

03 December 2018 | Visit Note

## Kossan Rubber Industries Berhad

*Continuous improvement on operation efficiency*

**Maintain NEUTRAL**

**Revised Target Price (TP): RM4.18**  
**(Previously RM4.09)**

### INVESTMENT HIGHLIGHTS

- **Focusing on increasing further the level of automation to reduce dependency on factory workers**
- **Achieve new handling rate of 2.5 workers per million gloves for the newly commenced Plant 16**
- **Nonetheless, the groups targets to further improves the handling rate to 1.8 workers per million gloves by 2HFY19**
- **Expecting higher demand from the US market towards the end of FY19 due to the heightened hygiene requirement**
- **Maintain NEUTRAL with a revised TP of RM4.18**

**Working towards greater operating efficiency.** We recently visited Kossan's state-of-the-art Plant 16 which commenced operation in August 2018. The Plant houses eight production lines with an annual installed gloves production capacity of 3.0b pieces. The Plant's efficiency level at the product handling stage (i.e. packaging and warehousing) currently stands at 2.5 workers per million gloves which is lower as compared to the group's average handling capability of 3.0 workers per million gloves. This was mainly due to higher level automation. Nonetheless, the group is targeting to further improve the efficiency level to 1.8 workers per million gloves by 2HFY19.

**Expectation of a strong glove demand from US in FY19.** The slew of new plants in FY18 and upcoming plants in FY19 is expected to boost the group's annual capacity to 32.5b pieces (+44.4%) from 22.5b pieces in FY17. We are anticipating the additional product capacity will be channelled towards the US market. This is in view of more stringent hygiene regulation in the United States' hospitals and labs effective from December 2019 which translates into higher intervals of glove replacement. Thus, we are expecting the glove production activity to intensify from 4QFY19 onwards. Note that traditionally export to the US market constitutes 45.0% of the group's total contribution.

**Earnings forecast.** We are maintaining our FY18F earnings forecast at this juncture. However, we are revising upwards our FY19F earnings forecast by +2.2%. In the short term, we expect that the group will benefit from a weaker Ringgit and lower Nitrile Butadiene Rubber (NBR) cost before the cost savings are eventually passed to the customers. Nonetheless, we expect a higher utilisation rate for the new efficient plants which will expand profit margins further in FY19. 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; (iii) delay in expansion plans.

### RETURN STATS

Price (30 <sup>th</sup> November 2018)	RM4.30
Target Price	RM4.18
Expected Share Price Return	-2.8%
Expected Dividend Yield	+1.8%
<b>Expected Total Return</b>	<b>-1.0%</b>

### STOCK INFO

KLCI	1,679.86
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	0.87m
3-mth Avg Daily Value	RM3.70m
Major Shareholders (%)	
Kossan Holdings Sdn Bhd	51.06
EPF	7.49

**Target Price.** Our target price is revised to **RM4.18** per share (previously RM4.09). This is derived via pegging our FY19F EPS of 19.0sen to PER19 of 22x, representing the average PER for the past five years.

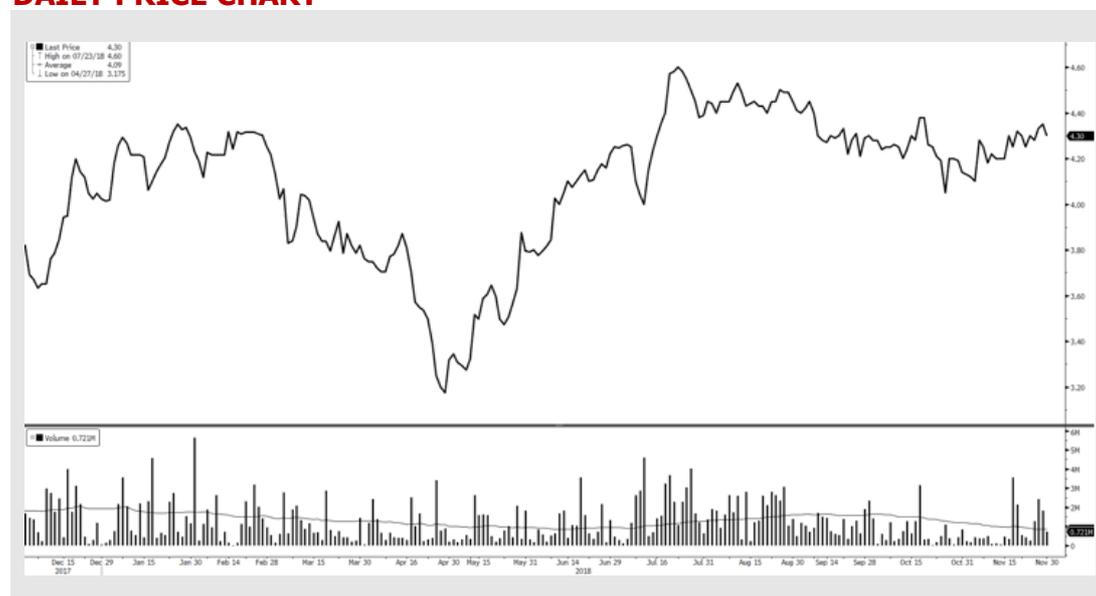
**Maintain NEUTRAL.** We are maintaining our **NEUTRAL** recommendation on Kossan. We believe that earnings growth for Kossan will be supported by high demands for glove going forward and its ability to keep with these demands as seen in its expansion plan. Also, we believe that the expected opening of new efficient plants will address the ever-escalating cost of labour and energy. This will gradually expand the group's profit margin. However, the share is trading at a 13.0% premium above its historical two-year average PER, and hence, we believe the market has priced-in the positivity surrounding the group. Also, at current share price, it also leads to unattractive dividend yield of less than two percent. 

## INVESTMENT STATISTICS

FYE Dec (RMm)	FY2015	FY2016	FY2017	FY2018F	FY2019F
<b>Revenue</b>	<b>1,635.9</b>	<b>1,668.3</b>	<b>1,957.4</b>	<b>2,024.1</b>	<b>2,290.5</b>
Operating Profit	278.6	223.4	240.9	288.7	338.7
PBT	268.5	213.4	229.6	274.7	324.8
<b>PATANCI</b>	<b>207.1</b>	<b>174.2</b>	<b>185.6</b>	<b>206.0</b>	<b>243.6</b>
Operating Profit margin (%)	17.0	13.4	12.3	14.3	14.8
PBT margin (%)	16.4	12.8	11.7	13.6	14.2
PATANCI margin (%)	12.7	10.4	9.5	10.2	10.6
EPS (sen)	15.9	13.4	14.4	16.1	19.0
EPS Growth (%)	42.3	-15.9	7.6	12.0	18.3
PER (x)	27.1	32.2	29.9	26.7	22.6
Dividend per share (sen)	6.0	5.5	5.5	6.5	7.6
Dividend yield (%)	1.4	1.3	1.3	1.5	1.8

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.