AmResearch

Company report

SUPERMAX

(SUCB MK, SUPM.KL)

22 November 2012

Diversifying its downstream activities

HOLD

(Initiation)

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Rationale for report: Initiation Coverage

Price	**RM1.99**
Fair Value	**RM2.20**
52-week High/Low	RM2.38/RM1.63

Key Changes

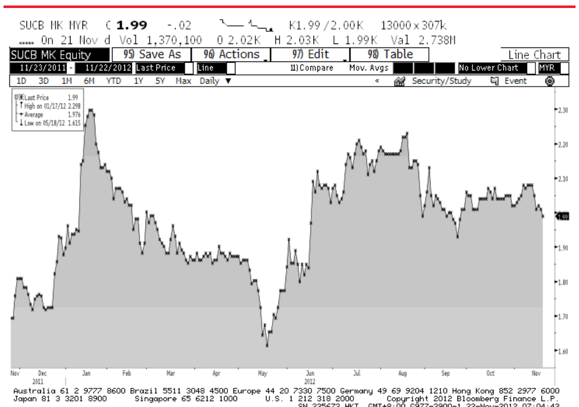
Fair value	Initiation
EPS	Initiation

YE to Dec	**FY11**	**FY12F**	**FY13F**	**FY14F**
Revenue (RMmil)	1,021.4	1,135.5	1,314.3	1,498.4
Core net profit (RMmil)	108.2	128.6	149.8	168.7
EPS (Sen)	15.9	18.9	22.0	24.8
EPS growth (%)	n/a	18.9	16.5	12.6
Consensus EPS (Sen)	15.9	19.5	22.1	24.6
DPS (Sen)	3.2	5.3	6.8	7.8
PE (x)	12.5	10.5	9.0	8.0
EV/EBITDA (x)	11.6	8.7	7.3	6.2
Div yield (%)	1.6	2.6	3.4	3.9
ROE (%)	14.3	15.8	16.3	16.3
Net Gearing (%)	22.7	15.6	12.5	8.9

Stock and Financial Data

Shares Outstanding (million)	680.2
Market Cap (RMmil)	1,353.5
Book value (RM/share)	1.13
P/BV (x)	1.8
ROE (%)	14.3
Net Gearing (%)	22.7
Major Shareholders	Kim Sim Thai (20.4%) Bee Geok Tan (15.1%)
Free Float (%)	50.3
Avg Daily Value (RMmil)	2.6

Price performance	**3mth**	**6mth**	**12mth**
Absolute (%)	(6.6)	19.2	14.4
Relative (%)	(5.0)	13.0	1.1



PP 12247/06/2013 (032380)

Investment Highlights

- **We initiate coverage on Supermax Corporation Bhd (Supermax), with a HOLD rating at a fair value of RM2.20/share, based on a fair PE of 10x FY13F earnings. We believe the slight premium above its 5-year mean is warranted given its brand value.**

- **Supermax's strength lies in its unique business model. Unlike the other gloves manufacturers which are mainly into contract manufacturing (OEM), Supermax's position as an OBM enables it to generate two income streams, namely distribution and manufacturing (46% and 54% of net profit, respectively). It intends to raise its sales mix ratio to 80% OBM in the next 3 years, from the current 69% OBM.**

- **While we applaud Supermax's expansion plans in the higher margin segments, (nitrile: doubled to 10.5bil pieces by end-2013 with a potential topline contribution of USD150mil and surgical: 10-fold rise to 336mil pieces), overcapacity in 2HFY13 and status quo allocation of surgical glove sterilisation capacity by the government could trim our forecast FY12F/13F EBITDA margin expansion of +2ppts.**

- **Management has indicated that the company will not be following its peers (Top Glove and Kossan) in moving upstream. Supermax will continue to leverage on its OBM business to penetrate the other emerging markets (a strategy that has led to it commanding 70% of the Brazilian glove market together with Top Glove). Other new ventures include embarking on global trading, sales and marketing via a newly incorporated subsidiary and cross-selling of products to diversify its product range.**

