

25 August 2017 | 2QFY17 Results Review

Kossan Rubber Industries

A stronger 2H expected

INVESTMENT HIGHLIGHTS

- **2QFY17 earnings within expectations**
- **Revenue flat qoq due to absence in new capacity**
- **Earnings to improve with new capacity**
- **FY17-18F earnings forecasts maintained**
- **Downgrade to NEUTRAL with unchanged TP of RM7.57**

Within expectations. Kossan's 2Q17 earnings came in at RM45.5m. This brings its 1H earnings to RM92.0m which is within our but below consensus full-year earnings expectation at 46% and 42% respectively. Against last year, revenue and earnings climbed by +21.5% and +11.0% respectively. However, on a quarterly sequential basis, it recorded a marginal decline in both revenue and earnings by -1.9% and -2.2% respectively.

Revenue flat qoq due to absence in new capacity. In 2QFY17, the increase in revenue year-over-year was mainly attributable to increase in sales volume and higher average selling prices (ASPs). During the quarter, its gloves division recorded an increase of +5.8%yoy. However, on a quarterly sequential basis, revenue was flat due to absence in new capacity during the 1H17. In addition, Kossan's revenue was also affected due to lower contribution from technical rubber products and cleanroom segments due to lag in passing on higher raw material costs during the quarter and soft demand from China. That said, management shared that revenue and earnings during the quarter were cushioned by the increment in average selling prices (ASP) for its gloves which grew by an average of +12.8%yoy.

Earnings to improve with new capacity. Management disclosed that Kossan is expecting Plant 16's +3.0b new capacity to start in this coming October. The plant has been fully-commissioned end-July and currently undergoing trial-runs. The plant which began its construction back in May 2016 is slated to focus on the production of Kossan's patented Low Derma gloves. Meanwhile the other two plants to be built along Jalan Meru (Plant 17 and 18) are now at their respective earthworks stage. Construction is expected to begin in the 2H17 and is expected to be operational in 2Q18 and 4Q18 respectively. These two new plants will add +4.5b of new capacity to Kossan going forward.

Downgrade to NEUTRAL
(Previously BUY)

Unchanged Target Price (TP): RM7.57

RETURN STATS

Price (24 August 2017)	RM7.15
Target Price	RM7.57
Expected Share Price Return	+5.9%
Expected Dividend Yield	+1.4%
Expected Total Return	+7.3%

STOCK INFO

KLCI	1,775.5
Bursa / Bloomberg	7153 / KRI MK
Board / Sector	Main / Trading Services
Syariah Compliant	YES
Issued shares (mil)	639.47
Market cap. (RM'm)	4,572.20
Price over NA	4.02
52-wk price Range	RM5.62 – RM7.36
Beta (against KLCI)	0.08
3-mth Avg Daily Vol	0.55m
3-mth Avg Daily Value	RM3.82m
Major Shareholders (%)	
Kossan Holdings Sdn Bhd	51.06
EPF	11.41
KWAP	2.39

Earnings forecast. We are maintaining our FY17-18F earnings forecasts at this juncture as we expect the incoming +3.0b and +4.5b in capacity this year and next year to assist in revenue and earnings growth going forward. Key risks to our earnings would most likely be: (i) increasing competition which may squeeze margins and ASP; (ii) sudden jump in raw materials prices i.e latex and nitrile and; (iii) demand and supply mismatch.

Downgrade to NEUTRAL with unchanged Target Price (TP) of RM7.57. Post earnings announcement; we are downgrading our recommendation on Kossan to **NEUTRAL** (from BUY previously) with an unchanged TP of **RM7.57** per share. Our TP is derived via pegging our FY18F EPS of 34.4sen to an unchanged PER of 22x, which is its 3-year average PER. We believe that as new capacity will only start contributing in October, earnings growth for this year will be fairly constrained. In addition, as its share price has recently surge to current level, we are expecting limited upside to its share price at this juncture hence, we are downgrading the stock to Neutral.



Table 1: Kossan's quarterly earnings review

FYE Dec (RM'm)	Quarterly results					Cumulative results		
	2QFY16	1QFY17	2QFY17	QoQ (%)	YoY (%)	1HFY16	1HFY17	YoY (%)
Revenue	403.8	500.0	490.5	(1.9)	21.5	816.1	990.5	21.4
Operating expenses	(350.8)	(442.3)	(432.7)	(2.2)	23.3	(695.7)	(875.0)	25.8
Other operating income	0.4	1.1	0.8	(25.0)	120.1	1.2	1.9	59.2
Finance costs	(2.6)	(2.4)	(2.6)	7.7	(1.2)	(5.1)	(5.0)	(3.0)
Profit Before Tax	50.7	56.3	56.1	(0.4)	10.5	116.4	112.4	(3.4)
Taxation	(8.9)	(9.1)	(10.2)	12.8	15.1	(22.2)	(19.3)	(13.1)
Profit After Tax	41.8	47.3	45.8	(3.0)	9.6	94.1	93.1	(1.1)
Non-controlling interest	0.9	0.7	0.3	(53.8)	(62.0)	1.9	1.0	(44.1)
PATANCI	41.0	46.5	45.5	(2.2)	11.1	92.3	92.0	(0.2)
Basic EPS (sen)	6.4	7.3	7.1	(2.2)	11.1	14.4	14.4	(0.2)
PBT margin (%)	12.6	11.3	4.6	(6.7)	(8.0)	14.3	9.1	(5.1)
PAT margin (%)	10.4	9.5	3.7	(5.7)	(6.6)	11.5	7.6	(4.0)
PATANCI margin (%)	10.1	9.3	3.7	(5.6)	(6.4)	11.3	7.5	(3.8)
Tax rate (%)	17.5	16.1	18.3	2.1	0.7	19.1	17.2	(1.9)
Segments								
Revenue								
Technical Rubber Division	40.7	48.1	33.7	(29.9)	(17.0)	82.1	81.8	(0.3)
Gloves Division	345.8	433.4	442.8	2.2	28.1	700.1	876.2	25.2
Clean Room Division	16.2	18.2	13.1	(28.0)	(18.8)	32.0	31.3	(2.1)
PBT								
Technical Rubber	7.9	5.4	2.8	(48.1)	(64.5)	14.7	8.2	(44.4)
Gloves	42.4	50.1	52.6	5.1	24.1	100.5	102.7	2.1
Clean Room	0.3	0.9	0.7	(22.9)	132.5	0.8	1.5	90.1

