

Kossan Rubber Industries Bhd

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

Average selling price continue to decline

KEY INVESTMENT HIGHLIGHTS

- **4QFY19 earnings came in at RM61.0m (+2.5%yoy), in line with our expectation**
- **4QFY19 revenue dropped marginally by -1.9%yoy as average selling price contracted further**
- **The rise in quarterly earnings rose was driven by a lower raw material cost and higher sales volume**
- **We do not expect a significant spike in sales volume resulting from the outbreak of Covid-19 in the near term**
- **Downgrade to NEUTRAL with an unchanged TP of RM4.64**

Met expectations. Kossan's 4QFY19 earnings came in at RM61.0m which brings its full year FY19 earnings to RM224.8m (+12.5%yoy). This met our and consensus' full-year earnings expectation at 97.2% and 98.7% of full year forecasts respectively. Comparing to the previous year corresponding quarter, 4QFY19 revenue declined marginally by -1.9%yoy. However, 4QFY19 earnings staged a slight improvement of +2.5%yoy thanks to higher sales volume.

Sales revenue dropped due to the lower ASP. Kossan's Plant 18 which has a production capacity of 2.5b pieces of glove was fully commissioned in the end of November 2019. Consequently, sales volume was up by +3.8%yoy. However, the decline in average selling price (ASP) by about -6.0%yoy, brought about by the heightened competition, had resulted in a lower group revenue.

However, earnings improved due to better profit margin. During the quarter, the price of Nitrile Butadiene Rubber (NBR) dropped by about -12.0%yoy. This had benefited the group as its nitrile to natural rubber split currently stands at about 79:21. The lower NBR cost had mitigated the increase in natural gas costs (+5.8%yoy), start-up costs from the recently completed plants, as well as higher foreign worker recruitment costs. Accordingly, 4QFY19 profit margin improved by +0.4ppts to at 10.5% (i.e 4QFY18: 10.1%).

Earnings forecast. We maintain our forecasts as our earnings estimates are still within expectation. Key risks to our earnings forecasts 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.

Target Price. We maintain our target price at **RM4.64** per share. The target price is derived via pegging our FY20F EPS of 21.1sen to PER of 22.0x which is its two-year historical average.

Downgrade to NEUTRAL

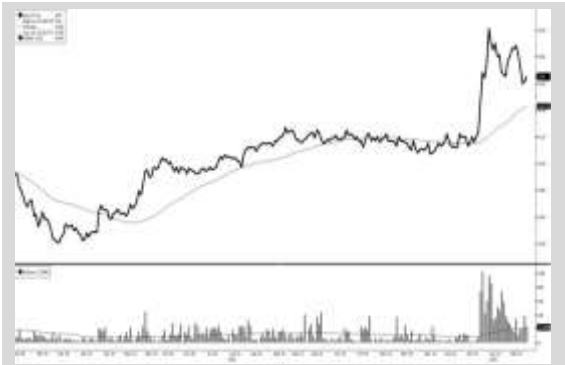
(Previously BUY)

Unchanged Target Price: RM4.64

RETURN STATISTICS

Price @ 21 st February 2020 (RM)	4.65
Expected share price return (%)	-0.2
Expected dividend yield (%)	+1.7
Expected total return (%)	+1.5

SHARE PRICE CHART



Share price performance (%)	Absolute	Relative
1 month	-2.1	0.6
3 months	11.8	16.6
12 months	16.0	30.4

KEY STATISTICS

FBM KLCI	1,531.20
Syariah compliant	Yes
Issue shares (m)	1,278.94
Estimated free float (%)	34.32
Market Capitalisation (RM'm)	5,974.05
52-wk price range	RM3.44 – RM5.18
Beta vs FBM KLCI (x)	0.39
Monthly velocity (%)	11.87
Monthly volatility (%)	11.09
3-mth average daily volume (m)	2.12
3-mth average daily value (RM'm)	9.83
Top Shareholders (%)	
Kossan Holdings M Sdn Bhd	51.21
EPF	7.17
KWAP	2.20