- **These new endeavors together with the usual capacity growth help bring some certainty to Supermax given the delays in its Glove City project due to infrastructure limitations. Management is now guiding for construction to begin in FY14. In line with that, we have incorporated an additional 4bil pieces (16% of FY14 capacity) from Glove City Phase 1 for FY14. Earlier commissioning could lead to a re-rating of Supermax.**

- **Presently, Supermax enjoys the lowest effective tax rate among the 4 leading glove manufacturers (1H12: 9%; 3-yr average of 12% vs. industry's 20%) mainly due to the availability or reinvestment allowance. Should there be no extension given by the government, its effective tax rate would double to 17%-20%, slashing FY12F-FY14F net profit by 7%-10%.**

- **We have incorporated capex of RM236.5mil for FY12F-14F – in manufacturing and process automation (RM66mil), replacement of old lines (RM26mil), and glove city project (RM50mil in FY14), amongst others.**

- **Going forward, we estimate FY12F and FY13F earnings to be RM129mil and RM150mil. This implies a growth of 24% and 17%, respectively. Based on Supermax's 30% dividend payout ratio, we forecast gross DPS of 5.3 sen, 6.8 sen and 7.8 sen for FY12F, FY13F and FY14F, respectively. This translates into dividend yields of 2.6%-3.9%.**

INITIATE COVERAGE WITH A HOLD CALL

We initiate coverage on Supermax Corporation Bhd (Supermax), with a HOLD recommendation and a fair value of RM2.20/share, based on a fair PE of 10x FY13F earnings.

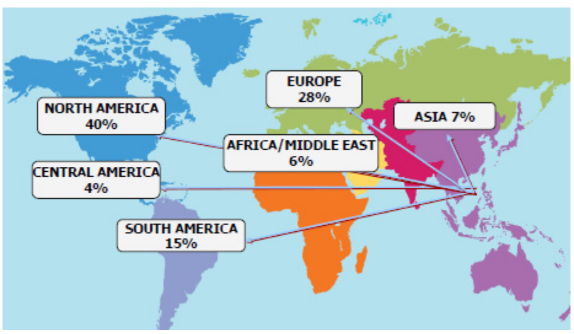
We believe this slight premium above its 5-year mean is warranted given its brand recognition.

COMPANY BACKGROUND

Supermax Corporation Bhd is the second largest glove manufacturer in terms of capacity and the first OBM (own brand manufacturing) latex glove manufacturer in Malaysia.

As at end-FY11, it had 9 plants, producing 17.6bil pieces of gloves for customers in over 146 countries. Its own glove brands (e.g. Supermax, Aurelia and Maxter) are well-known, especially in the medical segment (90% of sales).

CHART 1 : GEOGRAPHICAL DISTRIBUTION OF CUSTOMERS



Source: Company / AmResearch

Supermax's forte is in the US dental market, where it commands the largest market share for latex gloves (9.2%) and ranked 5th in the nitrile segment. To further strengthen its foothold, Supermax is aiming to increase its market share to 10% from the current 4.4% within 3 years.

TABLE 1 : SUBSIDIARIES

(1)	Supermax Glove Manufacturing S/Bhd (100%
(2)	Maxter Glove Manufacturing S/Bhd (100%)
(3)	Supermax Latex Products Sdn Bhd (100%)
(4)	Supermax Energy Sdn Bhd (100%)
(5)	Maxwell Glove Manufacturing Bhd (100%)
(6)	Supermax Global Limited (100%)

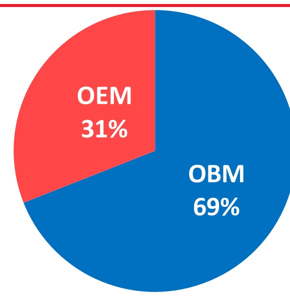
Source: Company / AmResearch

UNIQUE BUSINESS MODEL

Supermax's strength lies in its unique business model. Unlike the other gloves manufacturers which are mainly into contract manufacturing (OEM), Supermax's success thus far can be attributed to its position as an OBM.

About 69% of the gloves sold by Supermax in the last year were under its own brands. Management has indicated its intention to raise the company's sales mix ratio to 80% OBM going forward.

