**Initiation| Friday, 30 September 2022**

# Rhong Khen International

(7006 | RKI MK) Consumer Products & Services | Household Goods

***Initiate with* NEUTRAL**

## Export oriented, challenging outlook

**Target Price: RM1.23**

## KEY INVESTMENT HIGHLIGHTS

- **We initiate our coverage on Rhong Khen International with a NEUTRAL recommendation and TP of RM1.23**
- **Our valuation is based on the FY23F's EPS of 16.3sen multiplied by PER of 7.5x**
- **We nonetheless positive about the group's long-term outlook underpinned by: (1) consistent dividend payout ratio, (2) sound balance sheet, and (3) benefit from a stronger USD**

### Company background

**Rhong Khen International Bhd ("RKI")**, previously known as Latitude Tree Holdings Bhd was founded in 1988. RKI was transferred to Bursa Malaysia's Main Market in 2001 from Second Board. It is one of the biggest producers and exporters of rubber-wood furniture in Malaysia and Vietnam. The group is also an integrated household furniture manufacturer that specializes in the manufacturing and sale of custom-made wooden household furniture and components through its subsidiary companies. Bedroom, dining room, living room, and other collection sets are among the 4 collection sets offered by the group. The group exports almost 99% of its product with nearly 90.7% of its FY21's sales contributed from exports to US. Six factories owned by the business are located in Malaysia, Vietnam, and Thailand.

### Executive Summary

We initiate coverage on Rhong Khen International (RKI) with a NEUTRAL call and target price of RM1.23. Our valuation is based on the FY23F's EPS of 16.3sen multiplied by PER of 7.5x, which is slightly below its 3-year historical PE of 8.3x. Given the company's significant reliance on the US market, we are cautious about future profitability due to reduced customer orders. In view of US economic slowdown, consumers with limited household budgets may become more cautious about discretionary buying. Meanwhile, we remain positive about the group's long-term outlook underpinned by: (1) consistent dividend payout ratio at above 30%, (2) healthy balance sheet provides resistance to downside risk, and (3) benefit from a stronger USD. The stock is currently trading at 7.3x FY23F, well below its peer's PE of 24.3x. We think that the valuation is justified because of weaker earnings ahead. The group offers a decent dividend yield of 4.6% for FY22. **Re-rating catalyst** is strong housing demand in the US that leads to higher-than-expected demand for RKI's wooden furniture.

### Key Investment Thesis

i. Consistent dividend payout,
i. Healthy balance sheet,
ii. Benefit from a stronger USD,
iii. Export-oriented.

| RETURN STATISTICS | |
|---|---|
| Price @29th September 2022 (RM) | 1.31 |
| Expected share price return (%) | -5.97 |
| Expected dividend yield (%) | +4.09 |
| **Expected total return (%)** | **-1.88** |

**SHARE PRICE CHART**



| Share price performance (%) | Absolute | Relative |
|---|---|---|
| 1 month | 0.0 | 7.4 |
| 3 months | -7.1 | -10.5 |
| 12 months | -17.6 | -8.8 |

| KEY STATISTICS | |
|---|---|
| FBM KLCI | 1,397.50 |
| Syariah compliant | Yes |
| Issue shares (m) | 97.16 |
| F4BGM Index | No |
| ESG Grading Band (Star rating) | N/A |
| Estimated free float (%) | 44.68 |
| Market Capitalisation (RM'm) | 262.32 |
| 52-wk price range | RM1.31 - RM1.75 |
| Beta vs FBM KLCI (x) | 1.34 |
| 3-mth average daily volume (m) | 0.01 |
| 3-mth average daily value (RM'm) | 0.01 |
| Top Shareholders (%) | |
| Lin Chen Jui-Fen | 25.57 |
| Konsortium Kontrek Sdn Bhd | 15.34 |
| Samarang Asset Management SA | 7.26 |

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## A. BUSINESS OVERVIEW

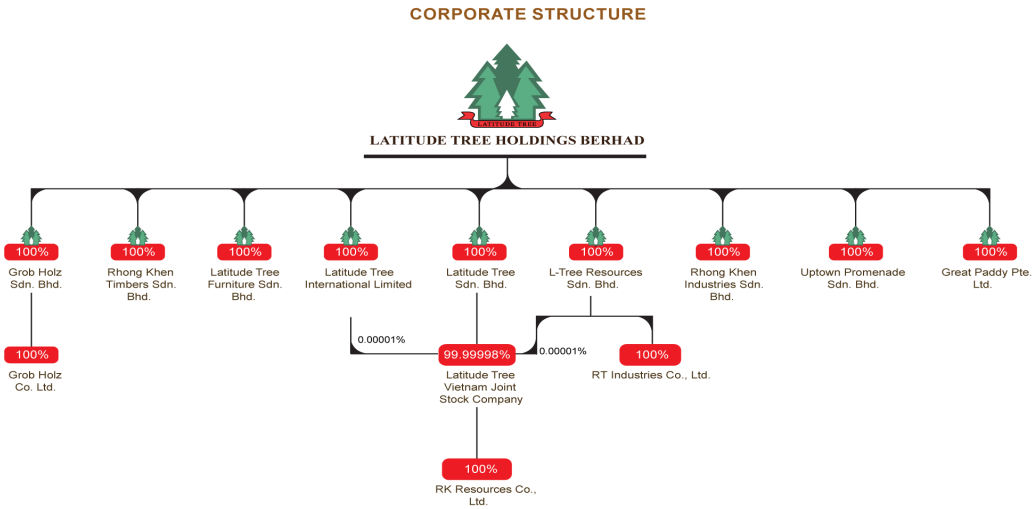
**Largest manufacturers and exporters of rubber-wood furniture in Malaysia and Vietnam.** Latitude Tree Holdings Bhd was the previous name of Rhong Khen International Bhd ("RKI"). The firm, which was established in 1988 as a manufacturer of dining set chairs, has grown to become the leading manufacturer and supplier of rubberwood furniture in Malaysia and Vietnam *(Chart 1-2)*. It is an integrated producer of household furniture that specializes in producing and marketing rubber-wood furniture for both the local and international markets. It specializes in providing high- and medium-end dining and bedroom sets has successfully carved itself a solid position in the home furnishings industry. The company exports made-to-order furniture to the US, Canada, Europe, South Africa, Australia, China, and nations in the Middle East. About 50% of its raw materials are rubber-wood-based with the remaining being oak, pine wood, and other wood-based materials.

**CHART 1: RHONG KHEN INTERNATIONAL —COMPANY HISTORY & KEY MILESTONES**

| | |
|---|---|
| 1988 | •Established as a manufacturer of chairs for dining sets. |
| 1997 | •Listed on Second Board of Bursa Malaysia Securities Berhad ("Bursa Securities) |
| 2001 | •Upgraded to Main Market of Bursa Malaysia Securities Berhad ("Bursa Securities) |
| 2002 | •Commenced business and production operation in Vietnam |
| 2005 | •Established RK Resources to meet the increasing demand for Collections Sets |
| 2006 | •One of the largest exporter of wooden furniture in Vietnam since then. Export wooden furniture to furniture importer/wholesalers/agents in United States;Canada;Middle East; Europe and Australia. |

*Source: Company data, MIDF RESEARCH*

**Chart 2: RHONG KHEN INTERNATIONAL—GROUP STRUCTURE**

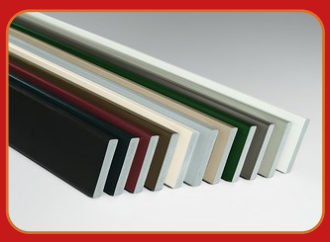



*Source: Company data*

**Extensive range of products.** The firm split its product offers into four (4) collection sets, including bedroom, dining room, living room, and others, to suit the needs and expectations of various clientele *(Chart 3)*. The Group has a team of designers, technologists, and developers that can create goods that satisfy client's needs and preferences for different markets. In response to new demand patterns for whole set and collection set furniture, the Group deliberately changed from producing traditional piece-meal furniture to manufacturing complete sets and sets.

