

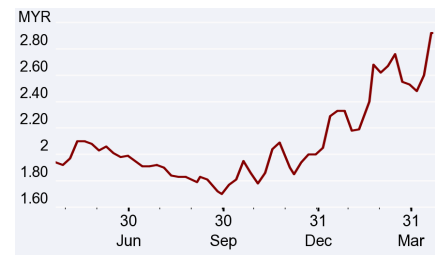
Supermax (SUPM.KL)

U/G to Buy: Valuation Gap to Narrow

- Estimate Change
- Target Price Change
- Rating Change

Buy	1
<i>from Sell</i>	
Price (23 Apr 18 17:00)	RM2.76
Target price	RM3.50
<i>from RM1.76</i>	
Expected share price return	26.8%
Expected dividend yield	1.6%
Expected total return	28.4%
Market Cap	RM1,877M US\$482M

Price Performance (RIC: SUPM.KL, BB: SUCB MK)



■ **Conclusion(s)** — We upgrade Supermax to Buy (from Sell) with a higher TP of RM3.50 (from RM1.76). Despite recent outperformance, the stock is trading at a c.45% discount (12m forward PER basis) to industry average. We believe the gap should narrow, underpinned by [1] Marked improvement in earnings visibility as water supply issues at Plant 10 and 11 are fully resolved, [2] Efficiency boost from its 'rebuilding and replacement' program with minimal impact to existing operations, [3] Earnings lift from the contact lens business which is expected to turn profitable in FY19E. We raise earnings by 23-25% over FY18-20E – 8-9% above the street. We now peg our TP to 17x (previous 11x) average CY18/19E PER (rolled forward from CY18E). With the upgrade, Supermax is our preferred pick in the sector.

■ **Back on track** — Supermax's 1HFY18E was strong (PATMI +52% YoY), anchored by increased output from Plant 10 & 11 (water issues resolved towards end-2017) as well as margins uptick from upgrading and refurbishment of older lines. We expect 2H18E to further surprise on the upside as we gather utilization remains high at c.80% with management optimistic that the margins seen in recent quarters are sustainable; seemingly still not priced in by the market as we are c.8-10% above consensus in our forecasts. Over the near term, Supermax will focus on expanding within its existing facilities; c.1.5bn additional capacity from the rebuilding and replacement program, c.4.2bn from a new plant in Block F, Kamunting (1H19) and Plant 12, Klang (2H19) – all of which are expected to boost efficiency and increase margins (we are forecasting a mild c.50bps uptick between FY18 to 20E). The contact lens business (current run-rate at c.RM5-10mn/a year negative contribution) also looks set to turn profitable in FY19E after a gestation period of more than 4 years.

■ **Valuation gap to narrow** — At c.14.7/13.4 CY18/19E PER, valuation is undemanding vs peers. We expect Supermax's valuation to catch up as execution risk is allayed with operational issues fully resolved, and potential positive earnings surprise. Switch out of Hartalega and Top Glove; Supermax's risk-reward profile looks more compelling despite our cautious view on the sector.

Statistical Abstract

FYE	Net Profit (RMM)	EPS (RM)	P/E (x)	D. Yld (%)
30 Jun				
2015A	127	0.19	14.8	1.4
2016A	153	0.23	12.2	2.9
2017A	70	0.10	26.7	1.6
2018E	130	0.19	14.5	1.8
2019E	140	0.21	13.4	2.0
2020E	155	0.23	12.0	2.0

Source: Powered by dataCentral

Earnings Revision

FYE	Net Profit (RMM)	EPS (RM)	% chg	DPS (RM)
30 Jun				
2018E	130	0.19	24.1	0.05
Prev	105	0.15		0.05
2019E	140	0.21	25.0	0.06
Prev	112	0.17		0.06
2020E	155	0.23	22.6	0.06
Prev	126	0.19		0.06

Source: Powered by dataCentral

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See Appendix A-1 for Analyst Certification, Important Disclosures and non-US research analyst disclosures.