CHART 2 : SALES MIX



Source: Company / AmResearch

❑ *Two income streams…*

As an OBM, Supermax is able to generate income from its distribution business, on top of revenue from the typical manufacturing-only division.

We understand that ex-factory selling prices to both distributors (i.e. the intermediaries in the OBM model) and contract customers (OEM model) are the same. However, there are additional gains to be made when the distributors sell it on to the end-customers.

In FY11, distribution contributed 46% of core net profits and manufacturing, the remaining 54%. There are no overlapping of costs and profits for both divisions.

At present, the group has 5 distribution centres in the United States, Germany, Brazil, Belgium and the United Kingdom selling its own brand.

❑ *…and counting*

Supermax Global Ltd (SGL), a recently-incorporated subsidiary, will undertake international trading, sales and marketing of internally-manufactured gloves and outsourced gloves, healthcare and medical devices.

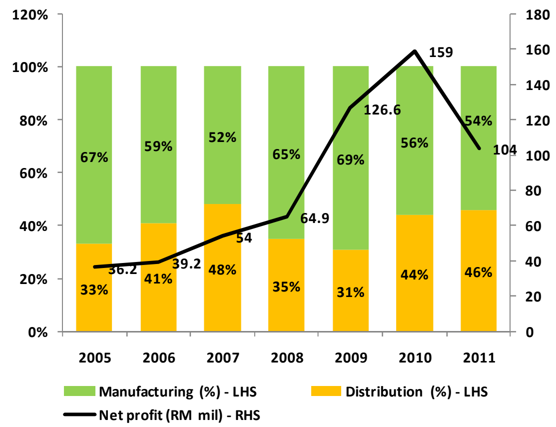
This will form Supermax's third income stream.

❑ *The importance of branding*

With gloves fast becoming a commodity, having its own brand helps Supermax add an extrinsic value to its products. Brand loyalty offers some stability to the company, especially when switching opportunities arise.

Branding may also be another tool to stave off international competition. Taking a global viewpoint, should Thailand and Indonesia (glove market share of 19% and 13%,

CHART 3 : BREAKDOWN OF NET PROFIT BY INCOME STREAM



Source: Company / AmResearch

respectively vs. Malaysia's 63%) improve their technology to match our glove players', the local players may lose out due to the lower production costs there. The threat has been muted thus far as we are still ahead in terms of innovation and technological processes.

The Malaysian Rubber Export Promotion Council (MREPC) has initiated some actions to assist in this development, including researching markets and providing the industry with market information on the various countries deemed a good start point to develop Malaysian brands.

- ***Expansion of National Distribution Headquarters in the US***

Earlier this year, Supermax purchased 14.06 acres of land in Chicago to build a National Distribution Headquarters for its US operations. Construction for Phase I (East Building, warehouse and distribution facility) has commenced with completion date scheduled for 2Q13. The project is valued at RM19.5mil.

Upon completion, the total built-up area of 25,000 sq ft will consists of warehouses, distribution facilities and office space.

We believe this is a good move for Supermax as it will be able to expand its product offerings to the medical, pharmaceutical and science laboratories market, which together make up ~90% of its sales.

Furthermore, it will help Supermax penetrate the hospitality and beauty industries, segments with potential growth due to its low glove usage now.

TABLE 2 :SUPERMAX'S DISTRIBUTION CENTRES AND SUBSIDIARIES

(1)	Supermax Healthcare Inc., USA (100%)
(2)	Supermax Deutschland, Germany (90%)
(3)	Supermax Brasil, Brazil (50%)
(4)	Supermax Canada Inc., Canada (50%)
(5)	Supermax Europe, Belgium (50%)
(6)	Supermax Healthcare, UK (100%)

Source: Company / AmResearch

EXPANSION PLANS ON-TRACK

- ***Installed capacity to grow 22% from FY11-FY13F***

To cash in on the strong global glove demand (+8% to 10%), Supermax has fast-tracked its new capacity expansion plans at Lot 6058 and Lot 6059 (Plant 10 and 11) in Meru, Klang. It has also replaced some old lines at Lot 6070 with 12 new inter-switchable nitrile/NR latex lines capable of producing 1.43bil pieces of gloves per annum.

