Kim Hin Industry Berhad

Industrial Product | Ceramic Tiles
Stock Code: 5371.KL Malaysia

BUY

Current Price	RM 1.69
Target Price	RM 2.06
Est. Upside Potential	22.1%
Market Cap	RM 237.00m
52-week Range	RM 1.58 – RM 2.60
Average Volume*	43,270
Shares Outstanding	140,239,000
Free float	38.50%
Beta	0.73
Valuation Basis	DCF model

* Source: FT.com

Investment Considerations

1) Heightened capital expenditure dragged down its cash flow but positive in the long run.

Although the acquisition weakened several metrics such as cash flow and interest coverage, making the comparable momentarily meaningless, but it provides longer term economic benefits. It has been reported that the acquisition would raise the production by 75% result in higher revenue and profit generation. Current Seremban's annual capacity is 4 million square meter which would be boosted up by 3 million square meter of glazed ceramic wall and floor tiles. They also reported to boost Shanghai's production by 25%. We expect the capital expenditure spending would remain heightened in short to medium term as it attempts to expand production. Well positioned to take advantage of potential economic recovery in the region.

2) Sudden spike in operating costs is a concern but growth potential is underappreciated by the market.

The main contributors for deteriorated profit margin were due to 1) the sudden spike in goods and operating costs in Q1 2016 (range from 6% to 29%), 2) unfavourable exchange rate (which the company reported to hedge 20% of its sales in 2015 and did not report on the hedging strategy on its costs), 3) loss on fair value of financial assets. Other expenses reported of RM 8.3million in Q1 2016, increased from RM 0.9 million compared to Q1 2015. Such expenses are not reported as part of the core operating cost hence it may not be recurring in nature hence temporarily dragged down the profit in FY 2016. It is supported by favourable growth prospect which we expect the profit generation to be much higher once the plants start to operate.

3) The sharp drop in share price provides a good opportunity to accumulate at lower price.

Current valuation is close to 52-week low and the P/E multiple is the lowest among the peers. EV / EBITDA of 5.80x which we expect it will elevated to approx. 7x by FY2016 due to its lower EBITDA margin. Based on Discounted Cash Flow Model, our result suggests that a target price of RM 2.06, a 22.1% upside potential.

The investment risks are discussed in the valuation section.

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KapitalWise

Company Profile

Kim Hin Industry Berhad is an investment holding company engages in the production of ceramic tiles, glazed decorative floor, monoporosa wall tiles and heavy duty homogeneous tiles. It has operations in Malaysia, China, Australia and Vietnam.

Top 5 Shareholders

Kim Hin (Malaysia) Sdn Bhd	61.46%
Galister International Ltd	17.07%
Yeoman 3-Right Value Asia Fund	2.78%
China Cruise Company Ltd	1.96%
Citibank N.A. Singapore	1.50%

