

HLIB Research

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HOLD (Maintain)

Target Price: **RM0.59**
Previously: **RM0.59**
Current Price: **RM0.605**

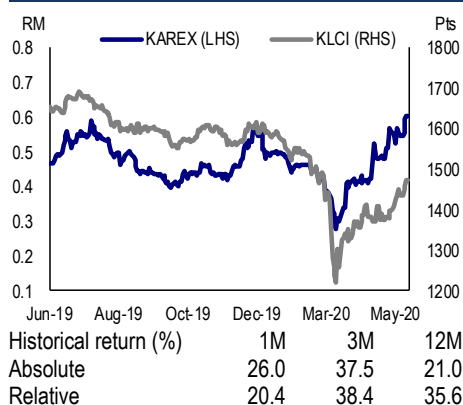
Capital upside -2.2%

Dividend yield 0.2%

Expected total return -2.0%

Sector coverage: Rubber products

Company description: Karex is the largest condom producer 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)	606
3-mth average volume ('000)	9,985
SC Shariah compliant	No

Major shareholders

Karex One Ltd	18.4%
Paribas Singapore Branch	18.4%
Goh Yin	7.6%

Earnings summary

FYE (June)	FY19	FY20f	FY21f
PATMI - core (RM m)	2.8	1.0	3.4
EPS - core (sen)	0.3	0.1	0.3
P/E (x)	213.1	636.4	180.6

Karex

Disappointment from MCO effect

Karex's 3QFY20 core loss of -RM4.3m brought 9MFY20 core loss of -RM3.6m. The results came in below ours and consensus expectations. Revenue continues to improve on the back of the completion of final social audits whereby customers are allowed to place orders to replenish the previously depleted stocks. However, hiccup faced in this quarter was due to the limited operating capacity that Karex faced during the MCO period, which hurt both production volume and export capabilities. We cut our FY20-22 earnings by -48%/-11%/-9% to reflect higher depreciation charges due to the incorporation of more automation in recent quarters and interest expense. We maintain our HOLD call with unchanged TP of RM0.59. Our valuation is based on 1.2x FY21 BVPS of 49.2 sen (-1SD below its 5 year mean).

Below expectations. 3QFY20 core loss of -RM4.3m (vs. RM1.6m QoQ, RM0.5m YoY) brought 9MFY20 core loss of -RM3.6m (vs. RM3.7m YoY). Core loss was derived after adjusting for net EIs of RM2.4m on unrealised foreign exchange gain (-RM2.3m) and provision on receivables (RM4.7m). We deem the results below expectations vs ours and consensus full year profit forecast of RM1.8-2m. The deviation was due to higher than expected depreciation charges due to increased automation in recent quarters (+14% YoY) and interest expense (+48% YoY).

Dividend. No dividend was declared.

QoQ. Revenue fell slightly to RM99.2m (from RM109.1m; -9.1% QoQ) due to lower contributions from Sexual Wellness (-10.1% QoQ) and Medical (-10.4% QoQ) segments. Gross profit mirrored the revenue reduction of -9.6%. From a barely breakeven base, PBT reduced to RM0.03m (-97.1% QoQ) due to fall in other income (-84.8% QoQ) which includes complimentary goods for sexual health products (i.e. toys, feminine hygiene wash); however this was slightly cushioned by the decrease in other expenses (-57.8% QoQ) and interest expense (-9.9% QoQ). Higher tax expense (+92.5% QoQ) has led to core loss of -RM4.3m (vs. RM1.6 in 2QFY20). The disappointment in the quarter was namely due to the limited operating capacity during the MCO period, which hurt both production volume and export capabilities. Karex was not allowed to operate for 10 days, before being allowed to operate at 50% capacity for the rest of the MCO period. Come CMCO, Karex was able to operate at full capacity.

YoY. Revenue improved (+16.5% YoY) mainly thanks to better contribution from the Sexual Wellness (+15.9% YoY) and Medical (+14.3% YoY) segments. This was partly credited to the completion of the final social audits, which allowed customers to place orders to replenish previously depleted stocks. PBT barely broke even at RM0.03m (vs. -RM0.5m 3QFY19) aided by the reduction in other expenses (-95.4% YoY). Higher tax expense (+>100% YoY) led to core loss of -RM4.3m (vs. RM0.5m 3QFY19).

YTD. Revenue of RM304.0m saw improvement (+4.5% YoY) mainly supported by the Sexual Wellness segment (+4.5% YoY) and Others segment (+27.8% YoY), while Medical segment remained flattish (+0.1% YoY). PBT declined (-63.0% YoY) due to higher interest expense (+54.9% YoY) despite lower other expenses (-89.0% YoY). Hence, Karex recorded a core loss of -RM3.6m (vs RM3.7m in 3QFY19) with a higher tax expense (+>100% YoY).

Outlook. Due to the Covid-19 outbreak, we understand that there is a global shortage of condoms, due to the lockdowns globally which have disrupted production and somewhat increased demand. With Karex being the largest condom maker globally, we feel it may benefit via higher ASPs which will be reflected in the next quarter

onwards. During the MCO, Karex had to halt production for 10 days which impacted production (as seen in this quarter). Following that Karex was allowed to operate a 50% capacity for the rest of MCO, and come CMCO, at full capacity. Since the outbreak of Covid-19, Karex's ASP has been on an upward trend, possibly due to other smaller domestic manufacturers that were not able to operate during MCO and/or faced hiccups in obtaining raw materials. We feel the improving ASPs will aid Karex in the coming quarters and will be felt in a more profound manner in FY21.

Forecast. We reduce our FY20-22 earnings by -48%/-11%/-9% to reflect higher depreciation charges and interest expense.

