Kossan Rubber Industries Berhad

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

Downgrade to SELL

Strong headwinds ahead

***Revised* Target Price: RM0.90**

(Previously RM1.28)

(KEY INVESTMENT HIGHLIGHTS)

- **Earnings below expectation**
- **Core earnings for 3QFY22 dipped -69.8%qoq to RM12.9m**
- **Poorer 9MFY22's PBT across all divisions**
- **Margin compression continues**
- **Slashed FY22-24F earnings estimates**
- **Downgrade to SELL (from NEUTRAL) with a lower TP of RM0.90 (from RM1.28)**

Earnings below expectation. Kossan Rubber Industries (Kossan)'s 9MFY22 core PATANCI of RM145m came in below our FY22 projection but above streets'. This is after stripping out a one-time off item of -RM15.1m. It represented 51.1% of our and 71.5% of the consensus full-year estimates. The key variance was due to lower-than-expected sales volume and greater-than-expected energy costs.

Core earnings for 3QFY22 dipped -69.8%qoq to RM12.9m, in line with lower revenue at RM560.5m. The weaker revenue was due to lower average selling prices (ASPs) and volume sold for glove products. The Technical Rubber Division (TRP) and Clean-room divisions posted improved PBT thanks to higher revenue coupled with stronger performance in the infrastructure segment and better margins in personal protection equipment and cleanroom products. On yearly basis, the core PATANCI has reached a new low in a decade at RM12.9m. This was largely due to lower revenue coupled with higher energy (increase in natural gas tariffs) and labor costs (higher minimum wage).

Poorer 9MFY22's PBT across all divisions. Cumulatively, the group's revenue plunged by -67.9%yoy to RM1.8b. This was due to reduced sales from the glove and clean-room divisions, which more than offset higher revenue from the TRP segment. Despite higher revenue in the TRP divisions, the PBT decreased by -13.9%yoy to RM64.7m due to the lackluster performance in the automotive segment. The weaker PBT for glove and clean room divisions was in line with lower revenue. The core earnings for 9MFY22 declined by -94.5%yoy to RM145m because of lower PBT across three divisions.

Outlook. Going forward, the group anticipates to continue facing challenges in 4QFY22 and FY23. Hence, the group keeps its short-term expansion plans on hold, subject to the supply-demand situation.

RETURN STATISTICS	
Price @ 02nd November 2022 (RM)	1.20
Expected share price return (%)	-25.30
Expected dividend yield (%)	+10.0
Expected total return (%)	**-15.29**

SHARE PRICE CHART



Share price performance (%)	Absolute	Relative
1 month	11.1	6.9
3 months	11.1	-2.5
12 months	-48.7	-45.6

KEY STATISTICS	
FBM KLCI	1451.61
Syariah compliant	Yes
Issue shares (m)	2551.62
F4BGM Index	No
ESG Grading Band (Star rating)	☆☆☆
Estimated free float (%)	88.35
Market Capitalisation (RM'm)	3,061.94
52-wk price range	RM0.91 - RM2.73
Beta vs FBM KLCI (x)	0.42
3-mth average daily volume (m)	9.03
3-mth average daily value (RM'm)	9.69
Top Shareholders (%)	
Kossan Holdings M Sdn Bhd	5.40
Employees Provident Fund Board	2.78
Blackrock	1.52

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Margin compression continues. We remained wary that the excess supply of gloves would persist in the near term due to the aggressive capacity installation from both existing and new entrants during the pandemic, overstock conditions in the industry, as well as subsequent inventory adjustment that result in uneven demand-supply dynamics. The impact of rising natural gas prices brought on by the Russia and Ukraine conflict as well as the recent increase in the minimum wage raised production costs. With all these headwinds, we foresee margin compression to persist in the near term until supply and demand reach equilibrium.

Slashed FY22-24F earnings estimates. We slashed our FY22-24F core PATANCI estimates by -42%, -30% and -13% to better reflect the margin compression after factoring in a lower utilization rate and higher energy costs.

Downgrade to SELL (from NEUTRAL) with a lower TP of RM0.90 (from RM1.28). Our TP of RM0.90 is derived from a valuation of 11.6x PER (below the mean of 3-year forward PE) pegged to FY23F EPS of 7.7sen. Given the ongoing oversupply scenario in the market and the high cost of production, we remain concern that the pricing and margin compression will likely continue for the remaining of FY2022 and FY2023. **Upside risks are: (**1) industry consolidation due to the recent declines in share price leading to a cheap valuation, (2) increasing demand as large buyers replenish their inventory, (3) small players exiting the market, and (4) supply-demand equilibrium.