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SUPM.KL: Fiscal year end 30-Jun						Price: RM2.76; TP: RM3.50; Market Cap: RM1,877m; Recomm: Buy					
Profit & Loss (RMm)	2016	2017	2018E	2019E	2020E	Valuation ratios	2016	2017	2018E	2019E	2020E
Sales revenue	1,545	1,127	1,293	1,375	1,485	PE (x)	12.2	26.7	14.5	13.4	12.0
Cost of sales	-1,327	-1,017	-1,128	-1,196	-1,286	PB (x)	1.8	1.8	1.6	1.5	1.4
Gross profit	217	110	166	179	199	EV/EBITDA (x)	7.2	13.6	9.8	9.0	8.2
Gross Margin (%)	14.1	9.7	12.8	13.0	13.4	FCF yield (%)	2.6	0.1	0.1	1.5	0.2
EBITDA (Adj)	266	143	202	220	243	Dividend yield (%)	2.9	1.6	1.8	2.0	2.0
EBITDA Margin (Adj) (%)	17.2	12.7	15.6	16.0	16.3	Payout ratio (%)	35	44	26	27	24
Depreciation	-49	-33	-37	-40	-44	ROE (%)	14.8	6.7	11.7	11.6	11.7
Amortisation	0	0	0	0	0	Cashflow (RMm)	2016	2017	2018E	2019E	2020E
EBIT (Adj)	217	110	166	179	199	EBITDA	266	143	202	220	243
EBIT Margin (Adj) (%)	14.1	9.7	12.8	13.0	13.4	Working capital	17	17	45	24	32
Net interest	-13	-11	-8	-8	-8	Other	-41	-45	-117	-78	-123
Associates	16	12	12	12	12	Operating cashflow	242	115	130	166	152
Non-Op/Except/Other Adj	0	0	0	0	0	Capex	-194	-113	-129	-138	-148
Pre-tax profit	221	110	170	183	203	Net acq/disposals	0	0	0	0	0
Tax	-67	-37	-41	-44	-49	Other	0	0	0	0	0
Extraord./Min.Int./Pref.div.	0	-3	1	1	1	Investing cashflow	-194	-113	-129	-138	-148
Reported net profit	153	70	130	140	155	Dividends paid	-74	-41	-31	-34	-37
Net Margin (%)	9.9	6.2	10.0	10.2	10.4	Financing cashflow	-75	-23	-13	-17	-19
Core NPAT	153	70	130	140	155	Net change in cash	-16	-21	-12	12	-15
Per share data	2016	2017	2018E	2019E	2020E	Free cashflow to s/holders	48	3	1	28	3
Reported EPS (RM)	0.23	0.10	0.19	0.21	0.23						
Core EPS (RM)	0.23	0.10	0.19	0.21	0.23						
DPS (RM)	0.08	0.05	0.05	0.06	0.06						
CFPS (RM)	0.36	0.17	0.19	0.24	0.22						
FCFPS (RM)	0.07	0.00	0.00	0.04	0.01						
BVPS (RM)	1.52	1.57	1.71	1.86	2.03						
Wtd avg ord shares (m)	680	680	680	680	680						
Wtd avg diluted shares (m)	680	680	680	680	680						
Growth rates	2016	2017	2018E	2019E	2020E						
Sales revenue (%)	46.7	-27.1	14.8	6.4	8.0						
EBIT (Adj) (%)	48.1	-49.5	50.9	8.4	10.7						
Core NPAT (%)	20.8	-54.2	85.0	8.1	10.3						
Core EPS (%)	20.8	-54.2	85.0	8.1	11.0						
Balance Sheet (RMm)	2016	2017	2018E	2019E	2020E						
Cash & cash equiv.	116	95	83	95	78						
Accounts receivables	384	246	248	264	285						
Inventory	162	202	224	237	255						
Net fixed & other tangibles	814	894	987	1,084	1,188						
Goodwill & intangibles	29	29	29	29	30						
Financial & other assets	260	227	227	227	228						
Total assets	1,766	1,693	1,797	1,935	2,064						
Accounts payable	180	78	87	92	99						
Short-term debt	236	294	252	252	253						
Long-term debt	140	126	168	168	169						
Provisions & other liab	173	131	131	161	160						
Total liabilities	730	629	638	673	681						
Shareholders' equity	1,037	1,065	1,160	1,263	1,383						
Minority interests	-1	-1	-1	-1	-1						
Total equity	1,036	1,063	1,159	1,262	1,382						
Net debt (Adj)	260	325	337	325	344						
Net debt to equity (Adj) (%)	25.1	30.5	29.1	25.8	24.9						

For definitions of the items in this table, please click [here](#).

