

Kossan Rubber Industries Berhad

(7153 | KRI MK) Health Care | Health Care Equipment & Services

Maintain NEUTRAL

Gloomy earnings ahead

Revised Target Price: RM1.28

(Previously RM1.34)

(KEY INVESTMENT HIGHLIGHTS)

- **1HFY22 core earnings came in below our expectation**
- **2QFY22 core PATANCI of RM47m was -47.8qoq lower**
- **Core PATANCI for the 1H22 period slumped by -93.6%yoy to RM137.1m**
- **Declining ASPs**
- **Maintain NEUTRAL with a lower TP of RM1.28 (from RM1.34)**

1HFY22 core earnings came in below our expectation. The group recorded a core PATANCI of RM137.1m, which came in below our projection but within consensus'. It accounted for 41.9% of ours and 46.5% of consensus full-year estimates. The key variance was attributable to faster-than-expected declined in the ASPs along with a higher-than-expected input cost. There was no dividend announced for the quarter.

2QFY22 core PATANCI of RM47m was -47.8qoq lower in line with revenue that plummeted -14.6%qoq to RM589.9m. This was primarily caused by a lower ASPs (average -12.5%qoq) and volume sold (-1%qoq) amidst oversupply of gloves in the market. Sales in the glove and technical rubber divisions dropped -15%qoq and -21.8%qoq, respectively, to RM517.7m and RM38.6m. Meanwhile sales in the cleanroom division increased by +8.6%qoq to RM30.9m. Pre-tax margin decreased -6.5%ppts as a result of higher input cost for energy, labor and raw material costs (average +5.5%qoq increase in NBR and +3%qoq increase in NR).

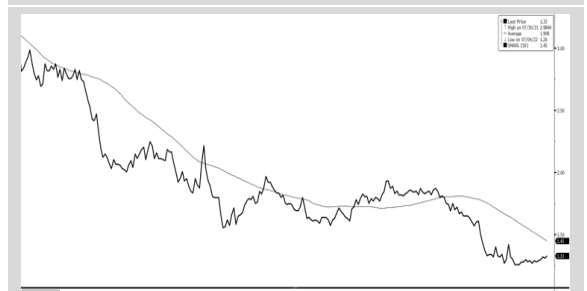
Core PATANCI for the 1H22 period slumped by -93.6%yoy to RM137.1m in tandem with a -71.1%yoy decline in revenue. This is mainly due to the tapering demand for rubber gloves amid oversupply of gloves, intense competition, and the shift to endemic which resulted the ASPs to drop. This was further dragged by decreased cleanroom product ASP and lower automotive segment deliveries, both of which contributed to a reduction in sales across all three divisions.

Declining ASPs. We turned wary that the ASPs for gloves would decline to levels below those of pre-covid before the uneven demand-supply dynamics returned to normal. This is mainly because of an overstock situation in the industry, which is characterised by the intense competition from Chinese's glovemakers, aggressive capacity installation from both existing and new entrant and lower customer deals. We anticipate that margin erosion will continue in the near term due to the inability to fully pass on the cost to the customer with the rising input costs noted above.

RETURN STATISTICS

Price @ 26 th July 2022 (RM)	1.33
Expected share price return (%)	-3.72
Expected dividend yield (%)	+3.02
Expected total return (%)	-0.70

SHARE PRICE CHART




Share price performance (%)	Absolute	Relative
1 month	-0.7	-2.6
3 months	0.8	-22.4
12 months	-59.2	-57.8

KEY STATISTICS

FBM KLCI	1463.69
Syariah compliant	Yes
Issue shares (m)	2551.62
F4BGM Index	No
ESG Grading Band (Star rating)	☆☆☆
Estimated free float (%)	39.71
Market Capitalisation (RM'm)	3,393.65
52-wk price range	RM1.21- RM3.53
Beta vs FBM KLCI (x)	0.60
Monthly velocity (%)	0.58
Monthly volatility (%)	27.87
3-mth average daily volume (m)	4.68
3-mth average daily value (RM'm)	6.88
Top Shareholders (%)	
Kossan Holdings M Sdn Bhd	48.13
Employees Provident Fund Board	5.99
Blackrock	2.60

Technical rubber products (TRP) benefitted from the economic and border reopening. We foresee improvement in the technical rubber division amid gradual pick-up in economic activity and domestic spending, which would boost the infrastructure and automotive segment. Noted that the divisions manufactured wide range of high technical input rubber products to sectors including automotive, aerospace, firefighting & flow-control, construction, mining, rail & other general applications via contract manufacturing arrangement.