**CHART 3: RHONG KHEN INTERNATIONAL—PRODUCTS OVERVIEW**



**Bedroom Collection Sets**
- Beds
- Nightstands
- Chests
- Armoires
- Wardrobes

**Dining Room Collection Sets**
- Tables
- Chairs
- Buffets
- Hutches
- Curious
- Sideboards
- Servers

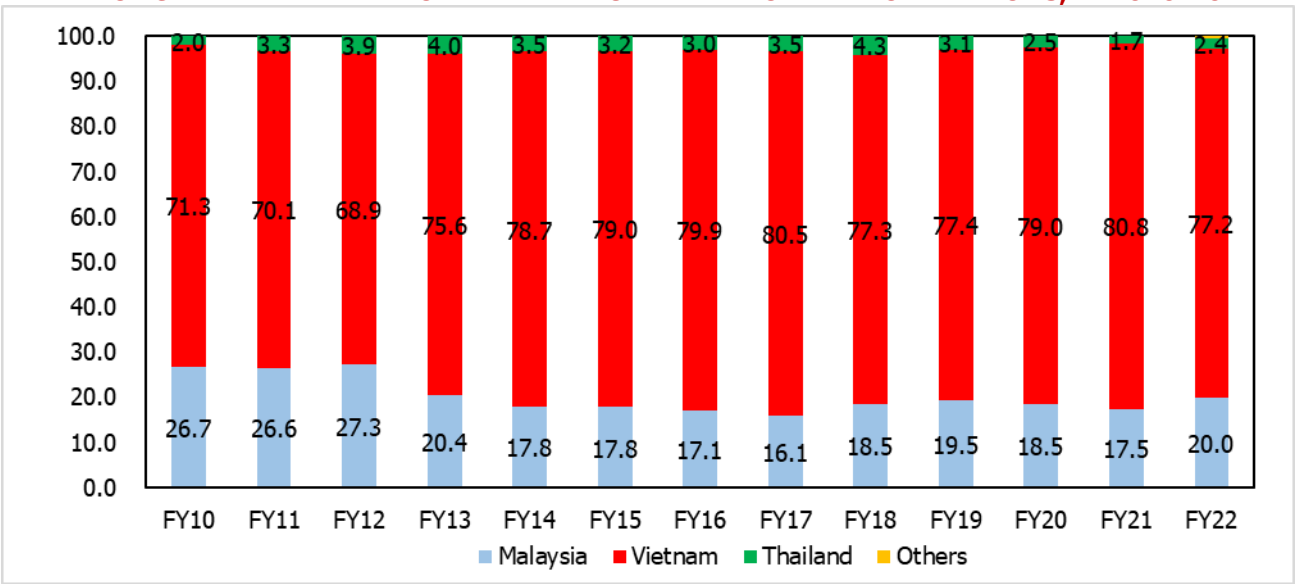
**Living Room Collection Sets**
- Sofas
- Sofa Tables
- Occassional Tables
- Coffee Tables
- Cabinets (TV & Low cabinets)
- Small Office
- Home Office (SoHo)

**Others**
- Polyester boards
- Decorative wood panels
- Impregnated papers

*Source: Company data, MIDF RESEARCH*

**Vietnam's business operation contributed 77.2% of FY22's total revenue.** The group categorizes its revenue based on the geographical location of the operation *(Chart 4).* The business division of the group primarily operates in Malaysia, Vietnam, and Thailand. As of FY22, Vietnam operations generated 77.2% of the total sales in FY22 (vs. 80.8% in FY21). The revenue contribution from Malaysia's operation improved to 20% in FY22 (vs. 17.5% in FY21 and 18.5% in FY20). Thailand's operation has the lowest contribution to the total revenue, at 2.4%.

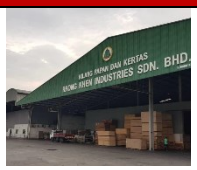
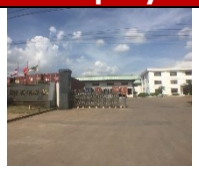
**CHART 4: RHONG KHEN INTERNATIONAL—REVENUE BREAKDOWN BY OPERATIONS, FY2010-2022**




*Source: Company data, MIDF RESEARCH*

**Factories are located across Malaysia, Vietnam, and Thailand**, which prevent excessive concentration in one market. The group's manufacturing activities are operated from its three (3) factories in Malaysia, two (2) factories in Vietnam, and one (1) factory in Thailand *(Table 1).* The six (6) manufacturing facilities' total floor area of more than 8.1m square feet (sq. ft.) with a present workforce is close to 6,000.

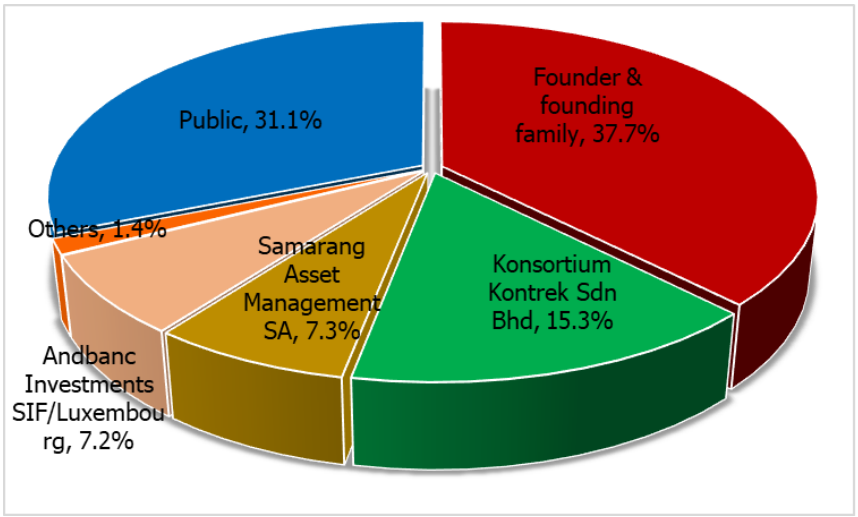
**TABLE 1: RHONG KHEN INTERNATIONAL—MANUFACTURING FACILITIES**

| Subsidiaries | Latitude Tree Furniture Sdn Bhd | Rhong Khen Timbers Sdn Bhd | Rhong Khen Industries Sdn.Bhd | Latitude Tree Vietnam Joint Stock Company | RK Resources Co. Ltd | Grob Holz Company Limited |
|---|---|---|---|---|---|---|
| **Factories** |  |  |  |  |  |  |
| **Location** | Kapar, Selangor, Malaysia | Kuala Terengganu, Malaysia | Kapar, Malaysia | Bình Dương, Vietnam | Binh Duong, Vietnam | Songkhla, Thailand |
| **Principal activities** | Manufacture and sale of wooden furniture and components | Manufacture and sale of wooden furniture parts and components | Manufacture and sale of decorative wood panels and papers | Manufacture and sale of wooden furniture and components | Manufacture and sale of wooden furniture and components | Manufacture and sale of wooden furniture parts and components |
| **Total floor area (sq.ft)** | 507,751 sq.ft | 1,545,324 sq.ft | 332,393 sq.ft | 889,120 sq.ft | 3,943,757 sq.ft | 869,024 sq.ft |

*Source: Company data, MIDF RESEARCH*

**Shareholder structure.** As of 2021, Lin Chen, Jui-Fen (one of the founders) is the largest shareholder of Rhong Khen International with 25.6% of the total issued share *(Chart 5).* This results in a total equity position owned by the founding family of 37.7% when combined with the shareholdings of 6.9% held by Lin Chin-Hung (her son) and 5.3% held by Lin Cheng-Hung (her nephew). The total share floating in the market remains moderate at 31.1%.

**CHART 5: RHONG KHEN INTERNATIONAL—SHAREHOLDER STRUCTURE**




*Source: Company data, Bloomberg, MIDF RESEARCH*

**Managed by an experienced board of directors and key management personnel.** Rhong Khen International is actively led by the founding family – the Lin family, with three of the family members sitting on the Board. The key directors and management personnel profiles are as follows:

