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CIMB Research Report

3 November 2009

Supermax

Getting out of the grip of debt covenants

RECOM	Buy
PRICE	RM3.55
MKT CAPITALISATION	RM952.3m
BOARD	Main (Syariah stock)
SECTOR	Industrial
INDEX COMPONENT	KLCI, FBMSC, FBMS FBMEMAS

SUCB MK / SUPM.KL

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Investment highlights

- **Buying back remaining bonds; maintain BUY.** Yesterday, Supermax announced that it would be redeeming the remaining three tranches of its RM120m serial bond with an outstanding balance of RM90m by mid-Nov. Although this news does not come as a surprise to us, we see it as a positive development as Supermax will now have the option to gear up for its expansion plans without being hampered by restrictive debt covenants. We make no change to our earnings forecasts or end-10 target price of RM6.40, which remains pegged to 10.5x P/E, a 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, we retain our BUY call. Potential re-rating catalysts for Supermax include the continuing uptick in glove demand and upcoming capacity expansion plans.
- **Benefits of early redemption.** At the company's 27 Oct EGM, its bondholders passed a resolution to sell the remaining bonds back to the company. According to the company, the reasons for the early redemption include 1) cost savings of approximately RM2.4m over the remaining tenure of the bond which was due to mature on 30 May 2012, and 2) freeing the company from overly restrictive covenants which hampered its growth over the past few years.
- **Mixture of lenders and greater payment flexibility.** Other benefits of this early redemption include a potential mixture of lenders with greater payment flexibility. The additional funding on top of the amount used to redeem the bond would also free up cash currently tied up in fixed assets which were previously funded by internally generated funds and unwind any mismatch of financing, i.e. short-term funds used to finance long-term assets.

Key stock statistics

FYE Dec	2008	2009F
EPS (sen)	17.8	49.8
P/E (x)	20.0	7.1
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)		RM4.04/RM0.78
Major Shareholders:		%
Dato' Seri Thai Kim Sim, Stanley		20.4
Datin Seri Tan Bee Geok, Cheryl		15.0
Lembaga Tabung Haji		5.9

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)	20.2	15.7	20.0	7.1
P/Cash Flow (x)	20.6	11.1	9.5	6.3
P/Book Value (x)	3.3	2.1	2.2	1.8
Dividend Yield (%)	0.9	0.9	0.9	2.7
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

Buying back the remaining bond. Yesterday, Supermax announced that it would be redeeming the remaining three tranches of its RM120m (Figure 1) serial bond with an outstanding balance of RM90m by mid-Nov. This is the outcome of the company's 27 Oct extraordinary general meeting (EGM) where its bondholders passed the resolution to sell back the remaining bonds to the company. Although this news does not come as a surprise to us, we see this as a positive development for Supermax as it will now have the option to gear up for its expansion plans without adhering to restrictive debt covenants which had slowed down the company's expansion plans over the past few years. The potential acceleration of expansion plans could also boost the company's earnings growth.

How will it be funded? According to the company, the redemption will be funded by two separate syndicated term loan facilities amounting to US$16.5m and RM50m. Both facilities will be granted by a group of lenders, with the lead arranger being HSBC Bank Malaysia Bhd. The facilities agreements between the company and the group of lenders were executed on 31 Oct 09.

Benefits of early redemption. The reasons for the early redemption include 1) cost savings of approximately RM2.4m over the remaining tenure of the bond which was due to mature on 30 May 2012 and 2) freeing the company from overly restrictive covenants which had hampered its growth over the past few years. For example, although the company had complied with the financial covenants, i.e. gearing ratio not exceeding 1.25x, there were a few cases when the bondholders declined the company's requests to issue corporate guarantees needed to secure funding for expansion.

Mixture of lenders and greater payment flexibility. Other benefits of this early redemption include a potential mixture of lenders with greater payment flexibility. The additional funding on top of the amount used to redeem the bond would also free up cash currently tied up in fixed assets which were previously funded by internally generated funds and unwind any mismatch of financing, i.e. short-term funds used to finance long-term assets.

Figure 1: Original schedule for serial bond repayment

Tranche	Principal Amount (RM m)	Due
1	30	May-09 (Paid)
2	30	May-10
3	30	May-11
4	30	May-12
Total	**120**	

Source: Company, CIMB Research

Earnings outlook

No change to earnings. Overall, this news did not come as a surprise to us as the company had in the past highlighted its wish to redeem the bonds. We take a positive view of this development as it gives the company flexibility to take on borrowings if it decides to fast track its expansion plans by using funds other than internally generated cash. However, as this procedure will only replace one type of borrowings i.e. bonds with another, i.e. term loans, the company does not expect a major impact on its borrowings, interest costs, earnings and gearing ratio. Taking all this into account, we retain our earnings forecasts while stressing that further acceleration of its capex plans would mean upside to our earnings estimates. As Supermax has been running at full capacity since the outbreak of H1N1 this year, we view the expansion plans laid out by the company for the next three years (Figure 2) as conservative given that its growth will still fall behind the smaller players like Hartalega (HART MK, Outperform) and Kossan (KRI MK, Outperform). Now that the company is free from the restrictive debt covenants, it has the choice of stepping up its expansion plans by taking on more debt.

Figure 2: Capacity expansion plans (bn pieces p.a)

	2009	2010	Annual increase (%)	2011	Annual increase (%)	Growth in 3 years (%)
Hartalega	6.5	8.2	26%	10.5	28.0%	69.4%
Kossan Rubber	11.1	14.5	31%	18.0	24.1%	62.2%
Latexx Partners	6.0	7.6	27%	9.0	18.4%	50.0%
Supermax	14.5	17.6	21%	21.7	23.6%	50.2%
Top Glove	31.5	34.5	10%	36.0	4.3%	14.3%
Total	**69.6**	**82.4**	18%	**95.2**	15.6%	**37.5%**

Source: Companies, CIMB Research

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

Maintain BUY. As there are no changes to our earnings forecasts, our end-10 target price remains firm at RM6.40, 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 6.7x against the sector average of 8.8x, 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	1,237.8	1,499.9
EBITDA (RM m)	74.9	98.9	184.6	205.0	235.6
EBITDA margins (%)	13.0%	12.2%	18.6%	16.6%	15.7%
Pretax profit (RM m)	58.6	52.0	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	61.0
EPS growth (%)	29.9%	-21.5%	180.2%	6.6%	14.9%
P/E (x)	15.7	20.0	7.1	6.7	5.8
Core EPS (sen)	22.6	23.5	49.8	53.1	61.0
Core EPS growth (%)	29.9%	3.7%	112.2%	6.6%	14.9%
Core P/E (x)	15.7	15.1	7.1	6.7	5.8
Gross DPS (sen)	3.0	3.2	9.5	10.5	12.5
Dividend yield (%)	0.9%	0.9%	2.7%	3.0%	3.5%
P/BV (x)	2.1	2.2	1.8	1.4	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/FCFE (x)	60.7	36.6	6.7	4.3	6.7
EV/EBITDA (x)	15.1	12.3	6.2	5.2	4.3
% change in EPS estimates			-	-	-
CIMB/Consensus (x)			1.08	1.06	1.10

Source: Company, CIMB Research, Reuters Estimates

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