

22 November 2019

## Kossan Rubber Industries

### 3QFY19 Hit By Temporary Labour Shortage

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**9MFY19 PATAMI of RM164m (+16% YoY) came in below expectations at 66%/68% of our/consensus full-year forecasts. The negative variance on our end was due to lower-than-expected volume sales as a result of a labour shortage in 3QFY19 which came without any warning. We cut our FY19E net profit by 8% taking into account lower volumes sales. However, we keep our FY20E earnings forecast unchanged as we expect production to return to normal. Our TP of RM5.25 is based on 25.5x FY20E EPS. Maintain Outperform.**

**9MFY19 PATAMI of RM164m (+16% YoY) came in below expectations at 66%/68% of our/consensus full-year forecasts.** The negative variance from our result was due to lower-than-expected volume sales as a result of labour shortage in 3QFY19. No dividend was declared in this quarter as expected.

**Key result highlights. QoQ, 3QFY19** revenue fell 4% due to lower contribution from rubber gloves (-3%) on lower volume sales (-3%) and ASP (-2%). The lower volume sales were largely due to a labour shortage leading to Plant 18 suffering lower utilisation rate. The Technical Rubber Product (TRP) division's revenue rose 9% churning higher PBT as sales deliveries picked up. Overall, 3QFY19 PBT margin lowered marginally by 0.9ppt to 11.8% compared to 12.7% in 2QFY19 due to lower volume sales and higher natural gas price leading to lower absorption cost. This brings 3QFY19 net profit to RM49m (-12% QoQ) due to higher effective tax rate of 20% compared to 19% in 2QFY19.

**YoY, 9MFY19** revenue rose 6% due to higher contribution from the Gloves division (+7%), underpinned by higher volume sales (+10%) which more than offset lower ASP (-6%). The volume growth could have been higher in 9MFY19 if not for the following reasons: (i) a revamp and upgrading works across the Group's plants for efficiency improvements and energy savings in 2Q19, and (ii) lower volume sales largely due to a labour shortage leading to Plant 18 suffering lower utilisation rate in 3QFY19. 9MFY19 PBT margin improved to 12.6% compared to 11.4% in 9MFY18 due to manufacturing efficiency and effective cost savings initiatives, including cost savings in heating and electricity. This brings 9MFY19 PATAMI to RM164m (+16%) despite a higher effective tax rate of 20% compared to 18.9% in 9MFY18.

**Plant 17,18 and 19 to boost earnings over next two years.** We understand that the labour shortage issue has been resolved since two months ago. Looking ahead, Plant 16 and Plant 17 are expected to boost subsequent quarters' earnings, which were fully commissioned in Aug 2018 and end 2018, respectively. Plant 18 (2.5b pieces) has commenced operations with six lines currently commissioned and the remaining two expected to be fully commissioned by end Nov 2018. Plant 19 (3.0b pieces) is currently on track, with expected full commissioning latest by 1HCY20. Upon completion, these three new plants will bring the group's total installed capacity to 32b (+28%) pieces of gloves per annum.

**We cut our FY19E net profit by 8%**, taking into account lower volumes sales. However, we keep our FY20E earnings forecast unchanged as we expect production to return to normal.

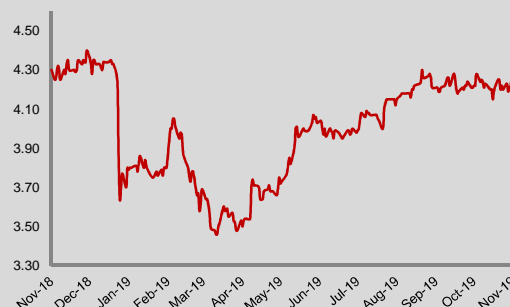
**Maintain OP.** We maintain our FY19E/FY20E earnings forecasts. Our TP of RM5.25 is based on 25.5x FY20E EPS (+1.0SD above 5-year historical forward mean). We like Kossan because it is trading at an unwarranted 25% discount to peers' PER average considering that its net profit growth is the highest at 23.7% compared to peers' average at 7%. **Reiterate Outperform.**

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

## OUTPERFORM ↔

**Price :** RM4.19  
**Target Price :** RM5.25 ↔

### Share Price Performance



|                     |          |
|---------------------|----------|
| KLCI                | 1,592.19 |
| YTD KLCI chg        | -5.8%    |
| YTD stock price chg | -3.5%    |

### Stock Information

|                      |               |
|----------------------|---------------|
| Shariah Compliant    | Yes           |
| Bloomberg Ticker     | KRI MK Equity |
| Market Cap (RM m)    | 5,358.7       |
| Shares Outstanding   | 1,278.9       |
| 52-week range (H)    | 4.46          |
| 52-week range (L)    | 3.44          |
| 3-mth avg daily vol: | 1,154,318     |
| Free Float           | 36%           |
| Beta                 | 0.6           |

### Major Shareholders

|                          |       |
|--------------------------|-------|
| Kossan Holdings Sdn Bhd  | 51.1% |
| Employees Provident Fund | 5.8%  |
| KWAP                     | 2.2%  |

### Summary Earnings Table

| FY Dec (RM'm)          | 2018A        | 2019E        | 2020E        |
|------------------------|--------------|--------------|--------------|
| Turnover               | 2144.2       | 2183.4       | 2425.5       |
| PBT                    | 249.3        | 291.5        | 335.5        |
| <b>Net Profit (NP)</b> | <b>200.8</b> | <b>228.6</b> | <b>263.3</b> |
| Consensus (NP)         | -            | 238.3        | 270.6        |
| Earnings Revision      | -            | -8%          | -            |
| 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)           | 26.7         | 23.4         | 20.3         |
| Price/BV (x)           | 4.1          | 3.6          | 3.2          |
| Net Gearing (%)        | 27.6         | 18.6         | 11.7         |
| Net Div. Yield (%)     | 1.4          | 1.4          | 1.4          |

