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CIMB Research Report

21 October 2009

Supermax

Demand stretches into 2010

RECOM	Buy
PRICE	RM3.60
MKT CAPITALISATION	RM955.1m
BOARD	Main (Syariah stock)
SECTOR	Industrial
INDEX COMPONENT	KLCI, FBMSC, FBMS FBMEMAS

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Investment highlights

- **Briefing highlights.** At yesterday's luncheon talk for analysts, fund managers and investors, Supermax elaborated on its strong 3Q09 performance and provided updates on the rubber glove industry and the group's expansion plans. There were some positive surprises from management including a bigger-than-expected spike in demand and accelerated expansion plans. Taking into account the upcoming expansion and potential increase in demand, we tweak our earnings forecasts up by 1-4%. This raises our target price from RM6.31 to RM6.40. We continue to use a target P/E of 10.5x based on an unchanged 30% discount to Top Glove's 15x target P/E. Potential re-rating catalysts for Supermax include the continuing uptick in glove demand and upcoming expansion plans. The stock remains a BUY.
- **Spike in global glove demand due to H1N1.** Global rubber glove demand has racked up consistent growth of about 8-10% per annum for the past few years. Supermax estimates the amount to about 135bn pieces this year but thinks that consumption may even hit 148bn pieces this year, an 18% over 2008, as H1N1 has caused a spike in demand, leading to a severe supply shortage.
- **Gearing up for higher demand.** Furthermore, Supermax believes that the shortage or tight supply of gloves will continue in 2010. The company said demand has been so great that it does not have enough capacity to handle all of its customers' orders. Orders received YTD total 17.5bn pieces vs. a total installed annual capacity of 14.5bn. The company estimates that it can only produce and ship 12.4bn pieces this year, which means a backlog of about 5.1bn pieces which will only be shipped next year. In view of this, the company has decided to accelerate its capital expansion plans and expand its capacity by 50% from the current 14.5bn pieces to 21.7bn pieces by the end of 2011.

Key stock statistics

FYE Dec	2008	2009F
EPS (sen)	17.8	49.8
P/E (x)	20.3	7.2
Dividend/Share (sen)	3.2	9.5
NTA/Share (RM)	1.6	2.0
Book Value/Share (x)	1.6	2.0
Issued Capital (m shares)		265.3
52-weeks Share Price Range (RM)		RM3.60/RM0.78
Major Shareholders:		%
Dato' Seri Thai Kim Sim, Stanley		20.4
Datin Seri Tan Bee Geok, Cheryl		15.0
Lembaga Tabung Haji		7.6

Per share data

FYE Dec	2006	2007	2008	2009F
Book Value (RM)	1.1	1.7	1.6	2.0
Cash Flow (sen)	17.2	32.0	37.3	55.9
Earnings (sen)	17.6	22.6	17.8	49.8
Dividend (sen)	3.3	3.0	3.2	9.5
Payout Ratio (%)	18.5	13.3	18.0	19.1
P/E (x)	20.8	15.9	20.3	7.2
P/Cash Flow (x)	21.3	11.4	9.8	6.5
P/Book Value (x)	3.4	2.2	2.3	1.8
Dividend Yield (%)	0.9	0.8	0.9	2.6
ROE (%)	17.9	17.9	11.7	27.7
Net Gearing (%)	77.9	87.9	90.0	55.1

Source: Company, CIMB estimates, Bloomberg

Recent developments

Spike in global glove demand due to H1N1. Global rubber glove demand has racked up consistent growth of about 8-10% per annum for the past few years. Supermax estimates the amount to about 135bn pieces this year but thinks that consumption may even hit 148bn pieces this year, an 18% increase over 2008, as H1N1 has caused a spike in demand, leading to a severe supply shortage.

No new capacity since 2008. After its APLI investment blunder, Supermax was very careful about expanding. As a result, its production capacity stagnated for almost two years, which was not a problem as the company operated at only about 75% utilisation last year. But this left it unprepared for the strong demand witnessed since the H1N1 outbreak. Since then, the company has been running at 86% utilisation, which is its limit as refurbishment and maintenance works prevented it from operating at 100% capacity in 2Q and 3Q. It expects to run at 90% of its capacity in 4Q to cater to orders. It is currently booked up to December.

Rationing of supply. Furthermore, Supermax believes that the shortage or tight supply of gloves will continue in 2010. The company said demand has been so great that it does not have enough capacity to handle all of its customers' orders. Orders received YTD total 17.5bn pieces vs. a total installed annual capacity of 14.5bn. The company estimates that it can only produce and ship 12.4bn pieces this year, which means a backlog of about 5.1bn pieces which will only be shipped next year. Supermax now has to give priority to the customers with whom it has strong relationships though it is trying to satisfy all of its customers by fulfilling at least part of their orders.

