RESULTS – 1QFY10

For period Jan-Mar 2010

25 May 2010

Kossan Rubber Industries		***Price:***	*RM7.07*
		Market Capitalisation:	*RM1130.3m*
		Board:	*Main Board*
Stock Code/Name:	*7153 / KOSSAN*	***FBM Index:***	*EMAS Shariah/Small Cap*
Recommendation:	*BUY*	***Sector:***	*Industrial Products*

***Analyst**: Edmund Tham*

Key Stock Statistics	**2010E**
EPS (sen)	62.7
P/E (x)	11.5
Dividend/Share (sen)	12.0
NTA/Share (RM)	2.86
Book Value/Share (RM)	2.86
Issued Capital (mil shares)	159.9
52- weeks share price (RM)	3.46 – 8.32
Major Shareholders:	%
Kossan Holdings (M) SB	51.8
Kump. Wang Persaraan (KWAP)	7.4
Asian Small Co Portfolio	4.9
AIM Advisors Inc	4.4

Per Share Data	**2007**	**2008**	**2009**	**2010E**
Book Value (RM)	1.57	1.87	2.24	2.86
Earnings (sen)	34.5	37.1	41.8	62.7
Dividend (sen)	9.4	6.8	7.5	12.0
Payout Ratio (%)	20.2	13.8	13.5	14.4
PER (x)	21.0	19.5	17.3	11.5
P/Book Value (x)	4.6	3.9	3.2	2.5
Dividend Yield (%)	1.3	0.9	1.0	1.7
ROE (%)	21.9	19.8	18.7	21.9
Net Gearing (x)	0.63	0.64	0.45	0.38

P&L Analysis (RM mil)	**2007**	**2008**	**2009**	**2010E**
Year end: Dec 31				
Revenue	702.6	893.1	837.0	1035.4
Operating Profit	68.6	84.1	96.5	136.4
Depreciation	(20.7)	(25.9)	(34.0)	(40.0)
Interest Expenses	(10.2)	(11.0)	(9.1)	(8.7)
Pre-tax Profit	58.3	73.1	87.4	127.8
Effective Tax Rate (%)	5.5	18.9	23.0	21.0
Net Profit	55.1	59.3	66.8	100.2
Operating Margin (%)	9.8	9.4	11.5	13.2
Pre-tax Margin (%)	8.3	8.2	10.4	12.3
Net Margin (%)	7.8	6.6	8.0	9.7

**50 sen par value*

1Q/ 31 Mar	**1Q10**	**1Q09**	**yoy %**	**4Q09**	**qoq%**
Rev (RMm)	262.8	202.4	29.8	227.7	15.4
EBIT (RMm)	40.7	20.7	96.8	32.9	23.9
NPAT (RMm)	30.4	14.0	116.5	24.0	26.7
EPS (sen)	19.0	8.8	116.5	15.0	26.7

PERFORMANCE

Kossan's annualized 1Q/FY10 **revenue was within our earlier estimates** while its strong net profit after tax and minority interest (NPATMI) was about 19% above our earlier expectations.

"Strong Q1 performance"

Kossan recorded a strong 1Q/FY10 revenue of RM262.8 million, an increase of 29.8% y-o-y. The higher turnover was mainly due to the higher output of rubber gloves and also higher average selling prices (ASPs). The company's 1Q/FY10 net profit after tax (NPAT) of 30.4% was 116.5% higher y-o-y. The higher net profit after tax was mainly attributed to the better product mix, with higher volume of gloves and also better margins. Generally, nitrile gloves have higher margins.

"Better product mix & higher ASPs"

Looking q-o-q, Kossan recorded a 1Q/FY10 revenue of RM262.8 million, which was 15.4% higher versus the figure in the preceding 4Q/FY09. The increase in turnover is partly due to the higher average selling prices (ASPs) of its rubber gloves. The higher ASPs were expected, given the higher cost of raw materials, such as latex. Consequently, Kossan's net profit margins were also better in 1Q/FY10 (11.6%) versus 10.5% during the preceding 4Q/FY09.

OUTLOOK/ CORP. UPDATE

The outlook for the rubber glove industry remains positive for the year. Global demand and consumption has been steadily growing at a rate of 8-10% per year. For the year 2010, the global demand for gloves is expected to be approximately 150 billion pieces. Disease outbreaks such as H1N1 would spur further demand and consumption for gloves. Healthcare reform in countries such as the US, Brazil and China would also boost the future demand and consumption for rubber gloves for the medical sector.

