

# Kossan Rubber Industries

## New Plants to Boost Margins

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We are positive on Kossan's earnings prospect, underpinned by take-ups for its Plant 16 and Plant 17 and also expect margins improvement due to better operational efficiencies from the new plants. We like Kossan because it is trading at an unwarranted 25% discount to peers' PER average considering that its net profit growth is the highest compared to peers. TP is RM5.25 based on 25.5x FY20E EPS (+1.0SD above 5-year historical forward mean). Maintain OP.

**Expect solid YoY 2Q19/1H19 earnings growth.** We expect its core 2Q19 PATAMI, which results are due to be released by end-Aug 2019, to be higher QoQ and YoY due to: (i) new capacity expansion and better margins due to high operating efficiencies from new plants, and (ii) a favourable USD/MYR rate (+3% QoQ). For illustration purposes, if we deduct our full-year net profit forecast of RM248.4m against 1Q19 PATAMI and divide by three (remaining three quarters), we expect 2Q19 PATAMI to be RM63m (+7% QoQ; +45% YoY). This brings 1H19 PATAMI to RM121.7m (+38%), which is within expectations at 49%/51% of our and consensus full-year forecasts.

**Sturdy new plants, margins to improve.** We expect gradual margins expansion from the fully-completed Plant 16, Plant 17 and eventual completion of Plant 18 and 19 by 2019. This is simply because the new plant is designed to save heating and electricity cost via the use of computerised control system and efficient usage of a single boiler instead of two as in the older plants. Additionally, the introduction of robotic packing system would lead to two-third lesser manpower requirements at the packing division. The older plants could see stable margins emanating from lower downtime due to their focus on larger orders for single product type and specification, thus reducing idle downtime from frequent machinery setting adjustments to accommodate diverse specifications.

**Plant 16,17,18 and 19 to boost earnings over next two years.** Looking ahead, Plant 16 and Plant 17 are expected to anchor subsequent quarters' earnings, which was fully commissioned in Aug 2018 and end 2018. Construction works for Plant 18 (2.5bn pieces) and Plant 19 (3.0bn pieces) are currently on track, with expected full commissioning by 3Q 2019 (two lines currently commissioned) and 4Q 2019, respectively. Upon completion, these two new plants will add an additional 5.5b pieces of gloves per annum, bringing the group's total installed capacity to 35bn (+19%) pieces of gloves per annum by end-FY19. The Group expects construction, which will start somewhere in 2019, to take eight years to complete, costing RM1.5b (works out to RM190m capex per annum) for an integrated glove manufacturing project in Bidor, subject to all relevant approvals being obtained. The expected capacity at the Bidor plant is estimated at 34bn pieces per annum, which will more than double from 32b pieces currently (once Plant 18 and Plant 19 are fully commissioned).

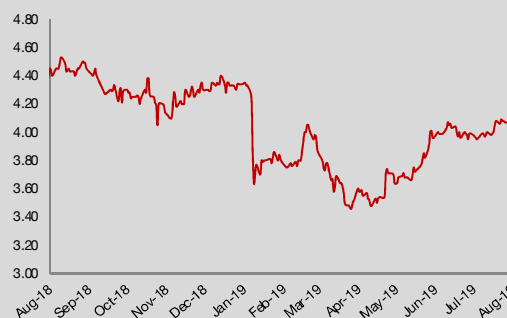
**Stock under-appreciated, unwarranted PER discount valuation to peers, Maintain Outperform.** We maintain our FY19E/FY20E earnings forecasts. Our TP of RM5.25 is based on 25.5x FY20E EPS (+1.0SD above 5-year historical forward mean). We like Kossan because it is trading at an unwarranted 25% discount to peers' PER average considering that its net profit growth is the highest at 23.7% compared to peers average at 9%. Reiterate Outperform.

**Key risk to our call** is slower-than-expected commissioning of the new plants.

## OUTPERFORM ↔

Price : **RM4.04**  
Target Price : **RM5.25** ↔

### Share Price Performance



KLCI 1,626.76  
YTD KLCI chg -3.8%  
YTD stock price chg -6.9%

### Stock Information

Shariah Compliant	Yes
Bloomberg Ticker	KRI MK Equity
Market Cap (RM m)	5,166.9
Shares Outstanding	1,278.9
52-week range (H)	4.60
52-week range (L)	3.44
3-mth avg daily vol:	1,230,064
Free Float	39%
Beta	0.6