** As of 31 March 2016*

Peer Comparable

2014					2015 / Last Twelve Months			
Kim Hin	*White Horse*	*Seacera Grp*	*Yi Lai*		*Kim Hin*	*White Horse*	*Seacera Grp*	*Yi Lai*
				Profitability				
16.77%	14.34%	16.23%	15.85%	*EBITDA Margin*	9.55%	11.83%	15.05%	13.59%
9.59%	8.81%	11.45%	10.46%	*EBIT Margin*	3.62%	5.44%	9.72%	7.57%
28.86%	26.01%	27.87%	18.40%	*Gross Profit Margin*	32.45%	26.00%	26.99%	17.14%
8.24%	7.74%	7.10%	8.18%	*Net Profit Margin*	6.52%	4.78%	6.53%	5.78%
4.72%	4.95%	1.71%	5.60%	*Return on Asset*	4.22%	2.78%	0.65%	3.23%
5.39%	8.02%	2.71%	6.46%	*Return on Equity*	4.70%	4.42%	0.79%	3.59%
				Operational Efficiency				
0.57x	0.64x	0.24x	0.69x	*Asset Turnover*	0.65x	0.58x	0.10x	0.56x
1.63x	1.63x	1.52x	2.10x	*Revenue / Fixed Asset*	1.68x	1.53x	0.14x	1.86x
5.27%	6.31%	7.28%	4.32%	*Capex / Revenue*	12.98%	3.13%	0.42%	2.69%
				Liquidity				
4.24x	1.97x	2.36x	6.17x	*Current Ratio*	5.18x	2.02x	1.58x	8.73x
2.23x	0.89x	2.21x	4.01x	*Acid Test*	2.77x	0.91x	1.34x	5.91x
0.76x	0.36x	0.26x	1.58x	*Cash Ratio*	0.88x	0.39x	0.31x	2.55x
				Leverage				
0.19x	1.95x	4.36x	0.00x	*Debt / EBITDA*	0.26x	2.71x	5.87x	0.00x
104.09x	11.19x	4.21x	0.00x	*EBITDA / Interest*	78.43x	14.67x	3.13x	0.00x
71.38x	6.27x	2.32x	0.00x	*(EBITDA - Capex) / Interest*	-28.15x	10.79x	3.05x	0.00x
383.28%	46.54%	-7.32%	0.00%	*FFO / Debt*	509.29%	34.11%	3.62%	0.00%
160.84%	-11.19%	-58.21%	0.00%	*FCF / Debt*	-31.31%	19.51%	-2.05%	0.00%
1.89%	17.86%	17.24%	0.00%	*Debt / Tangible Assets*	1.80%	18.63%	8.88%	0.00%
				Investment Metrics				
				Price to Earning	9.94x	14.12x	52.32x	17.79x
				Price to Book	0.47x	0.62x	0.41x	0.64x
				Price to Sales	0.65x	0.68x	3.42x	1.03x
				EV / EBITDA	5.80x	6.84x	25.25x	4.87x
				EV / EBIT	15.31x	14.90x	39.11x	8.73x
				EV / (EBITDA - Capex)	-16.16x	9.30x	25.97x	6.07x
				EV / Sales	0.55x	0.81x	3.80x	0.66x

- From multiple perspectives, Kim Hin has the lowest P/E multiple which is due to the sharp drop in share price combined with worse quarterly profit result reported.
    - Based on multiples, the valuation of Kim Hin seems fairly valued (eliminating the outliers) at current multiples except for the P/E ratio.
- The company spent a huge amount of capital expenditure in the last twelve months (c. 13% of the sales while industry average is around 3%), temporarily worsening its free cash flow generation.
- Generally, the competitors (except for Seacera Group) are not highly leveraged. Kim Hin has a high amount of headroom to leverage its balance sheet as it attempts to grow its production capacity through acquisitions.

Financial Summary

Valuation Metrics	Dec-12	Dec-13	Dec-14	Dec-15	Dec 16F	Dec 17F	Dec 18F
Price to Earnings	71.83x	137.62x	6.40x	8.95x	11.29x	6.70x	6.50x
Price to OCF	94.16x	28.59x	5.78x	6.69x	*n.a*	*n.a*	*n.a*
Price to Net Tangible Assets	0.39x	0.39x	0.35x	0.63x	0.45x	0.43x	0.41x
Price to FCF	*neg*	*neg*	10.11x	10.76x	*neg*	14.84x	13.26x
Price to Sales	0.71x	0.68x	0.53x	0.87x	0.63x	0.55x	0.48x
EV / EBITDA	9.67x	8.02x	3.81x	5.51x	6.35x	3.86x	3.28x
EV / (EBITDA - Capex)	*neg*	*neg*	7.27x	8.21x	*neg*	*neg*	*neg*

