

PP14767/09/2012(030761)

Kossan Rubber Industries

“Fundamentally Strong World No.2 Glove Maker”

The recent profit-taking activity in rubber glove stocks was mainly triggered by factors such as strengthening of RM against USD, upward turning of latex prices, rising natural gas costs, increase of foreign labour levy, etc. We reckon the rising costs are ‘transferrable’ to the glove original equipment manufacturers (OEMs). We believe the sell-off opens a good buying opportunity to collect world class growth-driven and resilient company such as Kossan Rubber Industries (Kossan), the world’s No.2 rubber glove maker.

Its strong fundamentals are supported by 4-5 years expansion plans and attractive valuations which suggest forward PER of 15x after being grossly oversold in the investment community. Hence, we have Kossan as our top pick among the Big-4 (Hartalega, Kossan, Top Glove and Supermax), valuing the company at RM8.62 with a BUY call and upside potential of 42% from the last closing RM6.05.

World’s no.2 glove maker. Kossan is ranked between the world’s No.1 natural rubber (NR) glove maker (Top Glove) and the world’s No.1 nitrile (SR) glove maker (Hartalega) in terms of sales quantity. The 37-year old company has a SR:NR product mix of 70:30 with a total capacity of 25 billion pieces/annum, operating at approximately 85% utilisation rate. This has positioned Kossan in a sustainable earnings channel, allowing the company to tap into double-digit growth in SR segment as well as the less-saturated NR segment where most glove players have shifted from.

Technical rubber product (TRP) provider. Gloves aside, Kossan is also one of the market leaders in the manufacturing of high technical input rubber products for wide range of application in automotive, marine, construction, infrastructure and many more. These include seismic bearing, port bearing, fenders, Ethylene-vinyl acetate (EVA) sheets, rubber rollers, etc. This division makes up approximately 10% of the total group sales. (See Chart 1)

Tuesday, April 26, 2016

BUY (TP: RM8.62)

Current Price (RM)	RM6.05
New Fair Value (RM)	RM8.62
Previous Fair Value (RM)	RM8.42
Previous Recommend.	BUY
Upside To Fair Value	42.3%
Dividend Yield (FY15)	3%

Stock Code

Bloomberg	KRI MK
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Stock & Market Data

Listing	MAIN MARKET	
Sector	Industrial	
Shariah Compliance	Yes	
Issued Shares (mn)	639.5	
Market Cap (RM mn)	3,868.8	
YTD Chg In Share Price	-34.9%	
Beta (x)	0.09	
52-week Hi/Lo (RM)	RM9.50	RM5.50
3M Average Volume (shrs)	1.7mn	
Estimated Free Float	29.4%	

Major Shareholders

Kossan Holding	51.1%
EPF	9.8%
Invesco	5.7%

Target to Double Capacity by 2020. After the capacity expansion in June 2013 that saw production capacity lifted from 16 billion pieces to 22 billion pieces p.a (+38%), Kossan is set to double its production capacity by another 22.7 billion to 44 billion pieces p.a in the next 5 years, of which 7.4 billion pieces of new capacity to be installed in FY17. Moving forward, we believe the new facilities are capable to produce minimum 42,000 gloves/hour/line and well absorbed by new orders in view of the strong 8-10% annual growth in world's glove demand. (See Chart 2)

Demand still ahead of supply. Global glove demand has been rising in tandem with the growing of ageing population as well as hygiene awareness throughout the globe. With more than 60% of global market share controlled by Malaysian rubber glove players, MREPC reveals an annual double-digit growth in the country's export of rubber gloves and remains optimistic to see continued healthy trend in the coming years. Assuming the world demand of rubber gloves reaches 288 billion pieces/annum in the next 4-5 years, we expect the Big-4 would be able to churn out only 160 billion pieces post-expansion by 2020 (versus the current 96-110 billion pieces), which still leaves some room to fit in the supply provided that the Big-4 continue to maintain its global market share of >60% by then, which is highly possible in our view. (Refer Chart 3 & the world demand vs. supply table in the sector report)

Healthy Gearing Ratio. We understand that Kossan is spending minimum RM150 million in capex per annum for expansion in the next 5 years to double its current production capacity of 22 billion pieces per year. Funding is not an issue for Kossan as we have seen the gearing ratio reduced over the years from FY14 (12%) to FY15 (2%). The management anticipates a payback period of no longer than 4 years for the capex spent.

