

4 November 2022

Consumer Non-cyclical | Pharmaceuticals

## Kotra Industries (KTRI MK)

# Buy

### A Miracle Pill In The Making; Initiate BUY

Target Price (Return):	MYR5.72 (+19%)
Price (Market Cap):	MYR4.80 (USD150m)
ESG score:	3.22 (out of 4)
Avg Daily Turnover (MYR/USD)	0.10m/0.02m

- **We initiate coverage on Kotra Industries with BUY, TP of MYR5.72 offers 19% upside with a c.4% FY23F (Jun) dividend yield.** We like Kotra for its robust earnings quality, strong recognition of its flagship over-the-counter (OTC) brand of pharmaceutical products (Appeton), attractive yields vs that of peers, and it being a beneficiary of a stronger USD. We expect the company to book a revenue CAGR of 9% over FY23-25F, premised on resilient demand for its nutraceutical products and the gradual pick-up in export sales. Our TP has a 4% ESG premium built in.

- **Superior earnings quality.** Kotra has recorded an impressive FY19-22 earnings CAGR of 39%, in spite of the various macroeconomic challenges related to the pandemic as well as issues regarding labour shortages. Its success story is built on the strong and longstanding reputation of the Appeton brand, which enjoys strong recognition among Generation X and Generation Y consumers. Its growth also coincided with the increase in healthcare spending per capita – at MYR2,057 in 2020 vs MYR1,331 2010, according to the Ministry of Health (MOH) – as well as health awareness among consumer seeking to improve immunity against COVID-19 and other non-communicable diseases (NCD).

- **Key beneficiary of a stronger USD.** Over 29% of its FY22 total sales are for exports – mainly to ASEAN countries and Africa. As export sales are denominated in USD terms, this enables it to capitalise on the strengthening USD. We also see further room for growth, from exports recovering to pre-pandemic levels (accounting for c.40-45% of total revenue) following the reopening of country borders and stock replenishing by customers. A 10% appreciation in the USD would boost earnings by 2%.

- **Attractive yields.** Kotra has been in a net cash position for three consecutive years, after raising its paid-up capital in FY19. Its dividend payout ratio has increased to 61% for FY22, representing a 5.3% yield. We expect dividends to normalise to pre-pandemic levels in FY23, ie at c.50% of earnings, as capex is set to rise due to a warehouse expansion. This would imply c.4% yields for the medium term.

- **Valuation.** Our TP of MYR5.72 is based on 14x FY23F P/E, to reflect the expected recovery of its export sales, as well as the pick-up in OTC supplementary product sales as health awareness continues to grow post pandemic. The stock is trading at 13.1x forward P/E, at 1.2SD above its historical mean of 10x. At the current valuation, Kotra is trading at a 13% discount from the sector's P/E mean of 15x (Figure 11). We believe Kotra is undervalued, given its proven track record, established brand in the local market and net cash position. Our TP includes a 4% ESG premium, since its ESG rating is two notches above the country median.

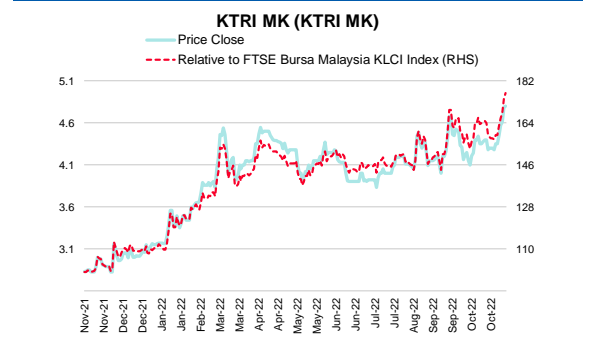
#### Analyst

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#### Share Performance (%)

	YTD	1m	3m	6m	12m
Absolute	51.9	15.7	14.6	12.1	69.6
Relative	61.3	14.1	19.3	23.4	76.9
52-wk Price low/high (MYR)	2.82 – 4.80				



Source: Bloomberg

#### Overall ESG Score: 3.22 (out of 4)

##### E: EXCELLENT

In 2022, both water and energy consumption have decreased by 28% and 42% respectively as compared to 2018. Kotra also partners with professional waste disposal contractor to responsibly manage, handle and dispose its waste.

##### S: EXCELLENT

Female composition in its workforce has increased to 53% in 2022 as compared to 52% in 2021. Kotra recorded a reduction of work accidents in 2022 by 40% as compared to 2019 and has maintained zero fatality during the same period. Kotra also conducted various local outreach programmes such as in-kind sponsorship to care centres and old folks' home as well as trainings for clinic assistants.

##### G: GOOD

Only a third of its Board directors are independent and there is only one female director. Kotra does disclose directors' remuneration on named basis.

Forecasts and Valuation	Jun-21	Jun-22	Jun-23F	Jun-24F	Jun-25F
Total turnover (MYRm)	160	208	224	245	265
Recurring net profit (MYRm)	24	59	56	60	63
Recurring net profit growth (%)	(19.2)	148.9	(6.1)	8.3	4.3
Recurring P/E (x)	29.65	11.95	12.72	11.75	11.27
P/B (x)	3.4	2.9	2.6	2.3	2.1
P/CF (x)	15.74	10.43	13.04	9.85	8.94
Dividend Yield (%)	1.9	5.3	3.9	4.3	4.4
EV/EBITDA (x)	15.58	8.67	8.84	8.10	6.94
Return on average equity (%)	12.3	27.6	21.6	21.0	19.8
Net debt to equity (%)	net cash	net cash	net cash	net cash	net cash

