

Company Note

Malaysia

HOLD (no change)

Consensus ratings*: Buy 1 Hold 5 Sell 3

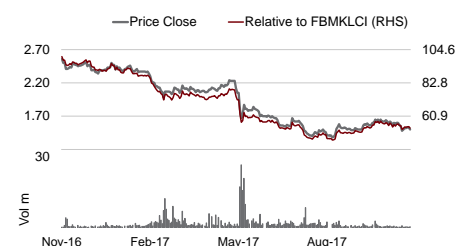
Current price:	RM1.50
Target price:	RM1.44
Previous target:	RM1.40
Up/downside:	-3.9%
CIMB / Consensus:	-0.9%

Reuters:	KARE.KL
Bloomberg:	KAREX MK
Market cap:	US\$366.1m
	RM1,504m
Average daily turnover:	US\$0.22m
	RM0.93m
Current shares o/s:	1,002m
Free float:	61.8%

*Source: Bloomberg

Key changes in this note

- FY18-20F EPS is lowered by 13.6-35.7%.



Source: Bloomberg

Price performance	1M	3M	12M
Absolute (%)	-6.8	1.4	-41.9
Relative (%)	-5.7	4.7	-47.6

Major shareholders	% held
Karex One Limited	31.8
Lam Yiu Pang Albert	6.4

Analyst(s)



Walter AW

T (60) 3 2261 9093

E walter.aw@cimb.com

Karex Berhad

1QFY18: A slower-than-expected recovery

- 1QFY6/18 core net profit of RM4.2m was well below expectations at 9.4% of our and 8.7% of Bloomberg consensus' FY18F estimates.
- Despite a higher 1QFY18 revenue (34.4% yoy), net profit was weaker than expected due to: i) weaker ASPs, ii) higher operating costs, and iii) increase in production costs.
- In light of the easing of pricing competition, the group has raised the prices of its condoms which will be reflected at the beginning of 3QFY18 (early CY18).
- Our FY18-20F EPS are cut by 13.6-35.7%. Nevertheless, we expect Karex to record stronger quarters ahead from higher ASPs and better cost control.
- Maintain Hold with a higher TP of RM1.44 as we roll over to end-2018.

1QFY18 net profit below expectations

1QFY6/18 revenue rose 34.4% yoy, mainly due to higher sales volume, especially in the tender segment. Despite stronger revenue, 1QFY18 net profit declined to RM4.2m (-49% yoy) while EBITDA margins fell 7.1% pts yoy to 7.9%. This was due to: i) stiff pricing competition leading to weak selling prices (ASPs), ii) higher overall operating costs, especially distribution charges, and iii) rising production costs. Overall, 1QFY18 net profit was well below expectations at 9.4% of our and 8.7% of consensus' FY18F estimates.

Weaker-than-expected recovery in 1QFY18 ASPs

In 1QFY18, we expected a stronger recovery in the selling prices of tender volumes which did not materialize due to large tender orders which were locked in earlier at lower margins during 2HFY17 when pricing competition was stiff. We understand that the bulk of these orders was delivered in 1QFY18, with delivery of the remainder expected by end-2QFY18. Also, distribution prices were higher, especially freight costs, while prices of key production components such as packaging and chemicals also rose significantly.

Higher ASPs to be reflected at the beginning of 3QFY18

Karex highlighted that it raised prices in 1QFY18 to account for the higher production costs as the competitive environment has eased slightly. However, this would only be reflected at the beginning of 3QFY18 as Karex begins to deliver these orders with higher ASPs. At the same time, the group aims to better manage its distribution and administrative (D&A) costs. D&A expenses were 21.5% of 1QFY18 revenue and Karex is aiming to lower this to 20-20.5% in the upcoming quarters.