U/G to Buy: Valuation Gap to Narrow

We upgrade Supermax to Buy, TP of RM3.50. Trading at c.14.7/13.4x CY18/19E PER, we expect the valuation gap vs peers (industry average at c.30x CY19E PER) to narrow, anchored by [1] A marked improvement in earnings visibility as water supply issues at Plant 10 and 11 are fully resolved, [2] Efficiency boost from its 'rebuilding and replacement' program with minimal impact to existing operations, [3] Earnings lift from the contact lens business which is expected to turn profitable in FY19E. We raise earnings by 23-25% over FY18-20E, 8-9% above the street.

We now peg our TP to 17x (previous 11x) average CY18/19E PER (rolled forward from CY18E). Supermax is now our preferred pick in the sector as we deem its risk-reward profile as attractive, despite our relatively cautious view on the sector. Our target PE of 17x is at a 20% discount to Kossan's target PE, being Supermax's closest comparable (capacity, product mix). Whilst this is relatively high vs history (Supermax's average PER is c.12x), we believe a re-rating away from historical trading range is due given that the overhang from its operational setbacks is now out of the way, coupled with a firmer expansion plan.

Figure 1. Comps table – Supermax is the least expensive glove-maker

Company	RIC	Rating	Price (lcy)	TP	ETR	Mkt Cap	ADTV	P/E (x)		P/B (x)		ROE (%)		Yield (%)	
			20 Apr	(lcy)	(%)	(US\$m)	(US\$m)	CY18E	CY19E	CY18E	CY19E	CY18E	CY19E	CY18E	CY19E
Glove-makers															
Hartalega	HTHB.KL	Sell	6.30	4.30	-30.5	5,363	4.7	43.5	41.3	10.0	8.9	24.3	22.8	1.2	1.2
Top Glove	TPGC.KL	Sell	10.00	7.84	-19.5	3,287	9.2	28.1	23.8	5.6	5.0	20.8	22.4	1.8	2.1
Kossan	KRIB.KL	Neutral	7.13	7.58	8.4	1,172	1.2	21.0	18.7	3.6	3.2	17.8	18.1	2.0	2.1
Supermax	SUPM.KL	Buy	2.92	3.50	21.7	510	3.1	14.7	13.4	1.6	1.5	11.6	11.7	1.8	1.9
Riverstone	RVHL.SI	NR	1.08	NA	NA	611	0.2	15.8	13.9	3.3	2.9	22.4	22.0	2.7	2.8
Brand owners															
Ansell Ltd	ANN.AX	Neutral	25.68	24.25	-3.0	2,844	11.5	23.6	21.0	2.5	2.6	23.0	11.0	2.4	2.6
Semperit AG Holding	SMPV.VI	NR	17.18	NA	NA	436	0.5	114.5	32.1	1.1	1.1	-1.5	3.3	0.3	1.1
MNCs															
Kimberly-Clark Corp	KMB.N	Sell	100.03	109.00	13.1	35,017	71.7	14.4	13.6	21.6	14.4	203.4	133.9	4.0	4.1
Beiersdorf AG	BEIG.DE	Sell	92.38	85.00	-7.2	28,741	49.3	26.6	24.8	3.6	3.3	14.5	13.9	0.8	0.8
Cardinal Health Inc	CAH.N	NR	62.07	NA	NA	19,534	48.8	10.8	9.8	2.6	2.4	23	23.4	3.1	3.3

Source: IBES for Not Rated (NR) stocks, Citi Research

Steep discount in valuation vs peers despite recent uptick

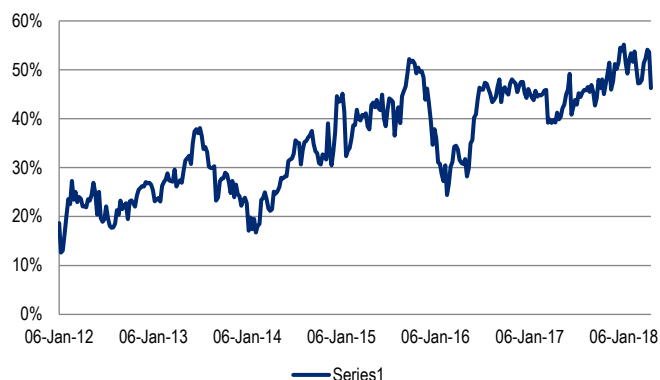
Supermax has outperformed on a 3 and 6 months basis, although it still lags behind on a 1-year share price performance basis vs Hartalega and Top Glove. Investors however should keep in mind that despite the recent uptick, the valuation gap between Supermax and the industry remains high at c.46% suggesting that there is still room for valuation to catch up.