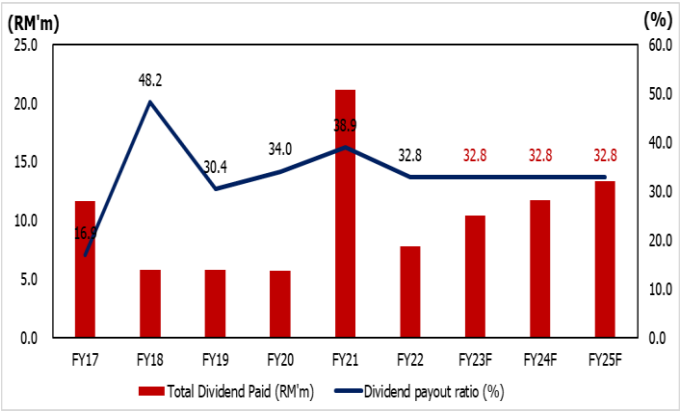
- **Dato' Dr. Norraesah Binti Haji Mohamad, Chairman/Independent Non-Executive Director (ED).** Dato' Dr. Norraesah was appointed to the board on 1 November 2018. She has over 48 years of experience in banking, consultancy, telecommunication, international trade, and commerce. She is currently the Chairman of the World Islamic Businesswomen Network of the World Islamic Economic Forum and the Executive Chairman of MY E.G. Services Berhad. She also sits on the Board of a few private limited companies.
- **Lin Chen, Jui-Fen, Deputy Executive Chairman/ED.** She was appointed as Executive Director on 28 April 1997. Lin was the Managing Director of the company from 2009-2012 and then was appointed as Deputy Executive Chairman. Lin together with the late Lin, Tzu-Keng founded the company in 1988. Presently she is the substantial shareholder of the company. She is the mother of Lin, Ching-Hung, and aunt to Lin-Cheng-Hung.
- **Lin, Chin-Hung, Managing Director.** He was appointed as Managing Director on 18 January 2012. Lin has over 21 years of experience in the marketing, production, purchasing activities, and procurement of all raw materials. Presently he is the substantial shareholder of the company. He is the son of Lin Chen, Jui-Fen, and cousin of Lin, Cheng-Hung.
- **Toh Seng Thong, JP, Independent Non-ED.** Toh was appointed on 18 August 2020. He has over 30 years of experience in auditing, taxation, and corporate and financial advisory. He is also a practicing Chartered Accountant of Malaysia. Presently he has directorship in Adventa Berhad and Grand Hoover Berhad.
- **Yek Siew Liong, Non-Independent Non-ED.** Yek was appointed on 18 May 2007. He has many years of experience in the timber trade and industry, hospitality industry, property development and management, cable manufacturing, retailing in machinery, hardware, and electrical goods, trading in petroleum, and provision of infrastructure and business facilities for the petrol service station. He is currently the Group Managing Director of Hock Lee Holdings Sdn. Bhd. He has directorship in various companies, including Sarawak Cable, Hock Lee Asia, and Cinacom Bintulu. Yek has a substantial shareholding of 15.3% held through Konsortium Kontrek Sdn. Bhd
- **Yeoh Joe Son, Group Finance Director.** He was promoted from Group Financial Controller to Group Finance Director. Yeoh has many years of working experience in accounting, audit, corporate finance, treasury, corporate recovery, and financial management. He is a Chartered Accountant of the Malaysian Institute of Accountants since 1995 and a Fellow Member of the Association of Chartered Certified Accountants since 1999.
- **Fong Toh Wai, Group Financial Controller.** Fong is a Chartered Accountant of the Malaysian Institute of Accountants and a Certified Practising Accountant of CPA Australia since 2007. He has many years of working experience in the fields of accounting, audit, corporate finance, taxation, and corporate governance.
- **Lu Chin-Chia, General Manager of Vietnam Division.** Lu has many years of working experience in wood-making machinery, furniture production, factory management, and manufacturing operations.

## B. INVESTMENT THESIS

ii. Consistent dividend payout ratio at above 30%,
iv. Healthy balance sheet provides resistance to downside financial risk,
v. Benefit from a stronger USD,
vi. Export-oriented hence more exposed to the global economy.

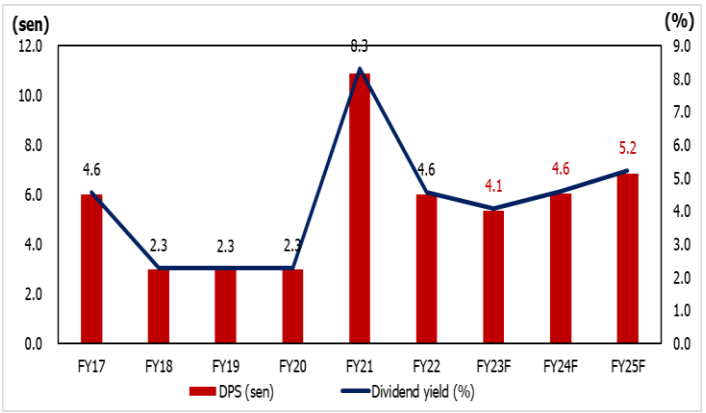
**Consistent dividend payout ratio supported by a positive operating cash flow.** The company has a track record of paying shareholders at least 30% of its core earnings in the previous five years, on average 36.9% *(Chart 6)*. The consistent dividend payout is supported by its capacity to produce strong operational cash flows, with average capital expenditure (Capex) of RM30m for the years FY18-FY22 *(Chart 8)*. The historical dividend yield for the group is 2.2%–7.3% for the years 2018–2022 *(Chart 7).*