Cutting FY18-20F EPS by 13.6-35.7%

Given the weaker-than-expected 1Q18 results, we are lowering our FY18-20F EPS by 13.6-35.7%. This is to reflect: i) lower margins in the OBM segment, ii) higher distribution and administrative expenses, and iii) increase in total manufacturing costs. Nevertheless, we expect Karex to record stronger earnings ahead in tandem with higher ASPs for condoms sold in the tender segment, as well as better cost control, especially in terms of distribution and administrative expenses.

Maintain Hold; weak near-term, but long-term potential remains

After inputting our EPS cuts while rolling over our valuation to end-2018, our TP is raised slightly to RM1.44. This is still based on an unchanged 28x CY19 P/E (-1 s.d. of its 3-year mean). Although the near-term earnings outlook remains weak, Karex is still attractive in the long-term given its position as the world's largest condom manufacturer and budding potential as an original brand manufacturer. We view any potential sell-down of the stock as a buying opportunity. Downside/upside risks: sharp decline/increase in condom ASPs.

Financial Summary

	Jun-16A	Jun-17A	Jun-18F	Jun-19F	Jun-20F
Revenue (RMm)	343.2	361.5	402.3	459.4	530.0
Operating EBITDA (RMm)	84.59	47.04	45.85	65.44	87.20
Net Profit (RMm)	66.88	27.95	28.45	43.45	59.79
Core EPS (RM)	0.062	0.033	0.028	0.043	0.060
Core EPS Growth	1.9%	(47.3%)	(13.1%)	52.7%	37.6%
FD Core P/E (x)	24.18	45.92	52.84	34.60	25.15
DPS (RM)	0.016	0.008	0.007	0.011	0.015
Dividend Yield	1.05%	0.54%	0.47%	0.72%	0.99%
EV/EBITDA (x)	16.38	29.53	30.58	21.53	16.15
P/FCFE (x)	NA	219.5	NA	287.1	90.2
Net Gearing	(24.7%)	(22.9%)	(19.6%)	(17.3%)	(16.1%)
P/BV (x)	3.13	2.98	2.86	2.69	2.49
ROE	13.6%	6.7%	5.5%	8.0%	10.3%
% Change In Core EPS Estimates			(35.7%)	(22.5%)	(13.6%)
CIMB/consensus EPS (x)			0.58	0.72	0.88

SOURCE: COMPANY DATA, CIMB FORECASTS

Figure 1: Results Comparison

FYE Jun	1Q	1Q	yoy %	4Q	qoq %	Prev. Comments	
(RM m)	FY18	FY17	chg	FY17	chg	FY18F	
Revenue	107.6	80.0	34.4	91.6	17.4	420.8	Stronger yoy revenue growth in 1QFY18 mainly due to higher sales volume especially in the
Operating costs	(99.1)	(68.0)	45.6	(84.6)	17.1	(355.4)	tender segment.
EBITDA	8.5	12.0	(29.2)	7.0	20.7	65.3	
EBITDA margin (%)	7.9	15.0	(7.1)	7.7	0.2	15.5	EBITDA margins waned due to: i) stiffer pricing competition, ii) higher overall operating costs
Depn & amort.	(3.5)	(2.1)	65.8	(3.3)	4.2	(10.0)	and iii) rising production costs.
EBIT	5.0	9.9	(49.4)	3.7	35.6	55.4	
Interest expense	(0.2)	(0.3)	(19.4)	(0.4)	(38.4)	(0.9)	
Interest & invt inc	0.4	0.9	(51.2)	0.5	(16.1)	3.4	
Exceptionals	-	-	-	-	-	-	
Pretax profit	5.2	10.5	(50.4)	3.8	36.5	57.9	Below expectations
Tax	(1.0)	(2.3)	(56.8)	(0.8)	26.6	(12.7)	
Tax rate (%)	19.3	22.2	-2.9	20.8	1.5	22.0	Lower-than-expected statutory tax rates due to lower tax incurred by foreign subsidiaries.
Minority interests	(0.0)	0.0	(>100)	(0.1)	(72.2)	(0.9)	
Net profit	4.2	8.1	(49.0)	2.9	43.2	44.3	
Core net profit	4.2	8.1	(49.0)	2.9	43.2	44.3	Accounted for only 9.4% and 8.7% of our and consensus estimates for FY18F respectively.
EPS (sen)	0.4	0.8	(49.0)	0.3	43.2	4.4	
Core EPS (sen)	0.4	0.8	(49.0)	0.3	43.2	4.4	

