COMPANY UPDATE
Tuesday, September 10, 2019
FBMKLCI: 1,604.47
Sector: Healthcare

TA SECURITIES
A MEMBER OF THE TA GROUP

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Supermax Corporation Berhad

TP: RM1.99 (+32.0%)

Last Traded: RM1.51

Buy

Beneficiary of US-China Trade War

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Key highlights from Supermax analyst briefing are:

- ***i) Supermax is a beneficiary of US-China trade war,***
- ***ii) Capacity expansion plans are on track;***
- ***iii) Bright FY20 earnings outlook and potential distribution of treasury shares.***

We adjust our FY20/21/22 earnings projections higher by 17.1%/15.9%/14.6 after increasing our sales volume and margins assumptions. Maintain Buy on Supermax with a higher target price of RM1.99/share.

Beneficiary of US-China Trade War

Recently, US imposed tariff on medical gloves from China by 15%, effective 1 Sept 2019. Meanwhile, non-medical gloves imports from China was also slapped with a 25% tariff back in May-19. Management believes the trade tension between US and China will create a sudden spike in demand from US importers for both medical and non-medical gloves. Management thinks that gloves production in China could be completely wiped out, especially US imports of vinyl gloves market as China commands more than 95% of global market share for vinyl gloves. Specifically, it expects the impact to be felt from 4Q19 onwards as US importers are having tight inventories.

According to Datuk Seri Stanley Thai, Supermax is expected to see **an increase in export volume to US by at least 10%.** Currently, the sales to US accounts for 30% of the group's total sales. The increasing sales to US is expected to come from Plant 12, which will commence operations in 4Q19.

The trade diversion to Malaysia is not without threats. Management believes that **Chinese manufacturers could dump the excess supplies** to other markets especially the European market, causing some pricing pressure. Currently, 27% of Supermax's exports go to the European market. This may result in margin compression for Supermax and other manufacturers in the European market. However, the impact is manageable to Supermax given its relatively high composition of OBM (70%) versus OEM sales (30%) to the European market. Note that OEM sales are susceptible to pricing pressure from oversupply in the market.

In our opinion, on the 15% tariff imposed on medical gloves, we reiterate our view that there is a possibility of trade diversion of some US' orders from China to Malaysia, Indonesia and Thailand, especially for nitrile gloves. Note that nitrile gloves ASPs in China and Malaysia are almost similar (before the 15% tariff imposed). Based on our channel checks, **orders for nitrile gloves have picked up substantially** as customers rush to replenish their inventories after the adoption of wait-and-see approach before 1 September 2019. This explains why Malaysia's rubber glove exports dropped 4.4% in 1H19 (see figure 1). According to MARMGA president, customers are flocking to Malaysia and this would bode well

Share Information

Bloomberg Code	SUCB MK
Stock Code	7106
Listing	Main Market
Share Cap (mn)	1306.3
Market Cap (RMmn)	1,972.5
52-wk Hi/Lo (RM)	2.05/1.30
12-mth Avg Daily Vol ('000 shrs)	6,122.8
Estimated Free Float (%)	62.9
Beta	0.9
Major Shareholders (%)	
	Dato' Seri Stanley Thai - 37.1

Forecast Revision

	FY20	FY21
Forecast Revision (%)	17.1	15.9
Net profit (RMmn)	159.4	179.4
Consensus	137.5	150.1
TA's / Consensus (%)	115.9	119.5
Previous rating	Buy (Maintained)	

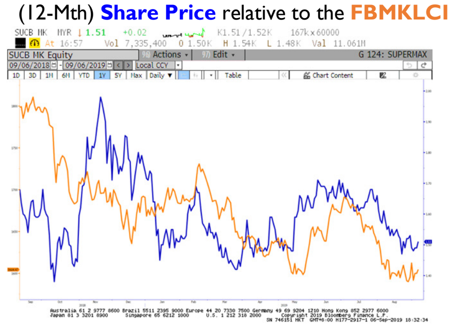
Financial Indicators

	FY20	FY21
Net gearing (x)	0.3	0.3
P/CFPS (x)	17.6	9.2
ROAA (%)	8.3	8.6
ROAE (%)	13.7	14.3
NTA/Share (RM)	0.9	0.9
Price/ NTA (x)	1.7	1.6

Share Performance (%)

Price Change	SUCB	FBM KLCI
1 mth	(3.2)	(0.7)
3 mth	(11.7)	(2.7)
6 mth	(0.7)	(4.5)
12 mth	(7.6)	(10.8)

(12-Mth) **Share Price** relative to the **FBMKLCI**



Source: Bloomberg

for rubber glove industry in Malaysia. It expects Malaysian rubber glove players to see an increase of 5-10% in volumes from the trade war.

However, for the production of non-medical glove, we stick with our opinion that Malaysian rubber glove manufacturers are **unlikely to benefit significantly from the 25% tariff imposed on China non-medical** gloves given that China vinyl glove average selling price (USD10/1000 pieces) is still cheaper than other alternative gloves (latex powder free at USD20/1000 pieces) and nitrile gloves (USD23/1000 pieces) before the tariff imposed.