Installed capacity is expected to grow by 22% from 17.6bil pieces per annum in FY11 to 21.6bil pieces per annum in FY13F.

- ***Nitrile glove capacity to more than double to 52% by end-FY13***

Its plan to more than double its nitrile glove capacity to 10.5bil pieces per annum by 4QFY13 could see a potential topline increase of USD150mil when all the lines are fully commissioned.

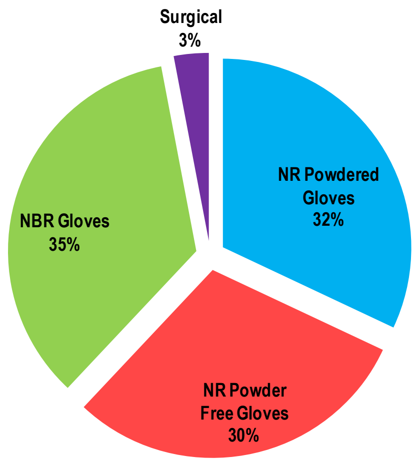
The increase in production capacity will see nitrile gloves form 52% of Supermax's product mix in FY13F, with the remaining 48% being natural rubber latex gloves.

- ***Surgical glove capacity jumps 10-fold***

Supermax's move to boost its surgical capacity by 10-fold to 336mil pieces per month is going well, with 4 out of the 7 lines at Lot 4 (Sg. Buloh) having been commissioned since May 2012.

We believe the additional capacity will be easily absorbed given the current 5- to 6-month oversold situation experienced by Supermax.

CHART 4 : PRODUCT MIX BY GLOVE TYPES



Source: Company / AmResearch

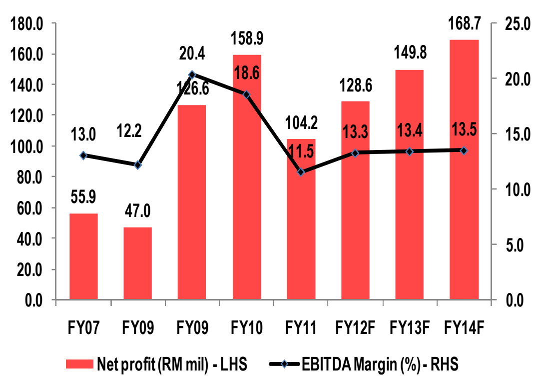
❑ *Slight EBITDA margin expansion barring any setbacks*

We forecast a slight EBITDA margin expansion of +2ppts to an average of 13% for FY12F-FY14F given increased market share and contributions from these higher margin segments, better productivity and improved efficiency from the automation processes being implemented.

However, we caution that setbacks such as:- (1) the likely nitrile glove overcapacity in 2HFY13; (2) no extra allocation of surgical glove sterilisation capacity by the government; or (3) delays in placing the additional automatic packaging machineries, could trim our forecasted EBITDA margins.

Presently, Supermax's global glove market share stands at 12% and is estimated to rise to 13% in FY12F.

CHART 5 : EBITDA MARGIN VS NET PROFIT



Source: Company / AmResearch

FUTURE PLANS

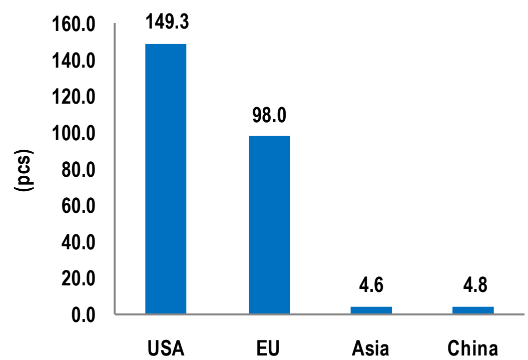
❑ *Not moving upstream*

Management has indicated that the company will not be following its peers (Top Glove and Kossan) in moving upstream into rubber plantation as the long gestation period represents too hefty an investment. It takes about 6 years for a rubber tree to mature before the latex can be harvested. As such, Supermax would be concentrating on the downstream activities of manufacturing, distributing and marketing of gloves.