### Major Shareholders

Kossan Holdings Sdn Bhd	51.1%
Employees Provident Fund	7.4%
KWAP	2.2%

### Summary Earnings Table

FY Dec (RM'm)	2018A	2019E	2020E
Turnover	2144.2	2324.1	2425.5
PBT	249.3	316.6	335.5
<b>Net Profit (NP)</b>	<b>200.8</b>	<b>248.4</b>	<b>263.3</b>
Consensus (NP)	-	237.7	269.4
Earnings Revision	-	-	-
Core EPS (sen)	15.7	19.4	20.6
Core EPS growth (%)	10.3	23.7	6.0
NDPS (sen)	6.0	6.0	6.0
BVPS (RM)	1.03	1.16	1.31
Core PER (x)	25.7	20.8	19.6
Price/Bv (x)	3.9	3.5	3.1
Net Gearing (%)	27.6	19.2	10.4
Net Div. Yield (%)	1.5	1.5	1.5



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## Income Statement

FY Dec (RM m)	2016A	2017A	2018A	2019E	2020E
Revenue	1668	1957	2144	2324	2425
EBITDA	285.8	309.6	344.4	418.3	436.6
Depre. & Amort	-69.2	-72.1	-77.0	-83.1	-84.1
Operating Profit	216.6	237.5	267.4	335.3	352.5
PBT	210.0	229.6	249.3	316.6	335.5
Taxation	-39.0	-44.0	-44.0	-63.3	-67.1
MI	-4.0	-1.6	-4.5	-4.9	-5.1
Net Profit	167.1	183.9	200.8	248.4	263.3

## Balance Sheet

FY Dec (RM m)	2016A	2017A	2018A	2019E	2020E
Fixed Assets	862.5	1,028	1,266	1,323	1,378
Int. Assets	4.9	4.9	4.9	4.9	4.9
Other FA	8.4	8.5	8.4	6.8	6.8
Inventories	210.7	206.2	251.6	272.7	284.5
Receivables	305.0	341.1	405.9	439.9	459.1
Other CA	50.6	48.9	37.6	40.7	42.5
Cash	109.8	208.0	143.1	221.3	333.4
Total Assets	1,552	1,845	2,117	2,309	2,510
Payables	200.8	185.1	191.5	207.5	216.6
ST Borrowings	106.2	206.8	242.4	242.4	242.4
Ot. ST Liability	29.4	(3.9)	(16.0)	(15.9)	(15.8)
LT Borrowings	56.0	187.0	264.4	264.4	264.4
Ot. LT Liability	85.4	87.5	89.7	89.7	89.7
Minorities Int.	28.9	26.7	28.9	32.8	37.9
Net Assets	1,045	1,156	1,317	1,488	1,675
Share Capital	319.7	319.7	323.9	323.9	323.9
Reserves	725.5	836.5	992.6	1,164	1,351
Equity	1,045	1,156	1,317	1,488	1,675

## Cashflow Statement

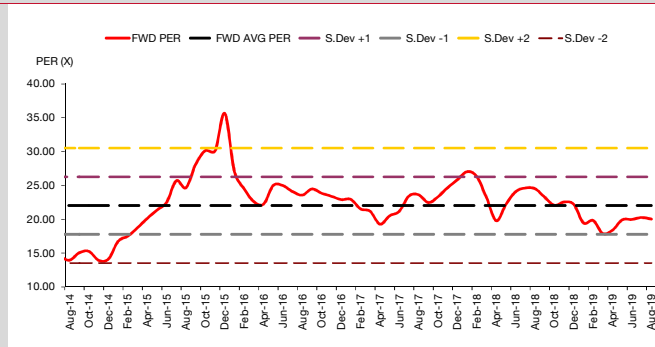
FY Dec (RM m)	2016A	2017A	2018A	2019E	2020E
Operating CF	149.9	123.0	135.7	294.2	328.8
Investing CF	(12.5)	(121.1)	(315.0)	(100.0)	(100.0)
Financing CF	(59.9)	98.3	112.2	(116.0)	(116.6)
Change In Cash	77.5	100.2	(67.1)	78.2	112.1
Free CF	59.9	33.0	35.7	194.2	228.8