**CHART 6: HISTORICAL DIVIDEND PAYOUT RATIO**



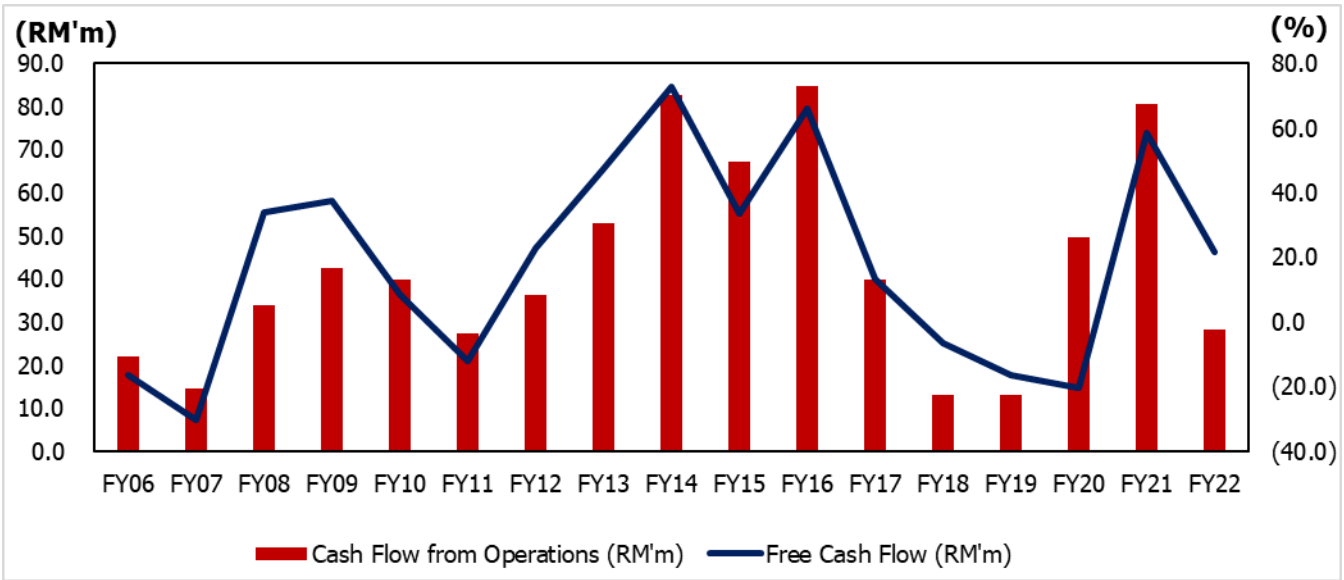

*Source: Company data, MIDF RESEARCH*

**CHART 7: HISTORICAL DIVIDEND YIELD**




*Source: Company data, MIDF RESEARCH*

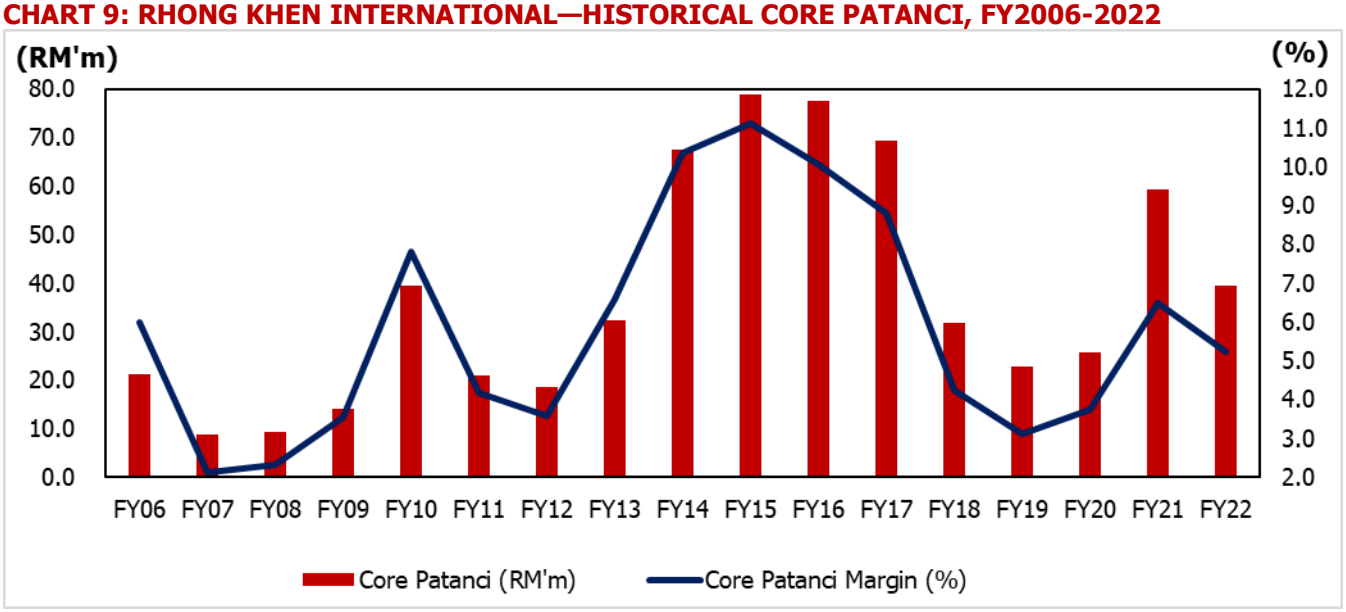
**CHART 8: RHONG KHEN INTERNATIONAL—HISTORICAL OPERATING CASH FLOW, FY2006-FY2022**




*Source: Company data, MIDF RESEARCH*

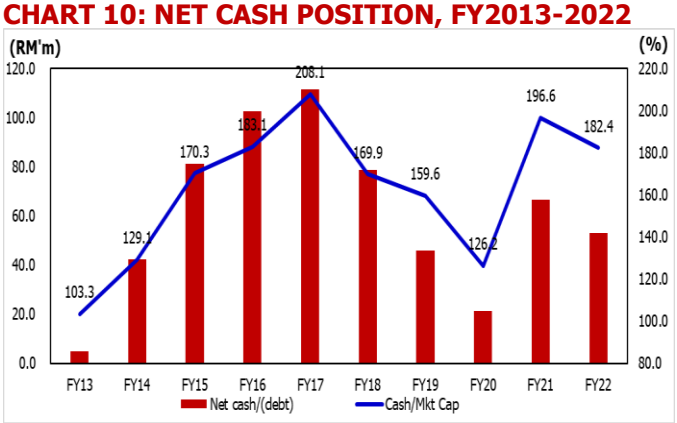
**Healthy balance sheet provides resistance to downside financial risk.** The group has remained profitable for more than 16 years, weathering many financial crises including the global financial crisis, the European debt crisis as well as Covid-19 pandemic. This indicates the business' capacity to maintain profitability even in tough times *(Chart 9).* For the years FY06-FY22, the group generated strong positive operational cash flows with average capital expenditure (Capex) of RM9.7m. Additionally, the group has a strong history of sustaining a net cash position between RM4.8m-RM208.1m, or around 103.3%-208.1% of its market capitalization, during the period of FY13-FY22 *(Chart 10).* The group has very little debt, with a total debt-to-equity ratio of 19.7% and a total debt-to-asset ratio of 12.0% for FY22 *(Chart 11).* Moving forward, we think the group is more resilient to a potential global economic slowdown given its strong net cash position, good operating cash flow, and moderate borrowing.

## CHART 9: RHONG KHEN INTERNATIONAL—HISTORICAL CORE PATANCI, FY2006-2022



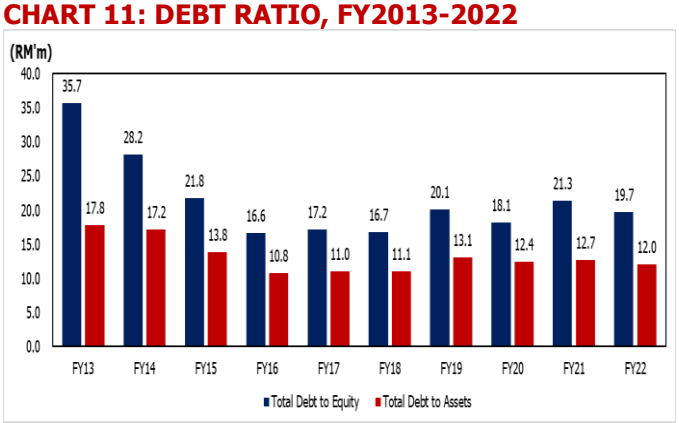

*Source: Company data, MIDF RESEARCH*

## CHART 10: NET CASH POSITION, FY2013-2022




*Source: Company data, MIDF RESEARCH*

## CHART 11: DEBT RATIO, FY2013-2022




*Source: Company data, MIDF RESEARCH*

**Beneficiary of a stronger USD.** As of 29 September 2022, USD has appreciated almost 12.3%ytd to RM4.65/USD. Our economist expects the USD/MYR rate at an average of 4.33 for CY22, which is far above CY21's USD/MYR rate of RM4.14. Given that almost 90% of the RKI's total revenue is export sales to the United States, which is denominated in USD. Hence, the appreciation of the USD has a positive impact on the company's earnings.

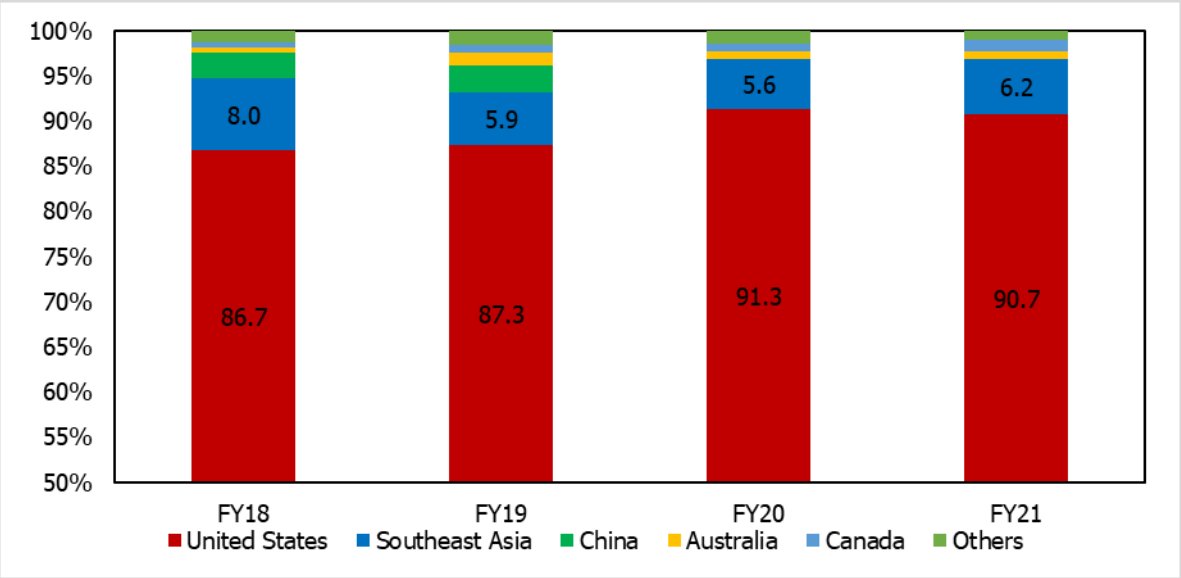
## CHART 12: USD/MYR




*Source: Google Finance*

**Export-oriented hence more exposed to performance of global economy.** Nearly 99% of the group's products are exported, with its primary business being the production of customized furniture. The main buyers of the company are furniture importers, wholesalers, and agents in developed countries, such as the United States of America (US), Canada, Europe, Australia, and the Middle East countries. Majority of the sales come from the US, which accounts for 90.7% of FY21's sales *(Chart 13).* On 22 September 2022, the US's Federal Open Market Committee (FOMC) downgraded its growth forecast for the US economy to only grow by +0.2% in 2022 (Jun-22 forecast: +1.7%). The committee also raised the Fed funds rate projection to 4.4% for 2022 (Jun-22 forecast: 3.4%) as the Fed needs to be more aggressive to address high inflation. This indicates that the US economy may slowdown in the future year, which would lead consumers to spend more on necessities than on luxuries. The ripple effect of cautious spending may lower the demand for furniture in the US. Because of this, importers of furniture would place fewer orders, which ultimately affected the group's sales and profitability.