The company will continue to leverage on its OBM business to penetrate the Middle East and other emerging markets. This strategy has been highly successful as Supermax, together with Top Glove, commands 70% of the Brazilian glove market.

As it is, the average consumption of gloves per capita in the Asian region (ex-Japan) is less than 10 pieces per annum, a stark contrast to the 100 pieces per annum of developed countries. As countries in this region are quite populous (China, India and Indonesia alone make up 40% of world population), glove demand growth could potentially be exponential.

CHART 6 : GLOVE CONSUMPTION PER CAPITA



Source: Hartalega / AmResearch

An impending threat would be from Hartalega, which has also adopted the OBM model as a means to break into the emerging markets.

However, we believe that with Supermax's existing distribution network and established brand, it will be able to make decent in-roads into the nitrile glove market, especially into the US dental nitrile gloves market within the next 2-3 years.

❑ *Other opportunities*

To ensure the company's sustainability, Supermax has identified a new income stream. As mentioned, this venture will involve global trading, sales and marketing via SGL, increasing its international influence going forward.

This somewhat brings Supermax back to its roots, when the company was first established as a trading business distributing latex gloves in 1987, albeit at a larger scale.

Under this business model, the company will not only buy and sell or promote its own gloves but also those produced by other manufacturers. It will also widen its product range by cross-selling, i.e. selling masks, aprons and other medical devices to diversify its product range.

WHAT HAPPENED TO GLOVE CITY?

These new endeavors together with the fast-tracked capacity expansion help bring some certainty to Supermax given the delays in its Glove City project due to infrastructure limitations.

❑ ***A grand plan***

Supermax's Glove City, which is located in Bukit Kapar, is its largest project on hand. Under a 10-year plan, Supermax aims to transfer all of its factories to one single plot to increase operating efficiency and enable further cost savings.

Initially slated to begin in FY11, it has been postponed due to the inability to secure gas supply for its plants there. (Glove manufacturers use natural gas as an energy source to dry the gloves.)

❑ ***Set to take off in FY14F***

Management is now guiding for construction to begin in FY14, with capacity contribution of 4bil pieces per annum from Phase 1 (16% of our total projected FY14F capacity of 25.8bil pieces per annum).

In line with that, we have incorporated the additional capacity into our model. Earlier commissioning could lead to a positive re-rating of Supermax, while further delays would further limit its growth prospects.

All in, we have incorporated capex of RM236.5mil for FY12F-14F – for manufacturing and process automation (RM66mil), replacement of old lines (RM26mil), and glove city project (RM50mil in FY14), amongst others.

TAX ADVANTAGES

❑ ***Last man standing***

Presently, Supermax enjoys the lowest effective tax rate among the 4 leading glove manufacturers (1H12: 9%; 3-yr average of 12% vs. industry's 20%) mainly due to reinvestment allowance (RA) claims by some of its subsidiaries. Our channel checks reveal that the other glove players have fully utilised theirs.

According to a recent news article, the 15-year RA given by the government will expire in the middle of next year. A company that enjoys RA will be given a 60% claim on the qualifying capex, in addition to the normal capital allowance claim.

❑ ***MARGMA is still negotiating***

Although the Deputy International Trade and Industry Minister Datuk Jacob Dungau Sagan has said the government will not be extending the RA, we understand that they are still in negotiations with the Malaysian Rubber Glove Manufacturers Association (Margma) to let it run for another 5 to 10 years.

❑ ***A host of other incentives***

We are not too concerned as there are many other incentives that glove manufacturers can make use of to protect their bottom line.

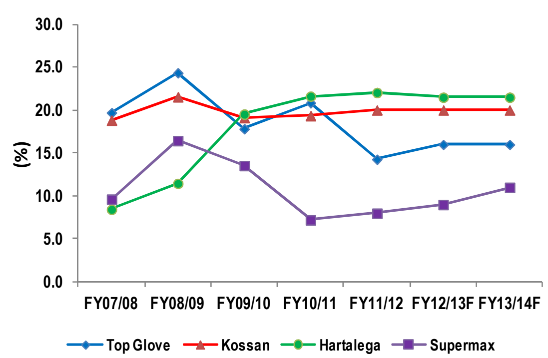
Being export-oriented, the increase in export allowances with 100% tax exemption would help reduce the effective tax rates. Moreover, in such a dynamic and competitive industry, manufacturers try to differentiate themselves through the introduction of new products. These research and development expenditure incurred is entitled for double deduction.