## Financial Data &amp; Ratios

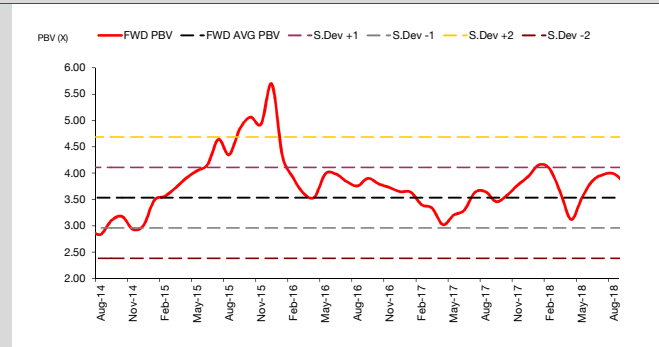
FY Dec (RM m)	2016A	2017A	2018A	2019E	2020E
<b>Growth (%)</b>					
Turnover	2.0	17.4	9.5	8.4	4.4
EBITDA	-16.8	8.3	11.3	21.5	4.4
Operating Profit	-21.7	9.7	12.6	25.4	5.1
PBT	-21.8	9.3	8.6	27.0	6.0
Net Profit /(loss)	-17.5	10.1	9.2	23.7	6.0
<b>Profitability (%)</b>					
EBITDA Margin	17.1	15.8	16.1	18.0	18.0
Operating Margin		13.0	12.1	12.5	14.4
PBT Margin	12.6	11.7	11.6	13.6	13.8
Core Net Margin	10.0	9.4	9.4	10.7	10.9
Eff. Tax Rate	22.8	23.7	21.4	20.0	20.0
ROA	10.8	10.0	9.5	10.8	10.5
ROE	16.0	15.9	15.3	16.7	15.7
<b>DuPont Analysis</b>					
Net Margin (%)	10.0	9.4	9.4	10.7	10.9
Assets T/O (x)	0.9	0.9	1.0	1.0	1.0
Lev. Factor (x)	1.5	1.6	1.6	1.6	1.5
ROE (%)	16.0	15.9	15.3	16.7	15.7
<b>Leverage</b>					
Debt/Asset (x)	0.1	0.2	0.2	0.2	0.2
Debt/Equity (x)	0.2	0.3	0.4	0.3	0.3
<b>Valuations</b>					
EPS (sen)	13.1	14.4	15.7	19.4	20.6
NDPS (sen)	6.0	6.0	6.0	6.0	6.0
BVPS (RM)	0.82	0.90	1.03	1.16	1.31
PER (x)	30.9	28.1	25.7	20.8	19.6
Net Div. Yield(%)	1.5	1.5	1.5	1.5	1.5
PBV (x)	4.9	4.5	3.9	3.5	3.1

Source: Kenanga Research

## Fwd PER Band



## Fwd PBV Band



Source: Kenanga Research, Bloomberg

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## Peer Comparison

Name	Last Price (RM)	Market Cap (RM'm)	Shariah Compliant	Current FYE	Revenue Growth		Core Earnings Growth		PER (x) - Core Earnings			PBV (x)		ROE (%)	Net Div Yld (%)	Target Price (RM)	Rating
					1-Yr. Fwd.	2-Yr. Fwd.	1-Yr. Fwd.	2-Yr. Fwd.	Hist.	1-Yr. Fwd.	2-Yr. Fwd.	Hist.	1-Yr. Fwd.	1-Yr. Fwd.			
<b>RUBBER GLOVES</b>																	
HARTALEGA HOLDINGS BHD	4.86	16285.6	Y	03/2020	3.7	6.2	11.6	6.7	35.2	31.5	29.5	7.1	6.4	20.3	1.4	5.85	OP
KOSSAN RUBBER INDUSTRIES	4.04	5166.9	Y	12/2019	8.4	4.4	23.7	6.0	25.7	20.8	19.6	3.9	3.5	16.7	1.5	5.25	OP
SUPERMAX CORP BHD	1.58	2064.0	Y	06/2019	11.9	4.9	19.1	4.0	20.1	16.9	16.2	2.1	1.9	11.4	2.5	1.70	MP
TOP GLOVE CORP BHD	4.55	11647.2	Y	08/2019	4.5	4.6	-5.2	13.8	26.7	28.2	24.8	4.8	4.5	15.8	1.9	4.70	MP

Source: Bloomberg, Kenanga Research

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**Stock Ratings are defined as follows:****Stock Recommendations**

OUTPERFORM	: A particular stock's Expected Total Return is MORE than 10%
MARKET PERFORM	: A particular stock's Expected Total Return is WITHIN the range of -5% to 10%
UNDERPERFORM	: A particular stock's Expected Total Return is LESS than -5%

**Sector Recommendations\*\*\***

OVERWEIGHT	: A particular sector's Expected Total Return is MORE than 10%
NEUTRAL	: A particular sector's Expected Total Return is WITHIN the range of -5% to 10%
UNDERWEIGHT	: A particular sector's Expected Total Return is LESS than -5%

**\*\*\*Sector recommendations are defined based on market capitalisation weighted average expected total return for stocks under our coverage.**

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