Source: Company data, RHB

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## Financial Exhibits













Asia	Financial summary (MYR)	Jun-21	Jun-22	Jun-23F	Jun-24F	Jun-25F
Malaysia	Recurring EPS	0.16	0.40	0.38	0.41	0.43
Consumer Non-cyclical	DPS	0.09	0.26	0.19	0.20	0.21
<b>Kotra Industries</b>	BVPS	1.40	1.65	1.84	2.04	2.26
KTRI MK / 2.00	Return on average equity (%)	12.3	27.6	21.6	21.0	19.8
Buy						
	<b>Valuation metrics</b>	<b>Jun-21</b>	<b>Jun-22</b>	<b>Jun-23F</b>	<b>Jun-24F</b>	<b>Jun-25F</b>
<b>Valuation basis</b>	Recurring P/E (x)	29.65	11.95	12.72	11.75	11.27
P/E of 14x on FY23F EPS	P/B (x)	3.4	2.9	2.6	2.3	2.1
	FCF Yield (%)	5.8	8.0	(1.5)	3.8	11.2
<b>Key drivers</b>	Dividend Yield (%)	1.9	5.3	3.9	4.3	4.4
i. Increasing consumer demand for pharmaceutical products;	EV/EBITDA (x)	15.58	8.67	8.84	8.10	6.94
ii. Recovery in export sales;	EV/EBIT (x)	25.00	10.89	10.97	10.25	9.15
iii. Growing general awareness of personal health						
	<b>Income statement (MYRm)</b>	<b>Jun-21</b>	<b>Jun-22</b>	<b>Jun-23F</b>	<b>Jun-24F</b>	<b>Jun-25F</b>
<b>Key risks</b>	Total turnover	160	208	224	245	265
i. Spike in raw material prices;	Gross profit	160	208	224	245	265
ii. Unfavourable drug pricing mechanism imposed by the Government;	EBITDA	42	72	75	83	89
iii. Depreciation of MYR against USD	Depreciation and amortisation	(16)	(15)	(15)	(17)	(22)
	Operating profit	26	58	61	65	68
	Net interest	(0)	1	(1)	(0)	(0)
	Pre-tax profit	26	58	60	65	68
	Taxation	(2)	4	(4)	(5)	(5)
	Reported net profit	24	62	56	60	63
	Recurring net profit	24	59	56	60	63
<b>Company Profile</b>						
Kotra Industries is a pharmaceutical company principally involved in the R&D and manufacture of pharmaceutical products.						
	<b>Cash flow (MYRm)</b>	<b>Jun-21</b>	<b>Jun-22</b>	<b>Jun-23F</b>	<b>Jun-24F</b>	<b>Jun-25F</b>
<b>Shareholders (%)</b>	Change in working capital	0.8	3.7	(28.9)	(5.2)	(4.8)
Piong Nam Kim Holdings	Cash flow from operations	45.0	68.1	54.5	72.1	79.4
Piong Teck Onn	Capex	(4.0)	(11.2)	(65.0)	(45.0)	0.0
Datuk Piong Teck Yen	Cash flow from investing activities	(3.1)	(38.0)	(63.7)	(43.7)	1.1
	Dividends paid	(9.6)	(24.4)	(27.9)	(30.2)	(31.5)
	Cash flow from financing activities	(36.3)	(48.3)	(36.5)	(41.2)	(42.1)
	Cash at beginning of period	49.3	68.7	89.7	91.6	79.1
	Net change in cash	5.6	(18.2)	(45.7)	(12.7)	38.5
	Ending balance cash	54.9	51.2	44.0	78.9	117.6
	<b>Balance sheet (MYRm)</b>	<b>Jun-21</b>	<b>Jun-22</b>	<b>Jun-23F</b>	<b>Jun-24F</b>	<b>Jun-25F</b>
	Total cash and equivalents	69	90	92	79	118
	Tangible fixed assets	122	112	162	190	168
	Total assets	253	299	357	381	407
	Short-term debt	11	7	0	0	0
	Total long-term debt	7	0	47	38	28
	Total liabilities	46	55	85	79	73
	Total equity	206	244	272	302	334
	Total liabilities & equity	253	299	357	381	407
	<b>Key metrics</b>	<b>Jun-21</b>	<b>Jun-22</b>	<b>Jun-23F</b>	<b>Jun-24F</b>	<b>Jun-25F</b>
	Revenue growth (%)	(7.0)	30.3	7.9	9.3	7.9
	Recurrent EPS growth (%)	(20.7)	148.2	(6.1)	8.3	4.3
	Gross margin (%)	100.0	100.0	100.0	100.0	100.0
	Operating EBITDA margin (%)	26.4	34.8	33.6	33.7	33.8
	Net profit margin (%)	15.3	29.9	24.9	24.7	23.8
	Dividend payout ratio (%)	54.4	60.8	50.0	50.0	50.0
	Capex/sales (%)	2.5	5.4	29.0	18.4	0.0
	Interest cover (x)	30.0	124.7	31.6	42.2	58.0

Source: Company data, RHB

## Investment Thesis

**Superior earnings quality.** Kotra has posted a tremendous earnings CAGR of 39% over FY19-22, despite various headwinds like the COVID-19 pandemic and the shortage of labour. Its success story is built on its 30-year flagship brand, Appeton, which accounted for 60-65% and 53% of total revenue in FY21 and FY22. Kotra also exports Appeton products to Singapore, Indonesia, Cambodia, Vietnam, and Africa. Product offerings under Appeton are comprehensive, and cater for nutritional and supplementary needs at different stages of a consumer's life. While this points to its keen understanding of a consumer's different nutritional and healthcare needs, it also allows the company to capitalise on building brand awareness, and improve its customer re-purchase rate, for those who used to consume Appeton products when they were younger.

**Figure 1: An overview of Appeton products**

Product categories	Type of Product
Child Health	   
Adult health	   
Nutrition and wellness	   

Source: Company data, RHB

The success growth story of the company had also coincided with the growing healthcare spending per capita (2020: MYR2,057 from 2010: MYR1,331, representing a 4% CAGR from 2010-2020 according to MOH). Apart from that, the increase of health awareness among consumer to improve immunity against COVID-19 and other non-communicable disease (NCD) is expected to be the near term re-rating catalyst in propelling the growth of OTC consumer healthcare products. According to Vodus Research, Malaysians have become more health-conscious owing to the COVID-19 pandemic, high rate of obesity and diabetes. In 2021, 50% of all Malaysians consumed health supplements products of which Vitamin C is among the most popular supplements consumed followed by multi-vitamins and fish oil.

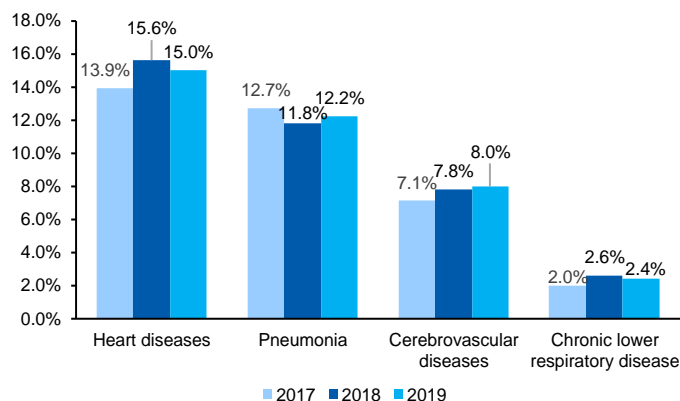
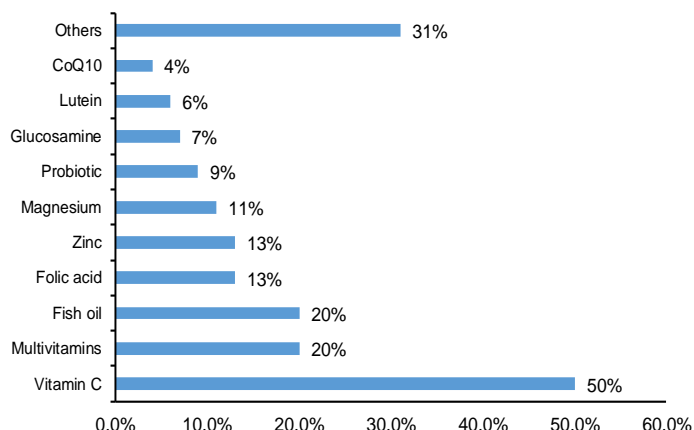
**Figure 2: Per capita expenditure on health in Malaysia (2010-2020)**

Year	Per capita expenditure on health (MYR)
2010	1,331
2011	1,358
2012	1,452
2013	1,495
2014	1,612
2015	1,697
2016	1,694
2017	1,759
2018	1,853
2019	1,960
2020	2,057