SOURCES: CIMB, COMPANY REPORTS

Figure 2: Earnings revision

RM m	2017A	2018F			2019F			2020F		
		Old	New	chg	Old	New	chg	Old	New	chg
Revenue	361	421	402	-4%	480	459	-4%	546	530	-3%
EBITDA	47	65	46	-30%	82	65	-20%	99	87	-12%
Core pretax profit	43	58	37	-36%	73	56	-24%	90	76	-15%
Core net profit	33	44	28	-36%	56	43	-23%	69	60	-14%
Core EPS	3	4	3	-36%	6	4	-23%	7	6	-14%

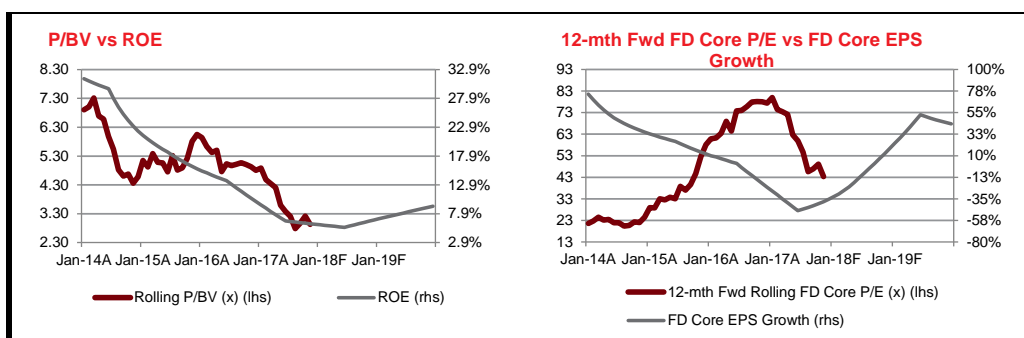
SOURCES: CIMB, COMPANY REPORTS

Figure 3: Segmental revenue and EBIT

Segmental revenue						
FYE Jun	1Q	1Q	4Q	qoq %	yoy %	Comments
(RM m)	FY18	FY17	FY17	chg	chg	
Sexual wellness	99.1	70.9	84.0	18.0	39.8	Sales increased due to stronger demand for condoms.
Medical	7.0	7.0	5.5	27.0	-	Revenue contribution from Medical remained stable.
Others	1.6	2.2	1.7	(6.2)	(29.9)	
Total revenue	107.6	80.0	91.1	18.1	34.4	
Segmental EBIT (ex. Interest income and unallocated amounts)						
FYE Jun	1Q	1Q	4Q	qoq %	yoy %	Comments
(RM m)	FY18	FY17	FY17	chg	chg	
Sexual wellness	4.4	7.8	2.1	(>100)	(44.2)	Lower EBIT yoy due to stiffer pricing competition, rising production costs and higher
Medical	1.1	1.8	1.7	(34.3)	(37.4)	distribution and administrative expenses.
Others	0.1	0.6	0.1	(52.8)	(91.0)	
Total EBIT	5.5	10.2	3.9	40.5	(45.6)	

