

21 May 2020

Consumer Non-cyclical | Rubber Products

Supermax Corp (SUCB MK)

Buy (Maintained)

Earnings Doubled, Best Is Yet To Come! Still BUY

Target Price (Return): MYR6.08 (32.5%)
 Price: MYR4.59
 Market Cap: USD1,362m
 Avg Daily Turnover (MYR/USD) 45.4m/10.2m

- **Still BUY with a higher DCF-derived MYR6.08 TP from MYR3.90, 33% upside and 1% yield.** 3QFY20 (Jun) earnings more than doubled and beat expectations. Both sales and margins are at record highs. As we expect 4QFY20 earnings to do even better, we increase our earnings estimates and TP. Our new TP implies 28.6x FY21 forward P/E. This reflects a 20% discount against the sector's average forward P/E of 35.8x, which we believe is justified due to Supermax Corp's lower market cap/liquidity.
- **Earnings beat expectations.** 9MFY20 core net profit of MYR126m trumped expectations, as it makes up 79% and 86% of our and consensus' FY20 estimates. The outperformance was caused by exceptional sales and EBITDA margins registered in 3QFY20. Note that sales surged 16% QoQ (+24% YoY) to MYR447m due to a climb in gloves demand. EBITDA margins also expanded QoQ and YoY on declines in raw material prices.
- **3QFY20 core earnings more than doubled QoQ and YoY...** In 3QFY20, Supermax's core net profit surged 105% YoY and 136% QoQ to MYR71m. The superb earnings are fundamentally driven. Note that both sales and EBITDA margins are at record highs for the company.
- **...and the best is yet to come!** We expect 4QFY20 earnings to be better than 3QFY20. Note that the ASP increase effect has not been fully reflected in this period. We believe the ASP increase only started from mid-February onwards – up to end March – for 3QFY20. As the price increase trend has likely continued in April and May, 4QFY20 will reflect the full impact of ASP rises from April-June. See page 5 for our demand-supply analysis.
- **Higher magnitude of ASP increase against peers due to own brand manufacturing (OBM).** While we expect the gloves industry's ASPs to increase, Supermax's magnitude should be higher. Note that 50% of its products are sold under the OBM segment, which allows it to enjoy margins all the way up to the end customer level instead of selling to distributors under the original equipment manufacturer (OEM) segment. Almost all of its peers' products are sold as OEM. After raising our ASP estimate, we have increased FY20F-22F earnings by 18-28%.
- **BUY with a higher MYR6.08 TP.** The higher TP is in line with better earnings estimates. In the near term, we expect Supermax to have an even stronger set of results in 4QFY20, which will capture a full quarter of higher ASPs. In the long run, Supermax is a beneficiary of the long-term uptrend in global gloves consumption: 8-10% annually, even without COVID-19. Risks to our call: Lower-than-expected sales volumes and USD/MYR, and higher-than-expected raw material prices.

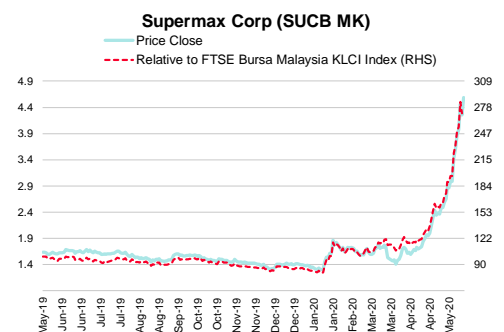
Analyst

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Share Performance (%)

	YTD	1m	3m	6m	12m
Absolute	230.2	136.6	192.4	223.7	189.4
Relative	240.6	135.8	199.6	234.8	200.7
52-wk Price low/high (MYR)					1.30 – 4.59



Source: Bloomberg

Forecasts and Valuation	Jun-18	Jun-19	Jun-20F	Jun-21F	Jun-22F
Total turnover (MYRm)	1,304	1,538	1,708	2,035	2,204
Recurring net profit (MYRm)	107	123	196	278	325
Recurring net profit growth (%)	-	15.5	58.9	41.9	16.9
Recurring P/E (x)	56.22	48.67	30.63	21.58	18.47
P/B (x)	5.9	5.3	4.8	4.1	3.6
P/CF (x)	33.84	25.51	15.85	14.23	13.58
Dividend Yield (%)	1.7	0.3	1.1	1.6	1.9
EV/EBITDA (x)	24.98	25.97	17.96	12.97	10.94
Return on average equity (%)	-	11.5	16.4	20.4	20.7
Net debt to equity (%)	28.5	19.2	2.4	net cash	net cash