Revise FY22-24 earnings estimates. We cut our FY22-23F core PATANCI estimates by -13.4% and -15.7% to RM283.5m and RM281.7m respectively, to better reflect the margin compression after factoring in a lower ASPs and higher input cost. Meanwhile, we raised our FY24F earnings projection by +10.5% to RM284.8m in view of stabilized raw material prices.

Maintain NEUTRAL with a lower TP of RM1.28 (from RM1.34). Our TP of RM1.28 is derived from a revised valuation of 11.6x PER, close to the 2-year historical average, pegged to FY23F EPS of 11.3sen. Dividend yield is estimated at 3.0%. We believe the price and margin compression will likely persist continue in 2HFY22 given a reduced demand from customer due to overstocking and subsequent inventory modifications. Kossan's net cash position, which comprises 75.4% of its market capitalization, could safeguards against the market volatility. Downside risks to our rating include a substantial depreciation of RM against the US Dollar, a greater-than-anticipated decline in ASPs to below pre-pandemic level, and a massive rise in raw material prices. 

INVESTMENT STATISTICS

Financial year ending 31st Dec (in RM'm, unless otherwise stated)	FY2020	FY2021	FY2022E	FY2023F	FY2024F
Revenue	3,638.5	6,631.5	2,954.9	3,044.0	3,142.4
EBITDA	1,555.7	3,835.8	338.3	329.7	323.8
EBIT	1,446.5	3,721.9	338.3	329.7	323.8
PBT	1,441.4	3,747.3	363.3	360.5	362.9
Core PATANCI	1,092.1	2,856.9	283.5	281.7	284.8
EPS (sen)	42.5	111.8	11.1	11.0	11.2
Dividend per share (sen)	14.0	48.0	4.0	4.0	4.0
Margin & Growth					
Revenue growth (%)	64.1	82.3	(55.4)	3.0	3.2
EBITDA margin (%)	42.8	57.8	11.5	10.8	10.3
EBIT margin (%)	39.8	56.1	11.5	10.8	10.3
PBT margin (%)	39.6	56.5	12.3	11.8	11.5
PATANCI margin (%)	30.0	43.1	9.6	9.3	9.1
EPS Growth (%)	141.8	163.2	(90.1)	(0.6)	1.1
Ratios & Valuation					
Net debt/Equity (%)	Net cash	Net cash	Net cash	Net cash	Net cash
ROCE (%)	54.6	87.5	7.9	7.4	7.0
ROA (%)	30.1	56.2	5.5	5.3	5.2
ROE (%)	45.3	70.4	6.7	6.4	6.2
Current ratio (x)	2.3	4.3	4.4	4.5	4.6
PER (x)	3.1	1.2	12.0	12.0	11.9
Dividend yield (%)	10.5	36.1	3.0	3.0	3.0