ANALYST

NABIL Zainoodin, CFA, CA
nabil.zainoodin@midf.com.my
 03 -2772 1663

Table 1: Kossan's capacity expansion plan

Plant	No.of lines	Production capacity (bn pcs p.a)	Timeframe (tentative)
Existing		29.0	-
19 (Meru, Klang)	10.0	3.0	2Q20
20 (Bidor, Perak)	TBA	TBA	CY21
Total	18.0	32.0	

Source: Company, MIDFR

Downgrade to NEUTRAL. The management has indicated that they are yet to see a significant improvement in sales volume resulting from the outbreak of Covid-19. Thus, we do not expect significant improvement in Kossan's earnings as a result of this outbreak as we opine that the pressure on ASP will persist at least in the near term given the increased competition in the glove market. Over a longer term period, we believe that earnings growth for Kossan will be supported by the higher production volumes in-tandem with its expansion plan. Its Plant 19 which is expected to be fully commenced in April 2020 will add additional 3.0b pieces of new production capacity which will increase existing capacity from 29.0b pieces to 32.0b pieces (+10.3%). Furthermore, its first plant in Bidor, Perak which will focus on specialised glove is expected to be fully completed in 2021. With the newer state-of-the-art plants, the group is targeting to further improve its efficiency level and profit margins. All things considered, we downgrade our recommendation to **NEUTRAL** (previously BUY) on Kossan considering the share price has risen by +11.0% since our last report on 22 November 2019. 

INVESTMENT STATISTICS

Financial year ending 31st Dec (in RM'm, unless otherwise stated)	FY2018	FY2019	FY2020F	FY2021F	FY2022F
Revenue	2144.2	2221.6	2516.8	2854.3	3126.2
Operating Profit	264.7	290.6	348.4	410.0	452.5
PBT	250.2	280.1	335.8	395.7	436.8
PATANCI	199.8	224.8	270.3	318.8	351.9
Operating Profit margin (%)	12.3	13.1	13.8	14.4	14.5
PBT margin (%)	11.7	12.6	13.3	13.9	14.0
PATAMI margin (%)	9.3	10.1	10.7	11.2	11.3
EPS (sen)	15.8	17.6	21.1	24.9	27.5
EPS Growth (%)	10.7	11.2	20.3	17.9	10.4
PER (x)	24.2	26.5	22.0	18.7	16.9
Dividend per share (sen)	6.0	7.0	8.0	9.0	10.0
Dividend yield (%)	1.4	1.5	1.7	1.9	2.2

Source: Company, MIDFR

Table 1: Kossan's quarterly earnings review

FYE Dec (RM'm)	Quarterly results			Cumulative results	
	4QFY19	YoY (%)	QoQ (%)	FY19	YoY (%)
Revenue	578.3	(1.9)	8.9	2,221.6	3.8
Operating expenses	(504.9)	(1.8)	8.2	(1,931.0)	2.9
Other operating income	1.0	(27.8)	(3.7)	4.4	(1.2)
Finance costs	(2.2)	(58.4)	(20.2)	(14.9)	(23.7)
Profit Before Tax	72.3	1.2	15.2	280.1	12.4
Taxation	(10.7)	3.2	(15.1)	(52.2)	16.8
Profit After Tax	61.6	0.9	22.8	227.9	11.4
Non-controlling interest	0.6	(62.2)	(42.0)	3.1	(35.0)
PATANCI	61.0	2.5	24.1	224.8	12.5
Basic EPS (sen)	4.8	2.5	24.2	17.6	12.5
PBT margin (%)	12.5	3.2	5.8	12.6	8.3
PAT margin (%)	10.6	2.8	12.8	10.3	7.3
PATANCI margin (%)	10.5	4.5	14.0	10.1	8.4
Effective Tax rate (%)	14.8	2.0	(26.3)	18.6	4.0
Segments					
Revenue					
Technical Rubber Division	44.9	(10.8)	(3.6)	180.9	(1.9)
Gloves Division	512.0	(1.4)	7.3	1,964.2	4.9
Clean Room Division	20.9	11.1	200.9	74.1	(8.5)
PBT					
Technical Rubber	4.9	(42.2)	(40.1)	27.3	(2.1)
Gloves	66.0	5.6	22.1	249.9	14.1
Clean Room	0.8	(30.3)	(7.5)	2.8	(22.9)

Source: Company, 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.