

**HLIB Research**

PP 9484/12/2012 (031413)

**Farah Diyana Kamaludin**
[FarahDiyana@hlib.hongleong.com.my](mailto:FarahDiyana@hlib.hongleong.com.my)

(603) 2083 1719

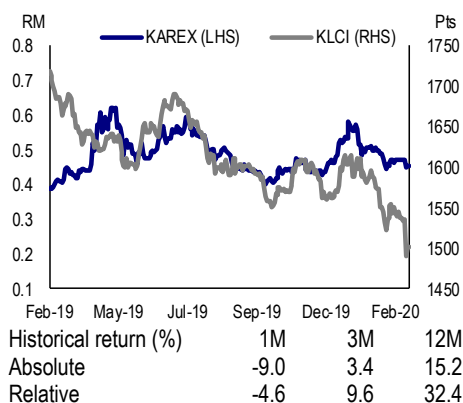
**SELL** (Maintain)

**Target Price:** **RM0.36**  
**Previously:** **RM0.36**  
**Current Price:** **RM0.455**

Capital upside -20.9%  
Dividend yield 0.2%  
Expected total return -20.7%

**Sector coverage:** Rubber products

**Company description:** Karex is the largest condom manufacturer by volume in the world.

**Share price**

**Stock information**

Bloomberg ticker KAREX MK  
Bursa code 5247  
Issued shares (m) 1,002  
Market capitalisation (RM m) 456  
3-mth average volume ('000) 3,028  
SC Shariah compliant No

**Major shareholders**

Karex One Ltd 18.4%  
Paribas Singapore Branch 18.4%  
Goh Yin 7.4%

**Earnings summary**

	FY19	FY20f	FY20f
FYE (June)	FY19	FY20f	FY20f
PATMI - core (RM m)	2.8	1.6	2.8
EPS - core (sen)	0.3	0.2	0.3
P/E (x)	160.2	287.8	161.6

# Karex

## Back in the black but challenges remain

Karex's 2QFY20 core PATMI of RM1.6m brought 1HFY20 core PATMI of RM0.7m came above expectations. The deviation was mainly due to higher than expected revenue contribution from recovery of condom sales. We adjust our earnings forecasts of FY20 to RM1.6m (from RM0.2m), FY21 to RM2.8m (from RM0.7m) and FY22 to RM7.0m (from RM6.4m) to reflect the improvement in margins following no more social compliance payments after 3QFY20. Maintain our SELL call with unchanged TP RM0.36. Our valuation is based on 0.75x FY21 BVPS of 49.2 sen (-1.25SD below its 2 year mean).

**Above expectations.** 2QFY20 core PATMI of RM1.6m (vs. -RM0.9m QoQ, -34.6% YoY) brought 1HFY20 core PATMI of RM0.7m (-85.3% YoY). Core PATMI was derived after adjusting for net EI of -RM0.7m on unrealised foreign exchange gain and provision on receivables. The results were above expectations due to improved sales for Sexual Wellness (+13.9% QoQ) and Medical (+20.2% QoQ) segments.

**Dividend.** Declared single interim dividend of 0.5 sen, going ex on 10<sup>th</sup> March 2020.

**QoQ.** Revenue improved to RM109.1m (from RM95.7m; +14.0% QoQ) thanks to higher contributions from Sexual Wellness (+13.9% QoQ) and Medical (+20.2% QoQ) segments. Lower latex prices during the quarter also aided in the improvement of gross profit (+17.3% QoQ). This then lead to Karex returning to black with core PATMI of RM1.6m (vs. -RM0.9m in 1QFY20).

**YoY.** Revenue fell by -3.9% due to lower contribution from the Sexual Wellness segment (-4.5% YoY) which was affected by reduced orders from the Tender and Commercial segments, however this was slightly cushioned by improvements in other segments (+12.2% YoY). Even though raw material cost eased, the ongoing social compliance costs continued to exert pressure on profitability, which resulted to a core PATMI of RM1.6m (-34.6% YoY).