Source: MOH, RHB

**Figure 3: Most popular supplements consumed in Malaysia (2021)**

**Figure 4: Statistics on the causes of death in Malaysia (2017-2019)**



Source: Statista, RHB

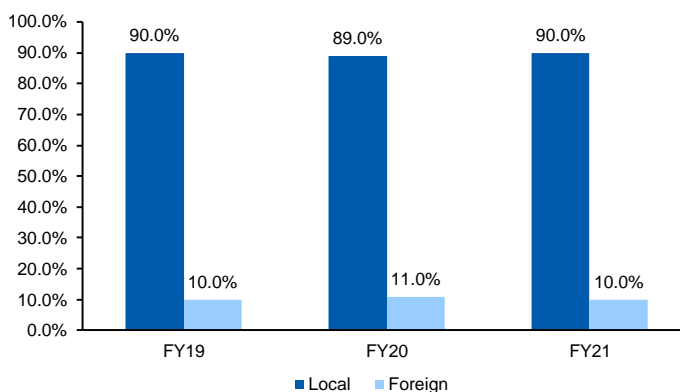
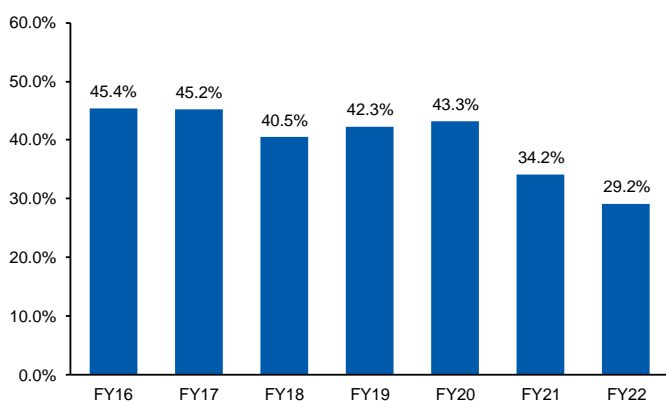
Source: Department of Statistics Malaysia (DOSM), RHB

**Key proxy for a stronger USD.** Over 29% of Kotra’s total sales in FY22 constitute exports sent to ASEAN countries and Africa. Given the export sales are denominated in USD, this indeed had placed the group in a favourable position to capitalise on the strengthening USD. On top of that, we see further room for the export segment to rebound to pre-pandemic levels (c.40-45% of total revenue) following the reopening of country borders, as well as the resumption of stock replenishing by customers. For every 10% appreciation in the USD, its earnings may rise by 2%.

**Undeterred by foreign labour shortage.** Given the labour-intensive nature of its manufacturing activities, Kotra was somewhat sheltered from the current labour shortage in Malaysia. This is because foreign labour only makes up 10-11% of its total workforce. Apart from that, the company continued to promote and attract local talent by creating employment opportunities and offering internship programmes, as well as conducting training sessions to employees on-site, to equip them with the relevant knowledge and skills required in the industry.

**Figure 5: Kotra’s export sales as a % of total revenue**

**Figure 6: Breakdown of local and foreign labour in its workforce**

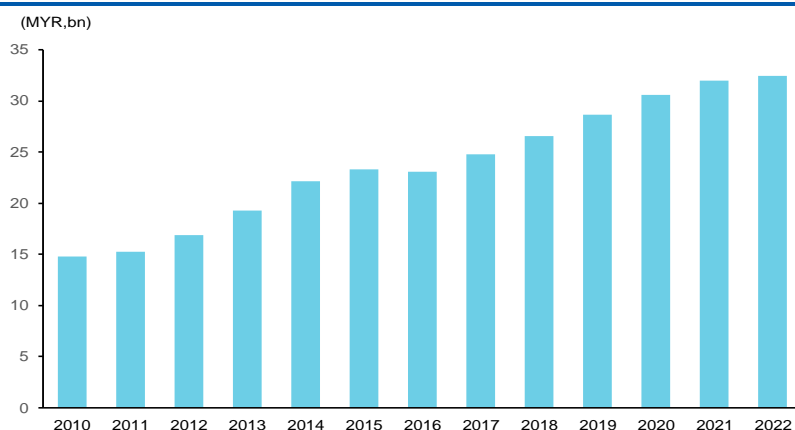


Source: Company data, RHB

Source: Company data, RHB

**Increasing budget allocation for the MOH.** The growth of the local healthcare industry is also partly influenced by the allocation of federal government budgets for the MOH. We note that the Malaysian Government has been putting emphasis on improving the wellbeing of the public. As such, allocations for public healthcare spending has expanded at a 10-year CAGR of 6.7%. Given the emphasis made in Budget 2022 to rebuild the nation’s resilience, the increase in allocation for the MOH was at MYR32.4bn in 2022, compared with MYR31.9bn in 2021. This would provide a positive catalyst to spur growth in the local healthcare sector, including the pharmaceutical industry.

Figure 7: Federal government budget allocations for the MOH



Source: Ministry of Finance Malaysia, RHB

**Presence of OTC products in local pharmacy stores.** OTC supplements, Kotra's key business segment, accounted for approximately 60% and 53% of FY21 and FY22 revenue, thanks to its strong OTC brand, Appeton. As Kotra has access to well-known authorised retailers in Malaysia, we estimate that customers would be able to find Appeton products in over 3,500 physical retail stores in Malaysia.

Figure 8: List of authorised retailers



Source: Company data

Figure 9: Estimated number of stores of authorised retailers

Authorised retailers	Estimated number of stores
99speedmart	2000
Guardian	500
Watsons	600
Caring	160
Aeon Wellness	66
Farmasi Mercury	80
Farmasi Alpro	102
Farmasi Al Arif	20
<b>Total</b>	<b>3528</b>

Source: Various sources, RHB

These retailers are found in both West Malaysia and East Malaysia, and are also in shophots near residential areas, as well as in high-end commercial buildings such as shopping malls. Therefore, the abundance of stores offering Appeton products makes it easier for Kotra to reach its customers regardless of the latter's income level.

**Strong pricing power over local peer.** Given the strong brand recognition, Kotra is able to leverage on Appeton's popularity to offer its products at a premium compared to its domestic peer. Our channel checks at various local pharmacies revealed that Appeton products are sold at premiums of 2-37% compared to the products of its domestic competitor. We believe this is made possible through its intensive marketing efforts and investments made in R&D over the years.

Figure 10: Product price comparison

Product category	Kotra	Duopharma	Blackmores (AUS)	price comparison (vs domestic)	price comparison (vs foreign)
<b>Adult health</b>	Appeton Essentials Activ-C Vitaman C 500MG	Flavettes 500mg Orange Sugar Free 50 Tablets	Blackmores Vitamin C 500mg 60 Tablets		
Pharmacy W	n.a.	27.8	42.0	n.a.	n.a.
Pharmacy G	31.9	26.5	29.4	20.4%	8.5%
Pharmacy C	33.3	32.7	29.4	1.8%	13.3%
<b>Child health</b>	Appeton A-Z Kids Vitamin C 30MG 100s	CHAMPS Vitamin C 30mg Blackcurrant Chewable Tablet 100s	BLACKMORES Koalakids Multivitamin 60s		
Pharmacy W	24.3	18.9	37.7	28.6%	-35.5%
Pharmacy G	25.8	18.9	40.6	36.5%	-36.5%
Pharmacy C	26.2	23.0	40.6	13.9%	-35.4%

Source: Various sources, RHB

**Robust balance sheet renders room for dividend growth.** Kotra has been in a net cash position for three consecutive years after it beefed up paid-up capital in FY19. The company boosted its dividend payout ratio to 61% in FY22, after which it declared a final DPS of 16 sen on 6 Oct. This represents a 5.3% yield, based on its closing price as at 3 Nov (of MYR4.80). We maintain our dividend payout ratio estimate at a conservative 50%, as we believe its payout ratio should normalise to pre-pandemic levels of c.43-54%. This should translate into c.4% forward dividend yields.

