

Kossan Rubber Industries Berhad

(7153 | KRI MK) Main | Healthcare | Healthcare Equipment and Services

Maintain SELL

In the Red

Revised Target Price: RM0.88
(previously: RM0.90)

KEY INVESTMENT HIGHLIGHTS

- **Missed estimations.**
- **Continuous margin compression in 2QFY23**
- **Similar trend in 1HFY2023**
- **Revised earnings projections for FY23-FY25F**
- **Reiterate SELL recommendation with a revised TP of RM0.88 (previously RM0.90)**

Missed estimations. Kossan Rubber Industries ("KRI") reported a 1HFY23 core net loss of -RM37.3m, after excluding a one-time off item of -RM9.8m. The core net losses were 69% of our full-year estimation of a net loss of -RM54m and significantly below consensus full-year projections of a net profit of RM55.8m for FY23F. This was mainly due to the shutdown of production capacity and lower-than-expected sales volume. No dividend was declared during the quarter as expected, given that the earnings are still incurring losses.

Continuous margin compression in 2QFY23. On a yearly basis, the revenue decreased by -34.3%yoy to RM 387.5m in 2QFY23, mainly due to the lower ASP for both gloves and cleanroom divisions, as well as reduced sales volume for gloves segment. This translates into a lower plant utilization rate combined with the increased energy and labor costs, causing margin compression for the glove divisions. Hence, the group reported a net loss of -RM2.8m in 2QFY23, compared to a net profit of RM 36.9m in 2QFY22. On a quarterly basis, KRI recorded a lower core net loss of -RM2.8m during the quarter, compared to -RM34.6m in 1QFY23. This was partly due to the lower quantum of revenue drop on a quarterly basis, as well as higher profits from the TRP and cleanroom divisions. Note that the revenue fell by -1.9%qoq in 2QFY23, compared to -18%qoq in 1QFY23.

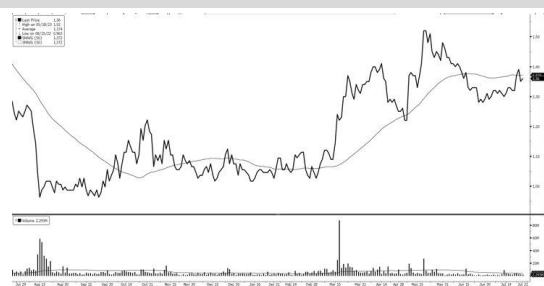
Similar trend in 1HFY2023. The group's revenue dropped by -38.9%yoy to RM782.3m, mainly due to the lower sales volume (decreased by 29-34%), as well as reduced ASP (dropped by 21-26%). Despite the lower raw material cost and higher margin for TRPs products, the core earnings turned into the red on the back of the lower plant utilization rate that raised the production cost per unit higher, and hence compressed the margin. As such, the group recorded a core net loss of -RM37.3m in 1HFY23.

Revised earnings projections for FY23-FY25F. Given that the earnings came in above our estimation, we tweak our earnings estimation for FY23F by +2.4% to a greater net loss of -RM55.3m. Additionally, we revised the earnings forecast for FY24F-25F by -2.9%/-3.7% respectively. This was after factoring in a lower production capacity of 30.5b pieces, as the group has decommissioned two older plants (total capacity of 3b pieces), to increase efficiency and sustain the margin.

RETURN STATISTICS

Price @ 27 th July 2023 (RM)	1.33
Expected share price return (%)	-34.30
Expected dividend yield (%)	0.0
Expected total return (%)	-34.25

SHARE PRICE CHART



Price performance (%)	Absolute	Relative
1 month	5.4	0.7
3 months	5.4	4.6
12 months	3.8	5.2


INVESTMENT STATISTICS

FYE Dec (RM'm)	2023F	2024F	2025F
Revenue	1,406.5	1,434.3	1,697.5
EBITDA	(6.6)	160.6	311.0
Profit Before Tax	(64.3)	111.6	235.1
Core PATANCI	(55.3)	84.0	177.0
Core EPS (sen)	(2.2)	3.3	6.9
DPS (sen)	0	1.3	2.8
Dividend Yield (%)	0	1.0	2.1