More Generous Dividend Payouts. The consistency of achieving better results over the quarters has seen Kossan's retained earnings piling up to more than RM600 million as at 3Q FY15. We are sanguine about potential revision of dividend policy in 2 years' time, expecting a payout ratio of 40-50% as opposed to the current 30%.

Proposed share buyback. The rebound in Ringgit has sent Kossan's stocks plunging from a record of RM9.50 in Dec-2015 to RM6.39 (-33%), however, its business and prospects remains status quo. The management proposed share buyback in February 2016 which will be tabled in the next AGM and the founder Mr. Lim Kuang Sia believes that the current price level is 'already low' for investors with long-term horizon.

Earnings Outlook. Moving forward, we expect stronger earnings visibility in coming quarters, backed by sales volume growth from SR gloves and the construction and commissioning of the 8 new plants. Of note, the remaining 50% earnings contribution from the new Plant 2 and 3 will spill over into FY16 and we expect Kossan to deliver another double-digit earnings growth by then. The additional 5 new SR-centric plants with 20 billion capacity are slated to start construction and contribute to earnings in FY17, which will further boost the top and bottom lines of Kossan up to FY21. We project Kossan to post FY16-17 net profit of RM233 million/RM271 million in FY16/17, respectively, converting into EPS of 36 sen and 42 sen in FY16/17.

Company Update - Kossan Rubber Industries

Valuation and recommendation

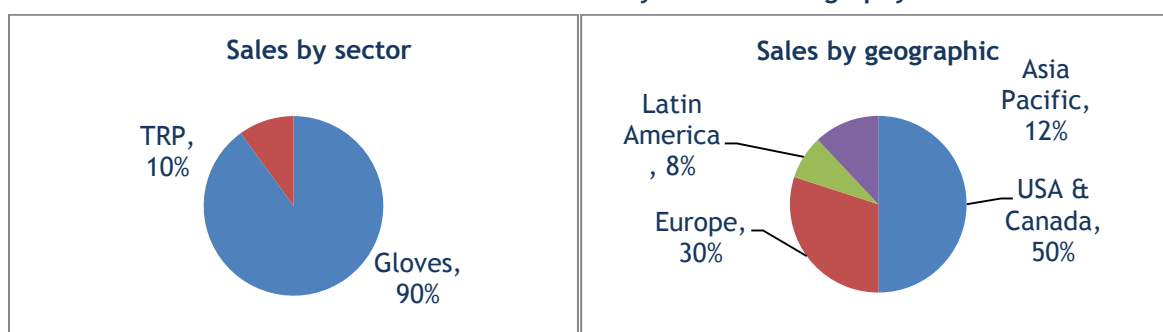
We like Kossan's hybrid earnings model that not only focus on glove manufacturing but also other technical rubber products which feed demand for various industries particularly in infrastructure and marine. On the back of progressive roll-out of expansion plans funded by annual capex of RM120 million - RM150 million, we reckon Kossan will continue to stay competitive in the country's top 5 exporters of SR glove list (potentially the 3rd largest SR exporter) in 3-5 years' time. We have Kossan as our top pick among the Big-4 with a **BUY** recommendation and value the company at its 3-year average PER of 21x, pegged to our FY17 EPS forecast of 42 sen, arriving the target price at RM8.62 with 33% upside from the last closing price.

Table 1: Peers Comparison

Company	Year Ended	Price (RM)	EPS (sen)		P/E (X)		P/B (X)		ROE (%)	Div Yield (%)	Target Price	Call
			FY14	FY15	FY14	FY15	FY14	FY15				
Kossan	Dec	6.05	23	30	20	20	4	4	22	2	8.62	BUY
Hartalega	Mar	4.85	16	14	22	32	5	5	19	2	5.70	BUY
Top Glove	Aug	5.02	15	23	16	17	2	3	23	3	6.12	BUY
Supermax	Jun	2.58	17	15	10	22	1	2	11	3	2.94	HOLD
Average					17	23	3	4				

