

5 January 2024

Consumer Cyclical | Rubber Products

Kossan Rubber (KRI MK)

Buy (from Neutral)

Improving Operating Dynamics; Upgrade To BUY

- **Upgrade to BUY from Neutral, new MYR2.20 TP from MYR1.45, 16% upside, c.1% yield.** We upgrade Kossan Rubber as recent robust export data indicates a demand recovery, and also due to its steady ASP performance. We continue to like Kossan for its relatively robust balance sheet and better-than-peers operating efficiency. Our TP incorporates an 8% ESG discount as Kossan's ESG score is below the country median.
- **What triggered our upgrade?** Malaysia's monthly glove exports saw positive YoY growth for two consecutive months, with a 2% YoY increase in Nov 2023 (Oct 2023: +33%). Despite export volumes contracting 25% MoM, export value was higher by 1% MoM in Nov 2023. We believe this indicates: i) Cost-pass-through has started to kick-in; ii) a better product mix in Nov 2023. We believe the ability to initiate cost-pass-through will serve as a crucial catalyst to drive profitability moving forward. It also indicates that risks from the price war has gradually dissipated. Based on our channel checks, Malaysia glove makers were selling at USD19-20 per 1,000 pieces in Dec 2023, largely unchanged vs 3Q23. While Malaysia glove makers suffered weaker ASPs in 3Q23 (3-7% lower QoQ), we think the pick-up in export value could substantiate management's guidance as well as our expectations of a stabilised ASP trend materialising in 2024.
- **Demand-supply dynamic.** Our 2024 industry supply is now at 376bn vs 2023's 373bn, taking into account 1bn in new capacity from Thailand and Hartalega's (HART MK, BUY, TP: MYR3.25) progressive capacity transition plan (estimated 2bn from the Next Generation Integrated Glove Manufacturing Complex or NGC 1.5). Malaysia glove makers have yet to announce any plans to commence new capacity in 2024, as the local industry's plant utilisation (PU) is still running below 50%. We raised our 2024 demand assumption to 397bn from 386bn previously, reflecting a 7% YoY growth (from 4% previously) vs the pre-pandemic 5-year average growth of 14%. That said, we expect the industry to achieve its equilibrium level by 2H24 as the bulk inventory stockpiled since 2020-2021 has been gradually consumed and approaching its shelf-life (typically 3-5 years).
- **Earnings revision and valuation.** We raise our 2023-2024 earnings to MYR76m and MYR167m from MYR64m and MYR103m respectively, taking into account better demand visibility and improving plant utilisation rates. Our DCF-derived TP represents 23x FY25 P/E, above its pre-COVID-19 5-year mean of 20x.
- **Key risks.** Decrease in glove ASPs, slower-than-expected capacity expansion, lower-than-expected utilisation rates, and higher-than-expected raw material prices.

Target Price (Return): MYR2.20 (15.6%)
Price (Market Cap): MYR1.90 (USD1,046m)
ESG score: 2.6 (out of 4)
Avg Daily Turnover (MYR/USD) 10.0m/2.13m

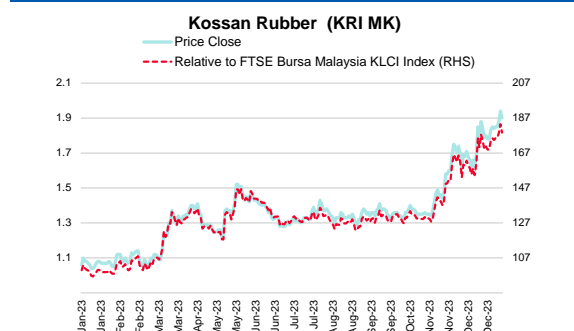
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Share Performance (%)

	YTD	1m	3m	6m	12m
Absolute	2.7	13.1	39.7	47.3	79.2
Relative	1.1	11.3	35.4	41.2	78.7
52-wk Price low/high (MYR)				1.04 – 1.94	



Source: Bloomberg

Overall ESG Score: 2.6 (out of 4)

E: GOOD

Kossan employs a 3R strategy to Reduce, Reuse and Recycle to manage the impacts of pollutants derived from its manufacturing process. The group undertake energy optimisation initiatives which include transition to solar energy plant, LED lights and solar-powered perimeter spotlights are fitted at all factories and offices.

S: GOOD

Kossan adopted Employee Pays (Zero-Cost) Policy under migrant workers recruitment process. Workers are protected from debt bondage, prohibit coercion into employment and allow freedom of movement. To ensure transparency employment contracts are make available in the workers' native languages. Potential recruitment agencies are also required to go through an onsite due diligence audit accompanied together with an independent consultant.

G: GOOD

44% of its board members are independent and 22% are female. Both are still below the Malaysian Code on Corporate Governance requirement of 50% independent and 30% female directors. On a positive note, Kossan provides full disclosures on its directors' remunerations. The company also holds regular investor briefings, which embodies good transparency and disclosure practices.