"Steady global demand for gloves"

During the first quarter of 2010, rubber latex prices had surged strongly. Latex, the main raw material cost in the manufacturing of rubber gloves, constitutes some 50-60% of the company's costs. Fluctuation in latex costs can be inputted into the final selling price of rubber gloves. Nevertheless, it may face a 1-month time lag in price variation due to contractual and timing reasons. As such there are some risks on profit margins, especially from any strong and sudden surge in latex prices. In mid-April 2010, the latex price was around RM7.62 per kilo of Wet Bulk Latex.

"Risk factors - Forex and latex price volatility"

The appreciation of the Ringgit versus the USD has also affected the value of Kossan's USD-denominated sales receipts. The Ringgit had reached a lot of 3.67 against the USD early last year. Since then, the Ringgit had steadily appreciated, and is now hovering at the 3.2-3.3 range against the USD. If the Ringgit continues to appreciate the USD, there could be some risk of translation losses for Kossan, barring any hedging efforts.

Kossan's performance, barring any future undesired foreign exchange losses, looks promising indeed. Going forward, the group will focus more on the high margin products especially the nitrile segment. Kossan aims to grow its profitability faster rather than its capacity. Kossan's management has also give reassurance that all the affected foreign exchange contracts had been fully exhausted and a stringent check and balance system is now in place to monitor the entire financial process of the group.

Kossan's total quantity of glove sold for FY09 stood at 8.45 billion pieces (FY08: 8.48 billion pieces). Adjusted for changes in product-mix to nitrile gloves, Kossan's effective installed capacity for FY09 stood at 9.2 billion pieces. The group's overall utilization rate stood at 92%. Meanwhile, the group is in the midst of commissioning some 16 lines (Phase-1) that have been earmarked to produce nitrile gloves and these lines are expected to start contributing during 3Q/2010. The Phase-1 expansion will add some 1.6 to 1.8 billion pieces of glove to the existing total installed production capacity of 9.2 billion pieces.

"Bonus issue proposed"

In April 2010, Kossan had proposed a bonus issue and increase in share capital. The proposed 1-for-1 bonus issue involves 159,866,976 new shares of RM0.50 par value each. Meanwhile, the proposed increase in authorised share capital involves an increase from RM150 million comprising 300 million shares of RM0.50 each to RM1 billion comprising 2 billion shares of RM 0.50 each;

Kossan has recognized and acknowledged the importance of a corporate culture that emphasizes good **corporate social responsibility (CSR)** and corporate citizenship. The company has contributed and worked for the betterment of employee welfare (via training, health & safety), market place (via customer satisfaction surveys) and community (via donations to various schools and organizations).

VALUATION

In April 2010, Kossan had declared a final tax exempt dividend of 9 sen per share for its FY09 ended 31st December 2009. The net dividend of RM14.4 million subject to members' approval at the forthcoming AGM, will be paid on 19th July 2010.

"Strong FY10 outlook"

With a steady global demand for gloves, we are still very optimistic on Kossan's financial performance and future outlook. We have assumed better margins and minimal impact from foreign exchange losses during Kossan's FY10. We favour Kossan for its high production capacity utilisation rate, strong technical capabilities and its focus on the higher-margin nitrile and powder-free natural rubber (NR) glove segment.

Nevertheless, the rubber glove sector continues to face risk factors such as a possible sectorial supply-glut from over-capacity, foreign exchange translation losses, surge in latex prices and hikes in energy costs (oil, electricity and gas). Another risk the sector faces is that their stock price may surge faster than its hike in future earnings.

"Valuation still attractive"

While Kossan's adjusted beta (correlation factor) to the KLCI is 1.16, its stock price (+30.2% YTD) has strongly outperformed the KLCI this year (-1.9% YTD). Based on our forecast of Kossan's FY10 EPS and an estimated P/E of 15 times, we set a FY10-end **fair value of RM9.41**, 29.9% above its current market price. As such, we are maintaining our **Buy Call** on Kossan. Kossan's FY10 valuation is still attractive versus the domestic rubber glove sector's P/E of 15.6 times and P/BV 3.2 times.

Kossan: 6-month Share Price

Source: NextView