

8 July 2020

Consumer Non-cyclical | Rubber Products

## Supermax Corp (SUCB MK)

**Buy** (Maintained)

**More Than Just a Manufacturer; Maintain BUY**

Target Price (Return): MYR13.88 (+30%)  
 Price: MYR10.68  
 Market Cap: USD3,224m  
 Avg Daily Turnover (MYR/USD): 169m/38.0m

- **Keep BUY with new DCF-derived MYR13.88 TP from MYR10.50, 30% upside.** Gloves demand remains on an upward trajectory and we expect inventory levels to stay extremely tight. We raise our earnings estimates and TP due to higher ASPs. As Supermax has its own distribution channel on top of its manufacturing arm, we expect earnings to outperform peers. Our new TP reflects 25x FY21F P/E. This is a 30% discount vs the sector average due to its smaller market cap and liquidity.
- **We expect gloves demand to surge in the US (biggest consumer globally with 35% of demand).** Demand should continue to surge throughout 3Q20F, as COVID-19 remains a global pandemic. In 2019, the US consumed an estimated 92.7bn pieces pa (ppa) of gloves, or 35% of global demand. This makes it the biggest gloves consumer globally. As COVID-19 cases remain at elevated levels in the US, gloves demand should also stay exceptionally high.
- **Gloves inventory is estimated to be extremely low at 11bn pieces, or less than half a month's supply.** Based on our channel checks, distributors have very low stock levels – sufficient to cover expected sales for the next two weeks. This is much lower than the average 2-month stock levels pre-pandemic.
- **Incoming supply from China to reduce the deficit, demand-supply equilibrium expected in 1Q23.** We expect the East Asian giant's capacity to increase by 19bn ppa in 2021. These will mainly be from Blue Sail Medical (002382 CH, NR) and Intco Medical Technology (300677 CH, NR), which have outlined their aggressive capacity growth. From 2019-2022, we expect China's capacity to increase by 47bn ppa. Moreover, there is a low oversupply risk, as we expect demand to rise by 46.7bn ppa over the same period. (Refer to page 3 for details).
- **ASP assumptions increased. Supermax has distribution centres in the US and Brazil.** We have increased FY20F-22F (Jun) ASP by 3-17%. Besides higher ASP at its manufacturing arm, Supermax owns distribution centres in eight countries, including the US and Brazil. Gloves demand in these two countries are high as COVID-19 infections remain elevated.
- **BUY with a higher TP.** We increased our FY20F-22F earnings by 46-75%. In the short term, we expect strong 4QFY20F core earnings due to ASP increase. Post COVID-19, Supermax's earnings growth outlook remains positive, as we expect gloves demand to continue its usual uptrend of 8-10% growth due to higher hygiene awareness. Risks are a faster-than-expected effective COVID-19 vaccine made available globally, lower-than-expected sales volume/USD and higher-than-expected raw material prices.

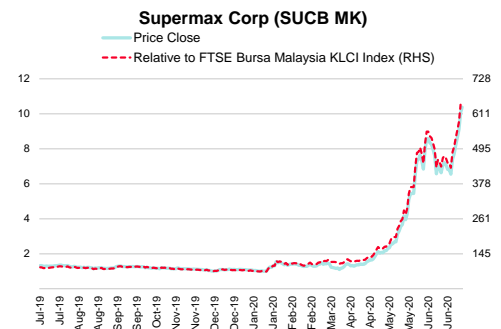
### Analyst

Alan Lim, CFA  
 +603 9280 8890  
[alan.lim@rhbgroup.com](mailto:alan.lim@rhbgroup.com)



### Share Performance (%)

	YTD	1m	3m	6m	12m
Absolute	668.3	20.3	535.7	679.6	553.2
Relative	669.1	19.0	520.6	681.7	559.5
52-wk Price low/high (MYR)				1.30	10.68



Source: Bloomberg

Forecasts and Valuation	Jun-18	Jun-19	Jun-20F	Jun-21F	Jun-22F
Total turnover (MYRm)	1,304	1,538	2,026	2,723	2,985
Recurring net profit (MYRm)	107	123	419	726	853
Recurring net profit growth (%)	-	15.5	240.4	73.2	17.5
Recurring P/E (x)	130.81	113.25	33.26	19.21	16.35
P/B (x)	13.8	12.4	9.8	7.2	5.5
P/CF (x)	78.74	59.35	21.91	15.24	14.30
Dividend Yield (%)	0.7	0.1	1.1	1.8	2.1
EV/EBITDA (x)	57.57	60.31	22.16	12.91	10.65
Return on average equity (%)	-	11.5	33.0	43.4	38.2
Net debt to equity (%)	28.5	19.2	net cash	net cash	net cash