SOURCES: CIMB, COMPANY REPORTS

BY THE NUMBERS



Profit & Loss

(RMm)	Jun-16A	Jun-17A	Jun-18F	Jun-19F	Jun-20F
Total Net Revenues	343.2	361.5	402.3	459.4	530.0
Gross Profit	125.8	117.9	124.7	148.1	177.8
Operating EBITDA	84.6	47.0	45.9	65.4	87.2
Depreciation And Amortisation	(9.0)	(11.5)	(10.0)	(11.0)	(12.1)
Operating EBIT	75.6	35.5	35.9	54.4	75.1
Financial Income/(Expense)	4.6	1.5	1.1	1.1	1.1
Pretax Income/(Loss) from Assoc.	0.0	0.0	0.0	0.0	0.0
Non-Operating Income/(Expense)	0.0	0.0	0.0	0.0	0.0
Profit Before Tax (pre-EI)	80.1	37.0	37.0	55.5	76.2
Exceptional Items					
Pre-tax Profit	80.1	37.0	37.0	55.5	76.2
Taxation	(13.1)	(8.2)	(8.1)	(11.7)	(16.0)
Exceptional Income - post-tax					
Profit After Tax	67.0	28.8	28.9	43.9	60.2
Minority Interests	(0.1)	(0.9)	(0.4)	(0.4)	(0.4)
Preferred Dividends					
FX Gain/(Loss) - post tax					
Other Adjustments - post-tax					
Net Profit	66.9	27.9	28.5	43.5	59.8
Recurring Net Profit	62.2	32.7	28.5	43.5	59.8
Fully Diluted Recurring Net Profit	62.2	32.7	28.5	43.5	59.8

Cash Flow

(RMm)	Jun-16A	Jun-17A	Jun-18F	Jun-19F	Jun-20F
EBITDA	84.59	47.04	45.85	65.44	87.20
Cash Flow from Inv. & Assoc.					
Change In Working Capital	(54.63)	(9.69)	(19.26)	(25.55)	(31.52)
(Incr)/Decr in Total Provisions					
Other Non-Cash (Income)/Expense					
Other Operating Cashflow	31.63	1.19	0.91	0.91	0.91
Net Interest (Paid)/Received	(1.12)	(1.19)	(0.91)	(0.91)	(0.91)
Tax Paid	(15.24)	(8.24)	(8.14)	(11.66)	(16.00)
Cashflow From Operations	45.23	29.11	18.45	28.24	39.67
Capex	(44.20)	(25.00)	(25.00)	(25.00)	(25.00)
Disposals Of FAs/subsidiaries					
Acq. Of Subsidiaries/investments					
Other Investing Cashflow	(47.16)	2.74	2.00	2.00	2.00
Cash Flow From Investing	(91.36)	(22.26)	(23.00)	(23.00)	(23.00)
Debt Raised/(repaid)	(0.70)	0.00	0.00	0.00	0.00
Proceeds From Issue Of Shares					
Shares Repurchased					
Dividends Paid	(16.71)	(8.19)	(7.11)	(10.86)	(14.95)
Preferred Dividends					
Other Financing Cashflow	(0.23)	(1.19)	(0.91)	(0.91)	(0.91)
Cash Flow From Financing	(17.64)	(9.38)	(8.02)	(11.77)	(15.85)
Total Cash Generated	(63.77)	(2.53)	(12.57)	(6.53)	0.82
Free Cashflow To Equity	(46.83)	6.85	(4.55)	5.24	16.67
Free Cashflow To Firm	(45.01)	8.04	(3.64)	6.14	17.58