INVESTMENT STATISTICS

FYE Dec (RM'm)	2020A	2021A	2022E	2023E	2024E
Revenue	3,638.5	6,631.5	2,265.9	2,499.7	2,741.7
Operating expenses	(2,082.8)	(2,795.6)	(2,059.6)	(2,264.6)	(2,443.5)
EBITDA	1,555.7	3,835.8	206.3	235.2	298.2
EBIT	402.8	157.3	(94.5)	14.0	26.8
Net finance (expenses)/income:	(5.3)	25.4	7.0	9.2	12.6
Profit before Associates & JV	1,441.2	3,747.3	213.3	244.4	310.8
Profit before tax (PBT)	**1,441.2**	**3,747.3**	**213.3**	**244.4**	**310.8**
Income tax expense	(349.3)	(890.4)	(50.6)	(47.2)	(60.0)
Profit After tax (PAT)	**1,091.9**	**2,856.9**	**162.8**	**197.2**	**250.8**
PATANCI	1,086.5	2,853.6	162.8	197.2	250.8
Core PATANCI	**1,025.7**	**2,857.1**	**162.8**	**197.2**	**250.8**
Basic EPS (sen)	42.5	111.8	6.4	7.7	9.8
Core EPS (sen)	40.4	112.2	6.4	7.7	9.8
DPS (sen)	14.0	48.0	12.0	6.0	6.0
Growth & Margin					
Revenue Growth (%)	64.1	82.3	(65.8)	10.3	9.7
EBITDA Growth (%)	311.4	146.6	(94.6)	14.0	26.8
Core PATANCI Growth (%)	348.7	178.6	(94.3)	21.2	27.2
EBITDA Margin (%)	42.8	57.8	9.1	9.4	10.9
PBT Margin (%)	30.0	43.1	7.2	7.9	9.1
Core PATANCI Margin (%)	28.2	43.1	7.2	7.9	9.1
Ratios & Valuation					
Effective tax rate (%)	24.2	23.8	23.7	19.3	19.3
Dividend Yield (%)	11.7	40.0	10.0	5.0	5.0
PER (x)	2.8	1.1	18.8	15.5	12.2
Cash/Market Capitalisation (%)	35.5	83.5	43.4	45.6	47.9
Cash per share (sen)	44.8	126.4	(84.5)	14.7	14.8