## Valuation & Recommendation

We initiate coverage on Kotra with BUY recommendation and a TP of MYR5.72, based on 14x FY23 P/E. This is premised on our positive outlook – an expected recovery in export sales, and a pick-up in OTC supplementary product sales due to rising health awareness, especially in post-pandemic times. This is backed up by its proven track record (3-year earnings CAGR of 39% from FY19-22), as well as its solid brand recognition.

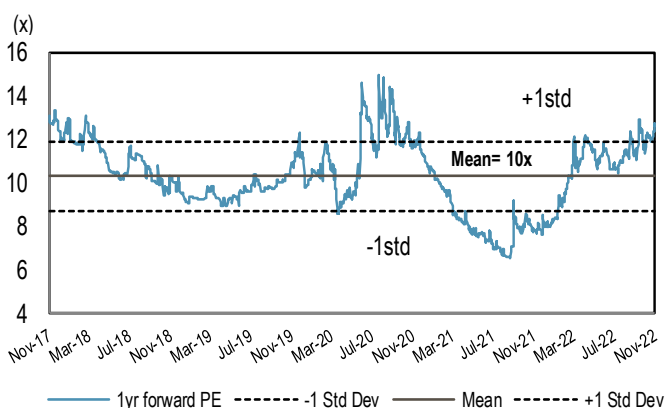
Kotra is trading at 13.1x forward P/E, at 1.2SD above its historical mean of 10x. At the current valuation, the company is still trading at a 13% discount from the pharmaceutical sector’s average P/E of 15x (Figure 11). Nevertheless, we still think that Kotra is undervalued apart from the abovementioned attributes – its robust balance sheet (net cash position vs net debt from most of its peers) and rewarding dividends are some of the rewarding factors that investors should not ignore. We incorporate a 4% ESG premium to our intrinsic value, as our ESG score of 3.2 is two notches above the country median, based on our in-house proprietary methodology.

Figure 11: Peer comparison

Company	FYE	Country	Price		Mkt Cap (MYRm)	P/E (x)		Div. Yld (%)	ROE (%)	EV/ EBITDA	NP Growth (%)		PEG
			3-Nov-22 (Local Currency)	Actual		1 Yr Fwd	2 Yr Fwd				1 Yr Fwd	2 Yr Fwd	
<b>Local</b>													
Kotra Industries	Jun	MY	4.80	710.4	11.4	13.1	11.7	3.9	21.6	8.8	(6.1)	8.3	0.9
Nova Wellness Group	Jun	MY	0.89	283.4	17.6	13.4	11.3	2.6	21.1	8.9	31.6	18.4	0.6
Duopharma Biotech	Dec	MY	1.38	1,314.1	20.0	15.2	14.9	2.4	13.8	10.6	31.4	2.5	6.0
Pharmaniaga	Dec	MY	0.54	700.8	4.1	10.0	9.9	6.9	14.9	10.5	(59.3)	0.7	13.9
Apex Healthcare	Dec	MY	3.2	1,528.2	25.7	21.5	20.0	1.8	14.0	14.2	19.7	7.3	2.7
Beshom Holdings	Apr	MY	1.43	429.1	14.8	11.8	9.9	7.7	11.1	6.2	25.8	18.5	0.5
YSP Southeast Asia Holding	Dec	MY	2.22	313.0	20.6	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
<b>Mkt. Cap Weighted Avg.</b>					<b>18.9</b>	<b>15.0</b>	<b>14.1</b>	<b>3.2</b>	<b>13.3</b>	<b>10.5</b>	<b>10.9</b>	<b>6.1</b>	

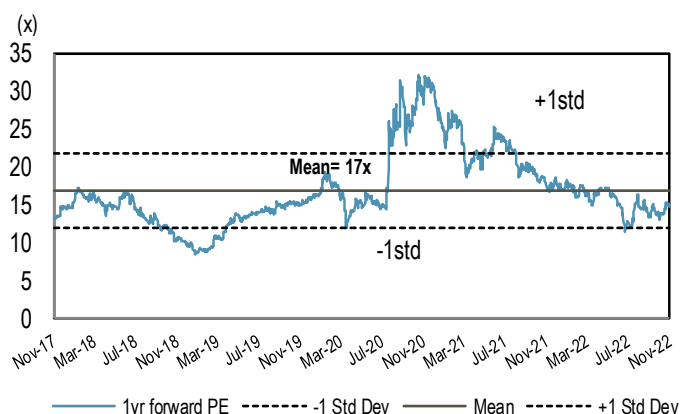
Source: Bloomberg, RHB

Figure 12: Kotra’s forward P/E band



Source: Bloomberg, RHB

Figure 13: Duopharma Biotech’s forward P/E Band



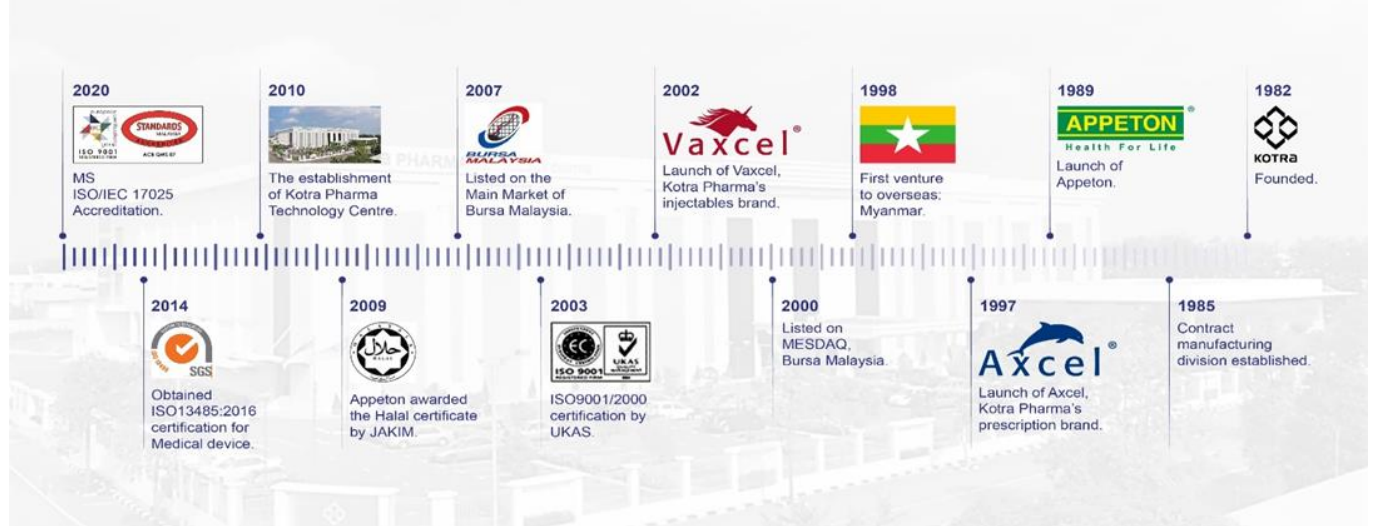
Source: Bloomberg, RHB

## Company Overview

### Historical background

Kotra Industries is a pharmaceutical company principally involved in the R&D and manufacture of pharmaceutical products. It was founded in 1982 and listed on the Main Market of Bursa Malaysia in 2007. It has two manufacturing facilities in Cheng Industrial Estate in Melaka. Its manufacturing facility is capable of making pharmaceutical products ranging from tablets, capsules, sterile vials, oral liquid to cream and ointments.