SOURCE: CIMB RESEARCH, COMPANY DATA

BY THE NUMBERS... cont'd

Balance Sheet					
(RMm)	Jun-16A	Jun-17A	Jun-18F	Jun-19F	Jun-20F
Total Cash And Equivalents	144.4	141.9	129.3	122.8	123.6
Total Debtors	133.5	140.5	156.4	178.6	206.1
Inventories	64.4	72.2	82.3	92.2	104.4
Total Other Current Assets	2.9	2.9	2.9	2.9	2.9
Total Current Assets	345.2	357.5	370.9	396.5	436.9
Fixed Assets	181.1	196.9	212.0	225.9	238.8
Total Investments	0.0	0.0	0.0	0.0	0.0
Intangible Assets	32.6	32.6	32.6	32.6	32.6
Total Other Non-Current Assets	0.2	0.2	0.2	0.2	0.2
Total Non-current Assets	213.9	229.7	244.7	258.7	271.6
Short-term Debt	9.2	9.2	9.2	9.2	9.2
Current Portion of Long-Term Debt					
Total Creditors	42.8	48.0	54.7	61.3	69.4
Other Current Liabilities	1.9	1.9	1.9	1.9	1.9
Total Current Liabilities	53.9	59.0	65.7	72.4	80.4
Total Long-term Debt	16.7	16.7	16.7	16.7	16.7
Hybrid Debt - Debt Component					
Total Other Non-Current Liabilities	7.8	7.8	7.8	7.8	7.8
Total Non-current Liabilities	24.5	24.5	24.5	24.5	24.5
Total Provisions	0.0	0.0	0.0	0.0	0.0
Total Liabilities	78.4	83.6	90.3	96.9	105.0
Shareholders' Equity	479.9	504.5	525.8	558.4	603.3
Minority Interests	0.7	1.6	2.0	2.4	2.8
Total Equity	480.7	506.1	527.8	560.8	606.1

Key Ratios					
	Jun-16A	Jun-17A	Jun-18F	Jun-19F	Jun-20F
Revenue Growth	15.4%	5.3%	11.3%	14.2%	15.4%
Operating EBITDA Growth	5.1%	(44.4%)	(2.5%)	42.7%	33.2%
Operating EBITDA Margin	24.6%	13.0%	11.4%	14.2%	16.5%
Net Cash Per Share (RM)	0.12	0.12	0.10	0.10	0.10
BVPS (RM)	0.48	0.50	0.52	0.56	0.60
Gross Interest Cover	67.53	29.83	39.61	60.04	82.86
Effective Tax Rate	16.4%	22.2%	22.0%	21.0%	21.0%
Net Dividend Payout Ratio	23.6%	29.3%	25.0%	25.0%	25.0%
Accounts Receivables Days	116.2	138.3	134.7	133.1	132.8
Inventory Days	97.6	102.4	101.5	102.3	102.2
Accounts Payables Days	66.08	68.06	67.51	68.03	67.93
ROIC (%)	29.9%	9.6%	9.1%	12.7%	16.0%
ROCE (%)	16.9%	7.4%	7.0%	9.9%	12.7%
Return On Average Assets	11.8%	4.8%	4.6%	6.7%	8.7%

Key Drivers					
	Jun-16A	Jun-17A	Jun-18F	Jun-19F	Jun-20F
ASP (% chg, main prod./serv.)	13.6%	0.0%	0.0%	0.0%	0.0%
Unit sales grth (% , main prod./serv.)	10.0%	15.0%	20.0%	0.0%	0.0%
Util. rate (% , main prod./serv.)	83.0%	90.0%	80.0%	0.0%	0.0%
ASP (% chg, 2ndary prod./serv.)	N/A	N/A	N/A	N/A	N/A
Unit sales grth (% ,2ndary prod/serv)	N/A	N/A	N/A	N/A	N/A
Util. rate (% , 2ndary prod/serv)	N/A	N/A	N/A	N/A	N/A
Unit raw mat ASP (%chg,main)	N/A	N/A	N/A	N/A	N/A
Unit raw mat ASP (%chg,2ndary)	N/A	N/A	N/A	N/A	N/A

