

28 July 2023

## Kossan Rubber Industries

### Cuts Production Capacity by 8%

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**KOSSAN's 1HFY23 results met our expectations but missed the consensus estimate. Its net loss in 2Q narrowed significantly to only RM3.3m from RM24m three months ago. It has decommissioned capacity amounting to 3b pieces per annum or 8% of its total capacity. We maintain our forecasts, TP of RM1.28 and UNDERPERFORM call.**

KOSSAN's 1HFY23 result came in at 36% of our full-year net loss forecast of RM76m but disappointed full-year consensus net profit estimate of RM55m. We deem the result within our forecast on the assumption of further weakness in 2HCY23 as the sector continues to grapple with subdued ASP and low plant utilisation amidst intense competition, especially from Chinese producers.

**QoQ**, its 2QFY23 revenue fell 2% due to lower volume sales (-3%). EBITDA rose 38% albeit low base effect in 1QFY23 and due to: (i) lower input nitrile raw material cost and natural gas price and (ii) weak margin as a result of reduced economies of scale, particularly, poor cost absorption, as its utilisation rate continues to remain weak. As a result, 2QFY23 losses narrowed to RM3.3m compared to RM24m in 1QFY23 albeit low base effect. No dividend was declared in this quarter as expected. **YoY**, 1HFY23 revenue fell dropped 39% due to lower ASP (-26%) and volume sales (-34%). This brings 1HFY23 net loss to RM28m compared to a profit of RM136m in 1HFY22.

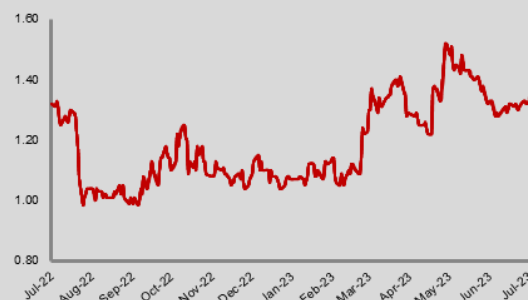
**Outlook.** The group highlighted in its 2QFY23 quarterly result note that it has embarked on a capacity rationalisation exercise by decommissioning two older plants with a total capacity of 3b pieces. The decommissioning will reduce its production capacity by 8% to 33.5b pieces per annum. The two plants are 14 and 19 years old respectively which means high maintenance cost. Due to massive global overcapacity, we believe the plant is also likely to sit idle over the next 12–18 months anyway.

We expect the operating environment to remain challenging in subsequent quarters, plagued by massive oversupply. Nevertheless, we expect the oversupply situation to be less acute and gradually improve following signs of players culling production capacity via decommissioning of selective plants. Based on our estimates, the demand-supply situation will only start to head towards equilibrium in 2025 when there is virtually no more new capacity coming onstream while the global demand for gloves continues to rise by 15% per annum underpinned by rising hygiene awareness. MARGMA projects 12%–15% growth in the global demand for rubber gloves annually from 2023, following an estimated 19% contraction to 399b pieces in 2022. It believes the supply-demand equilibrium may return in 6–9 months. However, we beg to differ, expecting the overcapacity situation to persist at least over the next 12 months. We project the demand for gloves to rise by 15% in 2023, which is consistent with MARGMA's forecast. On the supply side, we are now factoring in a reduction of 24b pieces (previous reduction was 21b pieces) of gloves in the system by end-FY23. This will result in an excess capacity of 112b pieces (instead of rising by 4% or 116b as previously forecast) which is similar to CY22. Despite the improvement, the overcapacity still persists which means low prices and depressed plant utilisation will continue to plague the industry in 2023.

## UNDERPERFORM ↔

**Price:** RM1.36  
**Target Price:** RM1.28 ↔

### Share Price Performance



KLCI	1,451.27
YTD KLCI chg	-3.0%
YTD stock price chg	23.6%

### Stock Information

Shariah Compliant	Yes
Bloomberg Ticker	KRI MK
Market Cap (RM m)	3,470.2
Shares Outstanding	2,551.6
52-week range (H)	1.62
52-week range (L)	0.92
3-mth avg daily vol:	4,380,450
Free Float	40%
Beta	0.6