Source: Company data, RHB

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## Financial Exhibits

Asia	Financial summary (MYR)	Jun-18	Jun-19	Jun-20F	Jun-21F	Jun-22F
Malaysia	Recurring EPS	0.08	0.09	0.32	0.56	0.65
Consumer Non-cyclical	DPS	0.08	0.02	0.11	0.19	0.23
<b>Supermax Corp</b>	BVPS	0.78	0.86	1.09	1.48	1.94
SUCB MK	Return on average equity (%)	-	11.5	33.0	43.4	38.2
Buy						
	<b>Valuation metrics</b>	<b>Jun-18</b>	<b>Jun-19</b>	<b>Jun-20F</b>	<b>Jun-21F</b>	<b>Jun-22F</b>
<b>Valuation basis</b>	Recurring P/E (x)	130.81	113.25	33.26	19.21	16.35
We use DCF-FCFE valuation.	P/B (x)	13.8	12.4	9.8	7.2	5.5
	FCF Yield (%)	0.8	0.9	3.5	5.5	5.9
<b>Key drivers</b>	Dividend Yield (%)	0.7	0.1	1.1	1.8	2.1
Our earnings forecasts are most sensitive to:	EV/EBITDA (x)	57.57	60.31	22.16	12.91	10.65
i. Nitrile and latex glove volumes;	EV/EBIT (x)	69.45	74.88	25.49	14.18	11.63
ii. USD/MYR;						
iii. Raw material prices.						
	<b>Income statement (MYRm)</b>	<b>Jun-18</b>	<b>Jun-19</b>	<b>Jun-20F</b>	<b>Jun-21F</b>	<b>Jun-22F</b>
<b>Key risks</b>	Total turnover	1,304	1,538	2,026	2,723	2,985
i. Lower-than-expected volume;	Gross profit	430	510	992	1,457	1,637
ii. Volatile currency movements;	EBITDA	244	232	613	1,009	1,169
iii. Volatile raw material prices.	Depreciation and amortisation	(42)	(45)	(80)	(91)	(98)
	Operating profit	202	187	533	919	1,071
<b>Company Profile</b>	Net interest	(14)	(20)	(3)	8	21
Supermax is one of the world's Big-4 glove makers. It produces both latex and nitrile gloves.	Pre-tax profit	162	172	551	954	1,121
	Taxation	(52)	(49)	(129)	(224)	(263)
	Reported net profit	107	123	419	726	853
	Recurring net profit	107	123	419	726	853
	<b>Cash flow (MYRm)</b>	<b>Jun-18</b>	<b>Jun-19</b>	<b>Jun-20F</b>	<b>Jun-21F</b>	<b>Jun-22F</b>
	Change in working capital	57	31	132	103	41
	Cash flow from operations	177	235	637	915	976
	Capex	(59)	(112)	(150)	(150)	(150)
	Cash flow from investing activities	(55)	(112)	(141)	(131)	(119)
	Dividends paid	(76)	(33)	(126)	(218)	(256)
	Cash flow from financing activities	(126)	(104)	(95)	(198)	(296)
	Cash at beginning of period	156	145	174	584	1,181
	Net change in cash	(4)	19	401	586	560
	Ending balance cash	145	174	584	1,181	1,751
	<b>Balance sheet (MYRm)</b>	<b>Jun-18</b>	<b>Jun-19</b>	<b>Jun-20F</b>	<b>Jun-21F</b>	<b>Jun-22F</b>
	Total cash and equivalents	145	174	584	1,181	1,751
	Tangible fixed assets	900	969	1,018	1,068	1,121
	Total investments	197	208	208	208	208
	Total assets	1,700	1,843	2,326	3,061	3,705
	Short-term debt	374	331	294	336	327
	Total long-term debt	62	61	129	121	114
	Total liabilities	677	708	897	1,122	1,167
	Total equity	1,023	1,134	1,429	1,939	2,538
	Total liabilities & equity	1,700	1,843	2,326	3,061	3,705
	<b>Key metrics</b>	<b>Jun-18</b>	<b>Jun-19</b>	<b>Jun-20F</b>	<b>Jun-21F</b>	<b>Jun-22F</b>
	Revenue growth (%)	0.0	17.9	31.7	34.4	9.6
	Recurrent EPS growth (%)	0.0	15.5	240.4	73.2	17.5
	Gross margin (%)	33.0	33.2	49.0	53.5	54.8
	Operating EBITDA margin (%)	18.7	15.1	30.3	37.1	39.1
	Net profit margin (%)	8.2	8.0	20.7	26.7	28.6
	Capex/sales (%)	4.5	7.3	7.4	5.5	5.0
	Interest cover (x)	14.5	9.5	46.2	85.8	108.3

