Kossan Rubber Industries Berhad

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

***Maintain* SELL**

Continued Earnings Woes

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

(Previously: RM0.95)

KEY INVESTMENT HIGHLIGHTS

- **Missed earnings projections**
- **Earnings continued in red**
- **Disappointed revenue and earnings in 1QFY23**
- **Falling ASP and sales volume**
- **Slashed earnings projections for FY23-FY25F**
- **Reiterate SELL with a revised TP of RM0.90 (from RM0.95)**

Missed earnings projections. Kossan Rubber Industries ("KRI") reported a net loss of -RM34.6m in 3MFY23, after deducting a one-time off item of RM10.3m. The earnings came in below ours and consensus full-year FY23F estimation of a net profit of RM85m and RM68.2m respectively. The negative deviation was mainly attributed to lower-than-expected sales volume, which lowered plant utilisation and raised production cost per unit. No dividend was declared during the quarter.

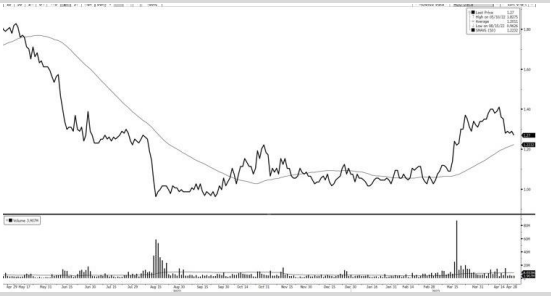
Earnings continued in red. On a quarterly basis, the group's revenue declined by -18.0%qoq to RM394.7m in 1QFY23, primarily as a result of: (1) reduced ASP and sales volume for gloves division, as well as (2) weaker demand for clean-room goods. Additionally, the intense competition and customer destocking activities resulted in an oversupply of gloves in the market, which correlated with higher input prices, compressed the margin. Consequently, KRI's net loss widened further from -RM13.5m in 4QFY22 to -RM34.6m in 1QFY23.

Disappointed revenue and earnings in 1QFY23. On yearly basis, Kossan recorded a net loss of RM34.6m during the quarter, as opposed to a core PATANCI of RM89.6m in 1QFY22. This was consistent with the reduced revenue, which fell -42.8%yoy to RM394.7m. The weaker performance was primarily caused by: (1) lower revenue from the glove and clean-room divisions; and (2) increased manufacturing cost per unit because of higher energy costs (caused by higher natural gas and electricity rates) together with the low utilisation rate.

Falling ASP and sales volume. We gather that in 1QFY23, both the average selling price (down 3-5%qoq; down 23-28%yoy) and sales volume (down 14-18%qoq; down 28-33%yoy) continued to fall on a quarterly and annual basis. This was mainly due to the continuous supply-demand mismatch, which has caused average selling prices (ASPs) to drop dramatically since FY21 as well as the normalising demand for gloves post-reopening that weakened the demand for gloves and lower sales volume.

RETURN STATISTICS	
Price @ 27th April 2023 (RM)	1.27
Expected share price return (%)	-29.50
Expected dividend yield (%)	0.0
Expected total return (%)	**-29.50**

SHARE PRICE CHART



Price performance (%)	Absolute	Relative
1 month	-3.1	-4.5
3 months	-3.1	24.2
12 months	-31.0	-22.8

INVESTMENT STATISTICS

FYE Dec (RM'm)	2023F	2024F	2025F
Revenue	1,422.7	1,708.0	2,094.1
EBITDA	(13.1)	153.7	312.3
Profit Before Tax	(70.0)	89.4	241.9
Core PATANCI	(54.7)	69.8	189.0
Core EPS (sen)	(2.1)	2.7	7.4
DPS (sen)	(0.9)	1.1	3.0
Dividend Yield (%)	(0.7)	0.9	2.3

