

14767/09/2012(030761)

Friday, May 22, 2015

Kossan Rubber Industries

“Steady Outlook”

Results Review

- **Actual vs. expectations.** Kossan Rubber Industries (Kossan) 1Q15 net profit of RM45 million (+23% y-o-y) came line our estimates and consensus estimates respectively, accounting 23% of ours and consensus full year net profit. The steady earnings performance 1Q15 was lifted by higher contribution from the glove division and clean-room division that registered a strong PBT of RM57 million and RM876k that gained by double digits of 34% y-o-y and 50% y-o-y.
- **Dividend.** No dividend was declared in the current quarter.
- **Top line vs. Bottom line.** 1Q15 revenue rose to RM369 million (21% y-o-y, 2% q-o-q) mainly driven by higher contribution from the glove division (+24% y-o-y, +7% q-o-q) and clean room division (+37% y-o-y, -7% q-o-q) on higher sales achieved of approximately 30% from the glove division. The higher quantity of glove sold was mainly attributed by the overhauled of 2 old plants which improved the production lines and hence, led to a higher output and an addition of a small capacity from Plant 2. 1Q15 EBIT margin increased marginally to 17% against 1Q14 margin of 16% that came in higher than 4Q14 margin of 14%. Kossan's PBT gained by double digits or by 25% y-o-y and 19% q-o-q to RM61 million from RM49 million in the preceding year, driven by improving cost factor benefitting from the softer global commodity prices.
- **Outlook.** The management expects its 4 billion pieces of capacity to fully start commencing by June from Plant 2 and 3 where the outputs have been taken up fully by the group's customers. Hence, with the prospects of strengthening of USD against Ringgit, the group would achieve better earnings in favour of the declining raw

HOLD (TP: RM6.12)

Current Price (RM)	RM6.20
New Target Price (RM)	RM6.12
Previous Fair Value (RM)	RM6.10
Previous Recomm.	HOLD
Upside To Fair Value	-1%
Dividend Yield (FY15)	1.14%

Stock Code

Bloomberg	KRI MK
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Stock & Market Data

Listing	MAIN MARKET	
Sector	Glove	
Shariah Compliance	Yes	
Issued Shares	639.5mn	
Market Cap	3,881.6mn	
YTD Chg In Share Price	35.79%	
Beta (x)	0.39	
52-week Hi/Lo	RM6.08	RM3.63
6M Average Volume (shares)	0.530mn	
Estimated Free Float	34%	

Major Shareholders

Kossan Holdings Sdn Bhd	51.06%
Invesco Ltd	7.07%
Kumpulan Wang Persaraan	5.58%

material prices. Note that, Kossan's current capacity stood at 22 billion pieces from 16 billion pieces in FY14 with the product mix of nitrile and natural rubber ratio of 69:31 from 57:43 in FY14. The management has intention to add another 2 nitrile plants to cater for the strong demand from the existing customers. The group expects these 2 new plants will produce 4.5 billion pieces of gloves per annum. These plants are projected to start construction within the next 3 months and are expected to be completed by FY17. Moving forward to FY16, the management sees a double digits growth in quantity of gloves contributed from Plant 2 and 3. The revamp of old plants with also improve production lines. These new plants are to cater orders from the existing customers as the group is unable to deliver the extra capacity.

- **Change to forecast.** We have revised upward our FY15 and FY16 earnings forecast to RM194 million (35%) and RM232 million (20%) respectively, credited to the steady demand for rubber gloves across the globe, manageable cost factor and the additional plants which will add a total of 17 new production lines. Our earnings forecast may change from our target if there's no destructive atmospheric condition such as heavy flood and sharp rebound of Ringgit. In addition, the likely weakness of Ringgit in FY15 will be the dark horse for all rubber gloves players.
- **Valuation and Recommendation.** We value Kossan at **RM6.12** based on PER of 17x over FY16 EPS of 36 sen as we revised upward our earnings, underpinned by i) the commence operation of its three new plants in FY15 that would push the capacity to reach 44 billion pieces of gloves and ii) higher demand for its TRP in tandem with the expected growth in Malaysia's industrial sector. Maintain **HOLD**.

Table 1: Peers Comparison

Company	Year Ended	Price (RM)	EPS (sen)		P/E (X)		P/B (X)		ROE (%)	Div Yield (%)	Target Price	Call
			FY15	FY16	FY15	FY16	FY15	FY16				
Top Glove	Aug	5.59	34	36	16	15	2.3	2.5	13.8	2.9	5.61	Hold
Supermax	Dec	2.00	19	21	11	10	1.4	1.9	10.8	2.5	2.30	Buy
Kossan	Dec	6.20	30	35	20	18	4.8	4.1	19.0	1.3	6.12	Hold
Hartalega	Mar	8.22	35	41	24	20	5.2	5.8	20.0	1.6	7.40	Hold
Average			29	33	18	16	3.4	3.5				

Source: Bloomberg, M&A Securities

Table 2: Earnings Forecast

YE: Dec (RM million)	2012	2013	2014	2015F	2016F
Revenue	1,234	1,307	1,299	1,691	1,987
EBIT	145	184	195	257	302
PBT	138	180	186	255	306
Net profit	102	136	144	194	232
EPS (sen)	32	21	22	30	36
Pre-tax margin	11%	14%	14%	15%	15%
Net profit margin	8%	10%	11%	11%	12%
PER (x)	11	20	15	20	17
P/BV (x)	1.8	3.9	3.2	4.1	4.0

