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9 November 2010

Supermax Corporation

Getting to grips with latex price rise

RECOM	Buy
PRICE	RM4.41
MKT CAPITALISATION	RM1.50bn
BOARD	Main (Syariah stock)
SECTOR	Industrial
INDEX COMPONENT	KLCI, FBMSC, FBMS FBMEMAS

SUCB MK / SUPM.KL

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Results highlights

- **Below expectations; maintain BUY.** At 90% of our forecast, Supermax's annualised 9M10 results were below our expectations though in line with consensus. We had underestimated the latex price volatility and further weakening of the US\$ during the period. We now reduce our FY10-11 EPS forecasts by 6% but leave FY12 unchanged as latex prices should moderate over the longer term and demand for Supermax's glove products should stay strong. Despite the earnings shortfall, we continue to rate Supermax a BUY. Our target price remains at RM7.82, still based on 11.0x P/E or a 20% discount to our target CY12 P/E of 13.8x for Top Glove. Potential re-rating catalysts are a) the eventual moderation of latex prices as weather patterns normalise, b) accelerated take-up of natural rubber medical gloves in emerging economies where hospitals and clinics operate at subpar hygiene standards, and c) a recovery of Supermax's distribution income.
- **Lower earnings due to margin compression.** 9M10 net profit rose 58% yoy to RM135m but 3Q10 net profit fell 5% yoy and 17% qoq to RM38m because of a) a contraction in gross profit margins resulting from higher raw material prices as spot latex price rose 4% in 3Q, b) lower RM-denominated revenues due to a 2% firming of the ringgit, and c) lower distribution income from associates.
- **ASP raised by as much as 30%.** During our last visit, management indicated that it had increased average selling prices (ASP) for low-protein and powder-free natural rubber gloves by 25-30% since Dec 09. This is in line with the 30% rise in spot latex price during the period and indicative of the strong demand for Supermax's gloves and the company's pricing power. ASPs for its nitrile gloves, however, have been stable, tracking the less volatile trend for crude oil prices.

Key stock statistics

	2009	2010F
FYE Dec		
EPS (sen)	37.8	54.1
P/E (x)	11.7	8.2
Dividend/Share (sen)	8.8	9.0
NTA/Share (RM)	1.7	2.2
Book Value/Share (RM)	1.7	2.2
Issued Capital (m shares)		339.46
52-weeks Share Price Range (RM)		RM2.72/RM6.60
Major Shareholders:		%
Dato' Seri Thai Kim Sim, Stanley		20.4
Datin Seri Tan Bee Geok, Cheryl		15.1
Employees Provident Fund		8.4

Per share data

	2007	2008	2009	2010F
FYE Dec				
Book Value (RM)	1.33	1.26	1.67	2.22
Cash Flow (sen)	25.6	16.1	67.4	50.0
Earnings (sen)	19.4	14.3	37.8	54.1
Dividend (sen)	3.0	2.6	8.8	9.0
Payout Ratio (%)	15.5	18.2	23.3	16.6
P/E (x)	22.7	30.9	11.7	8.2
P/Cash Flow (x)	17.2	27.4	6.5	8.8
P/Book Value (x)	3.3	3.5	2.8	2.1
Dividend Yield (%)	0.7	0.6	2.0	2.0
ROE (%)	17.9	11.7	26.0	27.9
Net Gearing (%)	87.9	90.0	31.5	13.8

Source: Company, CIMB estimates, Bloomberg

Please read carefully the important disclosures at the end of this publication.

Figure 1: Results comparison (RM m)

FYE Dec	3QFY10	3QFY09	% Change
Revenue	235.1	237.6	(1.0)
Operating Profit (EBIT)	45.2	50.8	(11.1)
Depreciation	(9.0)	(8.2)	65.7
Interest Expenses	(3.7)	(4.1)	(9.3)
Associates	8.3	11.3	(26.3)
Pretax Profit	41.4	46.7	(11.3)
Net Profit	38.1	40.2	(5.1)
Operating Margin	19.2	21.4	(10.2)
Pretax Margin	17.6	19.7	(10.4)
Net Margin	16.2	16.9	(4.1)

Source: Company, CIMB estimates

Figure 2: P&L analysis (RM m)

FYE Dec	2007	2008	2009	2010F
Revenue	574.3	811.8	803.6	929.6
Operating Profit (EBIT)	74.9	98.9	169.0	224.0
Depreciation	(19.9)	(28.8)	(31.9)	(39.2)
Interest Expenses	(15.3)	(20.3)	(22.3)	(15.1)
Pretax Profit	58.6	52.0	151.5	215.9
Effective Tax Rate (%)	4.4	9.6	16.4	15.0
Net Profit	55.9	47.0	126.6	183.5
Operating Margin (%)	13.0	12.2	21.0	24.1
Pretax Margin (%)	10.2	6.4	18.8	23.2
Net Margin (%)	9.7	5.8	15.8	19.7

Source: Company, CIMB estimates

Recent developments

Methods to mitigate rising raw material costs. Even as latex prices rise at a faster-than-expected pace, the rubber glove industry has already begun to adapt. For example, to allow for faster cost pass-through, some manufacturers are re-pricing their glove products as frequently as once a week instead of the usual practice of monthly quotes. This will tighten the linkage between ASP and spot latex prices, leading to better pass-through of rapidly rising raw material prices.