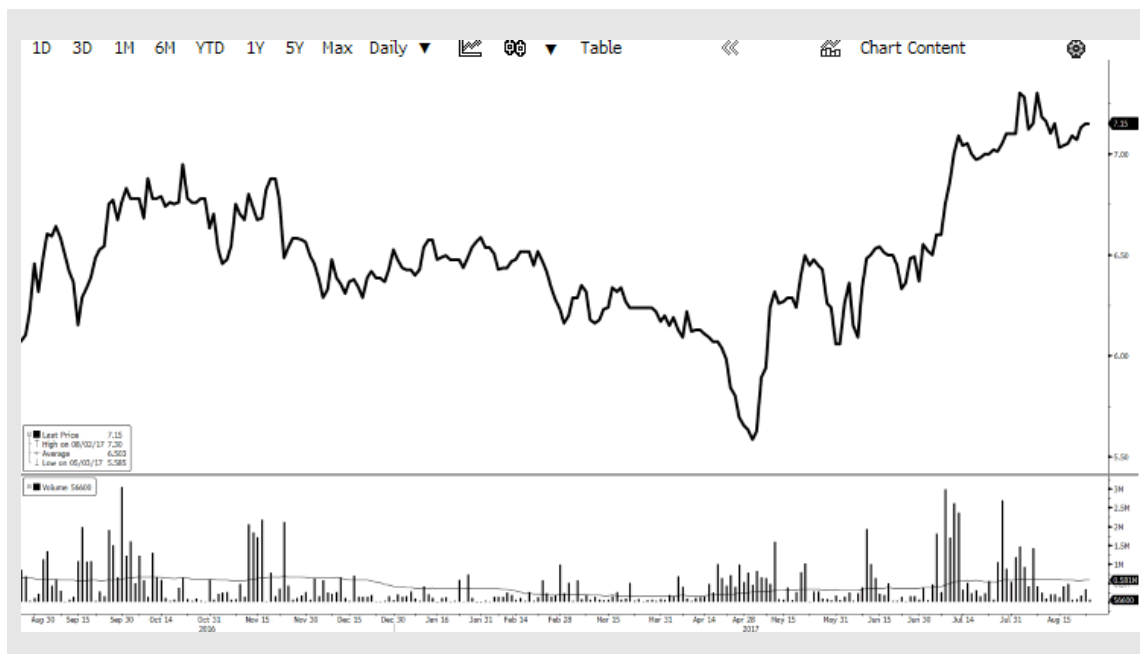
Source: Company

INVESTMENT STATISTICS

FYE Dec (RMm)	FY2014	FY2015	FY2016	FY2017F	FY2018F
Revenue	1301.7	1635.9	1668.3	1807.9	1854.5
Operating Profit	192.6	278.6	223.4	278.1	299.0
Profit Before Tax	186.7	268.5	213.4	272.1	293.2
Profit After Tax	145.6	207.1	174.2	204.1	219.9
Operating Profit margin (%)	14.8	17.0	13.4	15.4	16.1
PBT margin (%)	14.3	16.4	12.8	15.1	15.8
PATAMI margin (%)	11.2	12.7	10.4	11.3	11.9
EPS (sen)	22.1	31.8	27.2	31.9	34.4
EPS Growth (%)	3.5	44.0	-14.3	17.1	7.8
PER (x)	32.4	22.5	26.2	22.4	20.8
Dividend per share (sen)	3.4	5.5	7.5	9.1	10.2
Dividend yield (%)	0.5	0.8	1.1	1.3	1.4

Source: Company, Forecasts by MIDFR

DAILY PRICE CHART



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MIDF AMANAH INVESTMENT BANK : GUIDE TO RECOMMENDATIONS

STOCK RECOMMENDATIONS

BUY	Total return is expected to be >15% over the next 12 months.
TRADING BUY	Stock price is expected to <i>rise</i> by >15% within 3-months after a Trading Buy rating has been assigned due to positive newsflow.
NEUTRAL	Total return is expected to be between -15% and +15% over the next 12 months.
SELL	Total return is expected to be <15% over the next 12 months.
TRADING SELL	Stock price is expected to <i>fall</i> by >15% 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.