### Major Shareholders

Kossan Holdings SdnBhd	49.2%
Abrdn Plc	5.4%

### Summary Earnings Table

FY Dec (RM m)	2022A	2023F	2024F
Turnover	2316.2	1218.7	1629.5
PBT/(LBT)	213.0	-97.1	31.5
<b>Net Profit / (loss)</b>	156.7	-76.2	22.4
<b>Core Net Profit / (loss)</b>	151.3	-76.2	22.4
Consensus (NP)	-	55.8	92.6
Earnings Revision	-	-	-
Core EPS (sen)	6.1	-3.0	0.9
Core EPS growth (%)	(94.6)	(148.6)	(129.4)
NDPS (sen)	2.5	0.0	0.0
BVPS (RM)	1.52	1.49	1.50
Core PER (x)	22.2	NM	155.5
Price/BV (x)	0.8	0.9	0.8
Net Gearing (%)	N.Cash	N.Cash	N.Cash
Net Div. Yield (%)	2.2	0.0	0.0

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**Forecasts.** Maintained.

**Reiterate UNDERPERFORM.** Our TP is unchanged at RM1.28 based on 0.9x FY24F BVPS, at 60% discount to the sector's average of 1.7x charted during previous downturns in 2008–2011 and 2014–2015 as we believe the current downturn could be one of the deepest ever after imputing a 5% discount for a 2-star ESG rating as appraised by us (see Page 4).

**Key risks to our recommendation:** (i) the industry turning the corner sooner on stronger-than-expected growth in demand for gloves driven by rising hygiene standards and health awareness globally, (ii) industry consolidation reducing competition among players, and (iii) epidemic and pandemic occurrences.

**Result Highlights**

	2Q	1Q	Q-o-Q	2Q	Y-o-Y	6M	6M	Y-o-Y
FY Dec (RM m)	FY23	FY23	Chg %	FY22	Chg %	FY22	FY23	Chg %
Turnover	387.5	394.7	(1.8)	589.9	(34.3)	1,274.2	782.3	(38.6)
EBITDA	21.6	4.6	371.7	91.8	(76.5)	240.2	26.2	(89.1)
PBT	2.5	(19.1)	(113.3)	64.3	(96.1)	184.1	(16.5)	(109.0)
PATAMI (NP)	(3.3)	(24.3)	(86.4)	46.0	(107.2)	136.1	(27.6)	(120.3)
EPS (sen)	(0.1)	(1.0)	(86.3)	1.8	(107.2)	5.3	(1.1)	(120.3)
EBITDA margin (%)	5.6	1.2		15.6		18.8	3.3	
PBT margin (%)	0.7	(4.8)		10.9		14.4	(2.1)	
NP margin (%)	(0.9)	(6.1)		7.8		10.7	(3.5)	
Effective tax rate (%)	NM	NM		27.7		25.5	(58.6)	

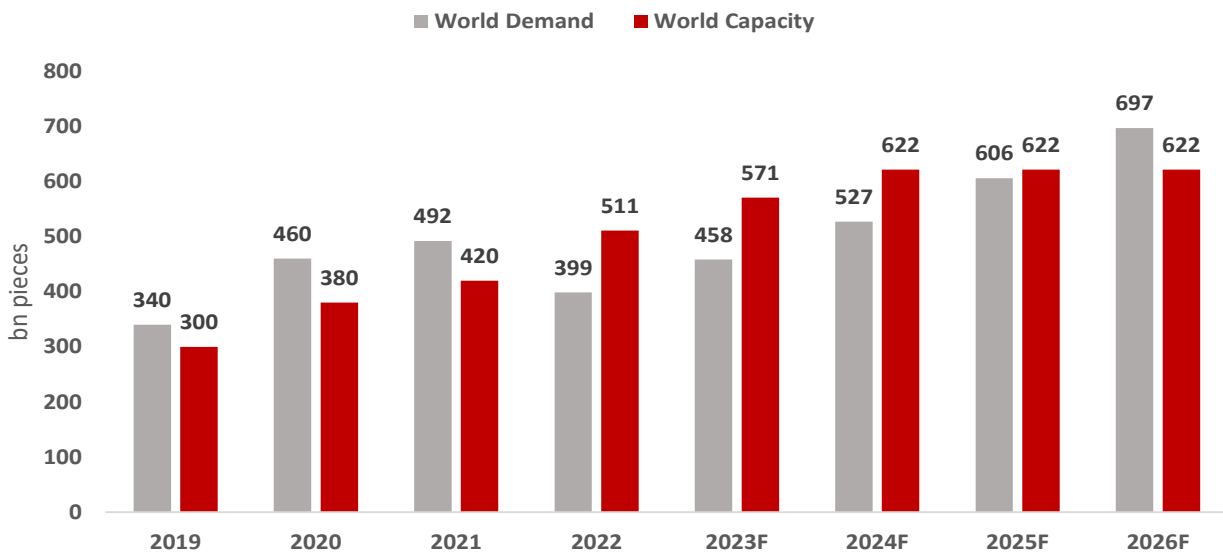
Source: Kenanga Research, Bursa Malaysia

