Securities

AFFIN HWANG CAPITAL

Out think. Out perform.

Break-even now, but when will it be profitable?

Despite turning profitable in 2QFY20, we believe overall results for 6MFY20 still disappointed, as 6MFY20 core loss of RM0.1m was significantly below consensus and our estimates. Consensus and Affin were forecasting PATAMI of RM2.3m and RM3.3m, respectively for FY20E. Although pricing in the tender market has started to improve, it is still not enough to compensate for higher labour costs. As such, we are cutting our EPS forecast for FY20-22E by 7.1-50.6% but maintain our DCF-based TP of RM0.25 unchanged. Reiterate SELL. Karex declared a 0.5 sen interim DPS, which was a positive surprise to us.

Potential beneficiary of Covid-19

Competition in the tender market has been challenging over the past 2-3 years, due to competition from China manufacturers as they started participating in international contracts after the local government stopped procuring condoms. Management believes that competition has started to ease, as GP margin for tender orders improved (but still below historical average) in recent months. The recent supply disruption in China due to Covid-19 has also resulted in default of several tender orders by the China manufacturers. We believe the current situation could help to expedite the consolidation among the players, which can help to stabilise selling prices.

Guiding for a better GP margin

Management is guiding future GP margin to be at 25-26%, which is an improvement from the current 21.6% in 2QFY20. We believe the target is achievable only in FY21E, despite the recovery in tender selling price, as Karex is still burdened by the social compliance costs of around RM0.5m/quarter, which will only end in 3QFY20. Once the compensation is fully paid out, we expect a meaningful margin recovery in the following quarters. Karex has also launched its OBM (ONE) into new markets (Thailand, Vietnam and Singapore) recently, which is contributing positively to its margin.

Maintain SELL with an unchanged TP of RM0.25

Although we expect an improving operating outlook, we are cutting our EPS forecast for FY20-22E by 7.1% to 50.6% to factor in our new margin assumptions. However, we keep our DCF-based TP unchanged at RM0.25 and reiterate our SELL call. Upside risks: better-than-expected recovery in tender orders; cost-effective distribution and marketing.

Earnings & Valuation Summary

FYE 30 June	2018	2019	2020E	2021E	2022E
Revenue (RMm)	408.0	379.9	411.2	441.2	479.4
EBITDA (RMm)	28.1	20.0	16.4	28.6	48.7
Pretax profit (RMm)	14.3	3.8	2.3	13.5	32.0
Net profit (RMm)	10.1	2.5	1.6	10.6	25.4
EPS (sen)	1.0	0.3	0.2	1.1	2.5
PER (x)	44.6	178.1	280.6	42.5	17.8
Core net profit (RMm)	10.1	2.5	1.6	10.6	25.4
Core EPS (sen)	1.0	0.3	0.2	1.1	2.5
Core EPS growth (%)	(63.8)	(74.9)	(36.5)	560.4	139.1
Core PER (x)	44.6	178.1	280.6	42.5	17.8
Net DPS (sen)	1.0	-	0.5	0.5	0.5
Dividend Yield (%)	2.2	-	1.1	1.1	1.1
EV/EBITDA (x)	15.3	21.0	24.5	15.1	9.2
Chg in EPS (%)			-50.6	-14.3	-7.1
Affin/Consensus (x)			0.7	1.1	3.3

Source: Company, Bloomberg, Affin Hwang forecasts

Results Note

Karex

Karex MK
Sector: Rubber Products

RM0.455 @ 25 February 2020

SELL (maintain)

Downside: 45%

Price Target: RM0.25

Previous Target: RM0.25

Price Performance

	1M	3M	12M
Absolute	-9.0%	2.2%	5.8%
Rel to KLCI	-4.6%	8.4%	21.6%

Stock Data

Issued shares (m)	1,002.4
Mkt cap	456.1/107.7
Avg daily vol - 6mth (m)	2.7
52-wk range (RM)	0.39-0.67
Est free float	22.1%
BV per share (RM)	0.49
P/BV (x)	0.93
Net cash/ (debt) (RMm)	9.19
ROE (2020E)	0.3%
Derivatives	No
Shariah Compliant	No