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| Result Highlight       |             |             |               |             |              |              |              |             |
|------------------------|-------------|-------------|---------------|-------------|--------------|--------------|--------------|-------------|
|                        | 3Q          | 2Q          | Q-o-Q         | 3Q          | Y-o-Y        | 9M           | 9M           | Y-o-Y       |
| FY Dec (RM'm)          | FY19        | FY19        | Chg           | FY18        | Chg          | FY18         | FY19         | Chg %       |
| Turnover               | 531.3       | 550.5       | (3.5)         | 573.9       | (7.4)        | 1,554.9      | 1,643.3      | 5.7         |
| EBITDA                 | 87.5        | 96.9        | (9.7)         | 94.6        | (7.5)        | 244.4        | 287.1        | 17.5        |
| PBT                    | 62.8        | 70.0        | (10.3)        | 70.8        | (11.4)       | 177.9        | 207.8        | 16.8        |
| <b>PATAMI (NP)</b>     | <b>49.2</b> | <b>55.9</b> | <b>(12.0)</b> | <b>54.1</b> | <b>(9.2)</b> | <b>141.3</b> | <b>163.8</b> | <b>15.9</b> |
| Core EPS (sen)         | 3.8         | 4.4         | (12.1)        | 4.2         | (9.2)        | 11.1         | 12.8         | 15.8        |
| EBITDA margin (%)      | 16.5        | 17.6        |               | 16.5        |              | 15.7         | 17.5         |             |
| PBT margin (%)         | 11.8        | 12.7        |               | 12.3        |              | 11.4         | 12.6         |             |
| NP margin (%)          | 9.3         | 10.2        |               | 9.4         |              | 9.1          | 10.0         |             |
| Effective tax rate (%) | 20.1        | 19.0        |               | 22.2        |              | 18.9         | 20.0         |             |

Source: Kenanga Research, Bursa Malaysia

| Quarterly segmental breakdown            |       |       |       |        |         |         |        |
|--|-------|-------|-------|--------|---------|---------|--------|
|  | 1Q19  | 2Q19  | 3Q19  | Chg %  | 9M      | 9M      | Chg %  |
|  |       |       |       | q-o-q  | FY18    | FY19    | y-o-y  |
| <b>Revenue (RM'm)</b>                    |       |       |       |        |         |         |        |
| Gloves division                          | 497.0 | 478.0 | 465.7 | (2.6)  | 1,357.5 | 1,452.2 | 7.0    |
| Technical rubber products (TRP) division | 46.7  | 42.7  | 46.6  | 9.1    | 134.2   | 136.0   | 1.3    |
| Cleanroom products division              | 17.1  | 29.1  | 18.4  | (36.8) | 60.7    | 53.2    | (12.4) |
| Investment Holding                       | 0.7   | 0.7   | 0.5   | (27.9) | 2.5     | 1.9     | (23.3) |
| Total                                    | 561.5 | 550.5 | 531.3 | (3.5)  | 1,554.9 | 1,643.3 | 5.7    |
| <b>Pre-tax profit (RM'm)</b>             |       |       |       |        |         |         |        |
| Gloves division                          | 68.0  | 61.9  | 54.1  | (12.7) | 156.9   | 183.9   | 17.2   |
| Technical rubber products (TRP) division | 6.8   | 7.5   | 8.2   | 9.6    | 20.0    | 22.4    | 12.0   |
| Cleanroom products division              | 0.6   | 0.6   | 0.8   | 31.3   | 2.5     | 2.0     | (17.5) |
| Investment Holding                       | (0.3) | (0.0) | (0.3) | NM     | (0.6)   | (0.6)   | (8.1)  |
| Total                                    | 75.1  | 70.0  | 62.8  | (10.3) | 178.8   | 207.8   | 16.3   |
| <b>Pre-tax profit margin (%)</b>         |       |       |       |        |         |         |        |
| Gloves division                          | 14    | 13    | 12    |        | 12      | 13      |        |
| Technical rubber products division       | 15    | 17    | 18    |        | 15      | 16      |        |
| Cleanroom products division              | 3     | 2     | 4     |        | 4       | 4       |        |

Source: Kenanga Research, Bursa Malaysia

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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   | 5.32            | 17939.9           | Y                 | 03/2020     | 3.7            | 6.2        | 11.6                 | 6.7        | 38.5                    | 34.5       | 32.3       | 7.8     | 7.0        | 20.3       | 1.3             | 6.00              | OP     |
| KOSSAN RUBBER INDUSTRIES | 4.19            | 5358.7            | Y                 | 12/2019     | 1.8            | 11.1       | 13.8                 | 15.2       | 26.7                    | 23.4       | 20.3       | 4.1     | 3.6        | 15.4       | 1.4             | 5.25              | OP     |
| SUPERMAX CORP BHD        | 1.43            | 1868.0            | Y                 | 06/2020     | 2.8            | 6.0        | 4.1                  | 6.3        | 15.3                    | 14.7       | 13.8       | 1.7     | 1.6        | 11.1       | 2.8             | 1.75              | OP     |
| TOP GLOVE CORP BHD       | 4.60            | 11775.1           | Y                 | 08/2020     | 6.3            | 0.5        | 5.4                  | 8.9        | 31.6                    | 30.0       | 27.5       | 4.8     | 4.3        | 14.3       | 1.6             | 4.00              | UP     |

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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