Source: Company data, RHB

## Sector Demand-Supply Outlook

Figure 1: Demand-supply estimates – peer comparison

Pieces (bn)	2018	2019	2020F	2021F	2022F
Hartalega	33.0	36.6	40.1	43.7	48.5
Growth (%)	10.0%	10.9%	9.6%	9.0%	11.0%
Kossan Rubber	26.5	29.0	32.0	35.0	38.4
Growth (%)	20.5%	9.4%	10.3%	9.4%	9.7%
Top Glove	60.5	70.1	78.7	100.4	106.6
Growth (%)	17.2%	15.9%	12.3%	27.6%	6.2%
Supermax	22.0	21.7	26.2	31.1	38.2
Growth (%)	-6.0%	-1.4%	20.6%	18.6%	22.9%
Sri Trang	21.0	27.0	33.0	38.0	43.0
Growth (%)	NA	28.6%	22.2%	15.2%	13.2%
China	7.0	9.0	18.0	37.0	56.0
Growth (%)	NA	28.6%	100.0%	105.6%	51.4%
Others	70.0	74.2	81.6	89.8	97.0
Growth (%)	NA	6.0%	10.0%	10.0%	8.0%
<b>Estimated manufacturing capacity</b>	<b>240.0</b>	<b>270.0</b>	<b>309.6</b>	<b>374.9</b>	<b>427.6</b>
Supply change	92.0	30.0	39.6	65.3	52.7
Supply growth	62.2%	12.5%	14.7%	21.1%	14.1%
<b>Global demand</b>	<b>256.0</b>	<b>263.0</b>	<b>333.7</b>	<b>383.9</b>	<b>428.4</b>
Demand change	28.0	7.0	70.7	50.3	44.4
Demand growth	12.3%	2.7%	26.9%	15.1%	11.6%
<b>Surplus/(deficit)</b>	<b>-16.0</b>	<b>7.0</b>	<b>-24.1</b>	<b>-9.0</b>	<b>-0.7</b>

Source: Company data, RHB

- ◆ Our capacity supply assumptions may be less aggressive than glove producers' plans
- ◆ Our key assumption: Rational capacity expansions, in which producers will balance between volume growth and margins

The latest demand-supply estimates suggest equilibrium to only happen in 1Q23. We have updated our demand-supply forecast (Figure 1) to reflect the worse-than-expected COVID-19 development in June. The number of COVID-19 cases has surged by more than 10x throughout the quarter to 10.5m as at 30 Jun. This is a sharp increase when compared to the 0.9m registered on 31 Mar. This has resulted in the escalating gloves demand.

**Incoming supply from China to reduce the deficit.** We expect China's capacity to increase by 19bn ppa in 2021. These will mainly be from Blue Sail Medical and Intco Medical Technology, which have outlined their aggressive capacity growth.

From 2019-2022, we expect China's capacity to increase by 47bn ppa. However, there is a low oversupply risk, as we expect demand to rise by 46.7bn ppa over this same period. We believe China's 2022 gloves consumption will hit 58.2bn ppa, assuming a population of 1.45bn and per capita usage of 40ppa. This is still lower than the US', Japan's, and Germany's 2019 per capita usage of 280, 117, and 235ppa.

Due to a higher supply in FY21F-22F, we expect the ASP increase to be more gradual at 15% and 5% as compared to FY20F's 28%. As we expect 1Q23 to be the equilibrium period, we assume ASP to be flat from FY23 onwards. However, we believe ASP will decline from FY23 if there is irrational overexpansion that focuses on revenue growth instead of bottomline growth. Our base case assumption is a rational expansion by the players, which would mean that producers will halt expansion when there is a higher-than-expected margin squeeze in the industry.

Figure 2: Key assumptions

Key assumptions	FY20F	FY21F	FY22F
Installed capacity (m ppa)	26,200	31,100	38,200
ASP change YoY	28%	15%	5%
Average USD/MYR	4.28	4.28	4.28
Utilisation rate	80%	90%	90%

Source: RHB

## Valuation

**FCFF increased.** In our DCF valuation, we have increased FCFF assumptions – this is in line with better earnings prospects. This is driven by a better ASP outlook, as demand-supply remains extremely tight.

Our DCF-derived TP of MYR13.88 reflects FY21F P/E of 25x. Our TP implies a 30% discount against the sector average forward P/E. This is justified due to its smaller market cap and lower liquidity.

For the discount factor, we have applied an 11-month discount to FY22F for the first cash flow to estimate the TP, as at Jul 2021, ie 12 months from now.

