Rhong Khen International Berhad

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

Continuous Sluggish Outlook

Maintain **NEUTRAL**

Revised **Target Price: RM1.30**
(previously RM1.35)

KEY INVESTMENT HIGHLIGHTS

- **Earnings below expectation**
- **3QFY23 earnings in the red**
- **Disappointing 9MFY23 earnings**
- **Lowered earnings projection for FY23F-25F**
- **Changed valuation method from PE valuation to P/BV**
- **Maintain NEUTRAL with a lower TP of RM1.30 (from RM1.35)**

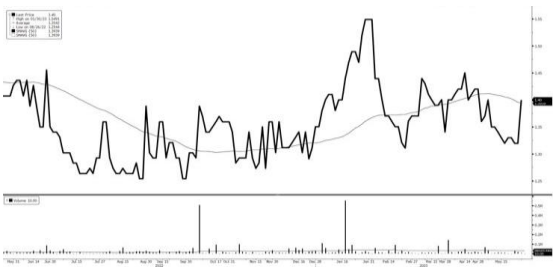
Below expectation. Rhong Khen International ("RKI") reported 9MFY23 core PATANCI of RM14.9m, after deducting a one-time off item of RM1.5m. The results fell short of our expectations, accounting for only 44.3% of our FY23 full-year forecast. This disappointing earnings was mainly attributed to the lower-than-anticipated revenue as a result of persistent over-inventory concerns in the US market, as well as higher-than-expected operational and labour costs. No dividends were declared for the quarter.

3QFY23 earnings in the red. In 3QFY23, the group registered substantial decline in revenue on a sequential basis, with a -47.4%qoq reduction to RM97.9m. This was primarily due to: (1) continual slowdown in furniture export owing to over-inventory issues in the US market, and (2) a prolonged weak demand for both sawmill and panel board lamination operations. Besides, the group implemented an extended discount program for customers to stimulate shipments. This, together with higher operational costs in Vietnam and higher labour costs in Malaysia, caused the gross profit margin to decrease by -11.2ppt qoq to 3.3% in 3QFY23. As such, the group sank into net loss of -RM7.3m in 3QFY23 from a net profit of RM10.9m in 2QFY23. On yearly basis, RKI's revenue plunged -49.7%yoy to RM97.9m, mainly due to the shipment slowdown and lower order intake. Similarly, core earnings were in the red with net loss of -RM7.3m mainly was due to the decreased revenue along with greater operational and labour costs.

Disappointing 9MFY23 Earnings. RKI's revenue increased marginally by +0.4%yoy to RM518.5m in 9MFY23, primarily driven by the favorable exchange rate of USD against RM (+6.9%yoy) which more than offset the slowdown in shipments and lower order intake. Despite the marginal revenue increase, core PATANCI declined from RM19.6m in 9MFY22 to RM14.9m in 9MFY23. This was attributed to margin compression due to extended discounts provided to customers to stimulate shipments, as well as high operating, labor, and finance costs.

RETURN STATISTICS	
Price @ 25th May 2023 (RM)	1.40
Expected share price return (%)	-7.10
Expected dividend yield (%)	+0.38
Expected total return (%)	**-6.69**

SHARE PRICE CHART



Price performance (%)	Absolute	Relative
1 month	-1.4	-0.3
3 months	3.7	5.7
12 months	-4.8	3.8

INVESTMENT STATISTICS

FYE Jun	2023F	2024F	2025F
Revenue	596.6	611.7	669.6
EBITDA	20.3	31.0	48.8
Profit before tax (PBT)	4.5	19.4	36.0
Core PATANCI	3.4	14.1	26.2
Core EPS (sen)	1.8	7.3	13.5
DPS (sen)	0.5	2.2	4.0
Dividend Yield (%)	0.4	1.6	2.9

KEY STATISTICS	
FBM KLCI	1,402.48
Issue shares (m)	194.31
Estimated free float (%)	43.47
Market Capitalisation (RM'm)	271.95
52-wk price range	RM1.3 - RM1.6
3-mth average daily volume (m)	0.01
3-mth average daily value (RM'm)	0.01
Top Shareholders (%)	
Lin Chen Jui-Fen	25.60
Konsortium Kontrek Sdn Bhd	15.34
Samarang Asset Management	7.66