**CHART 13: RHONG KHEN INTERNATIONAL—REVENUE BREAKDOWN BY GEOGRAPHICAL, FY2018-FY2021**




*Source: Company data, MIDF RESEARCH*

## C. Key Catalyst

| Strengths | Weakness |
|---|---|
| 1. Largest rubber-wood furniture manufacturers & exporters in Malaysia and Vietnam<br>2. Sound balance sheet, which offers resistance to possible negative risk.<br>3. Offer custom-made products, with greater ability to pass on cost to the customer. | 1. Export-oriented, with almost 90.7% of the FY21's contributed from the US market.<br>2. Dependent on rubber wood, with almost 50% of its raw materials being rubber-wood-based<br>3. Vulnerable to availability of raw material which depressed the margin due to higher cost. |
| **Opportunities** | **Threats** |
| 1. Launch of a new product or design that could boost sales.<br>2. The net cash position allowed RKI to acquire new businesses that provide synergized with the group's current operations.<br>3. Leverage e-commerce platform to connect millennial shoppers. | 1. Increasing consumer health awareness for nutritious and accessible products, which could affect the demand for HSIB's products.<br>2. Volatility in the VND, USD, THB, SGD, and CNH against RM.<br>3. Skilled labor shortage which impacted productivity |

*Source: MIDF RESEARCH*

## D. OUTLOOK

i. Weaker demand for wooden furniture ahead,
ii. Adopting Industry 4.0 technologies to enhance production efficiency.

**Weaker demand for wooden furniture ahead.** The company's sales will be impacted by the weaker economic outlook for US. Given that 90.7% of the company's FY21 income came from export sales to the US. On 27 September 2022, the Organization for Economic Cooperation and Development reduced the US's GDP growth to 1.5% in CY23 due to persistent upward pressure on prices and monetary tightening in the US to fight inflation. This is consistent with FOMC projections for 1.2% US GDP growth in CY23. Additionally, the FOMC recently lowered the unemployment rate for CY23 to 4.4% (from 3.8% in CY22) and the rate of personal consumption expenditures to 2.8% (from 5.4% in CY22). We thus expect that consumers with limited household budgets may become more cautious about discretionary buying, given the inflationary and increasing interest rate environment. Moving forward, we are wary that the demand for wooden furniture from US consumers would wane well beyond 2023, which will affect the group's top line, mostly because of lower client deals. Nevertheless, we are positive about the long-term prospect of the industry, underpinned by the increasing demand for branded and ready-made furniture. Growing urbanization, baby boomers' extended lifespans, millennials' lifestyle preferences, and foreign direct investment inflows have all influenced a commensurate increase in demand for custom-made hardwood furniture.

**Adopting Industry 4.0 technologies to enhance production efficiency.** Large-scale product personalization production is becoming more possible with Industry 4.0, with better quality and no additional costs or delays. In addition, businesses may simply move between the four production models, which require more agility and knowledge to react in real-time to changing demand, thanks to digitalization, IoT, and connectivity. Digital technology use in the furniture sector is anticipated to result in enhanced production flexibility and speed, as well as mass customization and higher productivity. The ability to manufacture lower batch sizes—even as tiny as batch-size 1—profitably and effectively at a cost and lead time equal to larger batch sizes would be a benefit for manufacturers that make customized furniture. The group has allocated an additional RM10.7m in FY21 to upgrade the existing production lines with advanced and automated machinery to further enhance production efficiency and reduce workers.

## E. KEY RISKS RELATED TO THE BUSINESS AND INDUSTRY

i. Exposure to fluctuation of foreign currency exchange,
ii. Risk to supply of raw material due to lack of long-term supply arrangements with supplier,
iii. Risk relating to fire incident at production facilities,
iv. Over-dependent on sub-contractor,
v. Vulnerable to political, economy and regulatory risk.

**Exposure to the fluctuation of foreign currency exchange.** The group is susceptible to the fluctuation of transactional currency risk that arises from sales or purchases that are denominated in a currency other than the functional currency of the Group, which is the RM, given that approximately 97% and 85% of the group's sales and costs are denominated in foreign currencies for FY21. The group also holds cash and cash equivalents denominated in foreign currencies for working capital purposes, at nearly 83% of the total cash in FY21. The group managed to use forward currency contracts to eliminate the currency exposures on its cash and cash equivalents. The group is vulnerable to volatility in VND, USD, THB, SGD, and CNH exchange rates. Based on our sensitivity analysis, RKI is benefitted from the strengthening in USD, SGD, and CNH, while the group's net profit will be impacted if VND/RM and THB/RM currency rates increased. Every 10% increase in USD/SGD/CNH against RM will increase the net profit for FY23F by +1.7%/+2.4%/+1.8%. Else, every 10% increase in VND/THB against RM will reduce the net profit for FY23F by -3.9%/-0.7%. The huge impact of the volatility in VND is mainly due to the group's business operation in Vietnam.

**Risk to supply of raw material due to lack of long-term supply arrangements with supplier.** Wood is one of the main raw materials used in the manufacturing of RKI's products. The wood or wood-based raw materials used in the product include rubber wood, poplar wood, pine wood, oak wood, particle boards, MDF, plywood, and veneer boards. The total cost of wood or wood-based raw materials accounted for 40% to 55% of our total costs of sales. The group is exposed to the risk of low availability of wooden material, especially rubber wood, which could drive the raw material price higher. This is due to about 50% of its raw materials being rubber-wood-based (Hevea brasiliensis) with the remaining being other wood-based materials. As a result, this will affect the company's furniture production's profit margin. Interruptions that might happen include inclement weather and difficulties moving the log. Furthermore, as the business does not have long-term supply agreements with the suppliers, hence there is no guarantee that it will be able to continue obtaining a sufficient

quantity of raw materials from them, promptly, at competitive costs. The Group has been offering financial loans to certain suppliers of wood-based raw materials in order to ensure that we have a sufficient supply to meet our manufacturing demands.

**Risk relating to fire incident at production facilities**. Due to the dominant use of wood in furniture production and the presence of dust or sawdust, a fire ignition would bring a devastating outcome that greatly affects Rhong Khen's performance. On 5 April 2018, a fire incident occurred at one factory building belonging to RK Resources Co. Ltd. ("RK Resources"), an indirect wholly-owned subsidiary of the Company. The affected building is located within RK Resources' manufacturing facilities in the Province of Binh Duong, Vietnam. The fire incident has led to a total loss of RM13.9m of which RM10.8 million relates to loss of inventories and RM3.1 million relates to property, plant, and equipment. This has resulted in a -82.5%yoy decline in the profit after tax (PAT) for FY18. The group received a total insurance compensation of RM10.3m with RM2.7m received in FY20 and RM7.7m in FY21. As such, the group has implemented a series of safety measures, including training such as the Fire Risk Management Workshop – Intermediate, and Fire Safety Training in FY21 to minimize the risk of fire.

**Over-dependent on sub-contractor.** The group sub-contracts the manufacture of certain furniture components, semi-finished products, and other parts and accessories required for our products, such as chair legs, chair seats, lathe, and bentwood to sub-contractors. It depends on the availability of subcontractors with the necessary expertise to meet the demands of production. The group may not be able to deliver our products on time or may have to spend additional expenses if there is a lack of subcontractors with the necessary capabilities or if our subcontractors fail to fulfill our quality standards or criteria or default on their delivery commitments or work specifications. If any of such events occurs, the group's revenue and profitability may be adversely affected.

**Vulnerable to political, economy and regulatory risk.** The group has been subject to the political, economy, and regulatory risks associated with countries where the business has operations and to which they export. The risk includes governmental regulations, changes in social, political, and economic conditions, changing exports & import duties on fixture items, limitations on foreign investment, changes in local labour conditions, minimum wage hikes, etc. Given that the company conducts business in Malaysia, Vietnam, and Thailand, any unanticipated risk might result in extra expenses for the firm. The group is also subject to the changes in political, economic, and regulatory in the US as almost 90.7% of its total sales exports to the US market. Any unforeseen political, economic, and regulatory risk could result in lower sales due to lower orders from furniture importers from the US market. The Group had in the year 2015 divested into manufacturing and distribution of polyester boards, decorative wood panels, and printing of impregnated paper to diversify its revenue stream and to enhance the Group's current product offering.