Forecasts and Valuation	Dec-21	Dec-22	Dec-23F	Dec-24F	Dec-25F
Total turnover (MYRm)	6,631	2,344	1,943	2,178	2,344
Recurring net profit (MYRm)	2,860	167	76	167	200
Recurring net profit growth (%)	164.1	(94.2)	(54.2)	118.9	19.6
Recurring P/E (x)	1.70	29.17	63.62	29.06	24.31
P/B (x)	1.2	1.3	1.2	1.2	1.2
P/CF (x)	1.51	52.04	19.10	22.01	15.48
Dividend Yield (%)	25.2	1.3	0.5	1.0	1.2
EV/EBITDA (x)	0.67	11.50	17.90	10.82	9.15
Return on average equity (%)	70.6	3.8	1.9	4.1	4.8
Net debt to equity (%)	net cash	net cash	net cash	net cash	net cash

Source: Company data, RHB

See important disclosures at the end of this report

Market Dateline / PP 19489/05/2019 (035080)

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Financial Exhibits

Asia	Financial summary (MYR)	Dec-21	Dec-22	Dec-23F	Dec-24F	Dec-25F
Malaysia	Recurring EPS	1.12	0.07	0.03	0.07	0.08
Consumer Cyclical	DPS	0.48	0.02	0.01	0.02	0.02
Kossan Rubber	BVPS	1.58	1.52	1.54	1.58	1.64
KRI MK	Return on average equity (%)	70.6	3.8	1.9	4.1	4.8
Buy						
Valuation basis	Valuation metrics	Dec-21	Dec-22	Dec-23F	Dec-24F	Dec-25F
Discounted Cash Flow(DCF) FCFF valuation	Recurring P/E (x)	1.70	29.17	63.62	29.06	24.31
	P/B (x)	1.2	1.3	1.2	1.2	1.2
	FCF Yield (%)	61.8	(0.5)	1.1	0.4	2.3
	Dividend Yield (%)	25.2	1.3	0.5	1.0	1.2
Key drivers	EV/EBITDA (x)	0.67	11.50	17.90	10.82	9.15
Earnings forecasts are most sensitive to changes in:	EV/EBIT (x)	0.69	19.61	41.50	16.95	13.75
i. Improvement in sales volume;						
ii. Positive effect of any change in the USD/MYR rate;						
iii. Lower nitrile butadiene prices;						
iv. Lower natural rubber prices.						
Key risks	Income statement (MYRm)	Dec-21	Dec-22	Dec-23F	Dec-24F	Dec-25F
i. Increase/decrease in gloves ASP;	Total turnover	6,631	2,344	1,943	2,178	2,344
ii. Slower/faster-than-expected capacity expansion;	Gross profit	4,068	451	166	303	395
iii. Higher/lower-than-expected utilisation rates;	EBITDA	3,841	314	200	332	386
iv. Lower/higher-than-expected raw material price.	Depreciation and amortisation	(120)	(130)	(114)	(120)	(129)
	Operating profit	3,722	185	86	212	257
	Net interest	25	29	13	11	11
	Pre-tax profit	3,741	204	99	223	268
	Taxation	(890)	(54)	(22)	(54)	(64)
	Reported net profit	2,847	148	76	167	200
	Recurring net profit	2,860	167	76	167	200
Company Profile	Cash flow (MYRm)	Dec-21	Dec-22	Dec-23F	Dec-24F	Dec-25F
Kossan is one of the world's Big 4 glove makers. It has a production capacity of 33.5bn pieces pa.	Change in working capital	(50)	319	77	(58)	(8)
	Cash flow from operations	3,225	93	255	221	314
	Capex	(220)	(115)	(200)	(200)	(200)
	Cash flow from investing activities	(222)	(812)	(182)	(182)	(182)
	Dividends paid	(1,200)	(1,225)	(23)	(50)	(60)
	Cash flow from financing activities	(1,541)	(481)	(28)	(57)	(66)
	Cash at beginning of period	1,090	2,558	1,348	1,392	1,374
	Net change in cash	1,462	(1,200)	44	(18)	65
	Ending balance cash	2,551	1,358	1,392	1,374	1,440
	Balance sheet (MYRm)	Dec-21	Dec-22	Dec-23F	Dec-24F	Dec-25F
	Total cash and equivalents	2,558	1,348	1,392	1,374	1,440
	Tangible fixed assets	1,420	1,420	1,506	1,586	1,657
	Total investments	1	0	0	0	0
	Total assets	5,013	4,286	4,410	4,562	4,735
	Short-term debt	187	77	77	77	77
	Total long-term debt	65	7	7	7	7
	Total liabilities	1,019	429	499	532	561
	Total equity	3,993	3,856	3,911	4,030	4,174
	Total liabilities & equity	5,013	4,286	4,410	4,562	4,735
	Key metrics	Dec-21	Dec-22	Dec-23F	Dec-24F	Dec-25F
	Revenue growth (%)	82.3	(64.7)	(17.1)	12.1	7.6
	Recurrent EPS growth (%)	164.1	(94.2)	(54.2)	118.9	19.6
	Gross margin (%)	61.3	19.2	8.5	13.9	16.9
	Operating EBITDA margin (%)	57.9	13.4	10.3	15.3	16.5
	Net profit margin (%)	42.9	6.3	3.9	7.7	8.5
	Dividend payout ratio (%)	43.0	43.2	30.0	30.0	30.0
	Capex/sales (%)	3.3	4.9	10.3	9.2	8.5
	Interest cover (x)	450	43	18	31	40