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Challenging outlook ahead. Demand for wooden furniture continues to remain lackluster globally owing mostly to the significant rise in interest rates in the US, which has adversely affected furniture sales in that market and resulting in a 30% to 50% decline in orders. This has led to an over-inventory of products in the US, causing a decline in shipment orders. Note that almost 99% of the company's products are exported overseas, with the United States being the largest importer of wooden furniture. Furthermore, the escalating labor costs in both Malaysia and Vietnam operations have further exacerbated the margin compression.

Lowered earnings projection for FY23F-25F. Given that the earnings came in below our estimation, we reduced our earnings projections for FY23F by -89.8%, FY24F by 62.4%, and FY25F by -37.8%. This was after accounting for decreased sales owing to weaker demand for wooden furniture globally, as well as increased cost of sales due to higher labor cost in Malaysia and Vietnam operations.

Changed valuation method from PE valuation to P/BV. Given that demand for wooden furniture is expected to remain sluggish in the near term, along with escalating input price, we are cautious that the profit margins are likely to stay compressed. Hence, we changed our valuation methodology from PE to the P/BV (Price-to-Book Value) methodology to better reflect the near-to-medium term prospect.

Maintain NEUTRAL with a lower TP of RM1.30 (from RM1.35). Our TP of RM1.30 is derived from FY24F's BVPS of RM3.00, multiplied by the 2-year historical mean P/BV ratio of 0.4x. Given the ongoing over-inventory situation in the US, we anticipate a sluggish demand for furniture in the future, resulting in reduced customer orders and subsequently lower revenue. Note that the US is the largest importer of wooden furniture from RKI. Moreover, we are aware that Malaysia and Vietnam's operations, being labor-intensive industries, will continue to face higher input costs, further compressing profit margins. Consequently, we expect low profitability for FY23F and FY24F. On a positive note, RKI strong net cash of RM121.3m in 3QFY23, which is equal to 44.6% of its total market capitalization could provide protection against the downside risk. RKI is currently trading at a fair FY24F P/BV of 0.46x, slightly above its 2-year average of 0.43x. Hence, we maintain **NEUTRAL** on RKI. **Re-rating catalyst** is the strong housing sales in the US that lead to higher-than-expected demand for RKI's wooden furniture.