**Quarterly segmental breakdown**

	1Q23	2Q23	Chg %	6M	6M	Chg %
			q-o-q	FY22	FY23	y-o-y
Revenue (RM m)						
Gloves division	317.5	315.9	(0.5)	1,127.0	633.4	(43.8)
Technical rubber products (TRP) division	56.2	47.8	(14.8)	87.9	104.0	18.3
Cleanroom products division	21.0	23.9	13.5	59.3	44.9	(24.3)
Total	394.7	387.5	(1.8)	1,274.2	782.2	(38.6)
Pre-tax profit (RM m)						
Gloves division	(34.9)	(12.1)	(65.4)	164.3	(47.0)	(128.6)
Technical rubber products (TRP) division	7.9	8.6	8.4	9.1	16.5	81.7
Cleanroom products division	1.6	2.4	49.3	3.4	4.0	18.5
Investment Holding	6.3	3.6	(42.3)	7.4	10.0	35.4
Total	(19.1)	2.5	(113.3)	184.1	(16.5)	(109.0)
Pre-tax profit margin (%)						
Gloves division	(11)	(4)		15	(7)	
Technical rubber products division	14	18		10	16	
Cleanroom products division	8	10		6	9	

Source: Kenanga Research, Bursa Malaysia

**Global Glove Demand & Supply Pointing to Sustained Excess Supply Over CY22-24**



Source: Kenanga Research

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### Peer Table Comparison

Name	Rating	Last Price (RM)	Target Price (RM)	Upside (%)	Market Cap (RM'm)	Shariah Compliant	Current FYE	Core EPS / (LPS) (sen)		Core EPS Growth		PER (x) - Core Earnings		PBV (x)	ROE (%)	Net Div. (sen)	Net Div Yld (%)
								1-Yr. Fwd.	2-Yr. Fwd.	1-Yr. Fwd.	2-Yr. Fwd.	1-Yr. Fwd.	2-Yr. Fwd.				
<b>Stocks Under Coverage</b>																	
HARTALEGA HOLDINGS BHD	UP	2.04	1.90	-7%	6,972	Y	03/2024	(2.4)	0.8	-138%	-68%	NM	264.7	1.5	-1.8%	0.0	0.0%
KOSSAN RUBBER INDUSTRIES	UP	1.36	1.28	-6%	3,470	Y	12/2023	(3.0)	0.9	-149%	-71%	NM	155.5	0.9	-2.0%	0.0	0.0%
SUPERMAX CORP BHD	MP	0.815	0.960	18%	2,100	Y	06/2023	(6.4)	0.9	-124%	-86%	NM	91.3	0.5	-3.7%	4.0	4.9%
TOP GLOVE CORP BHD	UP	0.875	0.880	1%	7,007	Y	08/2023	(6.9)	0.5	-340%	-93%	NM	173.7	1.4	-10.6%	0.0	0.0%

Source: Kenanga Research

### Stock ESG Ratings:

	Criterion	Rating				
<b>GENERAL</b>	Earnings Sustainability & Quality	★	★	☆		
	Community Investment	★	★	★		
	Workers Safety & Wellbeing	★	★	☆		
	Corporate Governance	★	★	★		
	Anti-Corruption Policy	★	★	★		
	Emissions Management	★	★	☆		
<b>SPECIFIC</b>	Product Quality & Safety	★	★	☆		
	Effluent/Waste Management	★	★	★		
	Automation & Innovation	★	★	★		
	Energy Efficiency	★	★	★		
	Supply Chain Management	★	★	★		
	Legal & Regulatory Compliance	★				
<b>OVERALL</b>		★	★			

☆ denotes half-star  
 ★ -10% discount to TP  
 ★★ -5% discount to TP  
 ★★★ TP unchanged  
 ★★★★ +5% premium to TP  
 ★★★★★ +10% premium to TP

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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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Published by:

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