Figure 2. Malaysian glove makers – share price performance

	1 week	1 mth	3 mth	6mth	1 year	YTD
Hartalega	-3.1%	8.1%	13.5%	63.0%	153.5%	18.0%
Top Glove	-1.6%	2.9%	11.2%	51.7%	109.2%	25.2%
Kossan	-8.6%	-7.9%	-15.3%	0.3%	16.9%	-12.1%
Supermax	12.3%	9.8%	25.3%	49.7%	49.0%	46.0%

Source: Citi Research

Figure 3. Supermax's valuation discount to industry* - at c.46% vs LT average of c.35%



* Industry = Hartalega, Top Glove, Kossan and Supermax
Source: IBES, Citi Research

More clarity on capacity revamp and capacity expansion

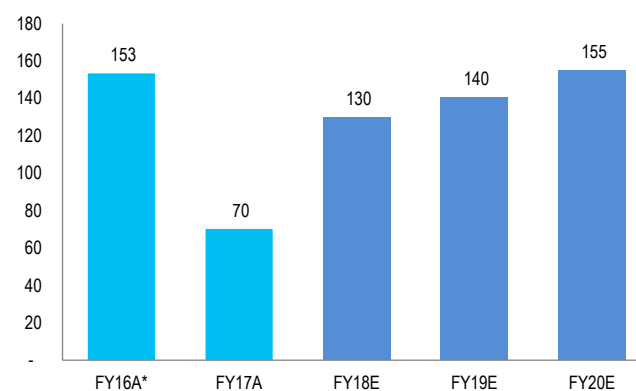
During our recent meet-up, management clarified that the impact of its capacity rebuilding and replacement program will not be as significant as we had initially expected – only Block G and Lot 38 plants will be impacted, with net capacity addition of c.1.5bn. Moreover, water supply issues in Plant 10 and 11 (c.5.6bn capacity) have finally been resolved which we believe should lift concerns on execution and topline growth. The company has also committed to increase its capacity by c.27% by end of CY19, with c.RM333mn in capex expected to be spent.

Figure 4. Supermax's capacity expansion plans

	Capacity (bn)	Remarks
Current	21.4	Excluding Lahat plant.
Block G	0.3	Rebuilding and replacement program - by 3Q18.
Lot 38	1.2	Rebuilding and replacement program - by 4Q19.
Block F	2.0	New, completion by 1H19
Plant #12	2.2	New, completion by 2H19
Total by end-CY19	27.2	

Source: Company, Citi Research

Figure 5. We've revised our FY18-20E earnings forecast by 23-25%



* 18-month period, change of financial year from Dec to June
Source: IBES, Citi Research

We've raised earnings by 23-25%, predominantly driven by revised capacity and utilization assumptions. FY18/19/20E capacity assumptions: 21.3bn/23.6bn/25.7bn. Whilst we have reflected a generally stronger Ringgit in our model, we are still looking at a mild margin expansion going into FY20E as we take into account positive contribution from Supermax's contact lens business as well as higher efficiency from the new lines. We are expecting Supermax to surprise on the upside in 2H18E, as our forecasts are c.8-9% above the street, following a strong 1H18.

Bull/Bear: Supermax (SUPM.KL)

Bull/Bear: Supermax (SUPM.KL)