Source: Company, M&A Securities

Table 3: Results Highlight

YE: Dec (RM million)	1Q15	1Q14	4Q14	QoQ	YoY	3M15	3M14	YoY
Revenue	369	306	361	2%	21%	369	306	21%
EBIT	61	49	51	19%	25%	61	49	25%
PBT	59	47	49	20%	25%	59	47	25%
Taxation	(13)	(10)	(10)	27%	32%	(13)	(10)	32%
Net Profit	45	37	38	20%	23%	45	37	23%
EPS (sen)	7	6	6	20%	23%	7	6	23%
EBIT margin	17%	16%	14%			17%	16%	
PBT margin	16%	15%	14%			16%	15%	
Net profit margin	12%	12%	11%			12%	12%	
Effective tax rate	22%	21%	21%			22%	21%	

Source: Company, M&A Securities

Table 4: Segmental Analysis

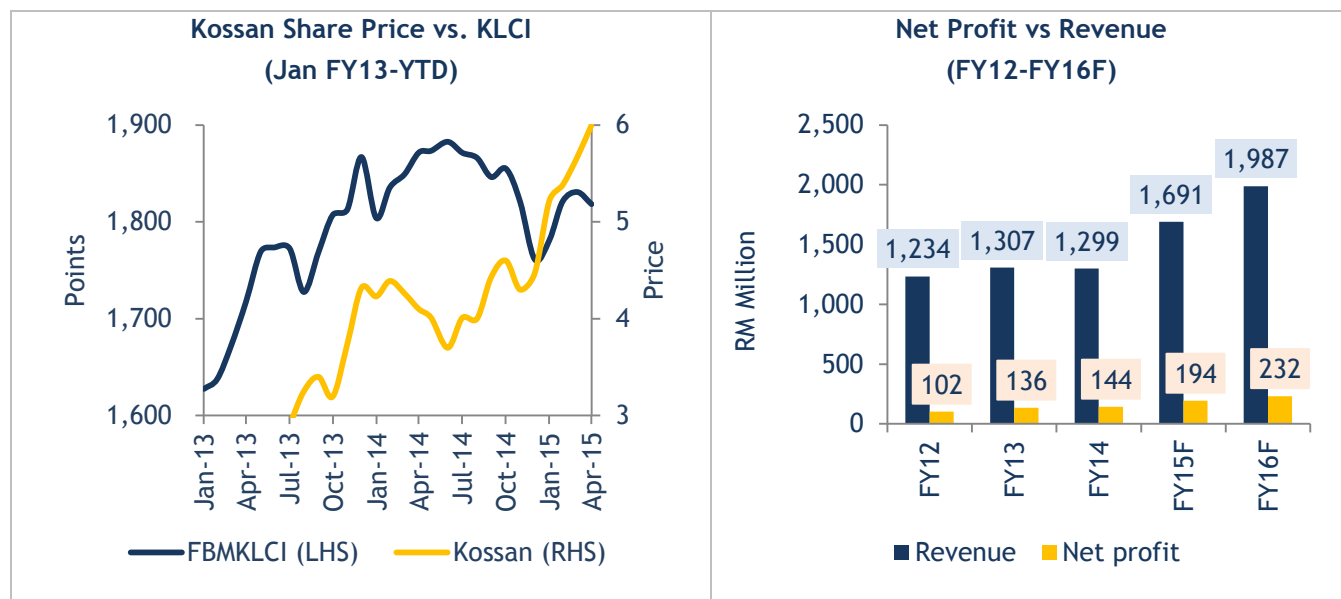
	1Q15	1Q14	YoY %
Revenue			
Technical rubber	35	37	-5%
Gloves division	322	260	24%
Clean-room division	12	9	37%
PBT			
Technical rubber	1	4	-69%
Gloves division	57	42	35%
Clean-room division	1	1	51%

Source: Company, M&A Securities

Table 5: Natural Rubber and Nitrile Price Movement

	4Q13	1Q14	2Q14	3Q14	4Q14	1Q15
Natural Rubber						
USD	1.64	1.46	1.44	1.33	1.13	1.10
RM	5.26	4.81	4.65	4.25	3.77	3.93
MYR/USD	3.21	3.29	3.23	3.19	3.28	3.68
Nitrile						
USD	1.14	1.11	1.05	1.12	1.09	0.92
RM	3.65	3.64	3.40	3.56	3.50	3.28
MYR/USD	3.21	3.29	3.23	3.19	3.28	3.68

Source: Company, M&A Securities



Source: Company, M&A Securities

M&A Securities

STOCK RECOMMENDATIONS

BUY	Share price is expected to be $\geq +10\%$ over the next 12 months.
TRADING BUY	Share price is expected to be $\geq +10\%$ within 3-months due to positive newsflow.
HOLD	Share price is expected to be between -10% and $+10\%$ over the next 12 months.
SELL	Share price is expected to be $\geq -10\%$ over the next 12 months.

SECTOR RECOMMENDATIONS

OVERWEIGHT	The sector is expected to outperform the FBM KLCI over the next 12 months.
NEUTRAL	The sector is expected to perform in line with the FBM KLCI over the next 12 months.
UNDERWEIGHT	The sector is expected to underperform the FBM KLCI over the next 12 months.

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