Figure 1 :1H19 Rubber Glove Export Figures

	Quantity (Million Pairs)		
Malaysia's Export (Jan-Jun)	**2018**	**2019**	**% Change**
Natural Rubber	15,097	14,369	-4.8%
Synthetic Rubber	25,432	24,366	-4.2%
Total	**40,529**	**38,735**	**-4.4%**

Source: MREPC, TA Securities

Capacity Expansion Plans

According to management, the completion of Plant 12 is timely to cope with the rising demand from US. Plant 12 will have an installed capacity of 4.4bn gloves/annum, coming from Block A and Block B that are slated for full commission by 4Q19 and 2Q20 respectively. Thereafter, the construction of Plant 13 (4.4bn gloves/annum), Plant 14 (4.4bn gloves/annum) and Plant 15 (4.4bn gloves/annum) is expected to start in 1Q20, 2Q21 and 3Q22 respectively.

All in, the group targets to increase its production to 24.0bn pieces by end-2019 and 27.4bn pieces by end-2020 from estimated 21.8bn pieces currently. Supermax plans to double its production capacity to 44.1bn pieces by mid-2024.

Lesser Spring-Cleaning Exercise Needed, FY20 Earnings Set to Grow Significantly

We note that historically, the group tends to impair the value of inventory in fourth quarter to better reflect the true value that complies with audit requirements. This has been done since FY16, where 4Q earnings were substantially lower QoQ (see figure 2). Looking forward, management is of the opinion that less spring-cleaning exercise is needed after writing-off obsolete products over the past few years.

Figure 2 : Historical PAT Performance

1QFY16	2QFY16	3QFY16	4QFY16	5QFY16	6QFY16	QoQ
24,947	24,743	38,455	38,820	19,670	6,787	-65.5%

1QFY17	2QFY17	3QFY17	4QFY17	QoQ
19,537	22,571	19,754	5,343	-73.0%

1QFY18	2QFY18	3QFY18	4QFY18	QoQ
27,901	35,903	33,376	9,474	-71.6%

1QFY19	2QFY19	3QFY19	4QFY19	QoQ
35,942	38,136	34,617	15,059	-56.5%

Source: Company, TA Securities

Management targets an EBITDA margin of >20% going forward, driven by: 1) commissioning of highly efficient plants (25-30% EBITDA margin), 2) revamping of older plants by rebuilding and refurbishing efficient production lines.

As far as the production of contact lens is concerned, management indicates that auditor has agreed that this business segment is at its growth phase (sales surged by 3x), thus no impairment is needed against its operational losses since inception.

Impact

Taking into account forward sales and EBITDA guidance from management as well as on-going capacity expansion plan, we raise our FY20/FY21/FY22 earnings estimates by 17.1%/15.9%/14.6%. Specifically, we expect FY20/21/22 sale volume to increase by 13.7%/15.1%/11.4%.

According to management, it is considering redistribution treasury shares to reward those long-term shareholders. Based on the group's total treasury shares of 54.0mn, the company can potentially reward its shareholders with 1 treasury shares for every 25 shares held, equivalent to a yield pickup of 4%.

Valuation & Recommendation

Following the earnings adjustments, our target price for Supermax is revised higher to RM1.99/share (previously RM1.73/share) based on an unchanged 16.0x CY20 EPS. Maintain Buy as the stock is currently trading at a steep discount of 45% against its peers.

Earnings Summary

P&L

YE June 31 (RMmn)	FY18	FY19	FY20F	FY21F	FY22F
Revenue	1,304.5	1,489.3	1,642.5	1,813.0	1,949.3
EBITDA	209.1	228.6	293.2	331.4	356.5
Dep. & amortisation	(41.8)	(43.6)	(48.6)	(54.6)	(58.2)
EBIT	167.3	185.0	244.6	276.8	298.3
Net finance cost	(13.5)	(17.8)	(24.8)	(28.3)	(31.6)
Share of associates	6.0	5.4	5.7	6.0	6.3
EI	0.0	0.0	0.0	0.0	0.0
PBT	161.9	172.6	225.4	254.5	272.9
Taxation	(51.8)	(49.0)	(66.0)	(75.1)	(80.5)
MI	(3.5)	0.1	0.0	0.0	0.0
Net profit (-MI)	106.7	123.8	159.4	179.4	192.4
EPS (sen)	7.8	9.1	11.7	13.2	14.1
DPS (sen)	4.0	1.5	5.3	5.9	6.4

