

23 May 2024

Kossan Rubber Industries

Earnings Risks Aplenty

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KOSSAN's 1QFY24 results met expectations. It returned to the black in 1QFY24 from a year ago in the absence of high-cost inventory. Massive overcapacity will continue to weigh on the sector's outlook. We maintain our earnings forecasts, TP of RM1.48 and UNDERPERFORM call.

Its 1QFY24 net profit met expectations at 26% and 23% of our full-year forecast and the full-year consensus estimate, respectively. No dividend was declared which came in within our expectation.

YoY, its 1QFY24 revenue rose 14% largely due to higher sales volume, partially offset by, we believe, a slightly lower ASP. It returned to the black at the net level from a loss a year ago in the absence of high-cost inventory (which weighed on its performance a year ago).

QoQ, its 1QFY24 revenue rose 13% due to a higher sales volume and we believe, a slight improvement in ASP. However, its core net profit declined by 13% due to: (i) higher cost of input nitrile butadiene rubber (+8%), (ii) weaker showing from its technical rubber products due to higher cost of input latex, and (iii) a higher effective tax rate.

Outlook. KOSSAN guided for the challenging operating environment to persist throughout FY24 as players continue to grapple with massive overcapacity, subdued ASPs and high input cost. The visibility for new orders is weak as distributors or end-users see no urgency to place sizeable orders or hold substantial stocks as the supply is plentiful and readily available. Not helping either, is predatory pricing by certain overseas players (i.e. selling below cost over an extended period of time to eliminate competitors).

Based on our estimates, the demand-supply situation will only start to head towards equilibrium in CY26 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 CY23, following an estimated 25% contraction to 300b pieces in CY23. We project the demand for gloves to rise by 30% in CY24 to 390b pieces (due to a low base effect in CY23) and resume its organic growth of 15% thereafter. This will result in an excess capacity of 212b pieces in CY24. The overcapacity still persists which means low prices and depressed plant utilisation will continue to plague the industry in CY24.

Forecasts. Maintained.

Valuations. Our TP is RM1.48 is based on 1.0x FY24F BVPS, at 40% discount to the sector's average of 1.7x charted during previous downturns in 2008–2011 and 2014–2015. Our TP reflects a 5% discount to account for a 2-star ESG rating as appraised by us (see Page 4). At 50x forward PER and forward ROE of 3%, its valuations are lofty despite the improved outlook. Reiterate **UNDERPERFORM**.

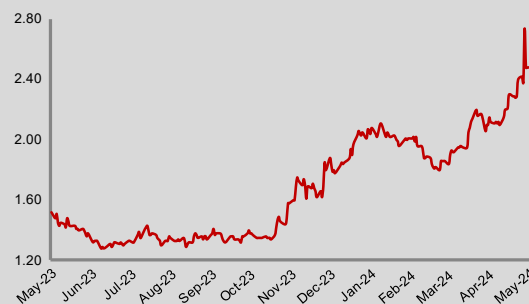
Key risks to our recommendation are: (i) certain Chinese glove giants stop their predatory pricing strategy (i.e. selling below cost over an extended period of time to eliminate competitors), leading to a strong earnings rebound for the sector, (ii) stronger-than-expected growth in demand for gloves driven by rising hygiene standards and health awareness globally, (iii) industry consolidation reducing competition among players, and (iv) epidemic and pandemic occurrences.

UNDERPERFORM ↔

Price: **RM2.44**

Target Price: **RM1.48** ↔

Share Price Performance



KLCI	1,622.09
YTD KLCI chg	11.5%
YTD stock price chg	31.9%

Stock Information

Shariah Compliant	Yes
Bloomberg Ticker	KRI MK
Market Cap (RM m)	6,226.0
Shares Outstanding	2,551.6
52-week range (H)	2.83
52-week range (L)	1.27
3-mth avg. daily vol.	5,783,713
Free Float	40%
Beta	0.7

Major Shareholders

Kossan Holdings Sdn Bhd	35.0%
EPF	5.6%

Summary Earnings Table

FY Dec (RMm)	2023A	2024F	2025F
Turnover	1585.9	1711.7	1793.8
PBT/(LBT)	35.8	158.6	166.7
Net Profit	14.2	119.0	125.1
Core Net Profit	49.6	119.0	125.1
Consensus (NP)	-	146.4	195.5
Earnings Revision	-	-	-
Core EPS (sen)	1.9	4.7	4.9
Core EPS Growth (%)	(68.3)	139.8	5.1
NDPS (sen)	4.0	4.0	4.0
BVPS (RM)	1.50	1.53	1.56
Core PER (x)	125.8	52.4	49.9
Price/BV (x)	1.6	1.6	1.6
Net Gearing (%)	N.Cash	N.Cash	N.Cash
Net Div. Yield (%)	1.6	1.6	1.6