## F. FINANCIALS

### RHONG KHEN INTERNATIONAL: 4QFY22 RESULTS SUMMARY

| FYE JUN (RM'm) | Quarterly results | | | | | Cumulative results | | |
|---|---|---|---|---|---|---|---|---|
| | 4QFY22 | 3QFY22 | 4QFY21 | YoY (%) | QoQ (%) | 12MFY22 | 12MFY21 | YoY (%) |
| Revenue | 240.2 | 194.8 | 216.0 | 11.2 | 23.3 | 756.3 | 911.9 | (17.1) |
| Cost of sales | (195.4) | (167.6) | (188.7) | 3.5 | 16.6 | (650.8) | (786.1) | (17.2) |
| **Gross Profit** | 44.8 | 27.2 | 27.3 | 64.0 | 64.7 | 105.5 | 125.9 | (16.2) |
| Other income | 1.3 | 1.0 | 1.2 | 11.4 | 23.4 | 6.0 | 13.2 | (54.8) |
| Selling and marketing expenses | (7.6) | (5.2) | (7.8) | (2.5) | 47.4 | (23.9) | (27.0) | (11.3) |
| Administrative expenses | (6.6) | (8.8) | (7.9) | (16.5) | (25.1) | (27.1) | (30.5) | (11.0) |
| **Other expenses** | (5.9) | (0.5) | (1.9) | **206.8** | **988.6** | (9.0) | (7.1) | **27.4** |
| Operating profit | 26.0 | 13.8 | 10.9 | 139.4 | 89.0 | 51.4 | 74.5 | (31.0) |
| **Net Interest:** | (0.8) | (0.5) | (0.8) | **(0.6)** | **50.0** | (2.6) | (3.0) | **(11.8)** |
| Finance cost | (0.8) | (0.5) | (0.8) | (0.6) | 50.0 | (2.6) | (3.0) | (11.8) |
| **Interest income** | 0.0 | 0.0 | 0.0 | **n.m.** | **n.m.** | 0.0 | 0.0 | **n.m.** |
| Profit before tax (PBT) | 25.2 | 13.2 | 10.0 | 150.9 | 90.6 | 48.8 | 71.6 | (31.8) |
| **Income tax expense** | (7.7) | (2.4) | (7.5) | 3.4 | 226.5 | (13.3) | (17.8) | (25.3) |
| Profit after tax | 17.5 | 10.8 | 2.6 | 580.4 | 61.0 | 35.5 | 53.8 | (34.0) |
| **Minority Interest** | 0.0 | 0.0 | 0.0 | **n.m.** | **n.m.** | 0.0 | 0.0 | **n.m.** |
| PATANCI | 17.5 | 10.8 | 2.6 | 580.4 | 61.0 | 35.5 | 53.8 | (34.0) |
| EI | 2.5 | 0.2 | 2.5 | (3.5) | 1143.7 | 4.0 | (4.5) | (189.2) |
| Core PATANCI | 19.9 | 11.0 | 5.1 | 289.9 | 80.3 | 39.5 | 49.3 | (19.8) |
| Basic EPS (sen) | 9.0 | 5.6 | 2.1 | 335.9 | 60.9 | 18.3 | 27.7 | (34.0) |
| **Growth & Margin (%)** | | | | ***+/(-) ppts*** | ***+/(-) ppts*** | | | ***+/(-) ppts*** |
| Revenue Growth | 23.3 | 27.7 | (0.3) | 23.6 | (4.4) | 46.5 | 31.0 | 15.5 |
| Gross Profit Growth | 64.7 | 47.3 | (9.4) | 74.2 | 17.4 | 73.8 | 27.7 | 46.1 |
| Operating Profit Growth | 89.0 | 70.2 | (28.6) | 117.6 | 18.9 | 102.3 | 17.1 | 85.2 |
| Core PATANCI Growth | 80.3 | 86.9 | (52.7) | 133.0 | (6.5) | 101.4 | 11.6 | 89.8 |
| Gross Profit Margin | 18.7 | 14.0 | 12.7 | 6.0 | 4.7 | 14.0 | 13.8 | 0.2 |
| Operating Profit Margin | 10.8 | 7.1 | 5.0 | 5.8 | 3.8 | 6.8 | 8.2 | (1.4) |
| PBT Margin | 10.5 | 6.8 | 4.6 | 5.8 | 3.7 | 6.5 | 7.8 | (1.4) |
| Core PATANCI Margin | 8.3 | 5.7 | 2.4 | 5.9 | 2.6 | 5.2 | 5.4 | (0.2) |
| **Ratios & Valuation** | | | | ***+/(-) ppts*** | ***+/(-) ppts*** | | | ***+/(-) ppts*** |
| Net cash/market cap (%) | 19.8 | 10.3 | 24.8 | (5.0) | 9.5 | 19.8 | 24.8 | (5.0) |
| Effective tax rate (%) | 30.7 | 17.9 | 74.4 | (43.8) | 12.8 | 27.2 | 24.9 | 2.4 |

*Source: Company data, MIDF RESEARCH*

### RHONG KHEN INTERNATIONAL: BREAKDOWN BY OPERATIONS

| FYE JUN (RM'm) | Quarterly results | | | | | Cumulative results | | |
|---|---|---|---|---|---|---|---|---|
| | 4QFY22 | 3QFY22 | 4QFY21 | YoY (%) | QoQ (%) | 12MFY22 | 12MFY21 | YoY (%) |
| **Revenue:** | | | | | | | | |
| Malaysia | 38.4 | 49.9 | 27.9 | 37.8 | (23.0) | 151.1 | 155.2 | (2.6) |
| Vietnam | 196.2 | 138.9 | 183.3 | 7.0 | 41.3 | 584.2 | 736.9 | (20.7) |
| Thailand | 4.5 | 5.1 | 3.9 | 16.8 | (10.7) | 17.8 | 15.9 | 12.1 |
| Others | 1.0 | 0.9 | 0.9 | 12.6 | 18.5 | 3.2 | 4.0 | (18.8) |
| **Total** | **240.2** | **194.8** | **216.0** | **11.2** | **23.3** | **756.3** | **911.9** | **(17.1)** |
| **Profit:** | | | | | | | | |
| Malaysia | 2.4 | 10.8 | (2.9) | (183.9) | (77.5) | 19.7 | 5.7 | 245.4 |
| Vietnam | 24.7 | 15.8 | 15.0 | 65.1 | 56.0 | 45.7 | 67.3 | (32.1) |
| Thailand | (0.8) | (1.6) | (1.4) | (43.9) | (51.3) | (3.9) | (1.0) | 303.5 |
| Others | (1.2) | (1.4) | (0.6) | 79.6 | (14.2) | (2.2) | (0.4) | 424.9 |
| **Total** | **25.2** | **23.6** | **10.0** | **150.9** | **6.5** | **59.2** | **71.6** | **(17.2)** |

*Source: Company data, MIDF RESEARCH*

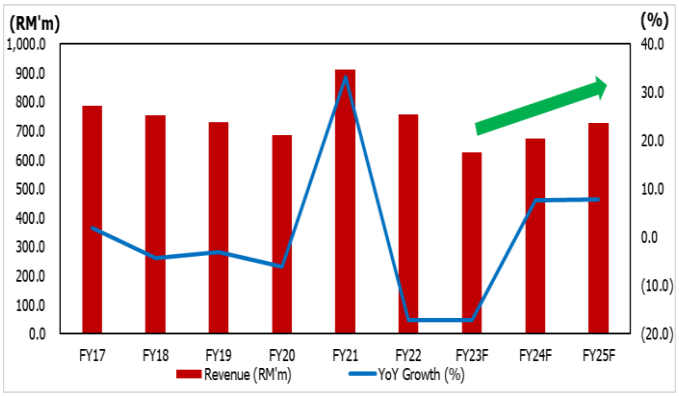
**Snapshot of 4QFY22 results**. On a quarterly basis, the group recorded a higher core PATANCI of RM19.9m (from RM11m in 3QFY22) mainly supported by: (1) higher sales in Vietnam operation at RM196.2 in 4QFY22 (vs. RM138.9m in 3QFY22), (2) +1.1%qoq increased in the USD against RM, (3) -25.1%qoq decline in administrative expenses to -RM6.6m, and (4) lower manufacturing cost as more production days which contributed to higher production output. The income tax expenses more than doubled to -RM7.7m (from -RM2.4m) mainly because of a higher tax provision in this quarter. On yearly basis, the group's stronger core earning of RM19.9m (from RM5.1m in 4QFY21) was in line with +139.4%yoy increase in the operating profit to RM26m. The positive performance is underpinned by the better sales and operating profit recorded in Malaysia and Vietnam operations.

