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20 October 2010

Supermax Corporation

Results round-up: Not losing their touch

RECOM	Buy
PRICE	RM4.65
MKT CAPITALISATION	RM1.58bn
BOARD	Main (Syariah stock)
SECTOR	Industrial
INDEX COMPONENT	FBM KLCI, FBMSC, FBMS FBMEMAS

SUCB MK / SUPM.KL

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Investment highlights

- **Maintain BUY.** The results that rubber glove companies announced during Aug-Oct were mostly in line with our expectations. However, two companies, i.e. Adventa and Top Glove missed our expectations. Despite the 36% yoy surge in core net profit for the six companies under our coverage during their recent results (quarters ending Jun to Aug), their average quarterly core net profit declined almost 4% qoq due to the unrelenting high level of latex prices, weak US\$ and softening demand. We continue to believe that these hiccups are only temporary as rubber glove demand remains resilient due to their importance to the healthcare industry. We make no change to our earnings forecasts and continue to rate Supermax a BUY given the healthy long-term prospects for the company. Although we continue to value Supermax at a 20% discount to Top Glove, our target price drops from RM8.60 to RM7.82 as we now peg it to 11x CY12 P/E (12.1x previously), having recently changed our valuation basis for Top Glove from a 10% premium over our 15x CY11 target market P/E to parity with our 13.8x CY12 target market P/E. Potential re-rating catalysts include higher earnings from continuous demand and the company's expansion.
- **Contraction in margins and earnings.** On average, glove manufacturers' earnings pulled back about 4% in the quarters ending Jun-Aug. We were most surprised by the significant contraction in margin and earnings for Top Glove. We gather that demand shrank about 5% for this glove manufacturer in 4QFY8/10.
- **Hiccups could drag on but we are not overly worried.** The slowdown in demand, coupled with slower-than-expected cost pass-through due to high latex prices and the weak US\$, could lead to a continuation of the weak earnings trend for the glovemakers. But we continue to view this as a temporary situation as growing hygiene awareness and increase in healthcare spending should give glove demand a big helping hand.

Key stock statistics			Per share data				
FYE Dec	2009	2010F	FYE Dec	2007	2008	2009	2010F
EPS (sen)	37.5	57.2	Book Value (RM)	1.3	1.3	1.7	2.3
P/E (x)	12.4	8.1	Cash Flow (sen)	25.6	16.1	67.4	34.2
Dividend/Share (sen)	8.7	9.0	Earnings (sen)	19.4	14.1	37.5	57.2
NTA/Share (RM)	1.7	2.3	Dividend (sen)	3.0	2.6	8.7	9.0
Book Value/Share (RM)	1.7	2.3	Payout Ratio (%)	15.5	18.4	23.2	15.7
Issued Capital (m shares)		339.5	P/E (x)	24.0	32.9	12.4	8.1
52-weeks Share Price Range (RM)		RM2.69/RM6.60	P/Cash Flow (x)	18.1	28.9	6.9	13.6
Major Shareholders:		%	P/Book Value (x)	3.5	3.7	2.8	2.1
Dato' Seri Thai Kim Sim, Stanley		35.5	Dividend Yield (%)	0.6	0.6	1.9	1.9
EPF		8.5	ROE (%)	17.9	11.7	26.0	29.3
			Net Gearing (%)	87.9	90.0	31.5	20.7

Source: Company, CIMB estimates, Bloomberg

Recent developments

Contraction in margins and earnings. As we had stressed in our last results round-up, the continuation of high latex prices and weakening US\$ could lead to further contraction in margins and earnings for the manufacturers due to the time lag in raising prices to recover the higher latex cost. We were most surprised by the significant contraction in margin and earnings for Top Glove. We gather that demand shrank about

5% for this glove manufacturer in 4QFY8/10. This is in line with the 7% drop in industry natural rubber (NR) glove volume in 2Q10. But exports of synthetic rubber gloves

continued to grow. Malaysia's nitrile glove exports in 2Q10 amounted to 5.3bn pieces compared to only 5.1bn pieces in 1Q10.

