Karex (KAREX MK)

HOLD (upgrade)
Up/Downside: +2.7%

Price Target: RM0.90
Previous Target (Rating): RM0.50 (SELL)

Good news already factored in

- **Karex reported a strong set of results, as 1QFY21 PATAMI of RM4.5m (+212% qoq) is above both our and consensus estimates, at 38% and 43% of the respective forecasts**
- **The better performance was due to improved efficiency from a higher degree of automation and higher contribution from better-margin commercial sales**
- **We raise our earnings forecasts for FY21-23E by 21%-41% to factor in the new development, raise our P/BV-based 12-month TP to RM0.90, and upgrade our call to HOLD from SELL**

"Higher demand from the commercial segment was a positive surprise to us"

Stronger commercial sales compensated for the decline in the tender market

We were expecting sales for the tender market to stabilise; however, as some ports in the African continent remain shut due to the current COVID-19 outbreak, sales for the tender market have contracted by 8.6% qoq in 1QFY21. Despite the decline in tender market sales, the 35% qoq increase in commercial sales was a positive surprise to us. Management guided that the improvement could have been led by both fulfilment of backlog orders and also higher demand from its clients. The commercial sales mainly focus on providing pharmacies, convenience stores and CVS with their home brands, and are higher margin compared to the sales for the tender market.

Higher degree of automation drives margin higher

Apart from the favourable sales mix, Karex is starting to see benefits from a higher degree of automation installed at its production line over the past months. While Karex's production processes are not fully automated yet, we believe that the packaging process is unlikely to be fully automated and will be the bottleneck for Karex. However, we believe it would be challenging for Karex to maintain the current EBITDA margin at 11.6%, as some of the sales in 1QFY21 were due to fulfilment of backlog orders. The higher commercial sales could also be due to retailers anticipating higher demand from lockdowns across the globe.

Upgrade to HOLD with a higher TP of RM0.90

We raise our EPS forecasts for FY21-23E by 21%-41% to factor in the improvement in efficiency and higher demand from the commercial segment. We raise our TP to RM0.90 from RM0.50, based on 2.0x our FY21 BVPS estimate (from 1.0x previously). We also upgrade our call to HOLD from SELL, as we believe that the current share price already fully reflects the latest development (the venture into glove manufacturing). Risks to our call include: i) better-than-expected margin, and ii) higher-than-expected decline in tender orders.

Earnings & Valuation Summary

FYE 30 June	2019	2020	2021E	2022E	2023E
Revenue (RMm)	379.9	395.1	433.6	457.3	482.2
EBITDA (RMm)	20.0	24.2	36.2	45.4	55.0
Pretax profit (RMm)	3.8	5.6	20.9	30.1	39.9
Net profit (RMm)	2.5	0.2	16.5	23.9	31.7
EPS (sen)	0.3	0.0	1.6	2.4	3.2
PER (x)	346.3	3,846.8	53.0	36.8	27.6
Core net profit (RMm)	2.5	0.2	16.5	23.9	31.7
Core EPS (sen)	0.3	0.0	1.6	2.4	3.2
Core EPS growth (%)	(74.9)	(91.0)	7,152.7	44.3	33.0
Core PER (x)	346.3	3,846.8	53.0	36.8	27.6
Net DPS (sen)	1.0	0.5	0.5	0.5	0.8
Dividend Yield (%)	1.1	0.6	0.6	0.6	0.9
EV/EBITDA	42.3	36.4	22.7	17.9	14.6
Chg in EPS (%)			40.5	27.1	20.9
Affin/Consensus (x)			1.6	1.5	0.9

Source: Company, Affin Hwang estimates

Share price performance

	1M	3M	12M
Absolute (%)	10.8	-19.7	94.4
Rel KLCI (%)	3.6	-20.7	94.4

	BUY	HOLD	SELL
Consensus	2	-	4

Source: Bloomberg

Stock Data

Sector	Rubber Product
Issued shares (m)	1,002.4
Mkt cap (RMm)/(US$m)	877.1/214.4
Avg daily vol - 6mth (m)	14.2
52-wk range (RM)	0.26-1.23
Est free float	38.7%
Stock Beta	1.16
Net cash/(debt) (RMm)	(8.81)
ROE (FY21E)	3.3%
Derivatives	No
Shariah Compliant	No

Key Shareholders

Karex One LTD	18.4%
Goh Yin	7.8%
Goh Yen Yen	7.2%

Source: Affin Hwang, Bloomberg

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Fig 1: Results Comparison

FYE 30 Jun (RMm)	1QFY20	4QFY20	1QFY21	QoQ % chg	YoY % chg	Comments
Revenue	95.7	91.1	101.7	11.7	6.3	The increase in sales qoq is mainly driven by higher contribution from the commercial segment
Op costs	(90.1)	(82.5)	(89.9)	8.9	(0.2)	
EBITDA	**5.7**	**8.6**	**11.8**	**38.1**	**109.2**	Favourable sales mix and also higher operating efficiency from higher degree of automation
EBITDA margin (%)	*5.9*	*9.4*	*11.6*	*+2.2 ppts*	*+5.7 ppts*	
Depn and amort	(5.3)	(3.8)	(4.5)	18.5	(15.3)	
EBIT	**0.4**	**4.8**	**7.4**	**53.4**	**>100**	
EBIT margin (%)	*0.4*	*5.3*	*7.3*	*2.0*	*6.8*	Flow through from EBITDA
Int expense	(0.4)	(0.6)	(0.4)	(30.2)	17.8	
Int and other income	0.2	0.0	0.0	(2.5)	(82.0)	
EI	-	-	-			
Pretax profit	**0.3**	**4.3**	**7.0**	**64.6**	**>100**	
Tax	(0.1)	(1.6)	(1.8)	10.3	>100	
Tax rate (%)	*40.6*	*38.4*	*25.7*	*-12.7 ppts*	*-14.9 ppts*	
MI	(0.3)	(1.2)	(0.8)	(37.4)	132.9	
Net profit	**(0.2)**	**1.4**	**4.5**	**212.4**	**na**	
EPS (sen)	(0.0)	0.1	0.4	212.4	na	
Core net profit	**(0.2)**	**1.4**	**4.5**	**212.4**	**na**	Above our and consensus estimates

Source: Company, Affin Hwang

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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