❑ ***What does this mean to glove manufacturers?***

We do not see any profound impact on the glove players' earnings, should Margma fail to secure an extension. As it is, most of the manufacturers, except Supermax, have effective rates of ~20%.

In such a scenario, we expect Supermax's effective tax rate to rise to 17%-20%, slashing its net earnings by 7%-10% for FY12F to FY14F.

CHART 7: EFFECTIVE TAX RATES FOR TOP 4 GLOVE MAKERS



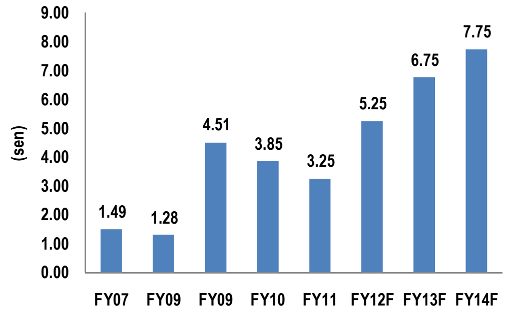
Source: Company / AmResearch

DIVIDEND POLICY

We forecast gross DPS of 5.3 sen, 6.8 sen and 7.8 sen for FY12F, FY13F and FY14F, respectively. This translates into dividend yields of 2.6%-3.9%.

Our estimates are based on its policy of paying out 30% of its net profit as dividends, up from 20% previously.

CHART 8 : DIVIDEND PER SHARE



- *adjusted for bonus issues*

Source: Company / AmResearch

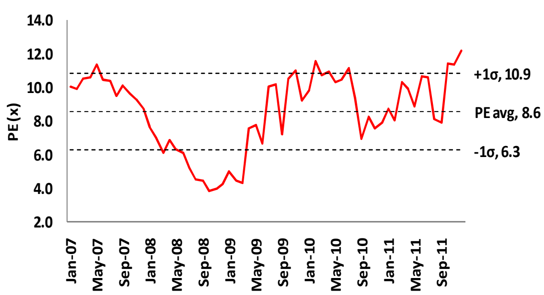
VALUATION AND RECOMMENDATION

Going forward, we estimate FY12F and FY13F earnings to be RM129mil and RM150mil. This implies a growth of 24% and 17%, respectively.

Supermax is currently trading near its historical PE of 9x. We have assumed a PE of 10x FY13F EPS to arrive at a fair value of RM2.20/share. We believe that the slightly higher PE is warranted given its brand value.

Nonetheless, it is still a steep 47% discount to industry leader Top Glove's PE of 19x because of liquidity reasons.

CHART 9 : 5-YR HISTORICAL PE BAND



Source: Bloomberg / AmResearch

TABLE 1 : FINANCIAL DATA

Income Statement (RMmil, YE 31 Dec)	2010	2011	2012F	2013F	2014F
Revenue	977.3	1,021.4	1,135.5	1,314.3	1,498.4
EBITDA	181.5	117.9	150.6	176.1	202.2
Depreciation	(26.0)	(24.1)	(30.3)	(33.6)	(37.8)
Operating income (EBIT)	155.5	93.8	120.3	142	164.4
Other income & associates	42.0	34.8	34.8	34.8	34.8
Net interest	(13.6)	(12.5)	(15.4)	(12.8)	(9.8)
Exceptional items	0.0	(4.0)	0.0	0.0	0.0
Pretax profit	**183.8**	**112.1**	**139.7**	**164.5**	**189.5**
Taxation	(24.9)	(8.1)	(11.2)	(14.8)	(20.8)
Minorities/pref dividends	0.0	0.1	0.1	0.1	0.1
Net profit	**158.9**	**104.2**	**128.6**	**149.8**	**168.7**
Core net profit	158.9	108.2	128.6	149.8	168.7

