Oil & Gas/Chemicals | Malaysia

Supermax Corp Bhd SUCB MK

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BUY

RESULTS FIRST LOOK

Despite a sequentially soft quarter, with NPAT down 11% from 1Q10, Supermax's results still came in within our and consensus expectations, making up 58% of the bottom line. Management reaffirmed intact fundamentals at the conference call today, with utilizations near 90%, no signs of a supply glut and an oversold position of 2-3 months. This we believe should reverse the share price underperformance lately. Output was up 9% sequentially, commendable given a seasonally quiet quarter, and in-line with our estimates. BUY with 35% upside.

Price target: MYR 7 | **Price (25 Aug 2010): MYR 5.07**

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Publish Date: 26 Aug 2010

1H10 comfortably inline despite soft quarter sequentially

- **Earnings vs. our Forecast:** **IN LINE**

Likely Impact:

- **Earnings Estimates:** **NO CHANGE**
- **Dividend Estimates:** **NO CHANGE**
- **Price Target:** **NO CHANGE**
- **Long-term View:** **CONFIRMED**

1H10 net profit comfortably in-line despite soft quarter sequentially

1H10 net profit was in-line with our numbers, at 58% of our full year estimates, despite a 11% sequential bottom line drop in 2Q10, translating into a 4ppt net margin contraction. Regardless, 1H10 has comfortably met ours and consensus expectations, which we believe should, together with the positive data points on output (up 9% qoq) and utilization rates (near 90%), reverse the share price underperformance lately due to the market pricing in the industry-wide bad news of latex prices and RM appreciation.

According to management during the analyst call, circa 53% of the sequential profit contraction was due to the RM fluctuation (RM3mn out of RM5.6mn). Although NPAT was sequentially down 11%, management mentioned that the RM51.5mn NPAT in 1Q10 comprised circa RM4mn exceptional earnings recognized from delayed shipments to customers, which was supposed to be shipped in 4Q09. Taking that into account, sequential earnings would have been flat moving into 2Q10, despite record latex prices and RM appreciation in 2Q10, a commendable performance given competitors' sequential margin contractions for comparable quarters.

Management remains confident of its ability to at least maintain 2Q10 profit performance in the next two quarters, as it has already budgeted for a RM3.10 RM/USD exchange rate in its financial forecasts. It is looking at a top-line of circa RM950mn – RM1bn for FY10F, in line with our estimates of RM1bn.

On a sequential basis, output (the ultimate indicator of bottomline strength) increased sequentially by 9% to 3.5bn gloves in 2Q10, as 6 new lines came online in 1H10. This is despite the fact that July/Aug 2010 are considered 'quiet' quarters for the company as most of its European customers are away on summer holidays.

Total output for 1H10 of 6.7bn pcs is in-line with our model assumptions (full year of 11.9bn pcs). Judging from current planned expansions into 2H10, management guided during the conference call that output will likely increase to 4bn pcs per quarter by 4Q10. Expansions continue to be at a measured pace, tempered by some unforeseen delays on the parts suppliers for the new lines. Though visibility has reduced from the 6-month levels as the company has worked off the extra backlog in 1Q10 arising from the H1N1 crisis, backlog orders still remain at 2-3 months. The aforementioned expansion delays have pushed utilizations to near 90%.

On a yoy basis, positive double digit growth numbers were seen across the board, with net profit up 80% yoy and net margin expansion of 6ppt.