Key Shareholders

KAREX ONE LTD	18.4%
GOH YIN	7.4%
GOH YEN YEN	7.2%

Source: Affin Hwang, Bloomberg

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Fig 1: Results Comparison

FYE June (RMm)	2Q FY19	1Q FY20	2Q FY20	QoQ % chg	YoY % chg	6M FY19	6M FY20	YoY % chg	Comments
Revenue	113.6	95.7	109.1	14.0	(3.9)	205.7	204.8	(0.4)	
Op costs	(107.6)	(90.1)	(103.0)	14.4	(4.3)	(193.6)	(193.1)	(0.3)	
EBITDA	**5.9**	**5.7**	**6.1**	7.7	3.2	**12.1**	**11.8**	(3.0)	Decline in profit due to higher costs from social compliance cost
EBITDA margin (%)	*5.2*	*5.9*	*5.6*	*-0.3ppts*	*+0.4ppts*	*5.9*	*5.7*	*-0.2ppts*	Overall margin still holding up due to increase in contribution from the OBM segment
Depn and amort	(3.9)	(5.3)	(4.5)	(15.5)	13.6	(7.7)	(9.7)	25.6	Increase in 1H20 was due to higher investment in automation
EBIT	**2.0**	**0.4**	1.6	314.9	(17.2)	**4.4**	**2.0**	(53.4)	
EBIT margin (%)	*1.8*	*0.4*	*1.5*	*+1.1 ppts*	*-0.2 ppts*	*2.1*	*1.0*	*-1.1 ppts*	Flow through from EBITDA
Int expense	(0.4)	(0.4)	(0.7)	106.5	89.4	(0.7)	(1.1)	58.9	
Int and other income	0.3	0.2	0.2	(19.4)	(34.5)	0.6	0.4	(29.0)	Due to declining net cash balances
EI	-	-	-			-	-		
Pretax profit	**1.9**	**0.3**	**1.1**	318.8	(41.6)	**4.3**	**1.4**	(68.2)	
Tax	(0.4)	(0.1)	(0.2)	89.6	(49.4)	(1.0)	(0.3)	(69.7)	
Tax rate (%)	*21.2*	*40.6*	*18.4*	*-22.2 ppts*	*-2.8 ppts*	*23.8*	*22.7*	*-1.1 ppts*	
MI	(0.1)	(0.3)	(0.8)	145.3	926.0	0.1	(1.1)	n.m	
Net profit	**1.4**	**(0.2)**	**0.1**	n.m	(92.7)	**3.4**	**(0.1)**	n.m	
EPS (sen)	0.1	(0.0)	0.0	n.m	(92.7)	0.3	(0.0)	n.m	
Core net profit	**1.4**	**(0.2)**	**0.1**	n.m	(92.7)	**3.4**	**(0.1)**	n.m	Results missed our and consensus expectations

Source: Affin Hwang, Company

Important Disclosures and Disclaimer

Equity Rating Structure and Definitions

BUY	Total return is expected to exceed +10% over a 12-month period
HOLD	Total return is expected to be between -5% and +10% over a 12-month period
SELL	Total return is expected to be below -5% over a 12-month period
NOT RATED	Affin Hwang Investment Bank Berhad does not provide research coverage or rating for this company. Report is intended as information only and not as a recommendation

The total expected return is defined as the percentage upside/downside to our target price plus the net dividend yield over the next 12 months.

OVERWEIGHT	Industry, as defined by the analyst's coverage universe, is expected to outperform the KLCI benchmark over the next 12 months
NEUTRAL	Industry, as defined by the analyst's coverage universe, is expected to perform inline with the KLCI benchmark over the next 12 months
UNDERWEIGHT	Industry, as defined by the analyst's coverage universe is expected to under-perform the KLCI benchmark over the next 12 months

This report is printed and published by:
Affin Hwang Investment Bank Berhad (14389-U)
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