KEY STATISTICS	
FBM KLCI	1,418.05
Issue shares (m)	2545.37
Estimated free float (%)	39.32
Market Capitalisation (RM'm)	3,240.56
52-wk price range	RM0.9 - RM1.88
3-mth average daily volume (m)	8.48
3-mth average daily value (RM'm)	10.43
Top Shareholders (%)	
Kossan Holdings M Sdn Bhd	49.00
Abrdn PLC	5.42
Employees Provident Fund Board	5.40

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Declining raw materials cost. The cost of raw materials for the group decreased considerably on a yearly basis. Notably, price of Nitrile Butadiene rubber (NBR) experienced the most significant drop, decreasing by 25—30%yoy, followed by price of Natural rubber (NR), which saw a decrease of 15—20%yoy. Price of NBR continued to decline on a quarterly basis by 1—2%qoq, while price of NR increased by 3—7%qoq. The increase in NR price can be attributed to decreased production brought on by the winter season, which is anticipated to last until May 2023.

Slashed earnings projections for FY23-FY25F. We slashed our earnings estimation for FY23F-25F given the result underperformance. Post earnings revision, we project a net loss of -RM54m for FY23F as opposed to our previous earnings estimates of a net profit of RM85m. We have also lowered our projections for FY24F and FY25F by -35.7% and -14.5% respectively. This is after considering: (1) lower sales volume owing to oversupply situation, and (2) high production cost per unit on the back of higher input costs (due to increasing energy and labour expenses) and poor plant utilization rate.

Reiterate SELL with a revised TP of RM0.90 (from RM0.95). Our TP is based on FY24F BVPS of 152sen pegged to an unchanged P/BV of 0.59x PER, which is its 2-years historical -1SD P/BV. We maintain our **SELL** call on Kossan. Despite lower raw material prices, we anticipate Kossan's profitability to remain weak in FY23F due to the ongoing oversupply issue and normalising glove demand. This was further dampened by the low plant utilization and rising input costs, which significantly raised production expenses per unit and thus eroded the margin. **Potential catalysts** include: (i) faster-than-expected recovery in ASP and utilization rate; and (ii) more new entrants leaving the market and/or existing companies discontinuing certain manufacturing line.

Kossan Rubber Industries: 1QFY23 Results Summary

FYE Dec (RM's)	Quarterly results					Cumulative results		
	1QFY23	4QFY22	1QFY22	YoY (%)	Qosqo (%)	3MFY23	3MFY22	YoY (%)
Revenue	394.7	481.4	690.6	(42.8)	(18.0)	394.7	690.6	(42.8)
Operating expenses	(430.6)	(499.6)	(579.7)	(25.7)	(13.8)	(430.6)	(579.7)	(25.7)
Other operating income	17.2	20.4	9.9	74.2	(15.4)	17.2	9.9	74.2
Operating profit (EBIT)	**(18.6)**	**2.2**	**120.9**	**(115.4)**	**(940.1)**	**(18.6)**	**120.9**	**(115.4)**
Net finance income/(cost)	(0.4)	(1.3)	(1.0)	(56.3)	(64.5)	(0.4)	(1.0)	(56.3)
Profit before tax (PBT)	(19.1)	1.0	119.8	(115.9)	n.m.	(19.1)	119.8	(115.9)
Taxation	(4.5)	(3.4)	(29.2)	(84.6)	30.9	(4.5)	(29.2)	(84.6)
Profit After tax (PAT)	**(23.6)**	**(2.5)**	**90.7**	**(126.0)**	**849.5**	**(23.6)**	**90.7**	**(126.0)**
PATANCI	(24.3)	(2.5)	90.1	(126.9)	874.4	(24.3)	90.1	(126.9)
Core PATANCI	**(34.6)**	**(13.5)**	**89.6**	**(138.6)**	**156.3**	**(34.6)**	**89.6**	**(138.6)**
Basic EPS (sen)	(1.0)	(0.1)	3.5	(126.9)	850.0	(1.0)	3.5	(126.9)
DPS (sen)	0.0	2.5	0.0	n.m.	(100.0)	0.0	0.0	n.m.
Growth & Margin (%)				*+/(-) ppts*	*+/(-) ppts*			*+/(-) ppts*
Revenue Growth	(18.0)	(14.1)	(25.3)	7.3	(3.9)	(83.0)	(89.6)	6.6
Core PATANCI Growth	156.3	(168.3)	(60.0)	216.3	324.5	(126.0)	(98.0)	(28.0)
Operating Profit Margin	(4.7)	0.5	17.5	(22.2)	(5.2)	(4.7)	17.5	(22.2)
Core PATANCI Margin	(8.8)	(2.8)	13.0	(21.7)	(6.0)	(8.8)	13.0	(21.7)
Ratios & Valuation				*+/(-) ppts*	*+/(-) ppts*			*+/(-) ppts*
Net cash/market cap (%)	38.9	40.5	45.3	(6.4)	(1.7)	(38.9)	(45.3)	6.4
Effective tax rate (%)	(23.6)	359.7	24.4	(48.0)	(383.3)	(23.6)	24.4	(48.0)
Revenue	394.7	481.4	690.6	(42.8)	(18.0)	394.7	690.6	(42.8)