Source: Company, MIDFR

Table 1: Kossan 3QFY22 earnings summary

FYE Dec (RM'm)	Quarterly results					Cumulative results		
	3QFY22	2QFY22	3QFY21	YoY (%)	QoQ (%)	9MFY22	9MFY21	YoY (%)
Revenue	560.5	589.9	1,302.8	(57.0)	(5.0)	1,841.0	5,732.9	(67.9)
Operating expenses	(546.2)	(538.6)	(614.6)	(11.1)	1.4	(1,664.5)	(2,273.7)	(26.8)
Other income	14.6	14.0	10.1	44.1	3.9	38.5	20.3	90.2
Operating Profit	**28.9**	**65.3**	**698.3**	**(95.9)**	**(55.6)**	**215.1**	**3,479.5**	**(93.8)**
Net finance income/(cost):	(1.4)	(1.0)	(1.5)	(3.7)	49.6	(3.4)	(5.5)	(37.6)
Profit before tax (PBT)	**27.5**	**64.3**	**696.8**	**(96.1)**	**(57.2)**	**211.6**	**3,474.0**	**(93.9)**
Income tax expense	(3.2)	(17.8)	(167.8)	(98.1)	(82.3)	(50.1)	(836.3)	(94.0)
Profit After tax (PAT)	**24.3**	**46.5**	**528.9**	**(95.4)**	**(47.6)**	**161.5**	**2,637.7**	**(93.9)**
Non-controlling interest	1.4	(0.5)	0.7	86.5	(375.1)	1.4	2.9	(50.7)
PATANCI	23.0	47.0	528.2	(95.7)	(51.1)	160.1	2,634.8	(93.9)
Core PATANCI	**12.9**	**42.5**	**530.0**	**(97.6)**	**(69.8)**	**145.0**	**2,632.9**	**(94.5)**
Basic EPS (sen)	0.9	1.8	20.7	(95.6)	(49.4)	6.2	103.2	(94.0)
Core EPS (sen)	0.5	1.7	20.8	(97.6)	(69.8)	5.7	103.2	(94.5)
DPS (sen)	0.0	0.0	12.0	(100.0)	n.m.	12.0	35.0	(65.7)
Growth & Margin (%)				*+/(-) ppts*	*+/(-) ppts*			*+/(-) ppts*
Revenue Growth	(5.0)	(14.6)	(41.8)	36.8	9.6	43.8	29.4	14.4
Operating Profit Growth	(55.6)	(46.0)	(50.3)	(5.3)	(9.6)	15.6	25.1	(9.6)
Core PATANCI Growth	(69.8)	(52.6)	(50.1)	(19.6)	(17.2)	9.7	25.2	(15.5)
Operating Profit Margin	5.2	11.1	53.6	(48.4)	(5.9)	11.7	60.7	(49.0)
PBT Margin	4.9	10.9	53.5	(48.6)	(6.0)	11.5	60.6	(49.1)
Core PATANCI Margin	2.3	7.2	40.7	(38.4)	(4.9)	7.9	45.9	(38.1)
Ratios & Valuation				*+/(-) ppts*	*+/(-) ppts*			*+/(-) ppts*
Net cash/market cap (%)	39.4	40.4	78.4	(39.0)	(1.1)	39.4	78.4	(39.0)
Net cash per share (sen)	(13.8)	(9.6)	78.9	(117.4)	43.3	(13.8)	78.9	(117.4)
Effective tax rate (%)	11.5	27.7	24.1	(12.6)	(16.2)	23.7	24.1	(0.4)
Inventories (Days)	217.0	266.4	242.1	(10.4)	(18.6)	71.2	65.4	8.8
Account receivables (Days)	224.2	234.8	248.3	(9.7)	(4.5)	68.3	56.4	21.0
Account payable (Days)	133.9	165.3	151.0	(11.4)	(19.0)	43.9	40.8	7.6

Source: Company, MIDFR

Table 2: Breakdown by Segment

FYE Dec (RM'm)	Quarterly results					Cumulative results		
	3QFY22	2QFY22	3QFY21	YoY (%)	QoQ (%)	9MFY22	9MFY21	YoY (%)
Revenue (External):								
Gloves Division	464.2	517.7	1,217.6	(61.9)	(10.3)	1,591.1	5,433.4	(70.7)
Technical Rubber Division	64.7	38.6	36.5	77.2	67.7	152.6	128.4	18.8
Cleanroom Division	31.7	30.9	46.4	(31.7)	2.5	91.0	164.9	(44.8)
Others	0.0	2.7	2.3	(100.0)	(100.0)	0.0	7.2	(100.0)
Total	**560.5**	**589.9**	**1,302.8**	**(57.0)**	**(5.0)**	**1,834.7**	**5,733.9**	**(68.0)**
PBT:								
Gloves Division	1.0	53.3	689.0	(99.9)	(98.1)	165.4	3,436.1	(95.2)
Technical Rubber Division	5.6	4.9	(1.2)	(572.9)	14.4	14.7	17.1	(13.9)
Cleanroom Division	4.5	4.0	3.7	22.9	13.5	7.9	30.4	(74.0)
Others	16.6	2.0	5.2	216.6	713.3	24.0	(9.5)	(351.8)
Total	**27.8**	**64.3**	**696.8**	**(96.0)**	**(56.8)**	**211.9**	**3,474.1**	**(93.9)**
PBT margin:				*+/(-) ppts*	*+/(-) ppts*			*+/(-) ppts*
Gloves Division	0.2	10.3	56.6	(56.4)	(10.1)	10.4	63.2	(52.8)
Technical Rubber Division	8.7	12.8	(3.3)	12.0	(4.1)	9.6	13.3	(3.7)
Cleanroom Division	14.3	12.9	8.0	6.4	1.4	8.7	18.4	(9.8)
Others	0.0	75.6	232.7	(232.7)	(75.6)	0.0	(132.1)	132.1
Total	**5.0**	**10.9**	**53.5**	**(48.5)**	**(5.9)**	**11.6**	**60.6**	**(49.0)**