Maintain HOLD, TP: RM0.59. We maintain our HOLD call with unchanged TP of RM0.59. To recap we changed our valuations on all rubber companies under our coverage in our Rubber Sector report (19 May); Karex's PB multiple was raised to 1.2x (-1SD below 5-year mean) from 0.75x with the promising outlook in rubber products segments. Thus, our TP increase to RM0.59 (from RM0.36) and upgraded our call to HOLD (from Sell). Our TP is a function of 1.2x FY21 BVPS of 49.2 sen (-1SD below 5-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	49.8	49.9	37.0
Receivables	98.2	83.0	119.9	108.8	112.7
Inventories	122.3	119.6	100.7	110.8	118.8
PPE	211.0	220.7	227.4	234.9	242.8
Others	104.8	108.1	108.1	108.1	108.1
Assets	584.6	595.1	605.9	612.6	619.4
Payables	62.7	60.3	71.4	75.2	76.9
Debt	27.8	33.7	33.7	33.7	33.7
Others	9.7	8.5	8.5	8.5	8.5
Liabilities	100.2	102.5	113.6	117.4	119.1
Shareholder's equity	483.3	491.0	490.7	493.6	498.7
Minority interest	1.0	1.6	1.6	1.6	1.6
Equity	484.4	492.6	492.3	495.2	500.3

FYE June	FY18	FY19	FY20f	FY21f	FY22f
EBITDA	28.1	20.0	21.6	25.8	31.3
Working capital	(22.3)	15.5	(6.9)	4.8	(10.2)
Taxation	(5.7)	(3.7)	(0.6)	(1.7)	(3.1)
Others	3.5	2.3	-	-	-
CFO	3.6	34.1	14.1	28.9	17.9
Capex	(28.4)	(20.9)	(25.0)	(26.5)	(27.4)
Others	(6.0)	2.6	0.6	0.5	0.5
CFI	(34.4)	(18.3)	(24.4)	(26.0)	(26.9)
Changes in debt	3.4	5.2	-	-	-
Dividends	(10.0)	(5.0)	(1.3)	(0.5)	(1.7)
Others	(0.4)	(0.3)	(2.3)	(2.3)	(2.3)
CFF	(6.9)	(0.1)	(3.6)	(2.8)	(4.0)
Net cash flow	(37.8)	15.7	(13.9)	0.2	(13.0)
Forex					
Others					
Beginning cash	85.1	48.2	63.6	49.8	49.9
Ending cash	48.2	63.6	49.8	49.9	37.0

Income Statement

FYE June	FY18	FY19	FY20f	FY21f	FY22f
Revenue	408.0	379.9	416.8	441.3	457.2
EBITDA	28.1	20.0	21.6	25.8	31.3
EBIT	14.0	4.2	3.8	7.3	12.2
Net Finance cost	0.2	(0.4)	(1.7)	(1.8)	(1.8)
Profit before tax	14.3	3.8	2.1	5.5	10.4
Tax	(4.1)	(0.7)	(0.6)	(1.7)	(3.1)
Net profit	10.2	3.1	1.5	3.9	7.3
Minority interest	(0.1)	(0.5)	(0.5)	(0.5)	(0.5)
Core PATMI	4.1	2.8	1.0	3.4	6.8
Exceptionals	(6.0)	(0.3)	-	-	-
Reported PATMI	10.1	2.5	1.0	3.4	6.8

Valuation & Ratios

FYE June	FY18	FY19	FY20f	FY21f	FY22f
Core EPS (sen)	0.4	0.3	0.1	0.3	0.7
P/E (x)	148.1	213.1	636.4	180.6	89.4
EV/EBITDA (x)	20.9	28.8	26.7	22.9	19.3
DPS (sen)	0.5	0.1	0.0	0.2	0.3
Dividend yield	0.8	0.2	0.1	0.3	0.6
BVPS (RM)	48.2	49.0	49.0	49.2	49.8
P/B (x)	1.3	1.2	1.2	1.2	1.2
EBITDA margin	6.9	5.3	5.2	5.8	6.8
EBIT margin	3.4	1.1	0.9	1.7	2.7
PBT margin	3.5	1.0	0.5	1.3	2.3
Net margin	2.5	0.8	0.4	0.9	1.6
ROE	0.8	0.6	0.2	0.7	1.4
ROA	1.7	0.4	0.2	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)	3QFY19	2QFY20	3QFY20	QoQ (%)	YoY (%)	9MFY19	9MFY20	YoY (%)
Revenue	85.1	109.1	99.2	-9.1	16.5	290.8	304.0	4.5
EBITDA	11.1	10.4	13.6	29.9	22.4	15.5	15.6	0.9
EBIT	-0.3	1.6	0.6	-63.3	NM	4.1	2.6	-35.3
PBT	-0.5	1.1	0.0	-97.1	NM	3.7	1.4	-63.0
PAT	0.3	0.9	-0.4	NM	NM	3.5	0.7	-80.2
Reported PATMI	0.2	0.1	-1.1	NM	NM	3.5	-1.2	NM
Core PATMI	0.5	1.6	-4.3	NM	NM	3.7	-3.6	NM
Core EPS (sen)	0.1	0.2	-0.4	NM	NM	0.4	-0.4	NM
EBITDA margin (%)	13.0	9.6	13.7			5.3	5.1	
EBIT margin (%)	-0.3	1.5	0.6			1.4	0.9	
PATMI margin (%)	0.6	1.5	-4.3			1.3	-1.2	

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HOLD	Expected absolute return of -10% to +15% over the next 12-months.
SELL	Expected absolute return of -10% or less over the next 12-months.
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