Rhong Khen International: 3QFY23 Results Summary

FYE JUN (RM'm)	Quarterly results					Cumulative results		
	3QFY23	2QFY23	3QFY22	YoY (%)	QoQ (%)	9MFY23	9MFY22	YoY (%)
Revenue	97.9	186.3	194.8	(49.7)	(47.4)	518.5	516.1	0.4
Cost of sales	(94.7)	(159.4)	(167.6)	(43.5)	(40.6)	(459.8)	(455.4)	1.0
Gross Profit	**3.2**	**26.9**	**27.2**	**(88.3)**	**(88.2)**	**58.6**	**60.7**	**(3.4)**
Other income	1.7	1.5	1.0	58.1	9.6	4.6	4.7	(1.6)
Selling and distribution expenses	(2.5)	(5.3)	(5.2)	(52.2)	(53.1)	(14.2)	(16.3)	(13.0)
Administrative expenses	(9.2)	(7.9)	(8.8)	5.0	17.2	(24.1)	(20.5)	17.2
Other expenses	(1.0)	(0.4)	(0.5)	85.2	146.7	(2.7)	(3.1)	(13.7)
Operating profit (EBIT)	**(7.9)**	**14.9**	**13.8**	**(157.1)**	**(152.9)**	**22.3**	**25.4**	**(12.4)**
Profit before tax (PBT)	**(8.8)**	**14.0**	**13.2**	**(166.5)**	**(162.8)**	**19.6**	**23.6**	**(17.0)**
Profit After tax (PAT)	(8.7)	11.3	10.8	(179.9)	(176.8)	13.0	18.1	(28.0)
PATANCI	(8.3)	11.3	10.8	(176.4)	(173.5)	13.4	18.1	(26.0)
Core PATANCI	**(7.3)**	**10.9**	**11.0**	**(166.2)**	**(167.2)**	**14.9**	**19.6**	**(24.3)**
Core EPS (sen)	(3.8)	5.6	5.7	(166.3)	(167.1)	7.7	10.1	(24.3)
DPS (sen)	0.0	0.0	0.0	n.m.	n.m.	0.0	0.0	n.m.
Growth & Margin (%)				*+/(-) ppts*	*+/(-) ppts*			*+/(-) ppts*
Gross Profit Margin	3.3	14.4	14.0	(10.7)	(11.2)	11.3	11.8	(0.5)
Operating Profit Margin	(8.0)	8.0	7.1	(15.1)	(16.0)	4.3	4.9	(0.6)
PBT Margin	(9.0)	7.5	6.8	(15.8)	(16.5)	3.8	4.6	(0.8)
Core PATANCI Margin	(7.5)	5.8	5.7	(13.1)	(13.3)	2.9	3.8	(0.9)
Ratios & Valuation				*+/(-) ppts*	*+/(-) ppts*			*+/(-) ppts*
Net cash/market cap (%)	44.6	37.5	10.1	34.5	7.1	44.6	10.1	34.5
Net cash per share	0.4	0.3	(0.0)	0.4	0.1	0.4	(0.0)	0.4

Source: Company, MIDFR

Rhong Khen International: Breakdown by operating segment

FYE JUN (RM'm)	Quarterly results					Cumulative results		
	3QFY23	2QFY23	3QFY22	YoY (%)	QoQ (%)	9MFY23	9MFY22	YoY (%)
Revenue (External):								
Malaysia	24.7	36.9	49.9	(50.5)	(33.0)	106.9	112.7	(5.1)
Vietnam	68.9	144.7	138.9	(50.4)	(52.4)	397.0	388.0	2.3
Thailand	3.8	3.9	5.1	(25.2)	(1.7)	12.2	13.3	(8.0)
Others	0.5	0.8	0.9	(44.8)	(42.8)	2.4	2.2	8.3
Total	**97.9**	**186.3**	**194.8**	**(49.7)**	**(47.4)**	**518.5**	**516.1**	**0.4**
Operating Profit:								
Malaysia	(4.2)	2.1	10.8	(139.1)	(303.7)	2.1	17.3	(88.0)
Vietnam	(2.6)	12.6	15.8	(116.7)	(120.9)	20.8	20.9	(0.8)
Thailand	(0.3)	0.2	(1.6)	(78.6)	(243.9)	(0.6)	(3.1)	(82.1)
Others	(1.6)	(0.9)	(1.4)	17.4	69.8	(2.7)	(1.1)	152.8
Total	**(8.8)**	**14.0**	**23.6**	**(137.2)**	**(162.8)**	**19.6**	**34.1**	**(42.4)**
Operating profit margin:				***+/(-) ppts***	***+/(-) ppts***			***+/(-) ppts***
Malaysia	(17.0)	5.6	21.5	(38.6)	(22.6)	1.9	15.3	(13.4)
Vietnam	(3.8)	8.7	11.4	(15.2)	(12.6)	5.2	5.4	(0.2)
Thailand	(9.1)	6.2	(31.6)	22.6	(15.3)	(4.5)	(23.3)	18.7
Others	(328.3)	(110.6)	(154.4)	(173.9)	(217.7)	(112.9)	(48.4)	(64.6)
Total	**(9.0)**	**7.5**	**12.1**	**(21.1)**	**(16.5)**	**3.8**	**6.6**	**(2.8)**