Source: Company, MIDFR

KOSSAN RUBBER INDUSTRIES: BALANCE SHEET

FYE Dec (RM'm)	2020A	2021A	2022E	2023E	2024E
Total Non-current assets	1,398.1	1,495.0	1,411.4	1,454.4	1,541.5
Total current assets	2,235.5	3,584.6	1,852.7	1,972.0	2,091.3
Total Assets	**3,633.6**	**5,079.6**	**3,264.2**	**3,426.4**	**3,632.9**
Total Equity	**2,413.2**	**4,060.3**	**3,901.8**	**3,945.9**	**4,043.7**
Total Non-current liabilities	235.5	194.1	(963.7)	(895.5)	(834.4)
Total Current Liabilities	985.2	825.3	326.0	375.9	423.6
Total Liabilities	**1,220.7**	**1,019.4**	**(637.7)**	**(519.6)**	**(410.8)**
Total Liabilities & Equity	**3,633.9**	**5,079.8**	**3,264.2**	**3,426.4**	**3,632.9**

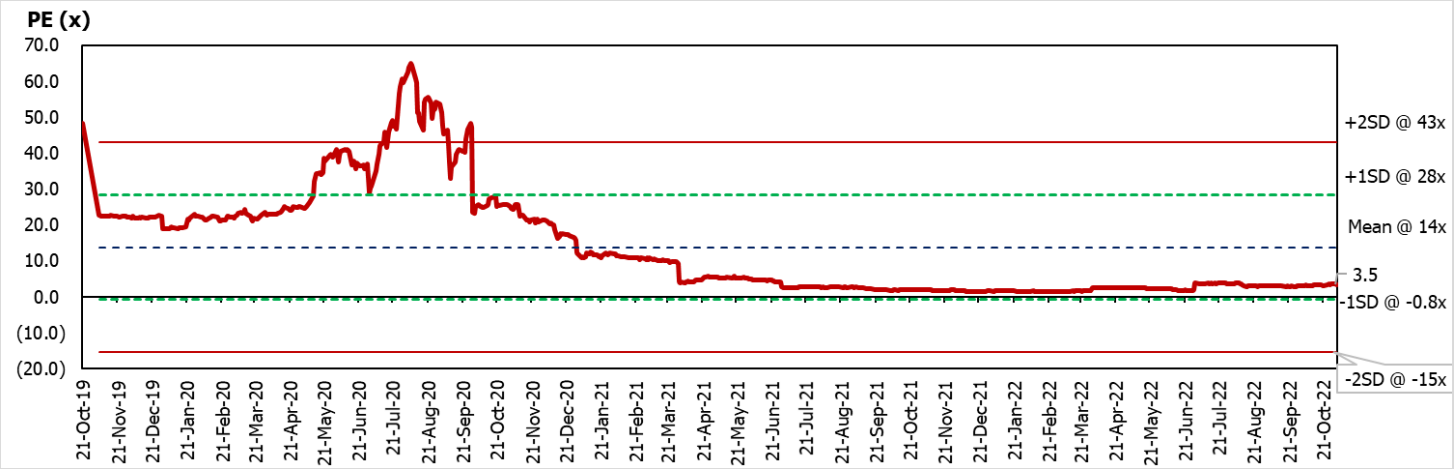
Source: Company, MIDFR

KOSSAN RUBBER INDUSTRIES: CASH FLOW

FYE Dec (RM'm)	2020A	2021A	2022E	2023E	2024E
Pretax profit	1,441.2	3,747.3	213.3	244.4	310.8
Cash flow from operations	1,145.9	3,224.7	(2,155.1)	374.0	376.9
Cash flow from investing	(30.4)	(222.9)	(84.4)	(91.5)	(97.7)
Cash flow from financing	(191.4)	(1,540.1)	1,011.8	(216.0)	(209.3)
Net cash flow	**924.1**	**1,461.7**	**(1,227.7)**	**66.5**	**69.8**
(+/-) Adjustments	3.2	6.5	0.0	0.0	0.0
Net cash/(debt) b/f	**162.2**	**1,089.5**	**2,557.8**	**1,330.0**	**1,396.5**
Net cash/(debt) c/f	**1,089.5**	**2,557.8**	**1,330.0**	**1,396.5**	**1,466.4**

Source: Company, MIDFR

KOSSAN RUBBER INDUSTRIES: 3-YEAR FORWARD PE



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 *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