Supermax's implied forward P/E of 25x is lower than the implied forward P/E for Hartalega (43.7x) (HART MK, BUY, TP: MYR19.00), Top Glove (36x) (TOPG MK, BUY, TP: MYR24.80) and Kossan (28.8x) (KRI MK, BUY, TP: MYR13.00). The implied forward P/E is lower than Hartalega and Top Glove as Supermax is not an FBMKLCI member. As compared to Kossan, the forward P/E is lower due to its lower exposure to nitrile gloves at 63%. Kossan's exposure is higher at 80%. Nitrile gloves ASP is higher and usually commands a higher margin than latex gloves.

**Figure 3: DCF valuation**

FYE Jun (MYRm)	FY22F	FY23F	FY24F	FY25F	FY26F	FY27F	FY28F	FY29F	FY30F	FY31F	Terminal
CFO	976	947	1,046	1,123	1,145	1,215	1,298	1,349	1,389	1,431	
+ Interest (1 - tax rate)	(8)	(7)	(6)	(6)	(5)	(4)	(4)	(3)	(3)	(3)	
- capital expenditure	(150)	(150)	(150)	(150)	(150)	(150)	(150)	(150)	(155)	(159)	
<b>FCFF</b>	<b>818</b>	<b>790</b>	<b>889</b>	<b>967</b>	<b>990</b>	<b>1,061</b>	<b>1,144</b>	<b>1,195</b>	<b>1,231</b>	<b>1,268</b>	<b>29,214</b>
Discount factor	0.92	0.84	0.77	0.71	0.65	0.59	0.54	0.49	0.45	0.41	0.41
PV of FCFF	754	666	686	682	639	626	618	591	557	525	12,087
Risk-free	4.0%										
Beta	0.92										
Cost of Equity	9.5%										
WACC	8.5%										
Terminal growth	4.0%										
Enterprise value (MYRm)	18,432										
Cash	218										
- Debt	(473)										
Equity value (MYRm)	18,178										
No of shares (m)	1309.90										
<b>Fair Value (MYR)</b>	<b>13.88</b>										

Source: RHB

## Our View On Windfall Tax Risk

**A windfall tax is unlikely to be imposed.** We believe there is a very low risk of the Government imposing a windfall tax on the rubber gloves sector. Unlike CPO, where prices are publicly available, there is no standard ASP for gloves, as they come in different types and specifications.

Additionally, the rubber gloves industry has been paying corporate taxes and foreign worker levies to the Government. Lastly, imposing a windfall tax may be counter-productive, as it may encourage local glove makers to prioritise their future expansion plans overseas eg Thailand or China.

**Figure 4: Sensitivity analysis on Supermax if a windfall tax is implemented**

Effective tax rate assumptions	FY20F	FY21F	FY22F	TP (MYR)
Base case: 23.5%	419	726	853	13.88
Scenario 1: 25%	411	712	836	13.60
Scenario 2: 27.5%	397	688	808	13.13
Scenario 3: 30%	384	664	780	12.68

Source: RHB

### Recommendation Chart



Source: RHB, Bloomberg

Date	Recommendation	Target Price	Price
2020-06-02	Buy	10.5	7.6
2020-05-22	Buy	6.7	5.8
2020-05-21	Buy	6.1	5.4
2020-05-13	Buy	3.9	3.6
2020-03-15	Buy	1.9	1.7
2019-11-29	Neutral	1.5	1.3
2019-09-03	Neutral	1.6	1.5
2019-07-19	Buy	1.9	1.6
2019-01-08	Neutral	1.9	1.6
2018-08-30	Neutral	4.2	1.7
2018-07-23	Buy	5.2	2.2

Source: RHB, Bloomberg

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#### KUALA LUMPUR

##### RHB Investment Bank Bhd

Level 3A, Tower One, RHB Centre  
Jalan Tun Razak  
Kuala Lumpur 50400  
Malaysia  
Tel : +603 9280 8888  
Fax : +603 9200 2216

#### JAKARTA

##### PT RHB Sekuritas Indonesia

Revenue Tower, 11th Floor, District 8  
- SCBD  
Jl. Jendral Sudirman Kav 52-53  
Jakarta 12190  
Indonesia  
Tel : +6221 509 39 888  
Fax : +6221 509 39 777

#### HONG KONG

##### RHB Securities Hong Kong Ltd.

12<sup>th</sup> Floor, World-Wide House  
19 Des Voeux Road  
Central  
Hong Kong  
Tel : +852 2525 1118  
Fax : +852 2810 0908

#### BANGKOK

##### RHB Securities (Thailand) PCL

10th Floor, Sathorn Square Office  
Tower  
98, North Sathorn Road, Silom  
Bangrak, Bangkok 10500  
Thailand  
Tel: +66 2088 9999  
Fax :+66 2088 9799

#### SINGAPORE

##### RHB Securities Singapore Pte Ltd.

10 Collyer Quay  
#09-08 Ocean Financial Centre  
Singapore 049315  
Tel : +65 6533 1818  
Fax : +65 6532 6211