchanged TP of RM4.09**

**Within expectations.** Kossan Rubber Industries Bhd's (Kossan) 3QFY18 earnings came in at RM55.1m which is broadly within our and consensus' full-year earnings expectation at 67.0% and 66.0% of full year FY18 earnings forecasts respectively. Comparing to the previous quarter where earnings was dragged by the lag effect in cost-pass-through arising from the increase in prices of Nitrile Butadiene Rubber (NBR) and natural gas, earnings for the quarter-in-review posed a strong recovery with an increase of +26.9%qoq. We expect this recovery momentum will continue into the 4QFY18.

**Glove division drives recovery in earnings.** The recovery in 3QFY18 earnings was mainly attributable to the improved performance of Kossan's glove division. The division's 3QFY18 revenue and profit before tax (PBT) increased by +17.0%qoq and +36.1%qoq respectively. This is mainly caused by the: (i) higher sales volume (+7.71%qoq) resulting from the new capacity contributed by the recently commissioned Plant 16 and existing plants running at full capacity; (ii) improved average selling price (+1.8%qoq) which partially mitigating the uptrend in NBR price; (iii) production efficiency and; (iv) effective cost control.

**Plant 17 has been fully commissioned.** Management disclosed that Kossan's Plant 17, which is expected to contribute additional 1.5b pieces of glove, has been fully-commissioned from November 2018. Coupled with the capacity of Plant 16 (commissioned in August 2018), Kossan has additional capability to produce 4.5b pieces. Meanwhile, the two other plants (Plant 18 and 19) are now currently under construction and expected to be completed in the 2QFY19 and 4QFY19 respectively. These two new plants will add additional 5.5b pieces of new production capacity in 2019. This will increase Kossan's existing glove production capacity from 27.0b pieces to 32.5b pieces (+20.3%). Hence, we believe that these plants will strongly contribute to Kossan's earnings going forward driven by the robust demand for glove product.

**Maintain NEUTRAL**


**Unchanged Target Price (TP): RM4.09**

RETURN STATS	
Price (16 <sup>th</sup> November 2018)	RM4.30
Target Price	RM4.09
Expected Share Price Return	-4.9%
Expected Dividend Yield	+1.7%
<b>Expected Total Return</b>	<b>-2.9%</b>

STOCK INFO	
KLCI	1,706.38
Bursa / Bloomberg	7153 / KRI MK
Board / Sector	Main / Trading Services
Syariah Compliant	YES
Issued shares (mil)	1,278.94
Market cap. (RM'm)	5,499.42
Price over NA	8.85
52-wk price Range	RM3.19 – RM4.72
Beta (against KLCI)	0.52
3-mth Avg Daily Vol	0.96m
3-mth Avg Daily Value	RM4.20m
Major Shareholders (%)	
Kossan Holdings Sdn Bhd	51.06
EPF	7.76
Citibank New York	1.95

**Earnings forecast.** We are maintaining our FY18 earnings forecast at this juncture as we expect strong 4QFY18 earnings driven by the sales volume contribution from Plant 16 and 17. Key risks to our earnings would be: (i) slowdown in demand for glove product; (ii) sudden jump in raw materials prices i.e. nitrile and latex and; (ii) delay in expansion plans. Meanwhile, we opine that the scheduled expansion for FY19 will keep our future earnings estimates intact.

**Target Price.** Our target price is unchanged at **RM4.09** per share. This is derived via pegging our FY19F EPS of 18.6sen to PER19 of 22x, representing the average PER for the past five years.