SOURCE: CIMB RESEARCH, COMPANY DATA

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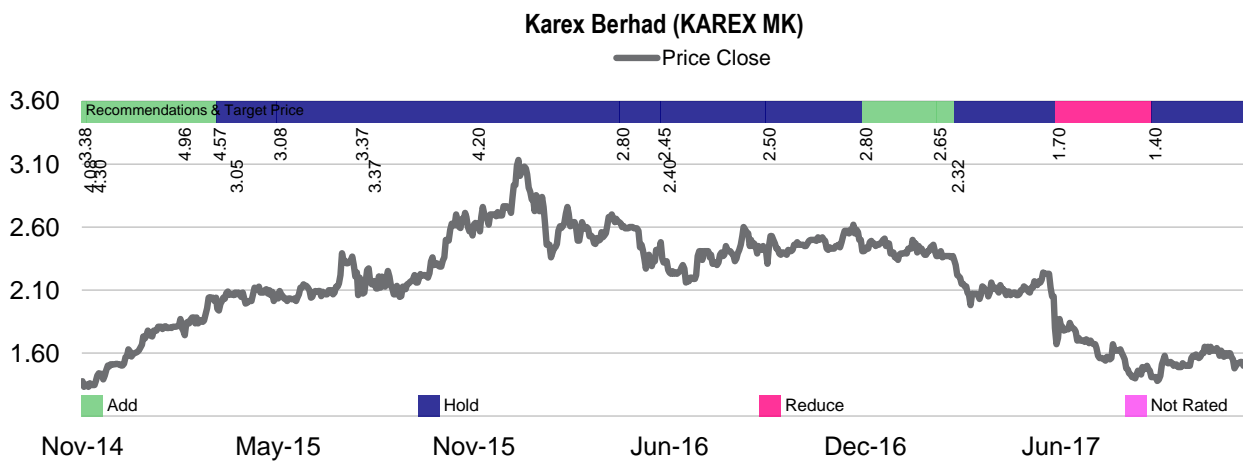
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1285 companies under coverage for quarter ended on 30 September 2017		
	Rating Distribution (%)	Investment Banking clients (%)
Add	53.5%	4.3%
Hold	35.9%	2.6%
Reduce	9.7%	0.2%

Spitzer Chart for stock being researched (2 year data)



Corporate Governance Report of Thai Listed Companies (CGR). CG Rating by the Thai Institute of Directors Association (Thai IOD) in 2017, Anti-Corruption 2017