Source: Bloomberg, M&A Securities

Chart 1: Kossan's Sales by Sector & Geography



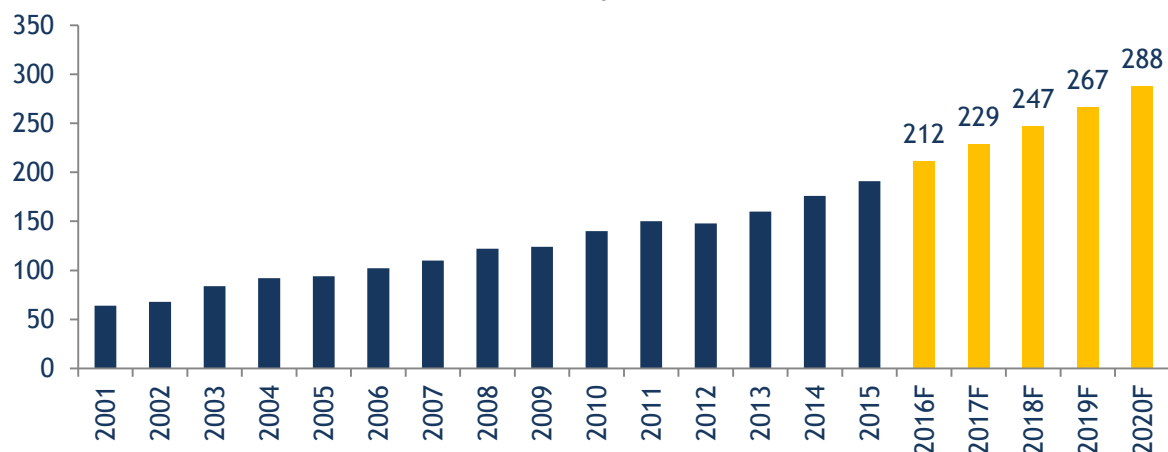
Source: Company, M&A Securities

Table 2: 5-Year Expansion plan

New lines	Added Capacity (billion pcs p.a)	Time Frame
8	2.7	2015-2017
12	4	2016-2018
24	8	2017-2018
24	8	2018-2020
68	22.7	
Existing capacity	22	2015
	44.7	By 2020