KEY STATISTICS

FBM KLCI	1,451.27
Issue shares (m)	2545.37
Estimated free float (%)	40.39
Market Capitalisation (RM'm)	3,470.20
52-wk price range	RM0.9 - RM1.62
3-mth average daily volume (m)	4.38
3-mth average daily value (RM'm)	6.02
Top Shareholders (%)	
Kossan Holdings M Sdn Bhd	49.19
Abrdn PLC	5.40
Employees Provident Fund Board	3.77

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Reiterate SELL recommendation with a revised TP of RM0.88 (previously RM0.90). Our TP is based on a lower FY24F BVPS of 150sen (previously 152 sen), pegged to an unchanged P/BV of 0.59x PER, which represents its 2-year historical -1SD P/BV. We maintain our **SELL** call on Kossan. Despite a lower core net loss, we anticipate the net loss to continue in the remaining FY23F due to weaker demand stemming from the ongoing oversupply issue. **Potential catalysts** include: (i) a faster-than-expected recovery in ASP and utilization rate; and (ii) more new entrants leaving the market and/or existing companies discontinuing certain manufacturing lines. 

Kossan Rubber Industries: 2QFY23 Results Summary

FYE Dec (RM's)	Quarterly results					Cumulative results		
	2QFY23	1QFY23	2QFY22	YoY (%)	QoQ (%)	1HFY23	1HFY22	YoY (%)
Revenue	387.5	394.7	589.9	(34.3)	(1.8)	782.3	1,280.5	(38.9)
Operating expenses	(401.8)	(430.6)	(538.6)	(25.4)	(6.7)	(832.4)	(1,118.3)	(25.6)
Other operating income	17.1	17.2	14.0	21.6	(1.0)	34.3	23.9	43.4
Operating profit (EBIT)	2.8	(18.6)	65.3	(95.7)	(115.0)	(15.8)	186.1	(108.5)
Net finance income/(cost)	(0.3)	(0.4)	(1.0)	(73.4)	(42.6)	(0.7)	(2.0)	(64.6)
Profit before tax (PBT)	2.5	(19.1)	64.3	(96.1)	(113.3)	(16.5)	184.1	(109.0)
Taxation	(5.2)	(4.5)	(17.8)	(70.9)	15.2	(9.7)	(47.0)	(79.4)
Profit After tax (PAT)	(2.7)	(23.6)	46.5	(105.7)	(88.7)	(26.2)	137.1	(119.1)
PATANCI	(3.3)	(24.3)	46.0	(107.2)	(86.4)	(27.6)	136.1	(120.2)
Core PATANCI	(2.8)	(34.6)	36.9	(107.5)	(92.0)	(37.3)	126.6	(129.5)
Basic EPS (sen)	(0.1)	(1.0)	1.8	(107.2)	(86.3)	(1.1)	5.3	(120.3)
DPS (sen)	0.0	0.0	0.0	n.m.	n.m.	0.0	0.0	n.m.
Growth & Margin (%)				+/- ppts	+/- ppts			+/- ppts
Operating Profit Margin	0.7	(4.7)	11.1	(10.3)	5.4	(2.0)	14.5	(16.6)
PBT Margin	0.7	(4.8)	10.9	(10.2)	5.5	(2.1)	14.4	(16.5)
Core PATANCI Margin	(0.7)	(8.8)	6.3	(7.0)	8.0	(4.8)	9.9	(14.7)
Ratios & Valuation				+/- ppts	+/- ppts			+/- ppts
Net cash/market cap (%)	36.1	37.1	36.5	(0.4)	(1.0)	36.1	36.5	(0.4)
Effective tax rate (%)	n.m.	(23.6)	27.7	177.3	228.6	n.m.	25.5	(84.1)