** Other Comprehensive Income*

Valuation Metrics	Dec-12	Dec-13	Dec-14	Dec-15	Dec 16F	Dec 17F	Dec 18F
Liquidity Metrics							
Current Ratio	5.0	4.6	4.2	4.5	5.4	5.6	5.2
Acid Test	2.8	2.6	2.2	2.5	3.0	3.1	2.6
Credit Metrics							
Debt / EBITDA	-	0.6	0.3	0.2	0.3	0.2	0.2
EBITDA / Interest	827.7	167.0	68.6	108.9	78.6	120.0	134.1
(EBITDA - Capex) / Interest	*neg*	*neg*	35.9	73.0	*neg*	*neg*	*neg*
Free Cash Flow / Debt	*n.a.*	*neg*	161%	323%	*neg*	173%	194%
Profitability Metrics							
Gross Profit Margin	21.50%	21.44%	28.86%	33.45%	32.00%	33.00%	33.00%
Net Profit Margin	0.99%	0.49%	8.24%	9.72%	5.60%	8.21%	7.35%
EBITDA Margin	5.04%	6.52%	11.06%	13.45%	9.27%	12.31%	11.95%
Free Cash Flow Margin	*neg*	*neg*	5.22%	8.09%	*neg*	3.70%	3.61%
Return on Assets	0.49%	0.25%	4.72%	6.11%	3.54%	5.71%	5.61%
Return on Equity	0.53%	0.28%	5.39%	6.94%	3.94%	6.34%	6.25%
Key Metrics							
Capex / Sales	11.59%	14.75%	5.27%	4.43%	13.00%	13.50%	14.00%
Net Income / Dividend	0.31	0.27	5.04	3.41	6.67	3.45	3.33
Free Cash Flow / Dividend	*neg*	*neg*	3.19	2.84	*neg*	1.56	1.64

Income Statement	Dec-12	Dec-13	Dec-14	Dec-15	Dec 16F	Dec 17F	Dec 18F
Revenue	246.6	261.1	313.4	367.4	374.8	431.0	495.7
y-o-y growth		*5.9%*	*20.0%*	*17.3%*	*2.0%*	*15.0%*	*15.0%*
Gross Profit	53.0	56.0	90.4	122.9	119.9	142.2	163.6
y-o-y growth		*5.6%*	*61.6%*	*35.9%*	*-2.4%*	*18.6%*	*15.0%*
SG&A	57.2	57.3	72.1	87.9	91.8	104.7	121.4
y-o-y growth		*0.3%*	*25.8%*	*21.9%*	*4.5%*	*14.1%*	*15.9%*
Net Income	2.4	1.3	25.8	35.7	21.0	35.4	36.4
y-o-y growth		*-47.3%*	*1912.2%*	*38.2%*	*-41.2%*	*68.4%*	*3.0%*
Recurring Net Income	2.4	1.3	19.4	35.7	21.0	35.4	36.4
y-o-y growth		*-47.3%*	*1407.1%*	*84.5%*	*-41.2%*	*68.4%*	*3.0%*
EBITDA	12.4	17.0	34.7	49.4	34.7	53.1	59.3
y-o-y growth		*37.2%*	*103.6%*	*42.6%*	*-29.7%*	*52.7%*	*11.7%*

Balance Sheet	Dec-12	Dec-13	Dec-14	Dec-15	Dec 16F	Dec 17F	Dec 18F
Tangible Fixed Assets	224.0	241.1	237.5	239.1	262.8	293.8	333.2
Total Non-Current Assets	297.1	303.2	303.3	313.3	310.2	341.2	380.6
Cash and Cash Eqv.	54.9	51.1	43.7	56.7	26.4	41.4	51.8
Total Current Assets	202.3	213.7	244.0	271.3	276.4	296.6	294.8
Total Bank Debts	0.0	11.1	10.2	9.2	9.2	9.2	9.2
Total Current Liabilities	40.2	46.5	57.5	60.2	51.5	52.6	56.4
Total Non-Current Liabilities	0.5	10.5	10.4	9.6	9.7	9.6	9.5
Retained Earnings	254.8	250.3	265.3	294.3	312.1	337.2	362.7
Total Shareholder's Equity	458.6	460.0	479.4	514.7	532.6	557.7	583.2