Source: Company, M&A Securities

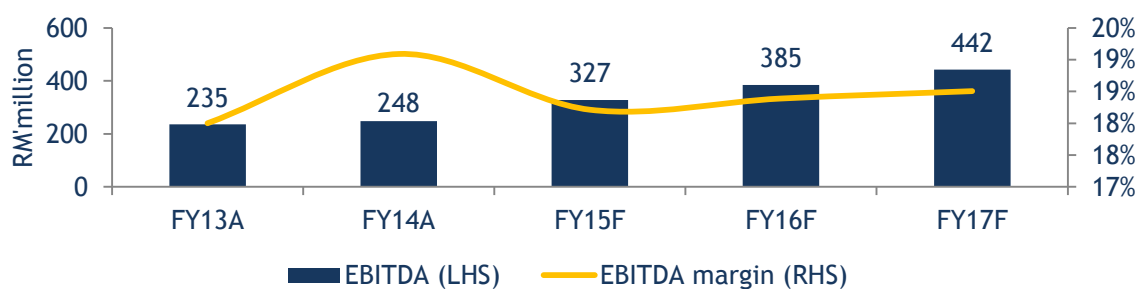
Chart 2: World Import of Rubber Gloves



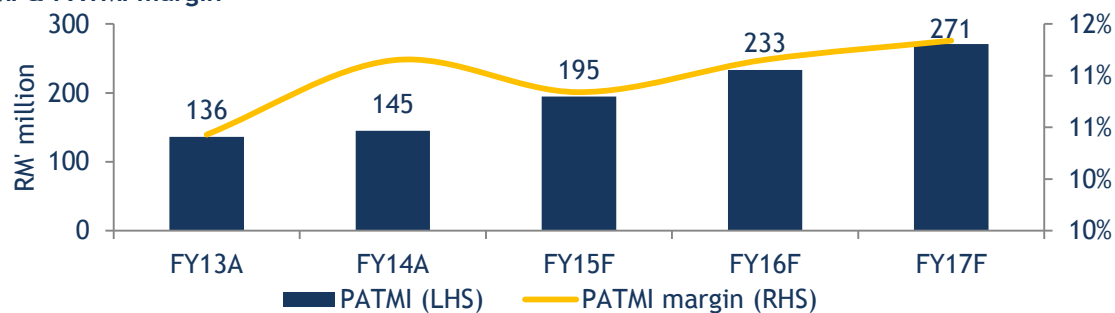
Source: MREPC, M&A Securities

Financial Exhibits

EBITDA & EBITDA margin



PATMI & PATMI margin



Reserves & ROE

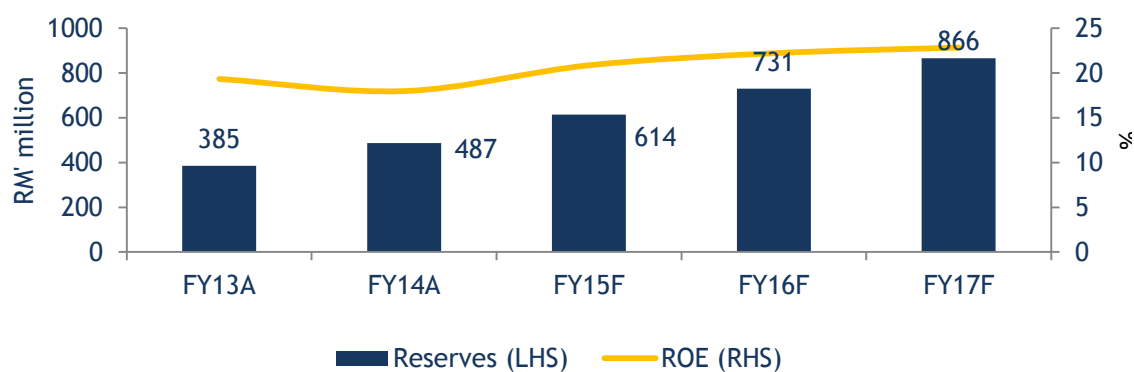
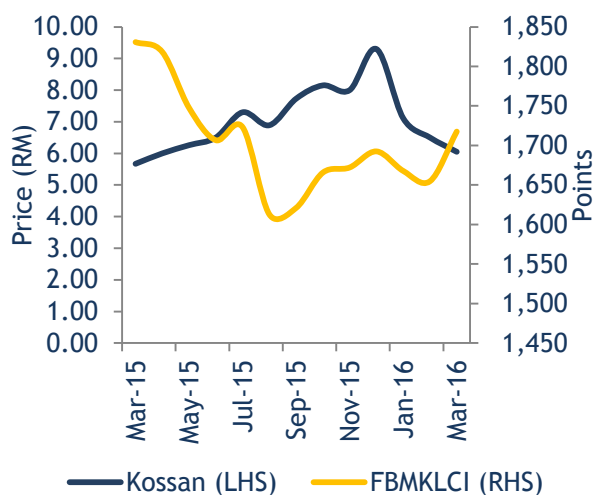
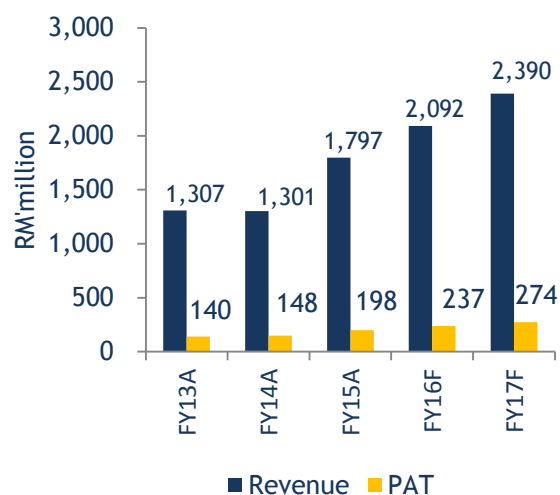


Chart 3: Financial Forecast

FYE DEC (RM million)	FY13A	FY14A	FY15F	FY16F	FY17F
Revenue	1,307	1,302	1,797	2,092	2,390
EBITDA	235	248	327	385	442
D&A	-51	-56	-66	-76	-86
EBIT	184	193	261	309	356
Net interest income	-4	-6	-6	-5	-5
PBT	180	187	256	303	351
Tax	-40	-38	-57	-66	-76
PAT	140	149	199	237	275
MI	-4	-4	-4	-4	-4
PATMI	136	145	195	233	271
EPS (sen)	21	23	30	36	42
EBITDA margin	18%	19%	18%	18%	19%
EBIT margin	14%	15%	15%	15%	15%
PBT margin	14%	14%	14%	15%	15%
Net profit margin	10%	11%	11%	11%	11%
PER (x)	21	20	15	12	11
P/BV (x)	4	4	3	3	2
Dividend (sen)	7	7	11	18	21
Dividend yield (%)	2	1	2	4	5

Source: M&A Securities

Kossan Share Price vs. KLCI
(March 2015 - March 2016)Revenue and Net Profit
(FY13 - FY17F)

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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