Source: Company, MIDFR

Table 1: Kossan 1QFY22 earnings summary

FYE Dec (RM'm)	Quarterly results					Cumulative results		
	2QFY22	1QFY22	2QFY21	YoY (%)	QoQ (%)	1HFY22	1HFY21	YoY (%)
Revenue	589.9	690.6	2,238.0	(73.6)	(14.6)	1,280.5	4,429.2	(71.1)
Operating expenses	(538.6)	(579.7)	(838.6)	(35.8)	(7.1)	(1,118.3)	(1,659.0)	(32.6)
Other operating income	14.0	9.9	5.6	152.5	41.9	23.9	10.1	136.3
Finance costs	(1.0)	(1.0)	(1.2)	(18.9)	(5.9)	(2.0)	(4.0)	(50.3)
Profit Before Tax (PBT)	64.3	119.8	1,403.7	(95.4)	(46.3)	184.1	2,776.3	(93.4)
Taxation	(17.8)	(29.2)	(337.9)	(94.7)	(39.0)	(47.0)	(668.5)	(93.0)
Profit After Tax (PAT)	46.5	90.7	1,065.9	(95.6)	(48.7)	137.1	2,107.8	(93.5)
Non-controlling interest	(0.5)	0.5	1.1	(147.9)	(191.6)	0.0	2.2	(97.9)
PATANCI	47.0	90.1	1,064.8	(95.6)	(47.8)	137.1	2,105.7	(93.5)
Core PATANCI	47.0	90.1	1,064.8	(95.6)	(47.8)	137.1	2,155.7	(93.6)
Basic EPS (sen)	1.8	3.5	41.6	(95.6)	(47.8)	5.4	82.3	(93.5)
PBT margin (%)	10.9	17.4	62.7	(51.8)	(6.5)	14.4	62.7	(48.3)
PAT margin (%)	7.9	13.1	47.6	(39.7)	(5.2)	10.7	47.6	(36.9)
PATANCI margin (%)	8.0	13.0	47.6	(39.6)	(5.1)	10.7	47.5	(36.8)
Effective Tax rate (%)	27.7	24.4	24.1	3.6	3.3	0.0	24.1	(24.1)
Segments								
Revenue:								
Gloves Division	517.7	609.3	2,124.7	(75.6)	(15.0)	1,127.0	4,217.6	(73.3)
Technical Rubber Division	38.6	49.3	50.4	(23.5)	(21.8)	87.9	91.9	(4.4)
Cleanroom Division	30.9	28.4	61.2	(49.5)	8.6	59.3	117.5	(49.5)
PBT:								
Gloves Division	53.3	111.0	1,384.3	(96.1)	(52.0)	164.3	2,739.0	(94.0)
Technical Rubber Division	4.0	5.1	4.4	(9.5)	(21.3)	9.1	13.4	(32.1)
Cleanroom Division	2.0	1.3	13.7	(85.0)	56.1	3.4	25.1	(86.7)

Source: Company, MIDFR

BALANCE SHEET

Financial year ending 31st Dec (in RM'm, unless otherwise stated)	FY2020	FY2021	FY2022E	FY2023F	FY2024F
Total Current Assets	2,235.5	3,584.6	3,590.9	3,725.4	3,867.1
Total Non-Current Asset	1,398.5	1,495.2	1,518.5	1,573.4	1,628.2
Total Assets	3,634.0	5,079.8	5,109.5	5,298.8	5,495.3
Total Current Liabilities	985.2	825.3	813.5	825.2	837.7
Total Non-Current Liabilities	235.5	194.1	69.2	66.9	69.0
Total Liabilities	1,220.7	1,019.4	882.7	892.1	906.7
Total Equity	2,413.2	4,060.3	4,226.7	4,406.7	4,588.6
Total Liabilities & Equity	3,633.9	5,079.8	5,109.5	5,298.8	5,495.3

CASH FLOW

Financial year ending 31st Dec (in RM'm, unless otherwise stated)	FY2020	FY2021	FY2022E	FY2023F	FY2024F
Pretax profit	1,441.4	3,747.3	363.3	360.5	362.9
Cash flow from operations	1,145.9	3,224.7	228.7	276.1	277.7
Cash flow from investing	(30.4)	(222.9)	(23.3)	(54.9)	(54.8)
Cash flow from financing	(191.4)	(1,540.1)	(103.1)	(114.9)	(112.2)
Net cash flow	924.1	1,461.7	102.3	106.4	110.7
Adjustments	3.2	6.5	0.0	0.0	0.0
Net cash/(debt) b/f	162.2	1,089.5	2,557.8	2,660.1	2,766.5
Net cash/(debt) c/f	1,089.5	2,557.8	2,660.1	2,766.5	2,877.1

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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.

ESG RECOMMENDATIONS* - source Bursa Malaysia and FTSE Russell

☆☆☆☆	Top 25% by ESG Ratings amongst PLCs in FBM EMAS that have been assessed by FTSE Russell
☆☆☆	Top 26-50% by ESG Ratings amongst PLCs in FBM EMAS that have been assessed by FTSE Russell
☆☆	Top 51%- 75% by ESG Ratings amongst PLCs in FBM EMAS that have been assessed by FTSE Russell
☆	Bottom 25% by ESG Ratings amongst PLCs in FBM EMAS that have been assessed by FTSE Russell

* ESG Ratings of PLCs in FBM EMAS that have been assessed by FTSE Russell in accordance with FTSE Russell ESG Ratings Methodology