

16 August 2024

KAREX

Favourable Products Mix

By Cheow Ming Liang | cheowml@kenanga.com.my

KAREX is expected to meet our RM25m net profit target for FY24, driven by strong sales in high-margin personal lubricants and a strategic shift to higher-margin segments. Furthermore, it is set to deliver its first synthetic condom order in November, which holds promise for significant growth, which we think sufficiently offsets concern on earnings drag from its underutilized glove segment. We keep our forecasts, TP of RM1.10 and OUTPERFORM call.

Remains solid. We anticipate that KAREX will deliver a decent 4QFY24 results, likely bringing full-year profit close to our RM25m estimate. The increasing contribution from high-margin personal lubricant products, now making up over 15% of group turnover (up from single digits last year), supports this positive outlook. Additionally, the company's strategic shift to higher-margin segments - specifically commercial (c. 20%-25%) and OBM (>50%) - from the lower-margin tender segment (7%-10%) is expected to further enhance margins going forward. The commercial, OBM, and tender segments contributed 61%, 19% and 20% to KAREX's total turnover as of 9MFY24, compared to 59%, 17% and 24% in FY23, respectively.

On track to deliver maiden synthetic condom order. KAREX is on track to deliver its first synthetic condom order to an OEM client in November (2QFY25), targeting the European market for the Christmas season. If the product performs well, KAREX anticipates receiving additional and larger orders for FY26 delivery. Last month, the company received CE certification for these synthetic condoms, which are designed to be more heat-sensitive, thinner, and cost-efficient. While revenue contributions from this product in FY25 are expected to be modest, a more significant impact is projected for FY26 after the OEM client's assessment of market demand. Based on preliminary estimates, this product could potentially generate approximately RM50m in sales should KAREX secure 3% of the OEM client's synthetic order.

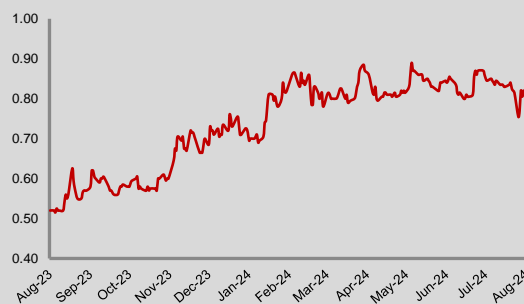
A growing synthetic condom market. The global condom market was valued at USD8b in 2022, with a robust projected 10-year CAGR of 8%-9%, according to various market research. Natural latex condoms dominate the market, holding 82.4% while synthetic condoms, valued at approximately USD1.4b, made up the remaining 17.6%. Durex holds a dominant position in the industry with a 35.6% market share, according to Osum market research. Demand for synthetic condoms, made from materials like polyisoprene, polyurethane and nitrile, has been growing particularly strong in North America, Europe, and Latin America, where people are more prone to latex allergies. Popular brands in this category include Durex Avanti Bare, SKYN, Trojan Supra, and Okamoto Zero One. These synthetic options are favored for their hypoallergenic properties and are gaining popularity as consumers increasingly seek alternatives to natural latex condoms.

The glove business segment continues to be a drag on KAREX's earnings. Since establishing production lines in 2020, the facilities have been underutilized due to global oversupply in the glove market. The group invested RM40m to set up two production lines and has incurred approximately RM8m annually in maintenance expenses (including depreciation and interest). This segment will likely continue to weigh on earnings unless utilization improves. However, the global glove sector's outlook is improving in the recent quarters, potentially offering modest growth opportunities for KAREX's glove segment (see overleaf for more details).

OUTPERFORM ↔

Price: **RM0.810**
Target Price: **RM1.10** ↔

Share Price Performance



KLCI	1,612.94
YTD KLCI chg	10.9%
YTD stock price chg	11.6%

Stock Information

Shariah Compliant	Yes
Bloomberg Ticker	KAREX MK EQUITY
Market Cap (RM m)	858.6
Shares Outstanding	1,053.5
52-week Range (H)	0.91
52-week Range (L)	0.51
3-mth avg. daily vol.	1,169,129
Free Float	25%
Beta	1.2

Major Shareholders

Karex One Ltd	17.5%
Bnp Paribas	16.9%
Maryen Holdings Limi	11.5%

Summary Earnings Table

FY Jun (RM m)	2023A	2024F	2025F
Turnover	532	512	560
EBIT	22	43	71
PBT	15	34	62
Net Profit	10	25	46
Consensus	-	25	46
Earnings Revision	-	-	-
EPS (sen)	1.0	2.4	4.4
EPS Growth (%)	269	138	85
NDPS (sen)	0.5	1.0	1.1
BVPS (RM)	0.45	0.47	0.50
Core PER (x)	81.9	34.5	18.6
Price/BV (x)	1.8	1.7	1.6
Net Gearing (x)	0.3	0.2	0.2
Net Div. Yield (%)	0.6	1.2	1.3

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Forecasts. Maintained.