Balance Sheet (RMmil, YE 31 Dec)	2010	2011	2012F	2013F	2014F
Fixed assets	387.9	402.2	424.4	486.8	537.8
Intangible assets	28.7	28.7	28.7	28.7	28.7
Other long-term assets	203.7	233.5	233.5	233.5	233.5
Total non-current assets	**620.3**	**664.4**	**686.5**	**749.0**	**800.0**
Cash & equivalent	97.4	104.5	128.5	88.0	59.5
Stock	133.1	223.1	210.5	233.9	266.4
Trade debtors	113.6	104.5	130.7	151.2	172.4
Other current assets	101.0	109.0	109.0	109.0	109.0
Total current assets	**445.1**	**541.1**	**578.5**	**582.1**	**607.2**
Trade creditors	40.1	60.0	61.5	71.1	81.0
Short-term borrowings	155.1	190.5	165.3	132.6	99.9
Other current liabilities	24.5	27.3	33.7	42.1	49.8
Total current liabilities	**219.7**	**277.7**	**260.5**	**245.8**	**230.7**
Long-term borrowings	140.5	140.5	122.7	94.4	66.2
Other long-term liabilities	13.6	18.2	18.2	18.2	18.2
Total long-term liabilities	**154.1**	**158.7**	**140.9**	**112.6**	**84.4**
Shareholders' funds	**691.5**	**769.1**	**863.7**	**972.7**	**1,092.1**
Minority interests	0.1	(0.1)	(0.1)	(0.1)	(0.1)
BV/share (RM)	1.04	1.13	1.27	1.43	1.61

Cash Flow (RMmil, YE 31 Dec)	2010	2011	2012F	2013F	2014F
Pretax profit	183.8	112.1	139.7	164.5	189.5
Depreciation	26.0	24.1	30.2	33.5	37.7
Net change in working capital	(94.9)	(48.0)	(15.1)	(53.6)	(63.5)
Others	(34.0)	(20.1)	(26.6)	(27.6)	(30.6)
Cash flow from operations	**62.3**	**56.4**	**124.6**	**108.0**	**118.0**
Capital expenditure	(46.6)	(38.1)	(52.2)	(95.8)	(88.5)
Net investments & sale of fixed assets	0.6	0.0	0.0	0.0	0.0
Others	0.0	0.0	0.0	0.0	0.0
Cash flow from investing	**(46.1)**	**(38.1)**	**(52.2)**	**(95.8)**	**(88.5)**
Debt raised/(repaid)	(23.5)	27.5	0.0	0.0	0.0
Equity raised/(repaid)	3.0	4.0	5.0	6.0	7.0
Dividends paid	(31.6)	(27.2)	(34.0)	(40.8)	(49.3)
Others	15.0	(16.5)	(20.5)	(18.9)	(16.8)
Cash flow from financing	**(37.0)**	**(12.3)**	**(49.5)**	**(53.7)**	**(59.1)**
Net cash flow	**(20.8)**	**6.0**	**22.9**	**(41.5)**	**(29.6)**
Net cash/(debt) b/f	**2.7**	**(21.4)**	**22.9**	**(41.5)**	**(29.6)**
Net cash/(debt) c/f	**(198.3)**	**(226.4)**	**(159.5)**	**(139.0)**	**(106.6)**

Key Ratios (YE 31 Dec)	2010	2011	2012F	2013F	2014F
Revenue growth (%)	21.6	4.5	11.2	15.8	14.0
EBITDA growth (%)	10.9	n/a	27.7	17.0	14.8
Pretax margins (%)	18.8	11.0	12.3	12.5	12.6
Net profit margins (%)	16.3	10.2	11.3	11.4	11.3
Interest cover (x)	11.2	7.5	7.8	11.1	16.7
Effective tax rate (%)	13.5	7.2	8.0	9.0	11.0
Net dividend payout (%)	16.0	21.2	27.8	30.6	31.2
Debtors turnover (days)	36	39	38	39	39
Stock turnover (days)	47	64	70	62	61
Creditors turnover (days)	15	18	20	18	19

Source: Company, AmResearch estimates

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