Source: Company data, RHB

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Figure 1: SOP valuation

FYE 31 March (MYR m)	FY24F	FY25F	FY26F	FY27F	FY28F	FY29F	FY30F	FY31F	FY32F	FY33F	Terminal
NOPAT	161	195	220	224	229	246	264	282	295	307	
+ D&A	120	129	139	148	156	163	170	177	184	191	
- Change in NWC	(58)	(8)	2	(12)	(13)	(14)	(9)	(24)	(27)	(28)	
- CAPEX	(200)	(200)	(200)	(200)	(150)	(150)	(150)	(150)	(150)	(150)	
Free cash flow to firm (FCFF)	24	117	161	160	221	244	275	285	301	320	6,929
Discount factor	0.94	0.91	0.85	0.79	0.74	0.69	0.65	0.61	0.57	0.53	0.53
PV of FCFF	22	106	136	127	164	170	178	173	171	170	3,680
Risk-free	4%										
WACC	7%										
Terminal growth	2%										
Enterprise Value (MYR m)	5,097										
- Minority	(83)										
Cash	1,329										
- Debt	(231)										
Equity Value (MYR m)	6,112										
No of shares (m)	2,552										
TP (MYR)	2.40										
ESG discount/premium	-0.20										
TP (MYR)	2.20										

Source: RHB

Figure 2: Changes in assumptions

	FY2023F		FY2024F		FY2025F	
	Before	After	Before	After	Before	After
Blended (ASP, USD/1000)	21	21	21	22	22	22
Total production	16,828	17,463	18,300	18,910	19,520	20,130
Utilisation	53%	55%	60%	62%	64%	66%

Source: RHB

Emissions And ESG

Trend analysis

Installed 3.16 MWp of solar energy as at 2022. Pledged to reduce carbon emission via "reduce and optimise" strategy.

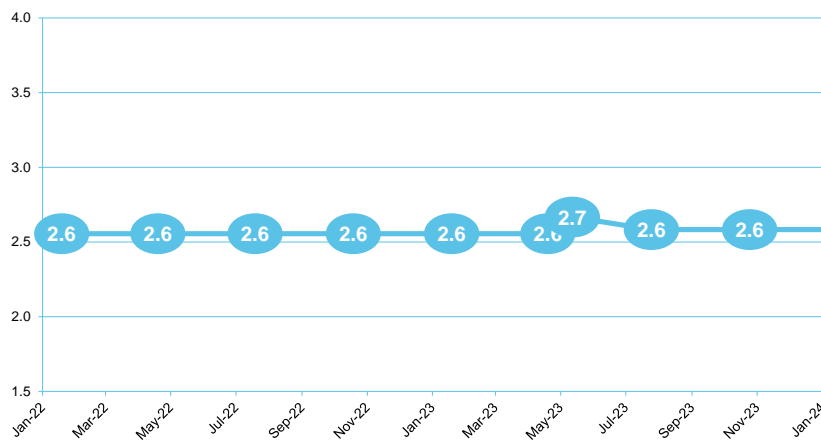
Emissions (tCO2e)	Dec-20	Dec-21	Dec-22
Scope 1	na	382,028	295,621
Scope 2	na	130,998	126,020
Scope 3	na	-	5,250
Total emissions	na	513,026	426,892

Source: Company data, RHB

Latest ESG-Related Developments

- Introduced a comprehensive carbon accounting system and database, and have improvised GHG calculation methodology by taking Methane (CH₄) and Nitrous Oxide (N₂O) into consideration when calculating emissions.

ESG Rating History



Source: RHB

Recommendation Chart



Source: RHB, Bloomberg

Date	Recommendation	Target Price	Price
2023-11-16	Neutral	1.45	1.58
2023-07-28	Neutral	1.27	1.38
2023-05-15	Neutral	1.27	1.33
2023-04-28	Neutral	1.24	1.25
2023-03-27	Neutral	1.40	1.31
2023-02-17	Neutral	1.08	1.12
2022-11-03	Sell	0.91	1.09
2022-09-27	Sell	0.86	1.00
2022-02-17	Buy	2.05	1.69
2021-12-26	Buy	2.05	1.78
2021-10-22	Neutral	2.38	2.51
2021-09-27	Neutral	2.33	2.27
2021-06-28	Neutral	3.30	3.20
2021-04-21	Buy	5.45	3.93
2021-02-17	Buy	5.45	4.01

Source: RHB, Bloomberg

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