Valuations. We maintain our TP of RM1.10 based on an unchanged FY25F targeted PER of 25x, at a 20% premium to the average historical 5-year forward PER of its international peers to reflect its dominant market position and strong growth prospect. There is no adjustment to our TP based on ESG given a 3-star rating as appraised by us (see Page 4).

Background of the medical glove venture. KAREX entered the medical glove manufacturing sector in 2020 and had invested RM40m to establish two production lines at its Hat Yai plant, which have a combined annual production capacity of 500m gloves. The rationales then were to: (i) enhance its tender order success rate and competitiveness by expanding its range of medical products, and (ii) meet the needs of its existing OEM partners, who were seeking more affordable and reliable medical products, such as gloves. However, the plan did not unfold as expected, as the global glove market became oversaturated with the entry of Chinese gloves, which drove down average selling prices. Consequently, KAREX has decided to adopt a cautious approach and wait for the right opportunity to re-enter the market.

Investment case. We continue to like KAREX for: (i) its leading market position and global reach in the rapidly growing condom industry, projected by industry experts at a CAGR of 8% to 9% over the immediate term, (ii) its strong R&D and product innovation; (iii) its adherence to international standards and certifications, (iv) its strategic shift in moving up higher the value chain, and (v) post-pandemic market recovery and changing consumer preferences, especially in markets like China, and growing preference for high quality innovative condom products. Maintain **OUTPERFORM**.

Risks to our call include: (i) reduced spending by governments around the world on birth control, (ii) lower acceptance rate for its new synthetic rubber condoms, (iii) less favourable product mix, and (iv) inability to raise prices to safeguard profit margins.

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Income Statement						Financial Data & Ratios					
FY Jun (RM m)	2021A	2022A	2023A	2024F	2025F	FY Jun	2021A	2022A	2023A	2024F	2025F
Revenue	420	422	532	512	560	Growth (%)					
EBITDA	25	20	47	68	97	Turnover	6.3	0.4	26.2	-3.8	9.4
Depreciation	23	23	25	25	26	EBITDA	-10.9	-19.7	134.5	44.9	42.6
Operating Profit	2	-3	22	43	71	Operating Profit	-72.9	-247.3	883.3	91.8	64.5
Interest Expense	5	4	6	4	10	PBT	-110.3	1115.0	333.2	126.2	82.2
Interest Income	2	4	7	9	8	Net Profit	-547.4	506.7	269.3	137.7	85.2
Associate	0	0	0	0	0	Profitability (%)					
Exceptional Items	1	2	3	4	5	EBITDA Margin	5.9	4.8	8.8	13.3	17.3
PBT	-1	-6	15	34	62	Operating Margin	0.5	-0.7	4.2	8.4	12.6
Taxation	-1	-0	5	9	16	PBT Margin	-0.1	-1.5	2.8	6.7	11.1
Minority Interest	-1	0	0	0	0	Core Net Margin	-0.2	-1.5	2.0	4.9	8.2
Net Profit	-1	-6	10	25	46	Effective Tax Rate	127.3	4.6	30.8	27.2	26.0
Core Net Profit	-1	-6	10	25	46	ROA	-0.9	1.5	3.4	5.9	6.6
						ROE	-0.2	-1.4	2.2	5.1	8.8
Balance Sheet											
FY Jun (RM m)	2021A	2022A	2023A	2024F	2025F	DuPont Analysis					
Fixed Assets	255	267	271	277	285	Net Margin (%)	-0.2	-1.5	2.0	4.9	8.2
Intangible Assets	95.5	97.2	98.8	97.8	97.5	Assets Turnover (x)	0.6	0.6	0.7	0.7	0.7
Other FA	31	27	27	27	27	Leverage Factor (x)	1.4	1.5	1.5	1.5	1.5
Inventories	131	152	158	150	165	ROE (%)	-0.2	-1.4	2.2	5.1	8.8
Receivables	105	118	128	123	135	Leverage					
Other CA	4	7	7	11	17	Debt/Asset (x)	0.2	0.2	0.2	0.2	0.2
Cash	54	22	32	40	52	Debt/Equity (x)	0.2	0.3	0.3	0.3	0.3
Total Assets	675	691	722	727	778	Net Cash/(Debt)	-62	-102	-125	-110	-99
						Net Debt/Equity (x)	0.1	0.2	0.3	0.2	0.2
Payables	89	95	72	62	68	Valuations					
ST Borrowings	67	55	86	81	81	EPS (sen)	-0.1	-0.6	1.0	2.4	4.4
Other ST Liability	1	12	14	18	23	NDPS (sen)	0.0	0.0	0.5	1.0	1.1
LT Borrowings	48	69	70	70	70	BV/Share (RM)	0.44	0.43	0.45	0.47	0.50
Other LT Liability	3	3	3	7	11	PER (x)	-841.4	-138.7	81.9	34.5	18.6
Minorities Int.	-	-	-	-	-	Net Div. Yield (%)	0.0	0.0	0.6	1.2	1.3
Net Assets	466	458	477	491	525	P/NTA (x)	1.8	1.9	1.8	1.7	1.6
						EV/EBITDA (x)	31.9	37.8	15.6	11.0	7.8
Share Capital	324	324	324	324	324						
Reserves	142	134	152	167	201						
Equity	466	458	477	491	525						
Cashflow Statement											
FY Jun (RM m)	2021A	2022A	2023A	2024F	2025F						
Operating CF	186	1	7	55	56						
Investing CF	2	-35	-22	-30	-34						
Financing CF	-106	2	22	-16	-12						
Change In Cash	82	-32	8	9	11						
Free CF	131	-34	-15	25	23						