Balance Sheet	Dec-12	Dec-13	Dec-14	Dec-15	Dec 16F	Dec 17F	Dec 18F
Cash Flow from Operations	22.1	12.8	32.9	46.0	36.7	74.2	87.3
Changes in Working Capital	- 9.1	7.5	- 6.1	- 7.2	- 6.3	14.6	23.8
Cash Flow from Investing							
Capex	28.6	38.5	16.5	16.3	48.7	58.2	69.4
Disposals of Assets	45.1	20.6	5.9	11.9	10.0	10.0	10.0
Cash Flow from Financing							
Dividends paid	7.8	4.8	5.1	10.5	3.1	10.3	10.9
Debt Borrowing	-	11.2	-	-	-	-	-
Equity Issuance	-	-	-	-	-	-	-
Fund from Operations*	31.2	5.3	39.0	53.2	43.0	59.6	63.5
Free Cash Flow	- 6.5	- 25.7	16.4	29.7	- 12.1	16.0	17.9

** Cash flow from Operations minus the changes in working capital*

neg = negative　　*n.a. = not applicable*

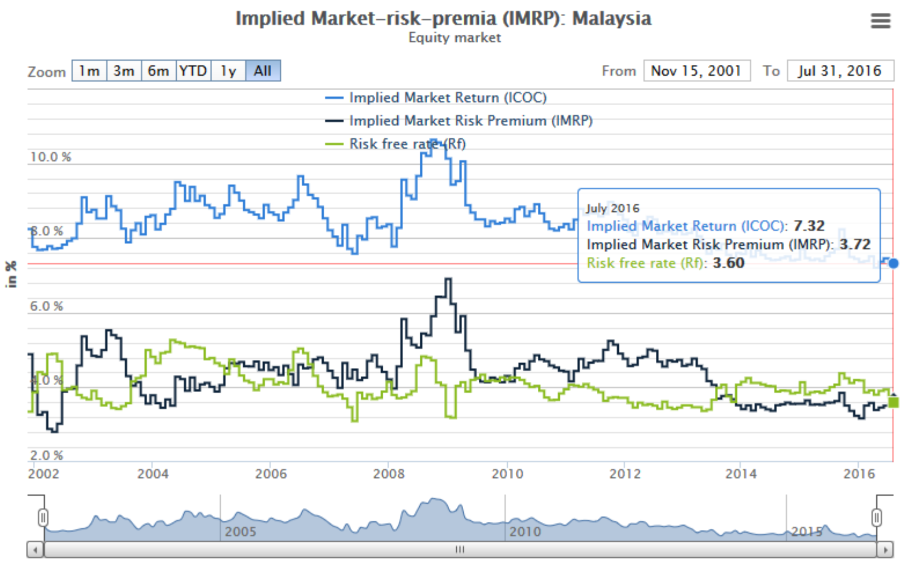
Segment Analysis

FYE 2014						FYE 2015				
Malaysia	*China*	*Australia*	*Vietnam*	*Total*		*Malaysia*	*China*	*Australia*	*Vietnam*	*Total*
212.94	59.49	40.28	0.66	313.37	*Revenue*	234.68	67.26	61.96	3.54	367.44
13.56	9.46	0.80	-0.27	23.54	*EBIT*	37.81	8.53	-0.01	-0.14	46.18
-0.51	-	-	-	-0.51	*Interest Expense*	-0.45	-	-	-	-0.45
13.07	9.46	7.28	-0.27	29.54	*EBT*	37.36	8.53	-0.01	-0.14	45.73
-0.78	-2.92	-0.00	-	-3.70	*Income Tax Expense*	-7.63	-2.39	-	-	-10.02
12.29	6.54	7.28	-0.27	25.84	*Net Profit*	29.73	6.14	-0.01	-0.14	35.72
12.29	4.51	7.28	-0.19	23.89	*Net Profit Attributable to Owners*	29.73	4.48	-0.01	-0.10	34.09
400.63	86.02	59.43	1.23	547.32	*Segment Total Assets*	411.72	102.41	66.91	3.61	584.63
37.90	8.40	20.70	0.89	67.88	*Segment Total Liabilities*	36.07	14.57	15.89	3.37	69.89
362.74	77.62	38.74	0.34	479.44	*Segment Total Equity*	375.65	87.84	51.02	0.24	514.74