Figure 14: Kotra's milestones



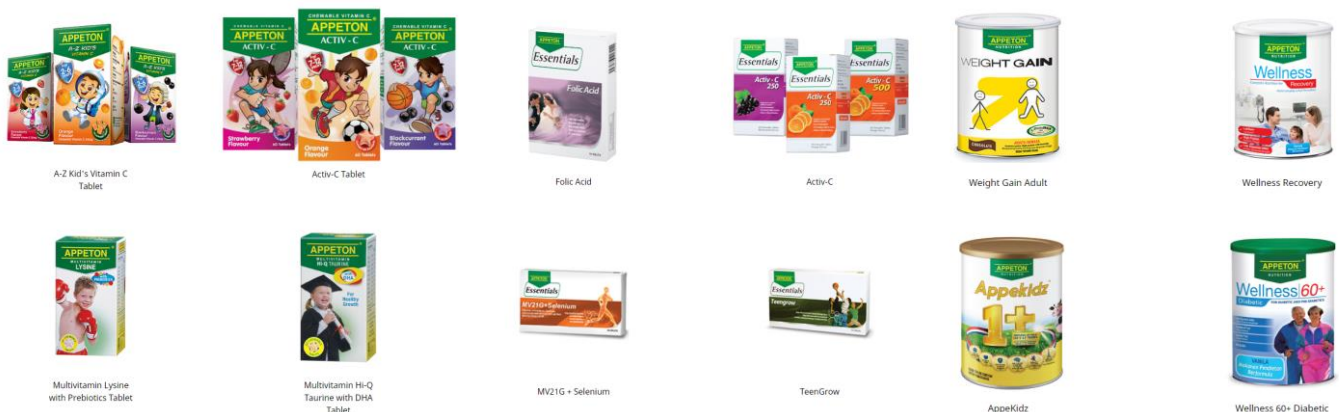
Source: Company data, RHB

The group has three subsidiaries: Kotra Pharma (M) and two other dormant units. The group, which mainly operates through Kotra Pharma, offers a wide range of healthcare products of OTC supplements (OTC), nutritional products as well as pharmaceutical products in various dosage forms. Products are marketed via the main brands elaborated on below.

### Appeton

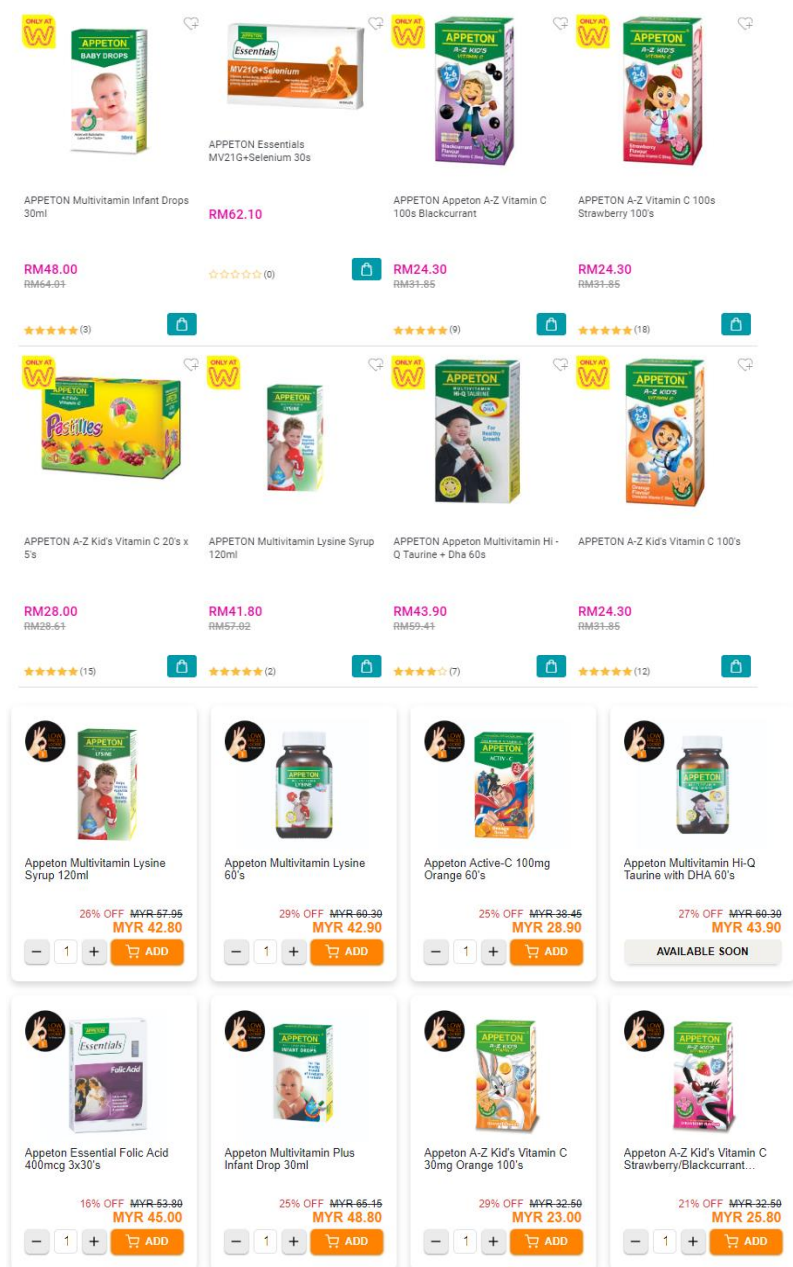
Kotra's main brand, Appeton, focuses on OTC products which accounted for approximately 60-65% and 53% of FY21 and FY22 revenue. Appeton products cater to all stages of life as the products are categorised into three segments – Child Health, Adult Health and Nutrition Health. Products under Child Health include vitamin-C tablets, multivitamin lysine syrup and multivitamin pastilles while Adult Health offers products such as fish oil, vitamin-C and folic acid for teenagers and adults. These products are manufactured in-house. Kotra also imports formula milk for children aged 1-12, weight gain formula and milk formula for the elderly.

Figure 15: Appeton products



Source: Company

Figure 16: Appeton's bestselling products



Source: Company

### Axcel and Vaxcel

Apart from OTC products, Kotra also manufactures generic drugs under the brands Axcel and Vaxcel. Axcel mainly focuses on pediatric care, anti-infection medicine and dermatological care which currently caters to 22 therapeutical classes in total. The products come in various forms of dosage.

Vaxcel products, on the other hand, are mainly sterile injectables that feature a range of antibiotics to treat various illnesses relating to respiratory, dermalogical, gastrointestinal and gynaecological health.

