Kossan Rubber Industries Berhad

Maintain SELL

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

Gloomy outlook

***Revised* Target Price: RM0.88**

(Previously RM0.90)

(KEY INVESTMENT HIGHLIGHTS)

- **Earnings fell short of expectations**
- **Disappointed revenue and earnings in 4QFY22**
- **Lower revenue and core PATANCI in 12MFY22.**
- **Slashed FY23-24F earnings estimates and introduce FY25F earnings projection**
- **Reiterate SELL with a revised TP of RM0.88 (from RM0.90)**

Earnings fell short of expectations. Kossan Rubber Industries (Kossan) reported a core PATANCI of RM137.7m in FY22 after excluding a one-time off item of -RM24m. The earnings came in below our expectations, accounting for 85% of our estimate and 82% of consensus' full-year FY22 projection. The earnings miss was mainly due to lower-than-expected revenue and higher-than-expected input costs. Meanwhile, the group declared its first interim dividend of 2.5sen per share.

Disappointed revenue and earnings in 4QFY22. Kossan's 4QFY22 revenue fell -14.1%qoq to RM481.4m owing primarily to lower sales from the gloves and technical rubber ("TRP") divisions which offset the higher revenue from Cleanroom division. The gloves division suffered an operating loss of -RM22.7m in 4QFY22 because of reduced revenue and higher energy cost. On the flip side, the TRP division's operating profit improved by +35.3%qoq to RM7.6m. This was mainly because of the stronger performance from the infrastructure segment and lower raw material costs, which more than enough to offset the decreased revenue. Meanwhile, the Cleanroom division's operating profit was lower due to low-margin products, which more than outweighed the increased revenue. As such, the core earnings fell from a core PATANCI of RM19.8m in 3QFY22 to a net loss of -RM13.5m during the quarter. On a yearly basis, earnings fell sharply to a net loss of -RM13.5m, in tandem with reduced revenue from RM924.6m in 4QFY21 to RM481.4m in 4QFY22. This was primarily caused by a steep decline in ASP (down 42%-47%yoy) and sales volume (down 25%-27%yoy), combined with higher energy costs that more than compensated lower raw material cost.

Lower revenue and core PATANCI in 12MFY22. The group's revenue decreased from RM6.7b in 12MFY21 to RM2.3b in 12MFY22. This was mainly due to lower ASP and lower sales volume amid an oversupply of gloves and the destocking of customers. Furthermore, increases in natural gas tariffs and minimum wage, combined with a low utilization rate, resulted in a higher cost of production per unit. As such, core PATANCI tumbled by -97.1%yoy to RM132.9m.

RETURN STATISTICS	
Price @ 16th February 2023 (RM)	1.13
Expected share price return (%)	-22.1
Expected dividend yield (%)	+3.1
Expected total return (%)	**-19.05**

SHARE PRICE CHART



Share price performance (%)	Absolute	Relative
1 month	8.6	8.8
3 months	3.6	-2.0
12 months	-33.3	-28.3

KEY STATISTICS	
FBM KLCI	1,484.26
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)	2,908.85
52-wk price range	RM0.91 - RM2.09
Beta vs FBM KLCI (x)	0.74
3-mth average daily volume (m)	3.58
3-mth average daily value (RM'm)	3.89
Top Shareholders (%)	
Kossan Holdings M Sdn Bhd	48.77
Employees Provident Fund Board	5.40
BlackRock Inc	3.18

Analyst(s)
Genevieve Ng Pei Fen
Genevieve.ng@midf.com.my
03-2173 1678

Slashed FY23-24F earnings estimates and introduce FY25F earnings projection. We reduced our core PATANCI estimates for FY23F by -56% and FY24F by -46%, to reflect the challenging outlook ahead. This is after accounting for lower ASPs, lower USD/RM exchange rate and higher energy costs, which reduce earnings estimates.

Reiterate SELL with a revised TP of RM0.88 (from RM0.90). We revised our **TP** to **RM0.88** (from RM0.90). Our TP is based on an FY24F EPS of 5.3sen pegged to a revised PER of 17x PER (from 11.6x), which is its historical 5-year mean PE. We maintain our **SELL** call on Kossan. Moving forward, we expect Kossan's outlook to remain challenging in the near term before turning profitable in 2HFY23F. This was primarily caused by the oversupply of gloves, which led to a low ASP and utilization rate. The low utilization rate then raised production cost per unit amid increased natural gas tariff and minimum wage. Hence, we expect margin compression to continue in FY23F. **Upside risks** include small players exiting the market or existing players discontinuing some production lines.