**Weaker 12MFY22's earnings.** The group's 12MFY22 core PATANCI declined by -19.8%yoy to RM39.5m in line with the weaker revenue at RM754.3m (from RM911.9m). The lackluster performance was attributable to (1) lesser production days amid lockdown in Malaysia and Vietnam, (2) lower sales and volume in Vietnam amid labor shortage following the resumption of operation, (3) lower shipment due to the congestion at US ports and limited shipping vessels, (4) elevated raw material prices and logistics cost, and (5) higher operating cost caused by the closure of furniture and sawmill plants in Malaysia as well as the implementation of "3 on the spot" approach by furniture plants in Vietnam during the lockdown. This has more than offset the strengthening of USD against RM by +2.7%yoy for the year. The PBT margin dropped -from 1.4ppt to 6.5% mainly due to a decrease in gross profit and higher fair value loss on derivatives and investment securities.

## G. KEY ASSUMPTIONS AND FINANCIAL OUTLOOK

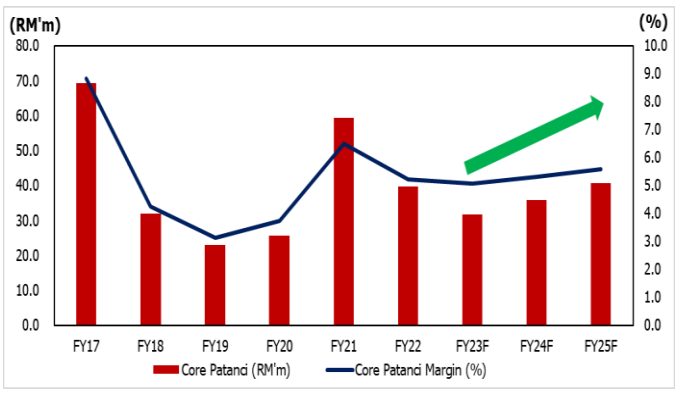
**Earnings outlook.** We anticipate a 3-year revenue CAGR of -1.3% for FY23F *(Chart 14)*. This is after accounting for the possibility of decreased sales due to a future decline in the demand for wooden furniture. Management expects a 15-25% reduction in sales moving forward due to the recession fears in the US market which caused lower discretionary spending. According to the breakdown of sales per business operation, we anticipate that the Vietnam operation will continue to contribute the most to overall revenue, at 78.8% of total sales for FY23F-25F. The US market's revenue contribution is forecast to be 89.7% in FY23F and normalise to 89.9%/90.2% in FY24F/25F. Going forward, we expect lower manufacturing costs to partially offset the impact of lower sales. The reduced cost is supported by: (1) increased output across all divisions following the economy's reopening, which results in more production days; and (2) decreased logistical costs as a result of the recent decreases in crude oil. In FY23F-25F, we forecast an increased EBIT margin of 7.3%/7.6%/8.0%. A core PATANCI CAGR of +0.9% over the course of three years results in FY25F *(Chart 15)*.

**CHART 14: REVENUE PROJECTION**




*Source: Company data, MIDF RESEARCH*

**CHART 15: CORE PATANCI PROJECTION**




*Source: Company data, MIDF RESEARCH*

**Moderate dividend payout ratio of 32.8%.** We project dividend of 5.4sen-6.9sen for FY23F-25F and a dividend yield of 4.1%-5.2% for FY23F-25F. This is consistent with the dividend payout of 32.8%. This is below its 5-years historical average of 36.9%, we think that the company might want to increase the retained earnings to preserve cash towards any potential downside. The company's net cash position and anticipated positive free cash flow are both taken into account in this dividend projection.

## H. VALUATION AND RECOMMENDATION

We initiate coverage on Rhong Khen International (RKI) with a **NEUTRAL** call and **target price** of RM1.23 with a total potential return of -1.88% (-5.97% of expected capital gain and 4.05% of dividend yield). Our target price is based on the FY23F's EPS of 16.3sen multiplied by PER of 7.5x, slightly below its 3-year historical PE of 8.3x. Given the company's significant reliance on the US market, we are cautious about future profitability mainly due to reduced customer orders. In view of US economic slowdown, consumers with limited household budgets may become more cautious about discretionary buying. Meanwhile, we remain positive about the group's long-term outlook underpinned by: (1) consistent dividend payout

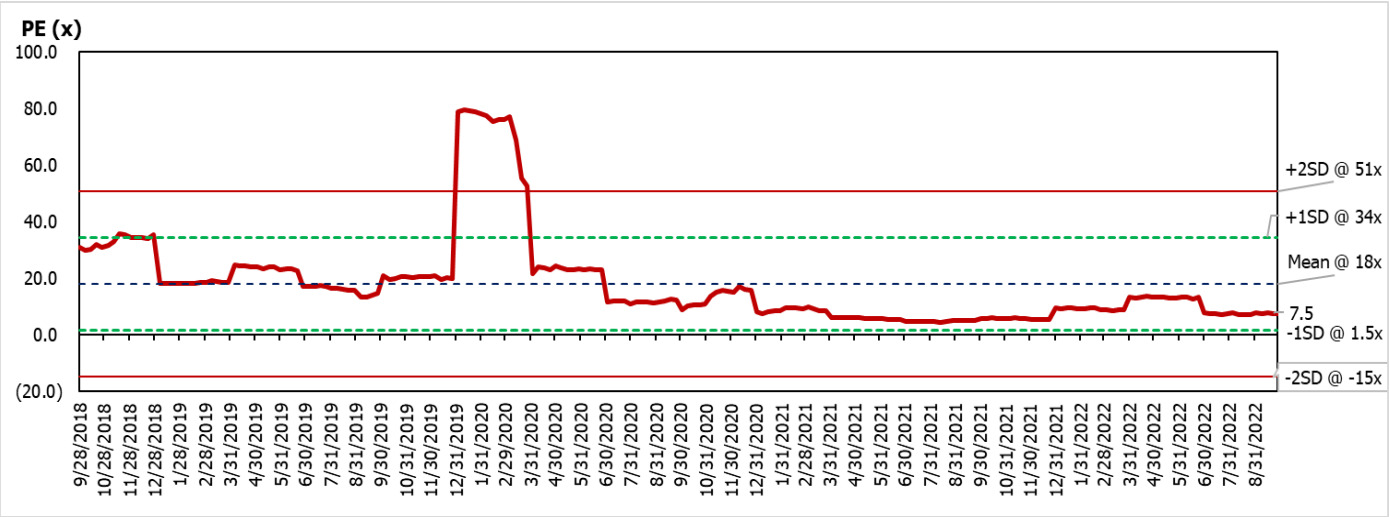
ratio at above 30%, (2) sound balance sheet provides resistance to downside financial risk, and (3) benefit from a stronger USD. **Re-rating catalyst** is the strong housing demand in the US that leads to higher-than-expected demand for RKI's wooden furniture.

## I. PEER COMPARISON TABLE

| Name | Recc. | Price @ 29/9 | TP | Mkt Cap (RM'm) | PER (x) | P/B (x) | Div.Yield (%) |
|---|---|---|---|---|---|---|---|
| Rhong Khen International | NEUTRAL | RM1.31 | RM1.23 | 254.6 | 7.2 | 0.2 | 3.1 |
| Sern Kou Resource | N/A | RM0.78 | N/A | 677.6 | 73.4 | 3.3 | N/A |
| Signature International | N/A | RM1.76 | N/A | 504.3 | 20.3 | 2.2 | N/A |
| Lii Hen Industries | N/A | RM0.82 | N/A | 442.8 | 8.0 | 0.3 | 5.1 |
| Poh Huat Resources Holdings | N/A | RM1.38 | N/A | 363.0 | 6.7 | 0.7 | 4.4 |
| Homeritz Corp | N/A | RM0.51 | N/A | 231.6 | 7.7 | 0.9 | 3.2 |
| HeveaBoard | N/A | RM0.39 | N/A | 215.0 | 18.8 | 0.5 | 2.6 |
| Jaycorp | N/A | RM0.69 | N/A | 185.4 | 8.8 | 1.0 | 6.9 |
| TAFI Industries | N/A | RM0.48 | N/A | 182.1 | 23.6 | 0.8 | N/A |
| Lee Swee Kiat Group | N/A | RM0.63 | N/A | 101.9 | 7.8 | 1.6 | 4.0 |
| FACB Industries Inc | N/A | RM1.10 | N/A | 92.3 | 12.8 | 0.4 | N/A |
| Federal International Holdings | N/A | RM0.53 | N/A | 73.0 | 5.6 | 0.7 | 1.0 |
| SHH Resources Holdings | N/A | RM0.68 | N/A | 68.0 | 13.2 | 0.9 | N/A |
| DPS Resources | N/A | RM0.10 | N/A | 67.0 | 17.9 | 0.4 | N/A |
| SWS Capital | N/A | RM0.21 | N/A | 57.8 | 27.7 | 0.4 | N/A |
| **Simple mean** | | | | | **17.3** | **1.0** | **3.8** |
| **Weighted Avg.** | | | | | **24.3** | **1.4** | **2.2** |