Axcel and Vaxcel account for 35-40% and 47% of the group's FY21 and FY22 revenue.

Figure 17: Axcel products



Source: Company, RHB

Figure 18: Vaxcel products



Source: Company, RHB

**Kotra’s manufacturing facility**

Kotra has two manufacturing facilities located in Melaka’s Cheng Industrial Estate. According to management, its manufacturing plants have been running at about 30-40% capacities over the past 10 years. While the low utilisation rates could be attributed to the weak contract manufacturing demand from the Government, the company – back in 2018 – invested in two key projects, the Metered Dosage Inhaler Line (MDI Line) and the Pre-filled Syringe Manufacturing Line (PFS Line). The projects were dubbed as pioneer initiatives in Malaysia, given that such products had never been made in Malaysia before, and any supply would be solely reliant on imports.

Presently, the group still has a piece of land reserved for the construction of a new warehouse within the vicinity of its manufacturing facilities. This is expected to house an additional c.26,000 pallets, and is slated to be completed by end-2024. The warehouse expansion project is in line with Kotra’s target of achieving 50% export sales following the reopening of international borders. While setting its new growth engine in the export market, the group’s venture into China is still at a preliminary stage, given the tough regulatory landscape.

Figure 19: Artist’s impression of Kotra’s upcoming manufacturing facility



Source: Company, RHB

## Management and shareholdings

**Kotra's board of directors is spearheaded by Independent Non-Executive Chairman Datuk Jamaludin bin Nasir.** He is also the Chairman of the Employees' Share Option Scheme Committee, Remuneration Committee, and Nomination Committee, Audit Committee.

**Piong Teck Onn is the Managing Director.** He has been a boardmember since 2000. A graduate of the University of Wales, he has a Bachelor of Science in Pharmacy degree, and has many years of experience in the pharmaceutical industry. He joined Kotra Pharma in 1984 and pioneered the development of its manufacturing, marketing, research and development departments.

**Chin Swee Chang, Executive Director.** She graduated from the University of Leeds with a Bachelor of Science (Hons) in Data Processing. Her experience includes being a programmer at Systems Automation, analyst programmer at Eastern Systems Design and Head of the Electronic Data Processing Department at Robert Bosch. Chin is currently the Chief Information Officer, and is responsible for overseeing the operations, development and enhancement of Kotra's management information systems, order processing and administration departments. Chin is married to Piong Teck Onn.

**Lee Min On, Independent Non-Executive Director.** He is also the Chairman of the Audit Committee and a member of the Employees' Share Option Scheme Committee, Remuneration Committee, and Nomination Committee. Lee is a chartered accountant under the Malaysian Institute of Accountants, a certified public accountant under the Malaysian Institute of Certified Public Accountants, as well as a Fellow (CFIIA) of Institute of Internal Auditors Malaysia. His experience includes working in KPMG, where he was a partner of the firm in the audit and consulting division.

**Datuk Piong Teck Yen, Non-Executive Non-Independent Director.** His experience includes Sales Manager and Marketing Manager of Kotra Pharma (M) as well as Business Director who was responsible for the developments of exports and international marketing activities of the Group. He is a brother of Piong Teck Onn, brother-in-law of Chin Swee Chang and uncle of Piong Chee Kien.

**Piong Chee Kien, Non-Executive Non-Independent Director.** With qualifications that entail a Bachelor of Science in Telecommunications Engineering as well as a Master of Science in e-Commerce Engineering, Piong Chee Kien's experience includes being a brand executive at Kotra Pharma (M) and general manager of Lonnix (M), where he specialised in a broad range of traditional medicine, food supplement and effervescent products. He is a nephew of Piong Teck Onn, Datuk Piong Teck Yen and Chin Swee Chang.

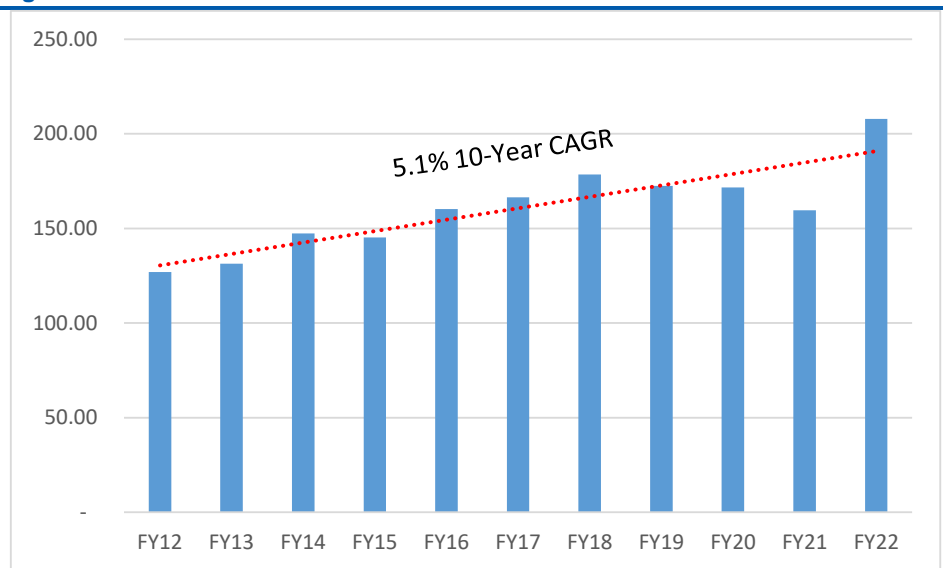
**Key senior management** includes Kotra's COO Cheah Ming Loong, CFO Daniel Chua Chong Liang, and the Business Lead – OCT Piong Chee Wei. The latter is the son of Piong Teck Onn and Chin Swee Chang.

**Shareholdings.** Piong Nam Kim Holdings is the major shareholder, with a 43.67% stake. This is followed by Kotra's managing director Piong Teck Onn, who owns a 11% direct stake in the group, and Datuk Piong Teck Yen with a 5.61% stake.

## Financial Overview & Forecasts

**Revenue.** Kotra's topline has expanded at a 10-year CAGR of 5.1%. The bulk of its sales was to local customers, and accounted for 55-71% of FY17-22 revenues. We understand from management that 53% of its FY22 revenue would come from OTC product sales, under Appeton.

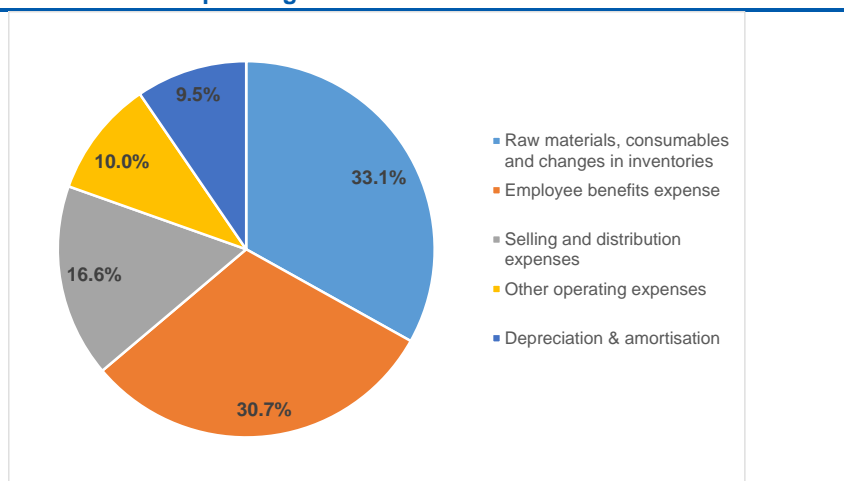
Figure 20: Revenue trend



Source: Company update, RHB

**Operating costs.** The main components of its operating costs are staff benefit expenses and raw materials, which account for 33% and 31% of total operating costs. We understand from management that the prices of its products are revised annually to reflect rising prices of its main raw material – active pharmaceutical ingredients (API) – while staff benefit expenses may also increase as a result of minimum wage hikes.