Source: Company, MIDFR

Kossan Rubber Industries: Breakdown by operating segment

FYE Dec (RM'm)	Quarterly results					Cumulative results		
	1QFY23	4QFY22	1QFY22	YoY (%)	QoQ (%)	3MFY23	3MFY22	YoY (%)
Revenue (RM'm):								
Gloves Division	317.5	402.6	609.3	(47.9)	(21.1)	317.5	609.3	(47.9)
Technical Rubber Division	56.2	44.4	49.3	13.9	26.4	56.2	49.3	13.9
Cleanroom Division	21.0	34.4	28.4	(26.1)	(38.8)	21.0	28.4	(26.1)
Others	0.0	0.0	3.6	(100.0)	n.m.	0.0	3.6	(100.0)
Total	**394.7**	**481.4**	**690.6**	**(42.8)**	**(18.0)**	**394.7**	**690.6**	**(42.8)**
Operating Profit (RM'm):								
Gloves Division	7.9	(22.7)	111.0	(92.9)	(134.9)	7.9	111.0	(92.9)
Technical Rubber Division	(34.9)	7.6	2.4	(1,532.3)	(557.5)	(34.9)	2.4	(1,532.3)
Cleanroom Division	1.6	3.5	5.1	(68.6)	(54.0)	1.6	5.1	(68.6)
Others	6.3	12.6	1.3	383.0	(49.7)	6.3	1.3	383.0
Total	**(19.1)**	**1.0**	**119.8**	**(115.9)**	**(2,095.2)**	**(19.1)**	**119.8**	**(115.9)**
Operating profit margin (%):				*+/(-) ppts*	*+/(-) ppts*			*+/(-) ppts*
Gloves Division	2.5	(5.6)	18.2	(15.7)	8.1	2.5	18.2	(15.7)
Technical Rubber Division	(62.2)	17.2	4.9	(67.1)	(79.3)	(62.2)	4.9	(67.1)
Cleanroom Division	7.6	10.1	17.9	(10.3)	(2.5)	7.6	17.9	(10.3)
Others	n.m.	#DIV/0!	36.1	n.m.	n.m.	n.m.	36.1	n.m.
Total	**15.1**	**12.0**	**17.6**	**(2.5)**	**3.1**	**15.1**	**17.6**	**(14.5)**