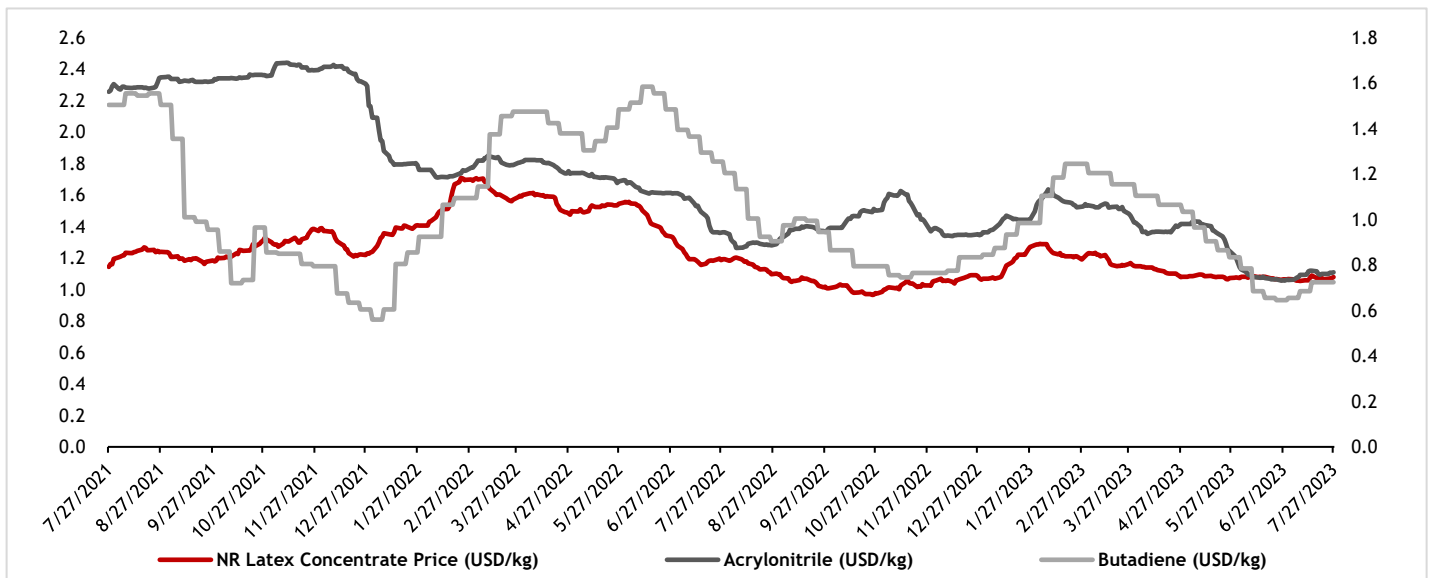
Source: Company, MIDFR

Kossan Rubber Industries: Breakdown by operating segment

FYE Dec (RM'm)	Quarterly results					Cumulative results		
	2QFY23	1QFY23	2QFY22	YoY (%)	QoQ (%)	1HFY23	1HFY22	YoY (%)
Revenue (RM'm):								
Gloves Division	315.9	317.5	520.4	(39.3)	(0.5)	633.4	1,129.7	(43.9)
Technical Rubber Division	47.8	56.2	38.6	24.0	(14.8)	104.0	87.9	18.3
Cleanroom Division	23.9	21.0	30.9	(22.7)	13.5	44.9	59.3	(24.3)
Others	0.0	0.0	2.7	(100.0)	n.m.	0.0	2.7	(100.0)
Total	387.5	394.7	592.6	(34.6)	(1.8)	782.3	1,279.6	(38.9)
Operating Profit (RM'm):								
Gloves Division	(12.1)	(34.9)	53.3	(122.6)	(65.4)	(47.0)	164.3	(128.6)
Technical Rubber Division	8.6	7.9	4.0	114.6	8.4	16.5	9.1	81.7
Cleanroom Division	2.4	1.6	2.0	16.4	49.3	4.0	3.4	18.5
Others	3.6	6.3	4.9	(26.0)	(42.3)	10.0	7.4	35.4
Total	2.5	(19.1)	64.3	(96.1)	(113.3)	(16.5)	184.1	(109.0)
Operating profit margin (%)				+ / (-) ppts	+ / (-) ppts			+ / (-) ppts
Gloves Division	(3.8)	(11.0)	10.2	(14.1)	7.2	(7.4)	14.5	(22.0)
Technical Rubber Division	17.9	14.1	10.4	7.6	3.8	15.9	10.3	5.5
Cleanroom Division	10.0	7.6	6.6	3.4	2.4	8.9	5.7	3.2
Others	n.m.	n.m.	182.4	n.m.	n.m.	n.m.	272.6	n.m.
Total	0.7	(4.8)	10.9	(10.2)	5.5	(2.1)	14.4	(16.5)

Source: Company, MIDFR

TABLE 1: Raw Material Futures Price Trend (USD/MT)