*N/A for non-rated stocks and forecast for non-rated stocks are based on Bloomberg's consensus forecast

**CHART 16: RHONG KHEN INTERNATIONAL—HISTORICAL 5-YEAR FORWARD PE BAND**




*Source: MIDF RESEARCH, Bloomberg*

## INCOME STATEMENT

| FYE JUN (RM'm) | FY2020 | FY2021 | FY2022A | FY2023F | FY2024F | FY2025F |
|---|---|---|---|---|---|---|
| **Revenue** | **684.7** | **911.9** | **756.3** | **626.6** | **674.8** | **727.5** |
| Cost of Sales | (611.5) | (786.1) | (650.8) | (539.2) | (577.8) | (619.7) |
| **Gross Profit** | **73.3** | **125.9** | **105.5** | **87.4** | **97.0** | **107.7** |
| Profit Before Tax (PBT) | 23.0 | 71.6 | 48.8 | 43.0 | 48.5 | 55.2 |
| Income Tax Expenses | (6.2) | (17.8) | (13.3) | (11.3) | (12.8) | (14.5) |
| **PATANCI** | **16.8** | **53.8** | **35.5** | **31.7** | **35.8** | **40.6** |
| **Core PATANCI** | **25.6** | **59.3** | **39.5** | **31.7** | **35.8** | **40.6** |
| EPS (sen) | 8.8 | 28.0 | 18.3 | 16.3 | 18.4 | 20.9 |
| Dividend per share (sen) | 3.0 | 10.9 | 6.0 | 5.4 | 6.0 | 6.9 |
| Dividend yield (%) | 2.3 | 8.3 | 4.6 | 4.1 | 4.6 | 5.2 |
| **Growth & Valuation (%)** | | | | | | |
| Revenue Growth | (6.1) | 33.2 | (17.1) | (17.1) | 7.7 | 7.8 |
| Gross Profit Growth | (11.8) | 71.8 | (16.2) | (17.2) | 11.0 | 11.0 |
| Core PATANCI Growth | 12.1 | 131.3 | (33.3) | (19.8) | 12.8 | 13.6 |
| Gross Profit Margin | 10.7 | 13.8 | 14.0 | 14.0 | 14.4 | 14.8 |
| PBT Margin | 3.4 | 7.8 | 6.5 | 6.9 | 7.2 | 7.6 |
| Core PATANCI Margin | 3.7 | 6.5 | 5.2 | 5.1 | 5.3 | 5.6 |
| Effective tax rate | 26.9 | 24.9 | 27.2 | 26.3 | 26.3 | 26.3 |

*Source: Company, MIDF RESEARCH*

## BALANCE SHEET

| FYE JUN (RM'm) | FY2020 | FY2021 | FY2022A | FY2023F | FY2024F | FY2025F |
|---|---|---|---|---|---|---|
| Property,plant and equipment | 246.9 | 251.2 | 255.5 | 272.2 | 279.4 | 288.3 |
| Investment in Affiliates | 65.5 | 59.6 | 52.2 | 52.2 | 52.2 | 52.2 |
| Other non-current assets | 49.1 | 35.5 | 32.8 | 32.7 | 32.7 | 32.7 |
| **Total Non-Current Asset** | **361.5** | **346.3** | **340.6** | **357.1** | **364.4** | **373.2** |
| Inventories | 194.9 | 229.0 | 253.4 | 148.2 | 150.6 | 161.5 |
| Trade and other receivables | 71.6 | 61.3 | 82.5 | 60.1 | 63.8 | 68.8 |
| Cash and cash equivalents | 126.2 | 196.6 | 182.4 | 196.4 | 216.8 | 239.6 |
| Other current assets | 89.6 | 190.3 | 214.9 | 214.9 | 214.9 | 214.9 |
| **Total Current Assets** | **482.3** | **677.2** | **733.1** | **619.6** | **646.1** | **684.8** |
| **Total Assets** | **843.8** | **1023.5** | **1073.7** | **976.8** | **1010.5** | **1058.0** |
| | | | | | | |
| Share capital | 98.4 | 98.4 | 98.4 | 98.4 | 98.4 | 98.4 |
| Retained Earnings | 408.0 | 443.5 | 471.3 | 492.6 | 516.6 | 543.9 |
| **Total Equity** | **578.0** | **610.2** | **655.3** | **676.6** | **700.6** | **727.9** |
| | | | | | | |
| LT Loans and borrowings | 9.3 | 22.1 | 26.0 | 25.9 | 25.7 | 25.5 |
| Other non-current liabilities | 10.2 | 8.5 | 8.7 | 14.3 | 19.3 | 34.5 |
| **Total Non-Current Liabilities** | **19.5** | **30.6** | **34.8** | **40.1** | **45.0** | **60.0** |
| Trade and other payables | 78.4 | 111.7 | 116.9 | 75.8 | 81.2 | 87.1 |
| ST Loans and borrowings | 95.6 | 108.1 | 103.3 | 102.6 | 102.0 | 101.3 |
| Other current liabilities | 28.7 | 33.0 | 81.7 | 81.7 | 81.7 | 81.7 |
| **Total Current Liabilities** | **202.7** | **252.8** | **301.8** | **260.1** | **264.8** | **270.1** |
| **Total Liabilities & Equity** | **800.2** | **893.6** | **1073.7** | **976.8** | **1010.5** | **1058.0** |

*Source: Company, MIDF RESEARCH*

## CASH FLOW

| FYE JUN (RM'm) | FY2020 | FY2021 | FY2022A | FY2023F | FY2024F | FY2025F |
|---|---|---|---|---|---|---|
| Pretax profit | 23.0 | 71.6 | 48.8 | 43.0 | 48.5 | 55.2 |
| Cash flow from operations | 49.6 | 80.5 | 28.2 | 54.5 | 56.3 | 63.9 |
| Cash flow from investing | (68.0) | (18.3) | (32.4) | (14.7) | (19.2) | (22.8) |
| Cash flow from financing | (24.9) | 23.0 | (16.8) | (14.8) | (16.7) | (18.3) |
| **Net cash flow** | **(43.3)** | **85.1** | **(21.0)** | **25.1** | **20.4** | **22.8** |
| Adjustments | 7.4 | (1.6) | 7.3 | 0.0 | 0.0 | 0.0 |
| **Net cash/(debt) b/f** | **137.4** | **101.4** | **185.0** | **171.4** | **196.4** | **216.8** |
| **Net cash/(debt) c/f** | **101.4** | **185.0** | **171.4** | **196.4** | **216.8** | **239.6** |

*Source: Company, MIDF RESEARCH*

## RATIOS & VALUATION

| FYE JUN (RM'm) | FY2020 | FY2021 | FY2022A | FY2023F | FY2024F | FY2025F |
|---|---|---|---|---|---|---|
| PER (x) | 11.1 | 6.0 | 7.7 | 8.0 | 7.1 | 6.3 |
| Net debt/Total Equity (%) | Net Cash | Net Cash | Net Cash | Net Cash | Net Cash | Net Cash |
| Dividend payout (%) | 34.0 | 38.9 | 32.8 | 32.8 | 32.8 | 32.8 |
| Current ratio (x) | 2.4 | 2.7 | 2.4 | 2.4 | 2.4 | 2.5 |
| Cash/Mkt Cap (x) | 49.6 | 77.2 | 71.6 | 77.2 | 85.2 | 94.1 |
| P/B (x) | 0.4 | 0.4 | 0.4 | 0.4 | 0.4 | 0.3 |
| ROE (%) | 4.4 | 9.7 | 6.0 | 4.7 | 5.1 | 5.6 |
| ROA (%) | 3.0 | 5.8 | 3.7 | 3.2 | 3.5 | 3.8 |
| EV/EBIT (x) | 9.7 | 2.6 | 3.9 | 4.1 | 3.2 | 2.4 |
| Inventories (Days) | 120.9 | 98.4 | 135.3 | 100.3 | 95.1 | 95.1 |
| Account receivables (Days) | 39.4 | 26.6 | 34.7 | 35.0 | 34.5 | 34.5 |
| Account payable (Days) | 50.8 | 44.1 | 64.1 | 51.3 | 51.3 | 51.3 |

*Source: Company, MIDF RESEARCH*

MIDF RESEARCH is part of MIDF Amanah Investment Bank Berhad (197501002077(23878 – X)).

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*Source: Company, MIDF RESEARCH*

| **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 *rise* 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 *fall* 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