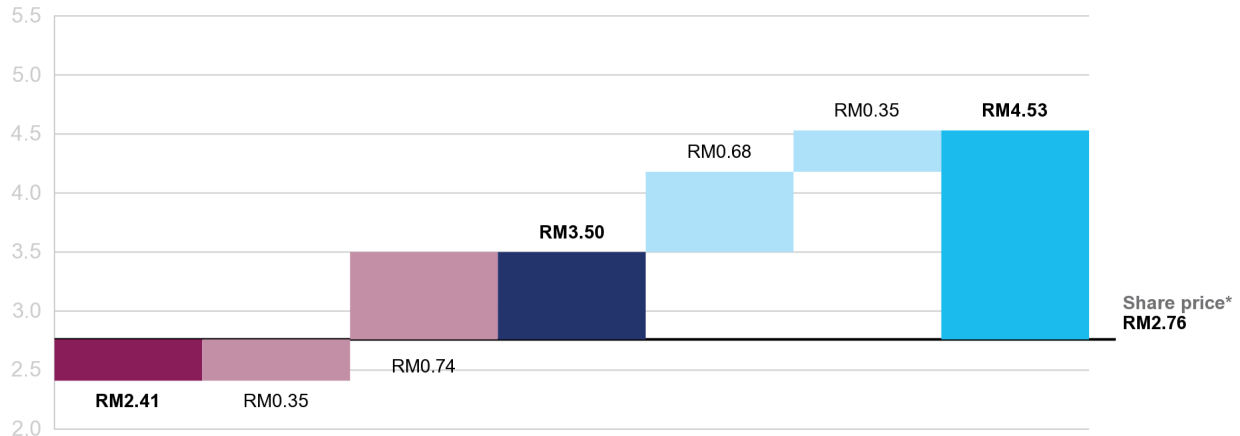


RM3.5 target price

27% expected share price return

Buy rating

77pp Bull/Bear Spread

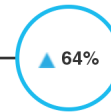


Earnings disappoint, 10% lower than expected.
Lower target multiple, at 13x.



Higher multiple (20x), rerates towards industry average.

Higher EPS by 10% due to better-than-expected margins.



Share price*
RM2.76

Source: Citi Research

*Share price as of 23 Apr 2018 17:00



RM4.53

- Better-than-expected earnings, +10% vs expectations.
- Higher target multiple of 20x.
- Implied valuation: RM4.53.



RM3.5

- Base case TP : RM3.50.



RM2.41

- Earnings disappoint, 10% lower than expectations.
- Lower target multiple at 13x.
- Implied valuation: RM2.41.

Supermax

Company description

Supermax is one of Malaysia's largest examination glove manufacturers. It produces natural rubber and nitrile gloves at its manufacturing facilities in Malaysia. As at Dec 2015, the group had 169 production lines with annual capacity of 19.8bn pieces of gloves. Besides producing for OEM customers, Supermax is one of the largest OBM producers in Malaysia. It has distribution centers in the US, Brazil, Belgium, Australia, and Canada. Supermax also recently became Malaysia's first home-grown contact lens manufacturer.

Investment strategy

We have a Buy recommendation on Supermax, TP of RM3.50 underpinned by: [1] Marked improvement in earnings visibility as water supply issues at Plant 10 and 11 are fully resolved, [2] Rebuilding and replacement program to boost efficiency with contact business expected to turn profitable in FY19E. [3] c.50% discount to the industry despite recent outperformance. Supermax's risk-reward profile looks more compelling despite our cautious view on the sector.

Valuation

Our target price for Supermax is RM3.50, derived from pegging 17x target PER to average CY18E/19E EPS, set at 20% discount to Kossan's target PE of 21x, being Supermax's closest peer in terms of capacity and product mix. Our target multiple is at a 20% discount to Kossan and also at a discount to the rest of the glove makers due to the company's lower margins and ROEs. We expect Supermax's valuation to catch up as execution risk is allayed with operational issues fully resolved, and potential positive earnings surprise.

Risks

Key risks that could cause the Supermax stock to trade below our target price are: [1] Sharp volatility in latex prices and the US dollar would affect Supermax's ability to accurately adjust selling prices and raw-material purchases. Based on our estimates, every 1% appreciation in Ringgit would cut earnings by c.3% if not passed on to customers. [2] Larger-than-expected capacity expansion by industry participants could lead to industry overcapacity. [3] Unscheduled changes in electricity and gas tariffs and the ability to pass on these additional costs to customers.

Appendix A-1

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Supermax (SUPM.KL)

**Ratings and Target Price History
Fundamental Research**

Analyst: Megat Fais
Covered since October 31 2016



	Date	Rating	Target Price	Closing Price
1	26-Nov-15 12:03:11	2	*2.55	2.29
2	11-Dec-15 06:53:03	2	*2.80	2.78
3	14-Jul-16 04:36:28	2	*2.17	2.05

	Date	Rating	Target Price	Closing Price
4	31-Oct-16 02:34:47	2	*2.13	2.17
5	24-Feb-17 09:34:24	2	*2.03	2.06
6	10-Aug-17 00:12:55	2	*2.00	1.85

	Date	Rating	Target Price	Closing Price
7	26-Oct-17 05:00:00	*3	*1.70	1.85
8	21-Nov-17 08:12:57	3	*1.76	2.00

*Indicates Change

Rating/target price changes above reflect Eastern Time

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Data current as of 31 Mar 2018	12 Month Rating			Catalyst Watch		
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% of companies in each rating category that are investment banking clients	64%	63%	55%	62%	64%	58%

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