Capacity expansion plans in place…. In response to the changing environment and strong global demand, management has decided to bring forward some of next year's capital expenditure plans to Nov 09. Instead of starting in Jan 2010, it will start putting in 12 new production lines at its Meru plant in Klang next month. It targets to complete by 1Q10. It also plans to decommission four old lines and replace them with six new production lines in that same plant by 3Q10.

… to handle the higher demand. Besides the Meru plant, the company intends to improve the operating efficiency of its other plants. This includes the ongoing refurbishment and upgrade of the old production lines at the plant in Lahat. Next year, it intends to decommission some of its old lines and replace with some new ones at it Malacca and Sungai Buloh plants. All these efforts will take its annual glove production capacity from 14.5bn pieces to 17.6bn pieces. On top of that, Supermax is firm on launching the first phase of its GloveCity project at Mukim Kapar, Klang with the first 32 new production lines adding capacity for another 4.2bn gloves, taking its glove production capacity to 21.7bn pieces per annum by the end of 2011, higher than its initial estimate of 19.2bn pieces.

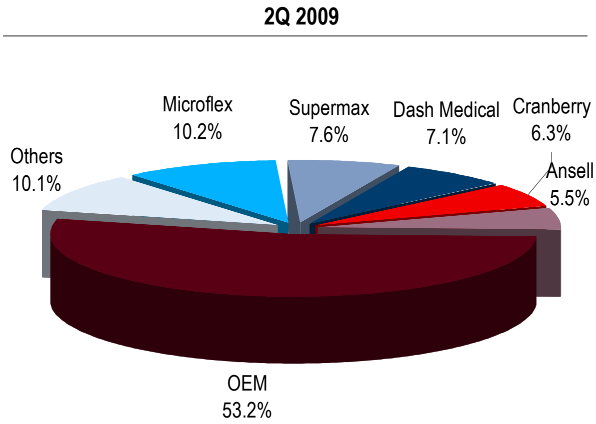
Figure 1: Capacity expansion plans

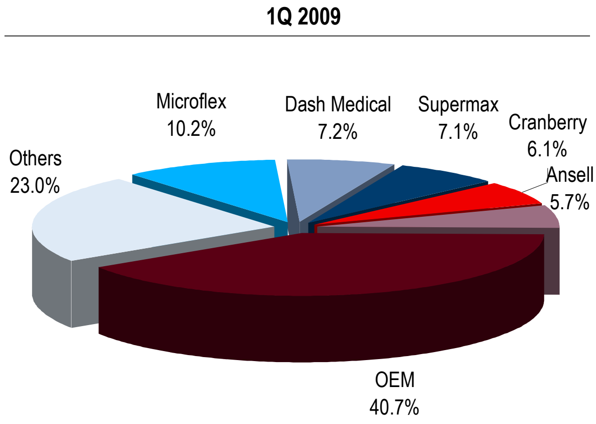
	2008	2009F	2010F		2011F	
			Previous target	New target	Previous target	New target
Installed capacity	14,476	14,476	14,476	14,476	16,204	17,588
Capacity contribution from APLI	2,640	-	-	-	-	-
Additional via lines upgrade or expansion	-	-	1,728	3,112	3,000	4,150
Total capacity	**17,116**	**14,476**	**16,204**	**17,588**	**19,204**	**21,738**

Source: Company, CIMB Research

Upgrade to the second place in US dental glove market. Supermax's global brand and products remain synonymous with quality and reliability in the global marketplace and continue to gain market share every year. As reported in Strategic Dental Marketing, Supermax's share of the dental market increased from 7.1% in 1Q09 to 7.6% in 2Q09, making in the second biggest glove brand in the US dental market. This is a feather in its cap as the company has been slowly building its reputation over the past nine years and now has a strong footing in the US dental glove industry. We gathered that this was driven largely by the group's ongoing efforts to penetrate into the US market by participating in international trade shows and exhibitions.

Figure 2: Dental market share in US





Source: Strategic Dental Marketing (USA) ,Company, CIMB Research

Strong contribution from associates. In 3Q09, contribution from Supermax's associates went up almost fivefold yoy to RM11.3m. We gathered that this was due to the company's ongoing efforts to develop its 50%-owned distribution business in Brazil, Canada and Belgium as well as the 33%-owned distribution centre in Australia. Demand has been exceptionally strong in Brazil as there are not many players there.