**YTD.** Revenue of RM204.8m was flattish (-0.4% YoY) mainly supported by the Sexual Wellness segment. Profitability was held back by less favourable sales coupled with the ongoing social compliance payments. Hence, a core PATMI decline of RM0.7m (-85.3% YoY) from RM4.7m (1HFY19).

**Outlook.** The global condom industry is expected to remain challenging with shifting trends in condom purchasing patterns, uncertainty surrounding humanitarian aid budgets around the world, rising costs for raw material as well as social compliance. Karex will continue to leverage on cost advantages via the implementation of automation (currently c. 40%) and persisting with the investment into Own Brand segment. Furthermore we understand that 3QFY20 would be the final quarter that Karex would be making social compliance payment, hence beyond that, earnings should improve. Other than that, with the COVID-19, we feel Karex would benefit with the transition of orders from China to Malaysia's condom makers.

**Forecast.** We tweak our earnings forecast of FY20 to RM1.6m (from RM0.2m), FY21 to RM2.8m (from RM0.7m) and FY22 to RM7.0m (from RM6.4m) to reflect the improvement in margins following the completion of social compliance payment in 3QFY20.

**Maintain SELL, TP: RM0.36.** Although Karex showed a meagre improvement in this quarter, we remain cautious because their margins remains at historic lows, whilst near term prospects remain pressured by sticky ASP as well as expected social compliance costs in 3QFY20. We maintain our SELL call. Our TP is a function of 0.75x FY21 BVPS of 49.2 sen (-1.25SD below its 2 year mean).

## Financial Forecast

All items in (RM m) unless otherwise stated

### Balance Sheet

FYE June	FY18	FY19	FY20f	FY21f	FY22f
Cash	48.2	63.6	55.7	52.6	38.2
Receivables	98.2	83.0	116.0	106.7	111.7
Inventories	122.3	119.6	97.4	108.8	117.7
PPE	211.0	220.7	226.9	234.8	243.2
Others	104.8	108.1	108.1	108.1	108.1
<b>Assets</b>	<b>584.6</b>	<b>595.1</b>	<b>604.2</b>	<b>611.0</b>	<b>619.0</b>
Payables	62.7	60.3	69.1	73.9	76.2
Debt	27.8	33.7	33.7	33.7	33.7
Others	9.7	8.5	8.5	8.5	8.5
<b>Liabilities</b>	<b>100.2</b>	<b>102.5</b>	<b>111.3</b>	<b>116.1</b>	<b>118.4</b>
Shareholder's equity	483.3	491.0	491.4	493.4	499.0
Minority interest	1.0	1.6	1.6	1.6	1.6
<b>Equity</b>	<b>484.4</b>	<b>492.6</b>	<b>492.9</b>	<b>495.0</b>	<b>500.6</b>

### Cash Flow Statement

FYE June	FY18	FY19	FY20f	FY21f	FY22f
EBITDA	28.1	20.0	21.6	23.4	29.8
Working capital	(22.3)	15.5	(2.1)	2.7	(11.6)
Taxation	(5.7)	(3.7)	(0.7)	(1.2)	(2.7)
Others	3.5	2.3	-	-	-
<b>CFO</b>	<b>3.6</b>	<b>34.1</b>	<b>18.8</b>	<b>25.0</b>	<b>15.5</b>
Capex	(28.4)	(20.9)	(24.2)	(26.0)	(27.2)
Others	(6.0)	2.6	0.6	0.6	0.5
<b>CFI</b>	<b>(34.4)</b>	<b>(18.3)</b>	<b>(23.6)</b>	<b>(25.4)</b>	<b>(26.7)</b>
Changes in debt	3.4	5.2	-	-	-
Dividends	(10.0)	(5.0)	(1.3)	(0.8)	(1.4)
Others	(0.4)	(0.3)	(1.9)	(1.9)	(1.9)
<b>CFF</b>	<b>(6.9)</b>	<b>(0.1)</b>	<b>(3.1)</b>	<b>(2.6)</b>	<b>(3.3)</b>
<b>Net cash flow</b>	<b>(37.8)</b>	<b>15.7</b>	<b>(7.9)</b>	<b>(3.1)</b>	<b>(14.4)</b>
Forex					
Others					
Beginning cash	85.1	48.2	63.6	55.7	52.6
Ending cash	48.2	63.6	55.7	52.6	38.2