Latex price volatility may be temporary. Latex prices have risen above RM8.00 per ton to an all-time high. We believe that the latest price spike is due to unusually violent storms and wet weather in Thailand, Indonesia and Malaysia, which together account for c. 70% of the world's natural rubber output. If these weather conditions prove to be temporary, latex prices should stabilise in 1Q11 and potentially moderate over the longer term as the weather-induced supply constraints begin to dissipate.

Deleveraging continues. In line with the company's strategy to degear its balance sheet and reduce borrowing costs, Supermax repaid a further RM3m of term loans in 3Q10, taking net debt to RM195m at end-Sep. This works out to a net gearing ratio of 0.28x, which is below Supermax's target of 0.50-0.70x.

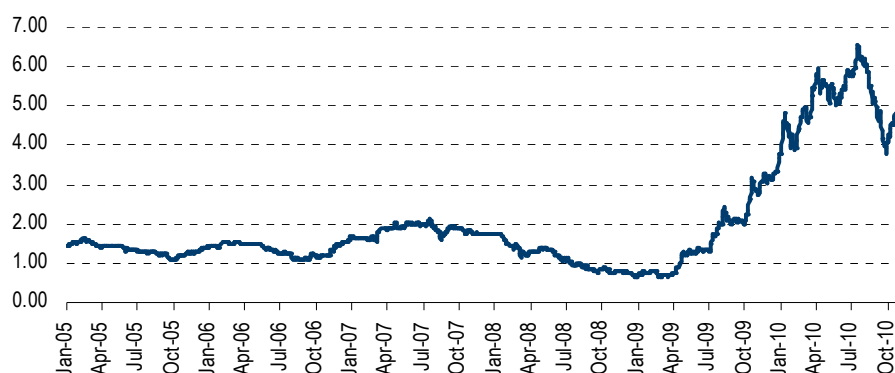
Financial flexibility for capacity expansion. We believe Supermax's current net debt position gives the company adequate financial flexibility to fund further capacity expansion initiatives, either through internally generated funds or additional bank borrowings. We estimate that Supermax can take on an additional RM290m in borrowings and still stay within its 0.70x net gearing target.

Recommendation

Factoring in the higher-than-expected latex price and US\$ depreciation, we scale back our FY10-11 EPS forecasts by 6% while retaining our FY12 forecast. We continue to rate Supermax a BUY while maintaining our target price of RM7.82, which we continue to base on 11.0x CY12 P/E or a 20% discount to our target P/E of 13.8x for Top Glove. Our valuation is well-supported by Supermax's FY10-12 net profit CAGR of 15% and 23% ROE for FY12, both of which are superior to the KLCI's 12% earnings CAGR and 20% ROE. Our forecast also implies an undemanding 6.2x P/E valuation for FY12 despite the company's above-average growth prospects, low gearing and stable OBM revenue model.

Potential re-rating catalysts for Supermax's share price are a) the eventual moderation of latex prices as weather patterns normalise, b) accelerated take-up of natural rubber and synthetic medical gloves in emerging economies such as China where hospitals and clinics operate at subpar hygiene standards, and c) a recovery of Supermax's distribution income in Latin America, Western Europe, and Canada.

Figure 3: Share price chart (RM)



Source: Bloomberg

Financial summary

FYE Dec	2008	2009	2010F	2011F	2012F
Revenue (RM m)	811.8	803.6	929.6	1,103.5	1,262.0
EBITDA (RM m)	98.9	169.0	224.0	259.9	303.6
EBITDA margins (%)	12.2	21.0	24.1	23.6	24.1
Pretax profit (RM m)	52.0	151.5	215.9	246.1	283.2
Net profit (RM m)	47.0	126.6	183.5	209.2	240.8
EPS (sen)	14.3	37.8	54.1	61.6	70.9
EPS growth (%)	-27%	+165%	+43%	+14%	+15%
P/E (x)	30.9	11.7	8.2	7.2	6.2
Core EPS (sen)	19.3	39.4	54.1	61.6	70.9
Core EPS growth (%)	-0%	+104%	+37%	+14%	+15%
Core P/E (x)	22.8	11.2	8.2	7.2	6.2
Gross DPS (sen)	2.6	8.8	9.0	11.0	12.0
Dividend yield (%)	0.6	2.0	2.0	2.5	2.7
P/NTA (x)	3.8	2.8	2.1	1.6	1.3
ROE (%)	11.7	26.0	27.9	24.7	23.1
Net gearing (%)	90.0	31.5	13.8	-	-
Net cash per share (RM)	-	-	-	0.03	0.49
P/FCFE (x)			17.5	10.4	7.9
EV/EBITDA (x)			7.1	5.7	4.4
% change in EPS estimates			-5.6%	-6.0%	0.0%
CIMB/Consensus (x)			1.02	1.05	1.11

Source: Company, CIMB Research, Bloomberg

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