Source: Kenanga Research

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Peer Comparison

Name	Rating	Last Price at 15-Aug (RM)	Target Price (RM)	Upside	Market Cap (RM m)	Shariah Compliant	Current FYE	Core EPS (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.	1-Yr. Fwd.	1-Yr. Fwd.	1-Yr. Fwd.	1-Yr. Fwd.
CONSUMER																	
AEON CO. (M) BHD	MP	1.41	1.21	-14.2%	1,979.6	Y	12/2024	8.7	8.9	6.9%	2.1%	16.1	15.8	1.0	6.5%	4.0	2.8%
FRASER & NEAVE HOLDINGS BHD	OP	29.18	38.25	31.1%	10,702.6	Y	09/2024	166.1	176.2	25.8%	6.1%	17.6	16.6	2.9	17.6%	85.0	2.9%
MR D.I.Y. GROUP (M) BHD	OP	2.09	2.27	8.6%	19,758.0	Y	12/2024	7.0	8.1	17.3%	16.8%	30.1	25.7	10.0	35.4%	5.0	2.4%
NESTLE (MALAYSIA) BHD	UP	106.10	114.90	8.3%	24,880.4	Y	12/2024	255.4	284.1	-9.2%	11.2%	41.5	37.3	36.2	87.9%	250.0	2.4%
PADINI HOLDINGS BHD	MP	3.30	3.63	10.0%	2,171.1	Y	06/2024	23.5	26.9	-30.4%	14.2%	14.0	12.3	1.9	14.3%	12.0	3.6%
POWER ROOT BHD	UP	1.51	1.40	-7.3%	686.9	Y	03/2025	9.1	9.8	2.6%	7.3%	16.6	15.4	2.0	12.2%	7.0	4.6%
QL RESOURCES BHD	MP	6.68	6.25	-6.4%	16,253.3	Y	03/2025	19.5	20.8	8.7%	6.2%	34.2	32.2	5.0	16.4%	9.0	1.3%
KAREX BHD	OP	0.815	1.10	35.0%	858.6	Y	06/2024	2.4	4.4	137.1%	85.1%	34.5	18.6	1.7	5.1%	1.0	1.2%
SECTOR AGGREGATE					77,290.6					6.1%	10.9%	28.8	25.9	5.8	20.0%		2.7%

Source: Bloomberg, Kenanga Research

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Stock ESG Ratings:

	Criterion	Rating			
GENERAL	ESG Framework & Policies	★	★	★	★
	Earnings Sustainability & Quality	★	★	★	★
	Balance Sheet	★	★	★	★
	Community Investment	★	★	★	★
	Workers Safety & Wellbeing	★	★	★	★
	Corporate Governance	★	★	★	
SPECIFIC	Product Quality & Safety	★	★	★	☆
	Effluent & Waste Management	★	★	★	☆
	Digitalisation & Innovation	★	★	★	☆
	Supply Chain Management	★	★	★	☆
	Energy Efficiency	★	★		
OVERALL		★	★	★	

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

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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KENANGA INVESTMENT BANK BERHAD (15678-H)
 Level 17, Kenanga Tower, 237, Jalan Tun Razak, 50400 Kuala Lumpur, Malaysia
 Telephone: (603) 2172 0880 Website: www.kenanga.com.my E-mail: research@kenanga.com.my