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Results Highlights

	1Q FY23	4Q FY23	1Q FY24	Q-o-Q Chg %	Y-o-Y Chg %
FY Dec (RM m)					
Turnover	394.7	400.1	451.6	12.9	14.4
EBITDA	4.6	55.7	56.9	2.1	1,144.1
Depreciation	(32.4)	(26.2)	(26.1)	(0.4)	(19.6)
Net interest income	8.8	9.3	10.1	9.2	15.5
EI [^]	0.0	(35.4)	0.0	0.0	0.0
PBT	(19.1)	3.4	41.0	NM	(314.9)
Tax	(4.5)	(1.8)	(9.0)	388.7	99.6
Minority interest	(0.7)	(0.8)	(0.6)	(25.2)	(13.0)
Net profit / (loss)	(24.3)	0.8	31.4	NM	NM
Core net profit / (loss)	(24.3)	36.2[^]	31.4	(13.2)	NM
EPS / (LPS) (sen)	(1.0)	0.0	1.2	NM	NM
EBITDA margin (%)	1.2	13.9	12.6		
PBT margin (%)	(4.8)	0.9	9.1		
NP margin (%)	(6.1)	0.2	7.0		
Effective tax rate (%)	(23.6)	NM	21.9		

Source: Kenanga Research, Company

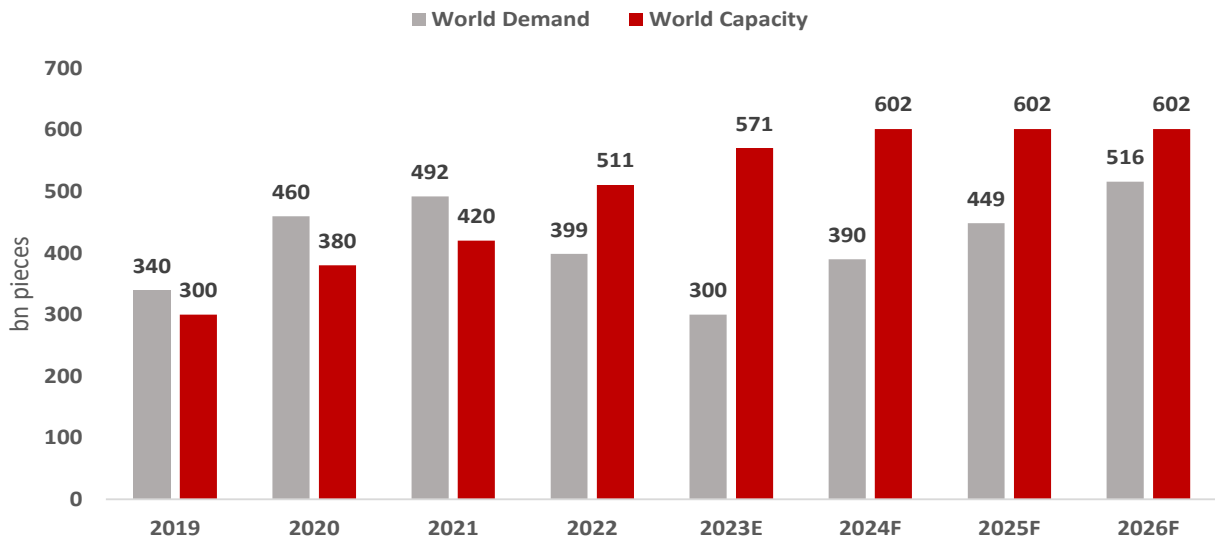
[^] one-off impairment loss of PPE (RM35.4m)

Quarterly segmental breakdown

	1Q23	4Q23	1Q24	Q-o-Q Chg %	Y-o-Y Chg %
Revenue (RM m)					
Gloves division	317.5	329.6	379.6	15.2	19.6
Technical rubber products (TRP) division	56.2	44.4	48.9	10.1	(12.8)
Cleanroom products division	21.0	26.1	23.0	(11.8)	9.6
Total	394.7	400.1	451.6	12.9	14.4
Pre-tax profit (RM m)					
Gloves division	(34.9)	(9.3)	26.6	(385.5)	(176.1)
Technical rubber products (TRP) division	7.9	10.0	8.9	(10.7)	12.7
Cleanroom products division	1.6	2.8	2.4	(14.6)	52.1
Investment Holding	6.3	(0.1)	3.1	NM	(51.4)
Total	(19.1)	3.4	41.0	NM	(314.9)
Pre-tax profit margin (%)					
Gloves division	(11)	NM	7		
Technical rubber products division	14	22	18		
Cleanroom products division	8	11	11		

Source: Kenanga Research, Company

Global Glove Demand & Supply Pointing to Sustained Excess Supply Over CY22–25



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.				
Stocks Under Coverage																	
HARTALEGA HOLDINGS BHD	UP	3.59	2.33	-35.1%	12,305	Y	03/2025	1.5	1.5	297%	3.8%	242	233	2.6	1.1%	0.0	0.0%
KOSSAN RUBBER INDUSTRIES	UP	2.44	1.48	-39.3%	6,241	Y	12/2024	4.7	4.9	140%	5.1%	52	50	1.6	3.1%	2.0	0.8%
SUPERMAX CORP BHD	MP	0.965	0.840	-13.0%	2,625	N	06/2024	(0.2)	0.3	-103%	69.2%	NM	298	0.6	-0.1%	0.0	0.0%
TOP GLOVE CORP BHD	UP	1.19	0.750	-37.0%	9,768	Y	08/2024	(1.6)	0.8	-114%	-48.6%	NM	149	2.1	-2.7%	0.0	0.0%

Source: Kenanga Research

Stock ESG Ratings:

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

☆ 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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