INVESTMENT STATISTICS

FYE Dec (RM'm)	2021A	2022A	2023E	2024E	2025E
Revenue	6,631.5	2,322.5	2,022.7	2,251.7	2,562.8
Raw materials and consumable used	(1,945.6)	(1,501.9)	(1,321.1)	(1,426.5)	(1,591.2)
Gross Profit	**4,685.8**	**820.6**	**701.6**	**825.1**	**971.6**
Other operating (expense)/income	15.0	58.9	4.3	5.1	5.8
Changes in inventories of finished goods & WIP	(39.4)	(15.9)	(14.1)	(16.0)	(18.6)
Goods purchased for resale	(45.1)	(6.3)	(5.5)	(6.1)	(7.0)
Staff costs	(419.7)	(403.7)	(398.5)	(421.5)	(441.4)
Other operating expenses	(360.8)	(236.3)	(165.9)	(175.4)	(189.7)
EBITDA	**3,835.8**	**217.3**	**121.9**	**211.2**	**320.8**
EBIT	**3,721.9**	**217.3**	**96.8**	**157.3**	**259.8**
Profit before tax (PBT)	**3,747.3**	**212.9**	**108.8**	**172.0**	**275.1**
Income tax expense	(890.4)	(53.9)	(23.8)	(37.6)	(60.1)
Profit After tax (PAT)	**2,856.9**	**159.3**	**85.0**	**134.4**	**215.0**
Core PAT	2,861.6	135.3	85.0	134.4	215.0
Core PATANCI	**2,857.1**	**132.9**	**85.0**	**134.4**	**215.0**
Basic EPS (sen)	111.8	6.2	3.3	5.3	8.4
DPS (sen)	48.0	3.5	1.3	2.1	3.4
Growth & Margin (%)					
Revenue Growth (%)	82.3	(65.0)	(12.9)	11.3	13.8
Gross Profit Growth (%)	120.1	(82.5)	(14.5)	17.6	17.8
Core PATANCI Growth (%)	178.5	(95.3)	(36.0)	58.1	59.9
Gross Profit Margin (%)	70.7	35.3	34.7	36.6	37.9
Core PATANCI Margin (%)	43.1	5.7	4.2	6.0	8.4
Ratios & Valuation					
Effective tax rate (%)	23.8	25.3	21.8	21.8	21.8
Dividend Yield (%)	42.5	3.1	1.2	1.9	3.0
PER (x)	1.0	18.1	33.9	21.4	13.4
Cash/Market Capitalisation (sen)	88.7	46.6	37.3	38.7	41.4
Cash/share (sen)	100.2	52.7	42.2	43.7	46.7

Source: Company, MIDFR

Table 1: Kossan 4QFY22 earnings summary

FYE Dec (RM'm)	Quarterly results					Cumulative results		
	4QFY22	3QFY22	4QFY21	YoY (%)	QoQ (%)	12MFY22	12MFY21	YoY (%)
Revenue	481.4	560.5	924.6	(47.9)	(14.1)	2,322.5	6,657.5	(65.1)
Operating expenses	(499.6)	(546.2)	(660.6)	(24.4)	(8.5)	(2,164.1)	(1,257.0)	72.2
Other operating income	20.4	14.6	10.3	97.2	39.7	58.9	30.6	92.6
Operating profit (EBIT)	**2.2**	**28.9**	**274.3**	**(99.2)**	**(92.3)**	**217.3**	**5,431.1**	**(96.0)**
Net finance income/(cost)	(1.3)	(1.1)	(0.6)	114.8	10.2	(4.4)	(6.1)	(27.4)
Profit before tax (PBT)	1.0	27.8	273.7	(99.7)	(96.6)	212.9	5,425.0	(96.1)
Taxation	(3.4)	(3.2)	(54.6)	(93.7)	9.0	(53.6)	(890.9)	(94.0)
Profit After tax (PAT)	**(2.5)**	**24.6**	**219.1**	**(101.1)**	**(110.1)**	**159.3**	**4,534.1**	**(96.5)**
PATANCI	(2.5)	23.3	218.7	(101.1)	(110.7)	156.9	4,530.8	(96.5)
Core PATANCI	**(13.5)**	**19.8**	**224.1**	**(106.0)**	**(168.3)**	**132.9**	**4,523.7**	**(97.1)**
Basic EPS (sen)	(0.1)	0.9	8.6	(101.2)	(111.0)	6.1	111.7	(94.5)
DPS (sen)	2.5	0.0	12.0	(79.2)	n.m.	2.5	47.0	(94.7)
Growth & Margin (%)				*+/(-) ppts*	*+/(-) ppts*			*+/(-) ppts*
Revenue Growth	(14.1)	(5.0)	(29.0)	14.9	(9.1)	26.2	16.1	10.0
Operating Profit Growth	(92.3)	(55.6)	(60.7)	(31.6)	(36.7)	1.0	5.3	(4.3)
Core PATANCI Growth	(168.3)	(46.5)	(57.6)	(110.6)	(121.8)	(9.2)	5.2	(14.4)
Operating Profit Margin	0.5	5.2	29.7	(29.2)	(4.7)	9.4	81.6	(72.2)
PBT Margin	0.2	5.0	29.6	(29.4)	(4.8)	9.2	81.5	(72.3)
Core PATANCI Margin	(2.8)	3.5	24.2	(27.0)	(6.3)	5.7	67.9	(62.2)
Ratios & Valuation				*+/(-) ppts*	*+/(-) ppts*			*+/(-) ppts*
Net cash/market cap (%)	45.6	41.8	80.4	(34.9)	3.7	(45.6)	(80.4)	34.9
Effective tax rate (%)	359.7	11.3	20.0	339.8	348.4	25.2	16.4	8.7
Inventories (Days)	214.9	217.0	234.3	(8.3)	(0.9)	49.6	123.1	(59.7)
Account receivables (Days)	201.9	224.2	214.5	(5.9)	(9.9)	41.9	29.8	40.5
Account payable (Days)	140.2	133.9	164.6	(14.8)	4.8	32.4	86.5	(62.6)