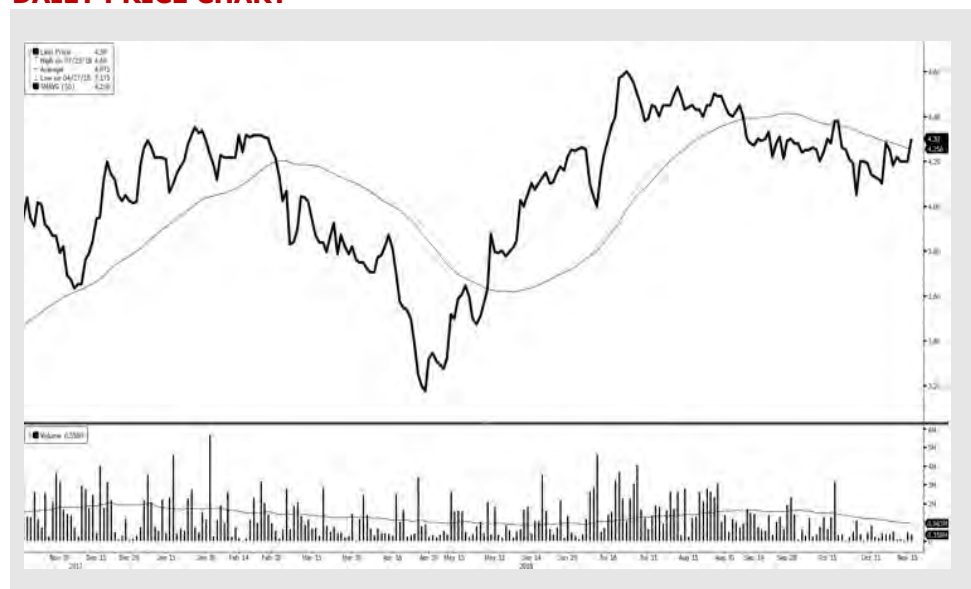
**Maintain NEUTRAL.** We are maintaining our **NEUTRAL** recommendation on Kossan. We believe that earnings growth for Kossan will be supported by high demands for glove and its ability to keep with these demands as seen in its expansion plan. Overall, we expect a stronger 2HFY18 performance to mitigate the subdued performance during the 1HFY18. Since April 2018, the share price has rebounded by +35.4yoy as we believe the market has priced-in the positivity surrounding the group. In addition, the rebound in share price has also lead to unattractive dividend yield of less than two percent. 

## 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>PATANGI</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)	27.1	32.2	29.9	26.7	23.1
Dividend per share (sen)	6.0	5.5	5.5	6.5	7.5
Dividend yield (%)	1.4	1.3	1.3	1.5	1.7

Source: Company, MIDFR

## DAILY PRICE CHART



## KOSSAN RUBBER INDUSTRIES BHD: Quarterly Earnings Review

FYE Dec (RM'm)	Quarterly results					Cummulative results		
	3QFY18	2QFY18	3QFY17	YoY (%)	QoQ (%)	9MFY18	9MFY17	YoY (%)
<b>Revenue</b>	<b>573.9</b>	<b>496.8</b>	<b>489.2</b>	17.3	15.5	<b>1,554.9</b>	<b>1,479.7</b>	<b>5.1</b>
Operating expenses	(498.4)	(438.9)	(428.7)	16.2	13.5	(1,365.4)	(1,303.7)	4.7
Other operating income	1.0	1.1	0.9	10.5	(14.6)	3.0	2.8	7.4
Finance costs	(5.6)	(4.1)	(3.1)	81.0	38.8	(13.6)	(8.1)	68.6
<b>Profit Before Tax</b>	<b>70.8</b>	<b>54.9</b>	<b>58.2</b>	21.7	29.0	<b>178.8</b>	<b>170.6</b>	<b>4.8</b>
Taxation	(15.7)	(10.2)	(12.2)	29.2	54.1	(33.7)	(31.5)	6.9
<b>Profit After Tax</b>	<b>55.1</b>	<b>44.7</b>	<b>46.0</b>	19.7	23.3	<b>145.1</b>	<b>139.1</b>	<b>4.3</b>
Non-controlling interest	0.0	1.3	0.3	(100.0)	(100.0)	2.0	1.4	46.1
<b>PATANCI</b>	<b>55.1</b>	<b>43.4</b>	<b>45.7</b>	20.6	26.9	<b>143.1</b>	<b>137.7</b>	<b>3.9</b>
Basic EPS (sen)	4.3	6.8	3.6	20.6	26.9	11.2	10.8	3.9
PBT margin (%)	12.3	11.1	11.9	3.7	11.7	11.5	11.5	(0.3)
PAT margin (%)	9.6	9.0	9.4	2.1	6.7	9.3	9.4	(0.7)
PATANCI margin (%)	9.6	8.7	9.3	2.8	9.8	9.2	9.3	(1.1)
Effective Tax rate (%)	22.2	18.6	20.9	6.1	19.4	18.8	18.5	2.0
<b>Segments</b>								
<b>Revenue</b>								
Technical Rubber Division	46.1	44.5	37.9	21.6	3.6	134.2	119.8	12.1
Gloves Division	505.8	432.4	425.9	18.7	17.0	1,357.5	1,302.1	4.2
Clean Room Division	21.0	19.3	24.8	(15.2)	8.9	60.7	56.1	8.1
<b>PBT</b>								
Technical Rubber	6.9	8.1	3.6	89.5	(15.1)	20.0	11.8	69.7
Gloves	63.1	46.3	53.6	17.6	36.1	156.9	156.3	0.4
Clean Room	0.9	1.1	0.8	16.2	(18.0)	2.5	2.3	6.9

Source: Company, MIDFR

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#### 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.