Source: Company, MID

FINANCIAL SUMMARY

Income Statement (RM'm)	2021A	2022A	2023F	2024F	2025F
Revenue	**911.9**	**756.3**	**596.6**	**611.7**	**669.6**
Cost of Sales	(786.1)	(650.8)	(546.7)	(546.5)	(583.3)
Gross Profit	**125.9**	**105.5**	**49.9**	**65.2**	**86.3**
Other Income	11.5	4.3	6.0	6.4	7.2
Selling and distribution expenses	(27.0)	(21.8)	(17.7)	(18.2)	(20.1)
Administrative expenses	(30.5)	(29.3)	(28.2)	(29.0)	(31.9)
Other expenses	(7.1)	(9.0)	(5.7)	(5.8)	(6.3)
EBITDA	**92.5**	**69.1**	**20.3**	**31.0**	**48.8**
EBIT	**72.8**	**49.8**	**4.3**	**18.5**	**35.2**
Profit before tax (PBT)	**71.6**	**48.8**	**4.5**	**19.4**	**36.0**
Profit After tax (PAT)	53.8	35.5	3.4	14.1	26.2
Core PATANCI	**59.3**	**38.1**	**3.4**	**14.1**	**26.2**
Core EPS (sen)	30.7	19.6	1.8	7.3	13.5
DPS (sen)	10.9	6.0	0.5	2.2	4.0

Balance Sheet (RM'm)	2021A	2022A	2023F	2024F	2025F
Property, plant and equipment	251.2	255.5	254.5	256.6	259.0
Intangible assets	0.0	0.0	0.0	0.0	0.0
Total Non-current assets	**346.3**	**340.6**	**340.3**	**343.9**	**347.9**
Inventories	229.0	253.4	212.9	211.8	224.9
ST - Trade and other receivables	61.3	82.5	65.0	65.4	70.1
Cash and cash equivalents	252.1	267.4	194.1	199.4	218.6
Total current assets	**547.3**	**607.6**	**472.1**	**476.6**	**513.8**
Total Assets	**893.6**	**948.2**	**812.5**	**820.5**	**861.7**
Total Equity	**610.2**	**655.3**	**590.2**	**587.9**	**605.0**
LT Loans and borrowings	22.1	26.0	15.6	16.4	19.7
Total Non-current liabilities	**30.6**	**34.8**	**24.2**	**25.2**	**29.0**
ST Trade and other payables	111.7	117.1	98.4	98.3	104.9
ST Loans and borrowings	108.1	103.3	62.0	65.1	78.1
Total Current Liabilities	**252.8**	**258.2**	**198.0**	**207.3**	**227.6**
Total Liabilities	**283.3**	**292.9**	**222.2**	**232.6**	**256.6**

Cash Flow (RM'm)	2021A	2022A	2023F	2024F	2025F
Pretax profit	71.6	48.8	4.5	19.4	36.0
Cash flow from operations	78.9	26.6	92.1	20.9	27.7
Cash flow from investing	(16.8)	(27.9)	(13.5)	(12.9)	(14.0)
Cash flow from financing	23.0	(20.5)	(55.0)	(2.7)	5.7
Net cash flow	**85.1**	**(21.8)**	**23.6**	**5.3**	**19.3**
(+/-) Adjustments	(1.6)	7.3	0.0	0.0	0.0
Net cash/(debt) b/f	**101.4**	**185.0**	**170.5**	**194.1**	**199.4**
Net cash/(debt) c/f	**185.0**	**170.5**	**194.1**	**199.4**	**218.6**

Key Metrics	2021A	2022A	2023F	2024F	2025F
Effective tax rate (%)	24.9	27.2	24.9	27.2	27.2
Cash/Market Capitalisation (sen)	93.2	98.3	71.3	73.3	80.4
Cash/share (sen)	130.5	137.6	99.9	102.6	112.5
BVPS (sen)	3.2	3.4	3.0	3.0	3.1
P/BV ratio (x)	0.4	0.4	0.5	0.5	0.4

Profitability Margins	2021A	2022A	2023F	2024F	2025F
Gross Profit Margin (%)	13.8	14.0	8.4	10.7	12.9
EBITDA Margin (%)	10.1	9.1	3.4	5.1	7.3
Core PATANCI Margin (%)	6.5	5.0	0.6	2.3	3.9

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