Figure 21: Breakdown of operating costs in FY22



Source: Company data, RHB

**FY22 results.** Kotra closed FY22 with a stellar performance, with its earnings jumped 160% YoY on the back of higher revenue and improved operating margins. Revenue rose 30% YoY partly due to the low base effect and likely boosted by inventory replenishment from customer as well as heightened awareness on health supplements products in the era of post-pandemic. Local sales made up 71% of the total revenue which garnered a higher operating margin of 35% (vs export's 22.9%). Kotra declared total dividend per share of 25.5 sen with respect to FY22.

Figure 22: 4Q22 and FY22 results review

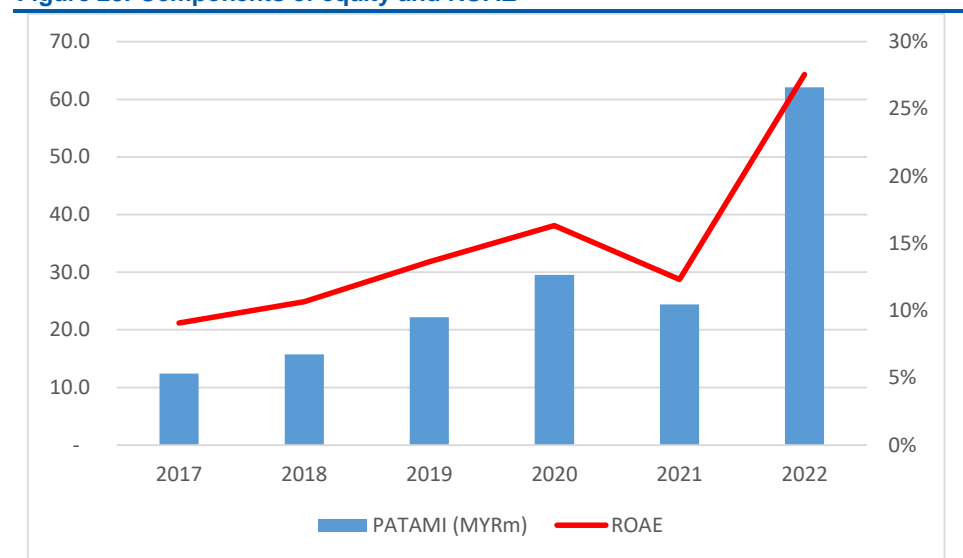
FYE Jun (MYRm)	4QFY21	3QFY22	4QFY22	QoQ (%)	YoY (%)	FY21	FY22	YoY (%)
<b>Revenue</b>	43.5	55.2	48.8	(11.7)	12.2	159.6	207.9	30.3
<b>Operating Profit</b>	14.5	17.2	12.4	(27.8)	(14.1)	27.2	58.7	116.4
OP margin (%)	33.3	31.2	25.5			17.0	28.3	
<b>EBITDA</b>	18.1	20.6	15.8	(23.2)	(12.4)	42.2	72.3	71.4
EBITDA margin (%)	41.5	37.3	32.4			26.4	34.8	
Depreciation and Amortisation	(3.9)	(3.7)	(3.7)	0.4	(4.2)	(15.9)	(14.7)	(7.4)
<b>EBIT</b>	14.2	16.9	12.1	(28.3)	(14.6)	26.3	57.6	119.0
EBIT margin (%)	32.6	30.6	24.8			16.5	27.7	
Interest Income	0.3	0.3	0.3	0.3	9.1	0.8	1.1	33.4
Interest Expense	(0.2)	(0.1)	(0.1)	(31.7)	(53.7)	(0.9)	(0.5)	(47.3)
Exceptional Items	0.2	0.5	1.6	218.8	553.3	0.5	2.6	422.1
<b>Reported PBT</b>	14.3	17.1	12.4	(27.7)	(13.6)	26.3	58.3	121.8
Tax	(1.9)	(0.1)	3.9	(6,794.8)	(308.1)	(1.9)	3.8	(302.7)
Effective tax rate (%)	13.0	0.3	(31.4)			7.2	(6.5)	
<b>Net Profit</b>	12.4	17.0	16.2	(4.7)	30.5	24.4	62.1	154.6
<b>Core Profit</b>	12.2	16.5	14.7	(11.4)	20.2	23.9	59.5	148.9
Core net margin (%)	28.1	29.9	30.1			15.0	28.6	

Source: Company data, RHB

**Net cash position.** As at FY22, Kotra was in net cash position due to the substantial repayment of borrowings amounting to MYR11.2m or approximately 63% of its debt balances. We anticipate the company to continue to be in a net cash position in FY23-25.

**ROAE.** Over the past five years, its ROE ranged from 10.7% to 27.6%. This is due to the increasing PATAMI over the years, which expanded at a solid 5-year CAGR of 38%. We expect ROE to be within this range, in FY23-25F.

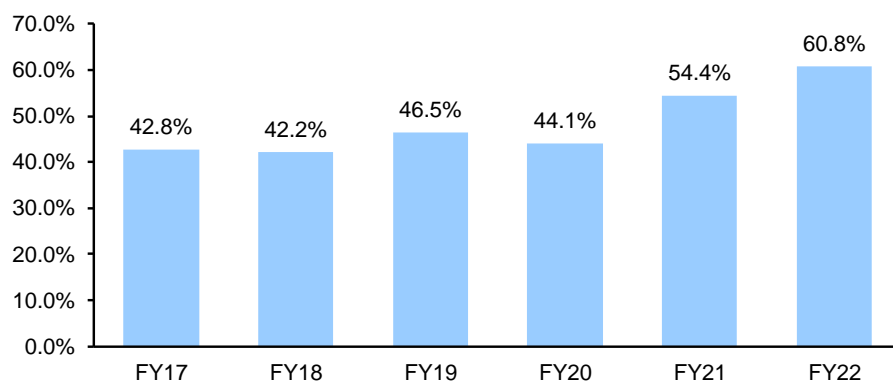
Figure 23: Components of equity and ROAE



Source: Company data, RHB

**Dividends.** Although Kotra does not have a fixed dividend policy, it has been paying dividends consistently, translating to payout ratios of 43-54% over FY17-21. Its latest FY22 dividend had also rewarded shareholders at an estimated yield of 5.3%, based on a total payout ratio of 61%.

**Figure 24: Kotra's dividend payout trend**



Source: Company data, RHB

**Capital expenditure.** Kotra's next substantial capital expenditure includes the construction of a new warehouse in Melaka. Building works are slated to begin in FY22, and expected to be completed by end-2024. The warehouse is expected to store an additional c.26,000 pallets. We understand from management that the construction will be funded by both new borrowings and internal funds.