Ratios

YE June 31 (RMmn)	FY18	FY19	FY20F	FY21F	FY22F
Valuations					
PER (x)	19.3	16.6	12.9	11.4	10.7
Dividend yield (%)	2.6	1.0	3.5	3.9	4.2
PBV (x)	2.0	1.8	1.7	1.6	1.4
Profitability ratios					
ROAE (%)	10.3	11.6	13.7	14.3	14.2
ROAA (%)	6.1	7.0	8.3	8.6	8.5
EBITDA margin (%)	16.0	15.4	17.9	18.3	18.3
PBT margin (%)	12.4	11.6	13.7	14.0	14.0
PAT margin (%)	8.2	8.3	9.7	9.9	9.9
Liquidity ratios					
Current ratio (x)	1.0	1.0	1.3	1.3	1.4
Quick ratio (x)	0.7	0.7	0.8	0.8	0.9
Leverage ratios					
Total liabilities/equity (x)	0.7	0.6	0.6	0.7	0.7
Net debt/equity (x)	0.3	0.2	0.3	0.3	0.2
Growth ratios					
Sales (%)	15.8	14.2	10.3	10.4	7.5
Pretax (%)	50.0	6.6	30.6	12.9	7.2
Earnings (%)	58.7	16.0	28.8	12.6	7.2
Total assets (%)	(5.0)	8.0	8.8	8.5	8.3

Balance Sheet

YE June 31 (RMmn)	FY18	FY19	FY20F	FY21F	FY22F
Fixed assets	**895.9**	**972.1**	**1,053.5**	**1,128.9**	**1,200.7**
Investments in associates	196.8	202.2	202.2	202.2	202.2
Intangible assets	28.7	28.7	28.7	28.7	28.7
Others	6.2	1.4	1.4	1.4	1.4
LT assets	**1,127.6**	**1,204.5**	**1,285.8**	**1,361.3**	**1,433.0**
Inventories	187.8	183.1	254.7	282.4	305.3
Trade receivables	188.1	149.9	215.7	240.3	259.9
Cash	145.2	173.8	116.8	159.2	225.2
Others	51.0	124.5	124.5	124.5	124.5
Current assets	**572.1**	**631.4**	**711.7**	**806.3**	**914.9**
Total assets	**1,699.7**	**1,835.8**	**1,997.6**	**2,167.6**	**2,347.9**
Trade payables	185.3	144.0	171.0	189.5	205.0
ST borrowings	374.5	349.9	263.4	295.1	330.5
Others	6.4	133.4	133.4	133.4	133.4
Current liabilities	**566.2**	**627.2**	**567.7**	**618.0**	**668.8**
LT borrowings	61.7	42.0	175.6	196.7	220.4
Others	49.0	39.6	39.6	39.6	39.6
LT liabilities	**110.7**	**81.6**	**215.2**	**236.3**	**260.0**
Share capital	340.1	340.1	340.1	340.1	340.1
Reserves	672.6	779.1	866.8	965.5	1,071.3
Shareholders' funds	1,012.7	1,119.2	1,206.9	1,305.5	1,411.4
MI	10.0	7.8	7.8	7.8	7.8
Total liabilities and equity	**1,699.7**	**1,835.8**	**1,997.6**	**2,167.6**	**2,347.9**

Cash Flow

YE June 31 (RMmn)	FY18	FY19	FY20F	FY21F	FY22F
PBT	161.9	172.6	225.4	254.5	272.9
Dep. & amortisation	41.8	43.6	48.6	54.6	58.2
Changes in WC	56.8	37.5	(110.3)	(33.7)	(27.2)
Tax paid	(64.1)	(43.4)	(66.0)	(75.1)	(80.5)
Others	(19.1)	17.8	19.2	22.3	25.4
Operational cash flow	177.2	228.2	116.8	222.6	248.8
Capex	(58.9)	(115.7)	(130.0)	(130.0)	(130.0)
Others	3.8	0.0	5.7	6.0	6.3
Investing cash flow	(55.1)	(115.7)	(124.3)	(124.0)	(123.7)
Dividend paid	(75.7)	(32.8)	(71.7)	(80.7)	(86.6)
Net change in debts	(14.4)	(44.3)	47.1	52.8	59.1
Others	(36.3)	(27.4)	(24.8)	(28.3)	(31.6)
Financial cash flow	(126.4)	(104.5)	(49.5)	(56.2)	(59.1)
Net cash flow	(4.3)	8.0	(57.0)	42.3	66.0
Opening cash flow	156.1	145.2	173.8	116.8	159.2
Forex	(6.6)	20.6	0.0	0.0	0.0
Closing cash flow	145.2	173.8	116.8	159.2	225.2

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Stock Recommendation Guideline

BUY	:	Total return within the next 12 months exceeds required rate of return by 5%-point.
HOLD	:	Total return within the next 12 months exceeds required rate of return by between 0-5%-point.
SELL	:	Total return is lower than the required rate of return.
Not Rated:		The company is not under coverage. The report is for information only.

Total Return is defined as expected share price appreciation plus gross dividend over the next 12 months. Gross dividend is excluded from total return if dividend discount model valuation is used to avoid double counting.

Required Rate of Return of 7% is defined as the yield for one-year Malaysian government treasury plus assumed equity risk premium.

As of Tuesday, September 10, 2019, the analyst, Tan Kong Jin, who prepared this report, has interest in the following securities covered in this report:
(a) nil

Kaladher Govindan – Head of Research

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