Source: Company, MIDFR

Table 2: Breakdown by Segment

FYE Dec (RM'm)	Quarterly results					Cumulative results		
	4QFY22	3QFY22	4QFY21	YoY (%)	QoQ (%)	12MFY22	12MFY21	YoY (%)
Revenue (External):								
Gloves Division	402.6	464.2	836.4	(51.9)	(13.3)	1,993.8	6,271.7	(68.2)
Technical Rubber Division	44.4	64.7	45.9	(3.2)	(31.3)	197.0	174.4	13.0
Cleanroom Division	34.4	31.7	42.0	(18.1)	8.6	125.3	205.8	(39.1)
Others	0.0	0.0	0.3	(100.0)	n.m.	6.3	5.6	12.1
Total	**481.4**	**560.5**	**924.6**	**(47.9)**	**(14.1)**	**2,322.5**	**6,657.5**	**(65.1)**
PBT:								
Gloves Division	(22.7)	1.0	286.8	(107.9)	(2,349.9)	142.6	3,714.9	(96.2)
Technical Rubber Division	7.6	5.6	(16.5)	(146.4)	35.3	20.6	(9.8)	(309.8)
Cleanroom Division	3.5	4.5	2.2	56.8	(23.7)	17.1	24.3	(29.7)
Others	12.6	16.6	1.1	1,026.2	(24.4)	32.5	18.5	76.2
Total	**1.0**	**27.8**	**273.7**	**(99.7)**	**(96.6)**	**212.9**	**3,747.8**	**(94.3)**
PBT margin:				*+/(-) ppts*	*+/(-) ppts*			*+/(-) ppts*
Gloves Division	(5.6)	0.2	34.3	(39.9)	(5.9)	7.2	59.2	(52.1)
Technical Rubber Division	17.2	8.7	(35.8)	53.0	8.5	10.5	(5.6)	16.1
Cleanroom Division	10.1	14.3	5.3	4.8	(4.3)	13.6	11.8	1.8
Others	#DIV/0!	#DIV/0!	401.4	n.m.	n.m.	514.3	327.1	187.3
Total	**0.2**	**5.0**	**29.6**	**(29.4)**	**(4.8)**	**9.2**	**56.3**	**(47.1)**

Source: Company, MIDFR

MIDF RESEARCH is part of MIDF Amanah Investment Bank Berhad (197501002077(23878 – X)).
(Bank Pelaburan)
(A Participating Organisation of Bursa Malaysia Securities Berhad)

DISCLOSURES AND DISCLAIMER

This report has been prepared by MIDF AMANAH INVESTMENT BANK BERHAD (197501002077 (23878 – X)) for distribution to and use by its clients to the extent permitted by applicable law or regulation.

Readers should be fully aware that this report is for information purposes only. The opinions contained in this report are based on information obtained or derived from sources that MIDF Investment believes are reliable at the time of publication. All information, opinions and estimates contained in this report are subject to change at any time without notice. Any update to this report will be solely at the discretion of MIDF Investment.

MIDF Investment makes no representation or warranty, expressed or implied, as to the accuracy, completeness or reliability of the information contained therein and it should not be relied upon as such. MIDF Investment and its affiliates and related companies and each of their respective directors, officers, employees, connected parties, associates and agents (collectively, "Representatives") shall not be liable for any direct, indirect or consequential loess, loss of profits and/or damages arising from the use or reliance by anyone upon this report and/or further communications given in relation to this report.

This report is not, and should not at any time be construed as, an offer, invitation or solicitation to buy or sell any securities, investments or financial instruments. The price or value of such securities, investments or financial instruments may rise or fall. Further, the analyses contained herein are based on numerous assumptions. This report does not take into account the specific investment objectives, the financial situation, risk profile and the particular needs of any person who may receive or read this report. You should therefore independently evaluate the information contained in this report and seek financial, legal and other advice regarding the appropriateness of any transaction in securities, investments or financial instruments mentioned or the strategies discussed or recommended in this report.

The Representatives may have interest in any of the securities, investments or financial instruments and may provide services or products to any company and affiliates of such companies mentioned herein and may benefit from the information herein.

This document may not be reproduced, copied, distributed or republished in whole or in part in any form or for any purpose without MIDF Investment's prior written consent. This report is not directed or intended for distribution to or use by any person or entity where such distribution or use would be contrary to any applicable law or regulation in any jurisdiction concerning the person or entity.

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