Company Note

# Company Update

Wednesday, 21 April 2010

For Internal Circulation Only

TA SECURITIES HOLDINGS BERHAD
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FBM KLCI : 1,335.9
Sector : Industrial
Bloomberg : SUCB MK

Analyst : TA Research
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**Target Price RM9.30 (31.0%)**

RM7.10 BUY

# Supermax Corporation Bhd

## *Demand for Rubber Gloves Still Strong*

**Share Info**

| | |
|---|---|
| Stock Code | Supermax |
| Listing | Main Board |
| Share Cap (m) | 271.2 |
| Market Cap (RMm) | 1926.0 |
| Par Value (RM) | 0.50 |
| 52-wk Hi/Lo (RM) | 7.45/1.18 |
| 12-mth Avg Daily Vol ('000 sl | 2,926.0 |
| Estimated Free Float (%) | 43% |
| Beta | 1.16 |
| Major Shareholders (%) | |
| | Datuk Seri Stanley Thai (20.4%) |
| | Cheryl Tan (14.6%) |

**Forecast Revision**

| | FY10e | FY11e |
|---|---|---|
| Chg (%) | - | - |
| Net profit (RMm) | 166.7 | 210.5 |
| *Consensus* | *166.0* | *191.0* |
| TA/Consensus | *100%* | *110%* |
| Previous Rating | BUY | |

**Financial Indicatotrs**

| | FY10e | FY11e |
|---|---|---|
| Net gearing (%) | 0.25 | 0.12 |
| CFPS (RM) | 1.1 | 1.6 |
| P/CFPS (x) | 6.72 | 4.32 |
| ROAA (%) | 0.16 | 0.16 |
| ROAE (%) | 0.27 | 0.28 |
| NTA/Share (RM) | 2.44 | 3.03 |
| Price/ NTA (x) | 2.91 | 2.34 |

**Share Performance (%)**

| Price chg | Supermax | FBMKLCI |
|---|---|---|
| 1 mth | 5.4% | 1.2% |
| 3 mth | 42.3% | 6.1% |
| 6 mth | 97.4% | 7.5% |
| 12 mth | 364.1% | 34.8% |

Supermax held an analyst briefing yesterday. Key highlights gathered from the meeting are as follows:

## Global demand remains strong

Total back orders have eased to approx. 3-4 months (from around 5 months in 4Q09). Recall that the increase was partially due to the shortage of ocean freights in December. The rollover issue has since been resolved and total backlog of orders is normalising to around 2 months. We believe the current high level of back orders is firm indication that demand for gloves has not let up. Other drivers for global demand include the US healthcare reform. According to management, the reform is estimated to create new demand for some 6bn pieces of gloves per annum.

**Table 1: Update on back orders**

| | FY08 | FY09 | Jan-Mar FY10 |
|---|---|---|---|
| **Orders from Supermax and Seal Polymer's customers** | 13,500 | 14,850 | 7,540 |
| **From APLI's customers** | 2,640 | 1,320 | 330 |
| **H1N1** | n.a. | 1,050 | 200 |
| **Total orders received** | **16,140** | **17,220** | **8,070** |
| **Total shipped** | (12,765) | (12,115) | (3,205) |
| **Total back orders** | **3,375** | **5,105** | **4,865** |

*Source: Company, TA Securities*

## Aggressively catching up on demand

18 refurbished and new production lines in the Lahat and Sungai Buloh plants are now up and running, adding 1.28bn glove output per annum. By end- 2010, the group plans to raise output by another 1.26bn via the installation and commissioning of 18 new production lines. As this juncture, the capacity expansion planned for 2009 and 2010 to add a total annualised output of 4,826mn to the group is on track. The launch of the Glove City Project in Kapar, Klang by 2011 will further boost installed capacity by another 32 lines or an annual capacity of 4,150mn gloves. Site clearing for the Glove City Project has started (in Mar 2010) for factories in Phase 1. Management cautioned that rising steel prices could lead to a higher revision in capex.

**Table 2: Summary of Capital Expenditure**

| Year | RM (mn) | Comments |
|---|---|---|
| 2009 | 30.5 | Refurbishment and installation of 25 old and 12 new production lines |
| 2010 | 35.0 | Decommissioning 8 old and replacing with 11 new production lines |
| | | Installation of 4 new production lines |
| 2010/11 | 15.0 | Decommissioning 4 old and replacing with 6 new production lines |
| 2011 | 50.0 | GloveCity project - Phase #1 |
| **Total** | **130.5** | |

*Source: Company, TA Securities*

### Riding on the OBM model

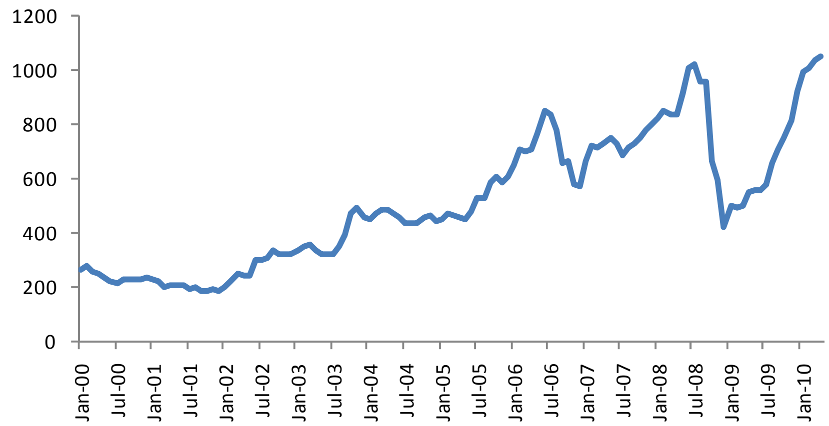
Management plans to expand its distribution reach, citing Germany and US as high growth areas. They explained that this segment is vital to providing the group with additional source of income as well as giving Supermax the platform to grow its OBM business. We note that PAT contribution from distribution by wholly owned subsidiaries have been climbing steadily from 1.7% in FY08 to 12.9% in FY09 and 19.6% in 1Q FY10.