### Income Statement

FYE June	FY18	FY19	FY20f	FY21f	FY22f
Revenue	408.0	379.9	403.4	432.8	453.1
EBITDA	28.1	20.0	21.6	23.4	29.8
EBIT	14.0	4.2	4.1	5.8	11.5
Net Finance cost	0.2	(0.4)	(1.2)	(1.3)	(1.3)
Profit before tax	14.3	3.8	2.8	4.5	10.2
Tax	(4.1)	(0.7)	(0.7)	(1.2)	(2.7)
Net profit	10.2	3.1	2.1	3.3	7.6
Minority interest	(0.1)	(0.5)	(0.5)	(0.5)	(0.5)
<b>Core PATMI</b>	<b>4.1</b>	<b>2.8</b>	<b>1.6</b>	<b>2.8</b>	<b>7.0</b>
Exceptionals	(6.0)	(0.3)	-	-	-
Reported PATMI	10.1	2.5	1.6	2.8	7.0

### Valuation & Ratios

FYE June	FY18	FY19	FY20f	FY21f	FY22f
Core EPS (sen)	0.4	0.3	0.2	0.3	0.7
P/E (x)	111.4	160.2	287.8	161.6	64.8
EV/EBITDA (x)	15.5	21.3	19.8	18.7	15.2
DPS (sen)	0.5	0.1	0.1	0.1	0.4
Dividend yield	1.1	0.3	0.2	0.3	0.8
BVPS (RM)	48.2	49.0	49.0	49.2	49.8
P/B (x)	0.9	0.9	0.9	0.9	0.9
EBITDA margin	6.9	5.3	5.3	5.4	6.6
EBIT margin	3.4	1.1	1.0	1.3	2.5
PBT margin	3.5	1.0	0.7	1.0	2.3
Net margin	2.5	0.8	0.5	0.8	1.7
ROE	0.8	0.6	0.3	0.6	1.4
ROA	1.7	0.4	0.3	0.5	1.1
Net gearing	N Cash	N Cash	N Cash	N Cash	N Cash

### Assumptions

FYE June	FY20f	FY21f	FY22f
Capacity (Bn pieces)	6.5	6.5	6.5
USDMYR	4.2	4.2	4.2

**Figure #1**      **Quarterly results comparison**

FYE June (RM m)	2QFY19	1QFY20	2QFY20	QoQ (%)	YoY (%)	1H19	1H20	YoY (%)
Revenue	113.6	95.7	109.1	14.0	-3.9	205.7	204.8	-0.4
EBITDA	9.7	4.7	10.6	>100	7.4	12.1	10.8	-10.6
EBIT	2.0	0.4	1.6	>100	-17.2	4.4	2.0	-53.4
PBT	1.9	0.3	1.1	>100	-41.6	4.3	1.4	-68.2
PAT	1.5	0.2	0.9	>100	-39.4	3.2	1.0	-67.7
Reported PATMI	1.8	-0.2	0.1	NM	-94.4	3.4	-0.1	-101.9
Core PATMI	2.4	-0.9	1.6	NM	-34.6	4.7	0.7	-85.3
Core EPS (sen)	0.2	-0.1	0.0	NM	-34.4	0.5	0.1	-85.3
EBITDA margin (%)	8.6	5.0	9.8			5.9	5.3	
EBIT margin (%)	1.8	0.4	1.5			2.1	1.0	
PATMI margin (%)	2.1	-1.0	1.5			2.3	0.3	

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**Hong Leong Investment Bank Berhad (10209-W)**

Level 28, Menara Hong Leong,

No. 6, Jalan Damanlela,

Bukit Damansara,

50490 Kuala Lumpur

Tel: (603) 2083 1800

Fax: (603) 2083 1766

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<b>BUY</b>	Expected absolute return of +10% or more over the next 12-months.
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<b>SELL</b>	Expected absolute return of -10% or less over the next 12-months.
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