Malaysia	*China*	*Australia*	*Vietnam*	*Total*		*Malaysia*	*China*	*Australia*	*Vietnam*	*Total*
67.95%	18.98%	12.85%	0.21%	100.00%	*Revenue Contribution %*	63.87%	18.31%	16.86%	0.96%	100.00%
5.77%	10.99%	18.07%	-41.21%	8.24%	*Net Profit %*	12.67%	9.13%	-0.02%	-3.95%	9.72%
0.53 x	0.69 x	0.68 x	0.54 x	0.57 x	*Asset Turnover*	0.57 x	0.66 x	0.93 x	0.98 x	0.63 x
3.07%	7.60%	12.25%	-22.11%	4.72%	*Return on Assets*	7.22%	5.99%	-0.02%	-3.88%	6.11%
3.39%	8.43%	18.79%	-79.07%	5.39%	*Return on Equity*	7.91%	6.99%	-0.02%	-59.32%	6.94%

- In 2014, Australia's net profit was boosted up by c. RM 6.5m arising from negative goodwill from acquisition.
- Malaysia remains the most profitable country but slowly diversify into other countries with noticeable growth in Australia and Vietnam. The loss in Vietnam is narrowing hence it could be a profit contributor by 2017 assuming the operating efficiency remains the same if not improving.
- However, China's economic growth remains an issue due to the slower growth which could also presents an opportunity to Kim Hin as more and more smaller manufacturers are driving out of the businesses.
  - In April 2016, the Star reported that Kim Hin plans to boost the production capacity in Shanghai (which shows the company's confidence in the market).
  - In our opinion, the expansion plan may be effective for Kim Hin as it will eliminate the unnecessary logistics cost of domestically produced tiles while establishing presence in China (to export to nearby countries or target Chinese consumers).
  - The Shanghai plant currently has 2 million sq m capacity and is expected to increase to 2.5 million sq m (25% increase from existing).

Cost of Equity



Discount Rate	
Risk Free Rate (%)	3.60
Adjusted Beta	0.82
Equity Risk Premium	3.72
Cost of Equity	6.65
Cost of Equity + Illiquid Discount (4.5%)	11.15%

- The implied equity risk premium and risk free rate are obtained from http://www.market-risk-premia.com.
- Beta has been adjusted using Blume Method.
- Final discount rate of 11.15% reflects the illiquidity risk resulting from low average trading volume.

Valuation

Base Case Scenario		2016	2017	2018	2019	2020	2021	2022	2023
FCF (RM millon)	-	12.1	16.0	17.9	30.5	37.0	43.2	49.5	70.0
Terminal Value*									433.4
Future Value (RM millon)	-	12.1	16.0	17.9	30.5	37.0	43.2	49.5	433.4
Discount Rate @ 11.15%		0.90	0.81	0.73	0.66	0.59	0.53	0.48	0.43
Present Value (RM millon)	-	10.9	12.9	13.0	20.0	21.8	22.9	23.6	186.0
Sum of PV (RM millon)		289.5							
Shares Outstanding (million)		140.2							
Fair Value Per Share (RM)		2.06							
Current Share Price		1.69							
Suggested Upside Potential		22.1%							

* Assume Negative Terminal Growth of 5% and discount rate equal to 11.15%

- As pointed out previously, we expect the capital expenditure will remain high in short to medium term thus our valuation and derivation of FCF has taken this into account. The Capex/sales ratio will increased to 14% and slowly decline to 4% in 2023 which is in line with the Malaysia's peers average.
- Revenue growth expects to increase by 15% and slowly decline to a moderate growth of 6% as production capacity reaches to the max.
- We assume there is no equity issuance by Kim Hin that would dilute the number of shares.
  - The reason being Kim Hin generates its cash organically and there is a high headroom to further leverage its balance sheet by taking on debt to fund operations or acquisitions.
- The discounted FCF model based on 11.15% cost of equity suggests Kim Hin's upside potential to be 22.1%.