Source: Company, MIDFR

FINANCIAL SUMMARY

Income Statement (RM'm)	2021A	2022A	2023F	2024F	2025F
Revenue	**6,631.5**	**2,343.8**	**1,422.7**	**1,708.0**	**2,094.1**
Raw materials and consumable used	(1,945.6)	(1,263.3)	(958.5)	(1,035.7)	(1,168.2)
Gross Profit	**4,685.8**	**1,080.5**	**464.2**	**672.3**	**925.9**
Other (expense)/income	15.0	44.1	26.3	31.5	38.6
Goods purchased for resale	(45.1)	(57.9)	(35.8)	(43.9)	(54.9)
Staff costs	(419.7)	(374.5)	(233.0)	(272.7)	(327.7)
Other operating expenses	(366.5)	(314.9)	(214.1)	(250.6)	(301.1)
EBITDA	**3,830.2**	**305.6**	**(11.8)**	**153.8**	**312.5**
EBIT	**3,710.6**	**174.2**	**(105.1)**	**70.3**	**201.4**
Profit before tax (PBT)	**3,736.0**	**203.2**	**(69.1)**	**110.7**	**235.3**
Profit After tax (PAT)	**2,845.6**	**148.9**	**(54.0)**	**86.5**	**183.8**
Core PATANCI	**2,845.8**	**135.4**	**(54.0)**	**86.5**	**183.8**
Basic EPS (sen)	111.8	6.2	(2.1)	3.4	7.2
DPS (sen)	48.0	2.5	(0.8)	1.4	2.9

Balance Sheet (RM'm)	2021A	2022A	2023F	2024F	2025F
Property, plant, and equipment	1,373.7	1,356.9	1,269.7	1,193.5	1,162.5
Intangible assets & Goodwill	6.0	6.0	3.7	4.4	5.4
Total Non-current assets	**1,495.2**	**1,470.6**	**1,405.7**	**1,344.2**	**1,332.1**
Inventories	424.0	287.1	267.8	285.0	316.7
ST - Trade and other receivables	558.6	276.0	254.0	300.3	362.7
Cash and cash equivalents	2,557.8	1,348.0	1,227.4	1,178.8	1,156.2
Total current assets	**3,584.6**	**2,856.5**	**2,622.6**	**2,720.0**	**2,904.3**
Total Assets	**5,079.8**	**4,327.1**	**4,028.3**	**4,064.2**	**4,236.4**
LT Loans and borrowings	56.0	0.9	0.1	0.1	0.1
LT Lease Liabiltiies	8.7	5.8	1.4	1.5	1.8
Total Non-current liabilities	**194.1**	**144.5**	**51.7**	**55.8**	**68.3**
ST Loans and borrowings	182.4	71.3	7.1	7.2	7.3
ST Trade and other payables	297.3	200.2	185.5	196.4	217.1
Total Current Liabilities	**825.3**	**284.7**	**220.4**	**205.8**	**304.4**
Total Liabilities	**1,019.4**	**429.2**	**272.0**	**261.6**	**372.8**

Cash Flow (RM'm)	2021A	2022A	2023F	2024F	2025F
Pretax profit	3,736.0	203.2	(69.1)	110.7	235.3
Cash flow from operations	3,224.7	93.4	(90.4)	(32.6)	114.8
Cash flow from investing	(222.9)	(812.3)	17.6	18.4	(64.2)
Cash flow from financing	(1,540.1)	(480.9)	(47.8)	(34.4)	(73.2)
Net cash flow	**1,461.7**	**(1,199.9)**	**(120.6)**	**(48.5)**	**(22.6)**
(+/-) Adjustments	6.5	(9.9)	0.0	0.0	0.0
Net cash/(debt) b/f	**1,089.5**	**2,557.8**	**1,348.0**	**1,227.4**	**1,178.8**

Key Metrics	2021A	2022A	2023F	2024F	2025F
Effective tax rate (%)	23.8	26.7	21.9	21.9	21.9
PER (x)	1.1	20.6	(60.0)	37.5	17.6
P/BV ratio (x)	0.80	0.83	0.86	0.85	0.84
Inventories (Days)	81.0	103.0	102.0	100.5	98.9
Cash/Market Capitalisation (sen)	78.9	41.6	37.9	36.4	35.7
Cash/share (sen)	100.2	52.8	48.1	46.2	45.3

Profitability Margins	2021A	2022A	2023F	2024F	2025F
Gross Profit Margin (%)	70.7	46.1	32.6	39.4	44.2
EBITDA Margin (%)	57.8	13.0	(0.8)	9.0	14.9
Core PATANCI Margin (%)	42.9	5.8	(3.8)	5.1	8.8

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