AAV – Very Good, n/a, **ADVANC** – Excellent, Certified, **AEONTS** – Good, n/a, **AMATA** – Very Good, n/a, **ANAN** – Excellent, n/a, **AOT** – Excellent, Declared, **AP** – Excellent, Declared, **ASK** – Very Good, Declared, **ASP** – Very Good, Certified, **BANPU** – Excellent, Certified, **BAY** – Excellent, Certified, **BBL** – Very Good, Certified, **BCH** – Good, Declared, **BCP** - Excellent, Certified, **BCPG** – Very Good, n/a, **BEM** – Very Good, n/a, **BDMS** – Very Good, n/a, **BEAUTY** – Good, n/a, **BEC** – Very Good, n/a, , **BGRIM** – not available, n/a, **BH** - Good, n/a, **BJC** – Very Good, Declared, **BJCHI** – Very Good, Declared, **BLA** – Very Good, Certified, **BPP** – Good, n/a, **BR** - Good, Declared, **BTS** - Excellent, Certified, **CBG** – Good, n/a, **CCET** – Good, n/a, **CENTEL** – Very Good, Certified, **CHG** – Very Good, Declared, **CK** – Excellent, n/a, **COL** – Very Good, Declared, **CPALL** – not available, Declared, **CPF** – Excellent, Declared, **CPN** - Excellent, Certified, **DELTA** - Excellent, n/a, **DEMCO** – Excellent, Certified, **DIF** – not available, n/a, **DTAC** – Excellent, Certified, **EA** – Very Good, n/a, **ECL** – Very Good, Certified, **EGCO** - Excellent, Certified, **EPG** – Very Good, n/a, **GFPT** - Excellent, Declared, **GGC** – not available, Declared, **GLOBAL** – Very Good, Declared, **GLOW** – Very Good, Certified, **GPSC** – Excellent, Declared, **GRAMMY** - Excellent, n/a, **GUNKUL** – Excellent, Declared, **HANA** - Excellent, Certified, **HMPRO** - Excellent, Certified, **ICHI** – Excellent, n/a, **III** – not available, n/a, **INTUCH** - Excellent, Certified, **IRPC** – Excellent, Certified, **ITD** – Very Good, n/a, **IVL** - Excellent, Certified, **JAS** – not available, Declared, **JASIF** – not available, n/a, **JUBILE** – Good, Declared, **KAMART** – not available, n/a, **KBANK** - Excellent, Certified, **KCE** - Excellent, Certified, **KGI** – Very Good, Certified, **KKP** – Excellent, Certified, **KSL** – Very Good, Certified, **KTB** - Excellent, Certified, **KTC** – Excellent, Certified, **LH** - Very Good, n/a, **LPN** – Excellent, Certified, **M** – Very Good, n/a, **MACO** – Very Good, n/a, **MAJOR** – Very Good, n/a, **MAKRO** – Very Good, Declared, **MALEE** – Very Good, n/a, **MBKET** – Very Good, Certified, **MC** – Very Good, Declared, **MCOT** – Excellent, Certified, **MEGA** – Very Good, n/a, **MINT** - Excellent, Certified, **MTLS** – Very Good, Declared, **NYT** – Excellent, n/a, **OISHI** – Very Good, n/a, **PLANB** – Excellent, Declared, **PLAT** – Very Good, Certified, **PSH** – Excellent, Certified, **PSL** - Excellent, Certified, **PTT** - Excellent, Certified, **PTTEP** - Excellent, Certified, **PTTGC** - Excellent, Certified, **QH** – Excellent, Certified, **RATCH** – Excellent, Certified, **ROBINS** – Excellent, Certified, **RS** – Very Good, n/a, **SAMART** - Excellent, n/a, **SAPPE** - Good, n/a, **SAT** – Excellent, Certified, **SAWAD** – Very Good, n/a, **SC** – Excellent, Declared, **SCB** - Excellent, Certified, **SCBLIF** – not available, n/a, **SCC** – Excellent, Certified, **SCN** – Very Good, Declared, **SCCC** - Excellent, Declared, **SIM** - Excellent, n/a, **SIRI** – Very Good, Declared, **SPA** - Good, n/a, **SPALI** - Excellent, n/a, **SPRC** – Excellent, Declared, **STA** – Very Good, Declared, **STEC** – Excellent, n/a, **SVI** – Excellent, Certified, **TASCO** – Very Good, n/a, **TCAP** – Excellent, Certified, **THAI** – Very Good, n/a, **THANI** – Very Good, Certified, **THCOM** – Excellent, Certified, **THRE** – Very Good, Certified, **THREL** – Excellent, Certified, **TICON** – Very Good, Declared, **TIPCO** – Very Good, Certified, **TISCO** - Excellent, Certified, **TK** – Very Good, n/a, **TKN** – Very Good, Declared, **TMB** - Excellent, Certified, **TNR** – Good, n/a, **TOP** - Excellent, Certified, **TPCH** – Good, n/a, **TIPIP** – not available, n/a, **TRUE** – Excellent, Declared, **TTW** – Very Good, n/a, **TU** – Excellent, Declared, **TVO** – Excellent, Declared, **UNIQ** – not available, Declared, **VGI** – Excellent, Declared, **WHA** – not available, Declared, **WHART** – not available, n/a, **WORK** – not available, n/a.

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Definition:

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- Neutral** A Neutral rating means stocks in the sector have, on a market cap-weighted basis, a neutral absolute recommendation.
- Underweight** An Underweight rating means stocks in the sector have, on a market cap-weighted basis, a negative absolute recommendation.

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