Worst Case Scenario		2016	2017	2018	2019	2020	2021	2022	2023
FCF (RM millon)	-	13.3	13.6	15.2	26.0	31.5	36.7	42.1	59.5
Terminal Value*									305.1
Future Value (RM millon)	-	13.3	13.6	15.2	26.0	31.5	36.7	42.1	305.1
Discount Rate @ 11.50%		0.90	0.80	0.72	0.65	0.58	0.52	0.47	0.42
Present Value (RM millon)	-	11.9	10.9	11.0	16.8	18.3	19.1	19.7	127.7
Sum of PV (RM millon)		211.5							
Shares Outstanding (million)		140.2							
Fair Value Per Share (RM)		1.51							
Current Share Price		1.69							
Downside Risk		-10.8%							

* Assume Negative Terminal Growth of 8% and discount rate equal to 11.5%

Assumptions under stressed scenario:
- Negative FCF worsened by 10%
- Positive FCF decreased by 15%
- Discount Rate surge up to 11.5%
- Negative terminal growth rate of 8%

- Under worst case scenario, we believe the downside risk is around 11%.
- The risk to our buy recommendation is the execution risks relating to the capacity expansion, further deterioration on profit margins and weaker overseas sales performance.

Key Investment Risks

Weaker worldwide consumer sentiment

The growth potential is supported by the growth in world population which leads to demand in properties (which is considered essential) thus ceramic tile manufacturers indirectly benefit from such demand.

Competition from products such as Luxury Vinyl Tiles

Luxury Vinyl Tile is a strong alternative to Ceramic tile in terms of cost, environment impact, durability and usage. Kim Hin has not stated publicly its intention to enter into Luxury Vinyl Tiles which may affect the market position when it gains recognition by the market

Sluggish domestic demand

After the implementation of GST, there's a noticeable decline in domestic sales (quarterly result showed that Malaysia's sales dropped c. 10% comparing Q1 2016 to Q1 2015. Such drop partly mitigated by diversify the customer base to overseas.

Uncertainty around the operating costs and fuel price

Currently there are rumours of production cap by Saudi Arabia. Fuel makes up 35% of the plant operating cost hence any material surge in fuel price may reduce profit margin. The company doesn't report on the hedge on the operating costs hence there are risks to fuel price.

Investment Ratings

Buy	= Share price may exceed 15% over the next 12 months
Neutral	= Share price may fluctuate within the range of ± 15% over the next 12 months
Sell	= Share price may fall more than 15% over the next 12 months

Investment Research Disclaimers

The opinions and views expressed in this report are solely of the analyst.

Any projections or estimations may not be accurate. Market conditions and assumptions could result in materially different outcomes.

Past performance is not necessarily an indicative of future performance and the analyst will not accept for any loss arising from information contained in this report.

This report is not intended as an offer to buy or sell the securities discussed.

Seek independent advice to understand the investment risk arising from taking investment actions based on this report. Consider your unique circumstances (such as time horizon, liquidity and risk tolerance) before investing as not all investment are suitable for every investor.

The analyst currently has no financial interests with the company analysed in this report. The company has not paid the analyst to write this research.

The analyst currently has no shareholding in the company analysed in this report.

The analyst may invest in the company analysed in the future but will only do so after 48 hours of publishing of this report.

Background of the analyst

- *Currently working as a Credit Analyst in the Bank of East Asia, analysing the retail, corporate and syndicated loans in various industries (Food and Beverage, Construction, Clothes Manufacturing etc.).*
- *Passed Level 3 of the CFA Program.*
- *Distinction in MSc Banking and Finance from the University of Sussex.*
- *First Class Honours in BA Accounting from the University of Portsmouth.*