Some key concerns, which were also highlighted during the meeting include:

### Cautious on high latex price and volatility of forex

Management explained that orders from large MNC-based customers did decline in the past 1-2 months due to the high latex price. However, management expects orders to resume by July 2010: 1) to replenish stockpile, and 2) take advantage of softer latex price. Latex price is expected to ease from May post wintering season. Elsewhere, the recent appreciation of the MYR will erode margin slightly. Despite that, overall EBITDA margin for the group is expected to remain healthy on the back of: 1) stronger margin from an increase in distribution business, 2) more effective pricing mechanism to help absorb impact from higher latex/freight costs as well as to manage foreign exchange risks, 3) shorter products pricing commitment (from an average of 90 days to 45-60 days), and 4) rise in average selling prices (ASP) due to shortage of gloves globally. For Supermax, we note that the ASPs for its products have increased by some 20-40% YoY.

**Figure 1: Latex prices (sen/kg)**




*Source: Bloomberg*

### Shortage of gas supply could hamper expansion plans

Petronas recently said that it would re-allocate 100mn standard cubic feet of natural gas currently meant for independent power producers to industries. While the government seeks to fill the gap until 2011, we understand that infrastructures such as gas pipelines are not adequately in place to cater for expansion in new industrial areas. As such, these glove manufacturers are forced to look for alternative fuels and expand on existing facilities rather than build new factories.

At this juncture, we understand the lack of gas supply has and would continue to hamper the glove manufacturers' aggressive expansion plans to cater for the robust demand. Based on our internal estimates, assuming: 1) the industry grows at a modest rate of 10% per annum, 2) Malaysian glove manufacturers raise planned capacity by 20% per annum, and 3) capacity utilisation of 70% - the industry would only be able to see a normalisation in supply and demand in 2015.

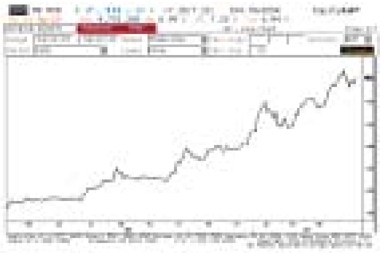
### Keeping FY10-12 earnings estimates unchanged for now

Management is positive that full year earnings should comfortably surpass the earlier PAT target of RM168mn (or EPS of 62 sen) for FY10. Notwithstanding higher latex costs and strong MYR envisaged, the group's bottomline should remain intact, in our view. We also like the group for its healthy cash flow and balance sheet position. Net gearing ratio – post full redemption of the serial bonds - currently stands at 0.3x (FY09: 0.31, FY08: 0.90).

### Valuation

TP maintained at RM9.30, attaching a 15x PER multiples against our FY10 earnings estimates. We believe the premium above industry's average weighted PER of 12.5x is justified due to Supermax's: 1) dominant market share (ranked #2 in terms of capacity), and 2) strong earnings growth momentum. BUY.

**Share Price chart**



*Source : Bloomberg*

**Earnings Summary (RMmn)**

| YE 31 Dec | | 2008 | 2009 | 2010F | 2011F | 2012F |
|---|---|---|---|---|---|---|
| Turnover | (RM mn) | 811.8 | 814.8 | 1,070.8 | 1,389.7 | ###### |
| EBITDA | (RM mn) | 97.3 | 164.6 | 203.5 | 250.1 | 329.7 |
| EBITDA Margin | (%) | 12.0% | 20.2% | 19.0% | 18.0% | 18.0% |
| Pretax profit | (RM mn) | 52.0 | 152.1 | 196.1 | 247.6 | 329.2 |
| Net profit | (RM mn) | 47.0 | 129.7 | 166.7 | 210.5 | 279.8 |
| Net profit - adjustec | (RM mn) | 47.0 | 129.7 | 166.7 | 210.5 | 279.8 |
| EPS | (sen) | 17.3 | 47.8 | 61.5 | 77.6 | 103.2 |
| EPS - adjusted | (sen) | 17.3 | 47.8 | 61.5 | 77.6 | 103.2 |
| EPS Growth | (%) | -16.0% | 175.9% | 28.5% | 26.3% | 32.9% |
| PER | (x) | 41.0 | 14.8 | 11.6 | 9.1 | 6.9 |
| Dividend | (sen) | 3.1 | 11.0 | 11.0 | 11.0 | 11.0 |
| Dividend Yields | (%) | 4.4% | 1.5% | 1.6% | 1.6% | 1.6% |
| ROE | (%) | 11.7% | 26.5% | 26.9% | 27.6% | 29.6% |