## Key Risks

**Rise in raw material prices.** Just like any other manufacturing firm, Kotra is subject to the risk of increasing input costs. For instance its key raw material ingredient – Active Pharmaceutical Ingredients (API) – could be susceptible to spikes in raw material costs. We gathered from management that API accounted for <50% of its total raw material cost. Based on our estimated 34% of the total raw material cost, any 1% spike in its raw material cost is expected to have a 0.3% impact on its bottomline.

**Regulatory risks.** As the pharmaceutical industry is highly regulated, the risk of changes in legislation that result in more stringent procedures to be implemented could delay the manufacture of pharmaceutical products and, as such, affect pharmaceutical players' financial and operational performance. Kotra would not be exempt from this. Also, government intervention on the pricing mechanism for drugs could also affect Kotra's topline. Recently, The Edge reported that the MOH is working on implementing a drug price transparency mechanism. Health Minister Khairy Jamaluddin plans to propose a policy where pharmaceutical companies are required to present the prices charged for their drugs to the Government. The Health Minister also noted that direct pricing control could be implemented if needed, though he mentioned that this is the last resort. If the transparency mechanism gets tabled, passed and becomes effective, we believe Kotra may be adversely affected by the policy, given the premium pricing strategy that it adopts.

**Foreign currency risks.** Apart from the local market, Kotra also concludes sales outside Malaysia, denominated in foreign currencies including USD and SGD. In the meantime, it also imports raw materials. We understand that API are imported from China, India and Europe by traders based in Malaysia. To extent the revenue and costs are not matched in the same currency, Kotra would be exposed to foreign currency risks.

## ESG Efforts

**Environmental: Better resource management for the past few years.** Kotra discloses its annual water and energy consumption, as follows:

**Figure 25: Kotra's annual water and energy consumption**

	FY18	FY19	FY20	FY21	FY22
Energy intensity (kWh per m revenue, MYR)	68,744	67,076	65,727	64,111	49,668
Water intensity (m3 per m revenue, MYR)	594	596	441	411	344

Source: Company data

Average energy intensity has declined by 28% in 2022 as compared to 2018, while water consumption dropped by 42% in the same period. This proves Kotra's efficiency in managing its resources over the years.

While not much disclosure has been made for waste management, we understand that Kotra hires a professional waste disposal contractor to better manage, handle and dispose its waste. All in, we assign an E score of 3.3 given the improvements that they have made in terms of their resource management over the past few years.

**Social: Decent improvements made.** For this pillar, we observe a few aspects such as gender diversity, the provision of training and development, the decrease in the number of accidents and fatalities as well as local community outreach programmes it has participated in.

Kotra has been successful in maintaining a balanced composition of its workforce in terms of gender. Women made up 51% of its workforce in FY19 as well as FY20, 52% in FY21 and this has increased slightly to 53% in FY22. We also understand from management that Kotra has been paying its staff above the minimum wage of MYR1,500 prior to its revision in May 2022.

As part of empowering its workforce, Kotra offers training and development for personal development and career growth for its own employees. This is implemented through Kotra Institute of Talent Excellence (KITE), its own structured training programme. It also provides training to local talents via the Clinic Assistant Programme, which is aimed to equip untrained clinic assistants with the relevant knowledge and skills to enhance their competency.

With regards to employees' safety and health, Kotra conducts regular training for employees on creating a safe working environment. We note that Kotra reported three accidents in FY22, down from four accidents in FY21 and seven in FY20 while Kotra maintains its record of zero fatalities over the three years.

In FY21, Kotra conducted various local outreach programmes as part of its corporate social responsibility such as annual sponsorship programmes at primary schools in conjunction with Children's Day, in-kind donations to underprivileged individuals in the community, and sponsorship of nutritional products to care centres, old folks' homes and nursery homes.

Given the various initiatives done for this pillar, we assign an S score of 3.7.

**Governance – room for improvement.** We believe the Governance pillar requires more emphasis by the management, particularly on board independence and gender diversity. In FY22, only two out of six directors are independent and female director accounted for a paltry 17% of the board, which is below the 30% threshold recommended by the Malaysian Code on Corporate Governance 2017 (MCCG). However, Kotra maintains a policy of limiting tenure of its independent directors to nine years, as per MCCG. Kotra does disclose the breakdown of remuneration packages for its directors on a named basis.

Therefore, we assign a relatively low score of 2.7. for its Governance pillar due to the lack of independent and female directors, as well as the low level of transparency on directors' remuneration.

**The overall ESG score of 3.2.** Taking the average of all three scores assigned above, the ESG score assigned to Kotra is 3.2. Based on our own RHB in-house proprietary methodology, the score assigned will be benchmarked against the median score of all the Malaysian stocks under our coverage, which is 3.0. If the difference between the score assigned to a stock to the country median score of 3.0 arises, every +/- 0.1 of the difference will translate to a 2% premium/discount to the intrinsic TP. In the case of Kotra, as the difference between its ESG score and the country median is +0.2, a 4% premium has been ascribed to its intrinsic value to derive our TP for this counter.

## Recommendation Chart

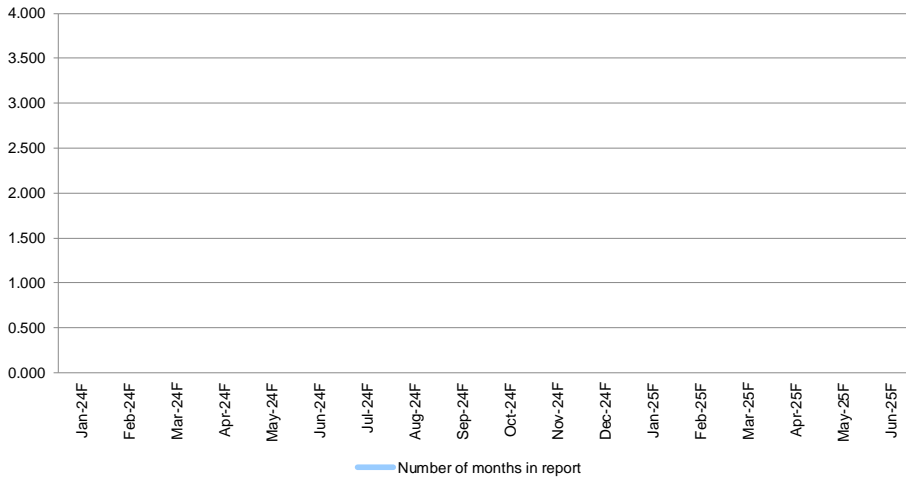


Date	Recommendation	Target Price	Price
2022-11-03			

Source: RHB, Bloomberg

Source: RHB, Bloomberg

## ESG Rating History



Source: RHB

## RHB Guide to Investment Ratings

<b>Buy:</b>	Share price may exceed 10% over the next 12 months
<b>Trading Buy:</b>	Share price may exceed 15% over the next 3 months, however longer-term outlook remains uncertain
<b>Neutral:</b>	Share price may fall within the range of +/- 10% over the next 12 months
<b>Take Profit:</b>	Target price has been attained. Look to accumulate at lower levels
<b>Sell:</b>	Share price may fall by more than 10% over the next 12 months
<b>Not Rated:</b>	Stock is not within regular research coverage

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