Source: MIDFR, Bloomberg

FINANCIAL SUMMARY

Income Statement (RM'm)	2021A	2022A	2023F	2024F	2025F
Revenue	6,631.5	2,343.8	1,406.5	1,434.3	1,697.5
Raw materials and consumable used	(1,945.6)	(1,263.3)	(947.6)	(802.1)	(939.8)
Changes in inventories of finished goods & WIP	(39.4)	(71.7)	(22.3)	(44.0)	34.0
Goods purchased for resale	(45.1)	(57.9)	(34.0)	(31.2)	(35.1)
Gross Profit	4,601.4	950.9	402.5	557.0	756.6
Other (expense)/income	15.0	44.1	26.0	25.1	28.3
Staff costs	(419.7)	(374.5)	(230.4)	(223.2)	(250.9)
Other operating expenses	(355.2)	(304.6)	(204.7)	(198.3)	(223.0)
EBITDA	3,841.5	315.9	(6.6)	160.6	311.0
EBIT	3,721.9	184.5	(99.9)	77.7	207.8
Profit before tax (PBT)	3,747.3	213.5	(64.3)	111.6	235.1
Profit After tax (PAT)	2,856.9	159.2	(55.3)	84.0	177.0
Core PATANCI	2,857.1	145.7	(55.3)	84.0	177.0
Core EPS (sen)	112.0	5.7	(2.2)	3.3	6.9
DPS (sen)	48.0	2.5	0.0	1.3	2.8

Balance Sheet (RM'm)	2021A	2022A	2023F	2024F	2025F
Property, plant and equipment	1,373.7	1,356.9	1,269.7	1,192.9	1,154.6
Intangible assets & Goodwill	6.0	6.0	3.6	3.7	4.4
Total Non-current assets	1,495.2	1,470.6	1,405.2	1,336.4	1,311.7
Inventories	424.0	287.1	264.8	220.7	254.8
ST - Trade and other receivables	558.6	276.0	251.1	252.2	294.0
Cash and cash equivalents	2,557.8	1,348.0	1,213.4	989.9	937.3
Total current assets	3,584.6	2,856.5	2,592.9	2,265.5	2,352.3
Total Assets	5,079.8	4,327.1	3,998.1	3,601.9	3,664.0
LT Loans and borrowings	56.0	0.9	0.1	0.1	0.1
LT Lease Liabilities	8.7	5.8	1.4	1.3	1.5
Total Non-current liabilities	194.1	144.5	51.1	46.9	55.4
ST Loans and borrowings	182.4	71.3	7.1	7.2	7.3
ST Trade and other payables	297.3	200.2	183.4	152.1	174.6
Total Current Liabilities	825.3	284.7	130.5	(273.9)	(286.6)
Total Liabilities	1,019.4	429.2	181.6	(227.0)	(231.2)

Cash Flow (RM'm)	2021A	2022A	2023F	2024F	2025F
Pretax profit	3,747.3	213.5	(64.3)	111.6	235.1
Cash flow from operations	3,236.0	103.7	(126.2)	(205.3)	70.0
Cash flow from investing	(222.9)	(812.3)	17.4	15.4	(52.1)
Cash flow from financing	(1,540.1)	(480.9)	(47.3)	(33.6)	(70.5)
Net cash flow	1,473.0	(1,189.6)	(156.2)	(223.5)	(52.6)
(+/-) Adjustments	6.5	(9.9)	0.0	0.0	0.0
Net cash/(debt) b/f	1,089.5	2,569.1	1,369.6	1,213.4	989.9

Key Metrics	2021A	2022A	2023F	2024F	2025F
Effective tax rate (%)	23.8	25.4	14.0	24.7	24.7
PER (x)	1.2	21.6	(61.4)	40.4	19.2
P/BV ratio (x)	0.84	0.87	0.89	0.89	0.87
Cash/Market Capitalisation (%)	75.4	39.7	35.8	29.2	27.6
Cash/share (sen)	1.3	0.0	(0.0)	(0.1)	0.0

Profitability Margins	2021A	2022A	2023F	2024F	2025F
Gross Profit Margin (%)	69.4	40.6	28.6	38.8	44.6
EBIT Margin (%)	56.1	7.9	(7.1)	5.4	12.2
Core PATANCI Margin (%)	43.1	6.2	(3.9)	5.9	10.4

Source: Bloomberg, MIDFR

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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