Orders to remain soft. Judging from the continuation of high latex prices, we believe that glove orders, especially for natural rubber gloves, will remain soft. But rubber glove manufacturers expect a stronger rebound in demand if latex prices reverse course.

Hiccups could drag on but we are not overly worried. The slowdown in demand, coupled with slower-than-expected cost pass-through due to high latex prices and the weak US\$, could lead to a continuation of the weak earnings trend for the glovemakers. But we continue to view this as a temporary situation as growing hygiene awareness and increase in healthcare spending should give glove demand a big helping hand.

Earnings outlook

No change to earnings but expect conditions to be tough. We make no change to our earnings forecasts. However, given the sustained high levels for latex prices, we believe that conditions will remain tougher for the natural rubber glove manufacturers. This leads us to believe that the quarters ahead could be challenging for Supermax. In light of this, our top picks are now Hartalega and Latexx given their bigger exposure to the nitrile glove segment.

Figure 1: P&L analysis (RM m)

FYE Dec	2007	2008	2009	2010F
Revenue	574.3	811.8	803.6	1,254.5
Operating Profit (EBIT)	74.9	98.9	169.0	236.7
Depreciation	(19.9)	(28.8)	(31.9)	(39.2)
Interest Expenses	(15.3)	(20.3)	(22.3)	(15.1)
Pretax Profit	58.6	52.0	151.5	228.6
Effective Tax Rate (%)	4.4	9.6	16.4	15.0
Net Profit	55.9	47.0	126.6	194.3
Operating Margin (%)	13.0	12.2	21.0	18.9
Pretax Margin (%)	10.2	6.4	18.8	18.2
Net Margin (%)	9.7	5.8	15.8	15.5

Source: Company, CIMB estimates

Recommendation

Maintain BUY. We remain positive on the long-term prospects of all rubber glove manufacturers and continue to rate Supermax a BUY. Although we continue to value Supermax at a 20% discount to Top Glove, our target price drops from RM8.60 to RM7.82 as we now peg it to 11x CY12 P/E (12.1x previously), having recently changed our valuation basis for Top Glove from a 10% premium over our 15x CY11 target market P/E to parity with our 13.8x CY12 target market P/E. Potential re-rating catalysts include higher earnings from continuous demand and the company's expansion.

Figure 2: Share price chart (RM)



Source: Bloomberg

Financial summary

FYE Dec	2008	2009	2010F	2011F	2012F
Revenue (RM m)	811.8	803.6	1,254.5	1,372.4	1,434.7
EBITDA (RM m)	98.9	169.0	236.7	275.6	303.2
EBITDA margins (%)	12.2%	21.0%	18.9%	20.1%	21.1%
Pretax profit (RM m)	52.0	151.5	228.6	261.8	282.9
Net profit (RM m)	47.0	126.6	194.3	222.5	240.4
EPS (sen)	14.1	37.5	57.2	65.5	70.8
EPS growth (%)	-22%	+165%	+53%	+15%	+8%
P/E (x)	32.9	12.4	8.1	7.1	6.6
Core EPS (sen)	18.7	38.8	57.2	65.5	70.8
Core EPS growth (%)	+3%	+108%	+47%	+15%	+8%
Core P/E (x)	24.9	12.0	8.1	7.1	6.6
Gross DPS (sen)	2.6	8.7	9.0	11.0	12.0
Dividend yield (%)	0.6%	1.9%	1.9%	2.4%	2.6%
P/NTA (x)	3.7	2.8	2.1	1.6	1.3
ROE (%)	11.7%	26.0%	29.3%	25.8%	22.6%
Net gearing (%)	90.0%	31.5%	20.7%	1.9%	N/A
Net cash per share (RM)	N/A	N/A	N/A	N/A	0.46
P/CF (x)	60.3	14.6	26.3	7.2	6.1
EV/EBITDA (x)	18.3	9.4	6.6	5.1	4.0
% change in EPS estimates			-	-	-
CIMB/Consensus (x)			1.02	1.04	1.10

Source: Company, CIMB Research, Bloomberg