Earnings outlook

Earnings tweaked. Judging from the strong pick-up in demand and the potential improvement in earnings and margins, Supermax is well on course for a strong FY09. The company is also optimistic that the strong demand trend witnessed since the outbreak of H1N1 will spill over to 2010. We believe that earnings in the final quarter of 2009 could be even better than 3Q's as its products are booked up to December and the company is already selling its capacity for January and February next year. Taking into account the accelerated expansion plans and potential increase in demand, we tweak our production and capex assumptions, resulting in 1-4% increases in our FY09-11 earnings numbers. We are also upping our FY09-11 dividend per share from 9-12 sen to 9.5-12.5 sen.

Figure 3: P&L analysis (RM m)

FYE Dec	2006	2007	2008	2009F
Revenue	400.3	574.3	811.8	990.5
Operating Profit (EBIT)	53.4	74.9	98.9	184.6
Depreciation	(13.0)	(19.9)	(28.8)	(32.9)
Interest Expenses	(12.7)	(15.3)	(20.3)	(34.1)
Pretax Profit	47.3	58.6	52.0	155.3
Effective Tax Rate (%)	*16.0*	*4.4*	*9.6*	*15.0*
Net Profit	39.7	55.9	47.0	132.0
Operating Margin (%)	*13.3*	*13.0*	*12.2*	*18.6*
Pretax Margin (%)	*11.8*	*10.2*	*6.4*	*15.7*
Net Margin (%)	*9.9*	*9.7*	*5.8*	*13.3*

Source: Company, CIMB estimates

Recommendation

Regaining confidence. From a high of 35.9% in 2006, Supermax's foreign shareholdings plummeted to less than 2% early this year as the company lost favour with investors, largely because of its disastrous investment in APLI. Helped in a big way by the H1N1-driven upsurge in demand, management has turned its prospects around and even exceeded our and consensus expectations every quarter this year. Since we upgraded the stock to a Buy in May, Supermax's share price has more than tripled. We believe that investors are slowly regaining confidence and interest in the company. This is borne out by the increased foreign shareholding level of 6.6% as at 19 Aug.

Maintain BUY. Using our revised earnings, we derive a new end-10 target price of RM6.40 (RM6.31 previously), still pegged to 10.5x P/E, an unchanged 30% discount to Top Glove's target P/E, which is based on our target market P/E of 15x. In view of the favourable outlook for the company, we retain our BUY call. Potential re-rating catalysts for Supermax include the continuing uptick in glove demand and upcoming capacity expansion plans. With the lowest CY10 P/E of 6.8x against the sector average of 9.0x, the stock still offers the cheapest exposure to the rubber glove sector and remains one of our top two picks for the sector.

Figure 4: Share price chart (RM)

Source: Bloomberg

Financial summary

FYE Dec	2007	2008	2009F	2010F	2011F
Revenue (RM m)	574.3	811.8	990.5	1237.8	1499.9
EBITDA (RM m)	74.9	98.9	184.6	205	235.6
EBITDA margins (%)	13.0%	12.2%	18.6%	16.6%	15.7%
Pretax profit (RM m)	58.6	52	155.3	165.7	190.3
Net profit (RM m)	55.9	47.0	132.0	140.8	161.7
EPS (sen)	22.6	17.8	49.8	53.1	61
EPS growth (%)	29.9%	-21.5%	180.2%	6.6%	14.9%
P/E (x)	15.9	20.3	7.2	6.8	5.9
Core EPS (sen)	22.6	23.5	49.8	53.1	61
Core EPS growth (%)	29.9%	3.7%	112.2%	6.6%	14.9%
Core P/E (x)	15.9	15.3	7.2	6.8	5.9
Gross DPS (sen)	3.0	3.2	9.5	10.5	12.5
Dividend yield (%)	0.8%	0.9%	2.6%	2.9%	3.5%
P/NTA (x)	2.2	2.3	1.8	1.5	1.2
ROE (%)	17.9%	11.7%	27.7%	23.7%	22.3%
Net gearing (%)	87.9%	90.0%	55.1%	32.7%	19.0%
P/CF (x)	61.6	37.2	6.8	4.4	6.8
EV/EBITDA (x)	15.3	12.5	6.3	5.3	4.4
% change in EPS estimates			4.4%	2.4%	1.4%
CIMB/Consensus (x)			1.56	1.48	1.65

Source: Company, CIMB Research, Reuters Estimates

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