Supermax output figures (in bn pcs)	2Q10	1Q10	% chg q-q	1H10 as % of Nomura full year output estimates
No of pcs shipped	3.5	3.2	9.4	56

*Source: Company

Supermax PnL quarterly figures (RM mn)	2Q10	2Q09	% chg y-y	1Q10	% chg q-q
Revenue	234.8	188.5	22	220.7	6
EBITDA	60.0	43.8	37	66.1	-9
EBITDA margin (%)	25.5	23.2		29.9	
Finance Costs	3.3	4.5	-27	3.8	-13
Associate contribution to net profit	10.4	9.0	16	10.5	-1
Net profit	45.9	25.8	80	51.5	-11
Net profit margin (%)	19.5	13.7		23.3	

*Source: Company

Supermax Actual versus Nomura	1H10	Nomura full year	% of our full year numbers	Consensus (Bberg)	% of consensus
Revenue	455.5	1061.1	43	1075.4	42
EBITDA	126.1	195.9	64	220.0	57
EBITDA margin (%)	27.7				
Finance Costs	7.1	13.2	54		
Associate contribution to net profit	20.9	50.1	42		
Net profit	97.4	168.9	58	186.1	52

*Source: Company, Nomura, Bloomberg

<u>Operational and balance sheet ratios healthy</u>

Net gearing of 0.34x is still below management's target level of 0.50-0.75x. Finance costs were sequentially down 13% and down 27% yoy.

Trade receivables increased 63% in 1H10 from end-Dec 2009, but that was largely due to the fact that the bulk of 2Q10 shipments were to customers in the U.S.A and extra time was taken as the containers going to the U.S.A need to be held for U.S FDA clearance. Higher selling prices for 1H10 versus end Dec 2009 (due to higher latex prices) also contributed to higher value of trade receivables in 1H10.

Supermax key ratios	2Q10	1Q10	Management target (if officially stated)
Net Gearing	0.34	0.30	0.50-0.75
Finance costs	3.3	3.8	
Interest cover	15.8x	15.5x	

*Source: Company

<u>Supermax has come a long way from 2006; BUY call remains with upside of 35% with no change in estimates</u>

As mentioned earlier, 1H10's reported performance comfortably met our expectations, evidencing a resilience in Supermax's operations despite well-known industry headwinds of high latex prices, RM appreciation, and lower buying appetite from customers in 2Q10. An additional 10 new lines are envisaged to come up in 2H10, allowing Supermax to be able to capitalize on the seasonal rebound in glove demand as customers resume ordering to replenish inventories ahead of next year's wintering season.

Judging by the numbers, Supermax has come a long way from 2006, where its one quarter EBITDA performance (for 2Q10) is already equal to its EBITDA numbers for the entire year of 2006. As such, we are keeping our estimates unchanged and reaffirming our BUY call on Supermax with an upside of 35% to our PT.

Valuation Methodology and Investment Risks: We peg Supermax's target P/E of 11.5x at a 21% discount to Top Glove, derived from its historical discount of ~30% to Top Glove; however, we argue that it should see an upward re-rating given its write-off of the APLI investment. Applying this to FY11F EPS, we derive our PT of RM7.00. Downside to our call is industry-related similar to Top Glove, as well as adverse and rapid currency movements that could affect income from its overseas distribution arms.

Note: Ratings and Price Targets are as of the date of the most recently published report (http://www.nomura.com/research) rather than the date of this email.

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Mentioned Stocks:

Mentioned Company	Ticker	Price	Price Date	Stock Rating	Disclosures
Supermax Corp Bhd	SUCB MK	MYR 5.07	25 Aug 2010	Buy	

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As at 30 Jun 2010.

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• A rating of "4", or **"Reduce"**, indicates that the analyst expects the stock to underperform the Benchmark by 5% or more but less than 15% over the next six months.
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• A rating of "1", or "**Strong buy**" recommendation indicates that upside is more than 20%.

• A rating of "2", or "**Buy**" recommendation indicates that upside is between 10% and 20%.
• A rating of "3", or "**Neutral**" recommendation indicates that upside or downside is less than 10%.
• A rating of "4", or "**Reduce**" recommendation indicates that downside is between 10% and 20%.
• A rating of "5", or "**Sell**" recommendation indicates that downside is more than 20%.

Sectors:

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A "**Bearish**" rating means most stocks in the sector have (or the weighted average recommendation of the stocks under coverage is) a negative absolute recommendation.

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