Source: Company data, RHB

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Financial Exhibits

Asia	Financial summary (MYR)	Jun-18	Jun-19	Jun-20F	Jun-21F	Jun-22F
Malaysia	Recurring EPS	0.08	0.09	0.15	0.21	0.25
Consumer Non-cyclical	DPS	0.08	0.02	0.05	0.07	0.09
Supermax Corp	BVPS	0.78	0.86	0.97	1.12	1.29
SUCB MK	Return on average equity (%)	-	11.5	16.4	20.4	20.7
Buy						
	Valuation metrics	Jun-18	Jun-19	Jun-20F	Jun-21F	Jun-22F
	Recurring P/E (x)	56.22	48.67	30.63	21.58	18.47
	P/B (x)	5.9	5.3	4.8	4.1	3.6
	FCF Yield (%)	2.0	2.0	3.8	4.5	4.9
	Dividend Yield (%)	1.7	0.3	1.1	1.6	1.9
	EV/EBITDA (x)	24.98	25.97	17.96	12.97	10.94
	EV/EBIT (x)	30.14	32.25	23.84	16.39	13.63
	Income statement (MYRm)	Jun-18	Jun-19	Jun-20F	Jun-21F	Jun-22F
	Total turnover	1,304	1,538	1,708	2,035	2,204
	Gross profit	430	510	670	809	882
	EBITDA	244	232	325	434	497
	Depreciation and amortisation	(42)	(45)	(80)	(91)	(98)
	Operating profit	202	187	245	344	399
	Net interest	(14)	(20)	(4)	1	6
	Pre-tax profit	162	172	257	365	427
	Taxation	(52)	(49)	(60)	(86)	(100)
	Reported net profit	107	123	196	278	325
	Recurring net profit	107	123	196	278	325
	Cash flow (MYRm)	Jun-18	Jun-19	Jun-20F	Jun-21F	Jun-22F
	Change in working capital	57	31	97	53	23
	Cash flow from operations	177	235	378	421	442
	Capex	(59)	(112)	(150)	(150)	(150)
	Cash flow from investing activities	(55)	(112)	(143)	(138)	(134)
	Dividends paid	(76)	(33)	(59)	(83)	(97)
	Cash flow from financing activities	(126)	(104)	(27)	(61)	(135)
	Cash at beginning of period	156	145	174	392	624
	Net change in cash	(4)	19	208	222	173
	Ending balance cash	145	174	392	624	806
	Balance sheet (MYRm)	Jun-18	Jun-19	Jun-20F	Jun-21F	Jun-22F
	Total cash and equivalents	145	174	392	624	806
	Tangible fixed assets	900	969	1,018	1,068	1,121
	Total investments	197	208	208	208	208
	Total assets	1,700	1,843	2,096	2,423	2,674
	Short-term debt	374	331	294	336	327
	Total long-term debt	62	61	129	121	114
	Total liabilities	677	708	824	954	977
	Total equity	1,023	1,134	1,273	1,468	1,697
	Total liabilities & equity	1,700	1,843	2,096	2,423	2,674
	Key metrics	Jun-18	Jun-19	Jun-20F	Jun-21F	Jun-22F
	Revenue growth (%)	0.0	17.9	11.0	19.2	8.3
	Recurrent EPS growth (%)	0.0	15.5	58.9	41.9	16.9
	Gross margin (%)	33.0	33.2	39.3	39.8	40.0
	Operating EBITDA margin (%)	18.7	15.1	19.0	21.3	22.5
	Net profit margin (%)	8.2	8.0	11.5	13.6	14.7
	Capex/sales (%)	4.5	7.3	8.8	7.4	6.8
	Interest cover (x)	14.5	9.5	21.2	32.1	40.3

Source: Company data, RHB

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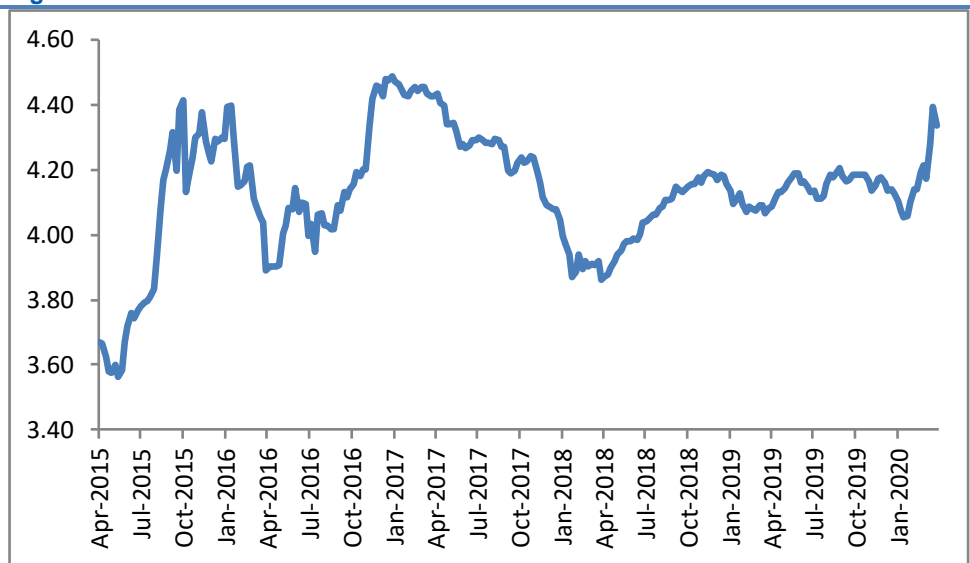
Figure 1: Results snapshot

FYE June (MYRm)	3QFY19	2QFY20	3QFY20	QoQ (%)	YoY (%)	9MFY19	9MFY20	YoY (%)	Comments
Revenue	361.2	385.5	447.2	16.0	23.8	1,113.4	1,202.7	8.0	Surge in gloves demand.
EBITDA	64.3	59.3	111.9	88.7	74.0	202.2	220.4	9.0	Higher margins due to high OBM exposure.
<i>EBITDA margin (%)</i>	<i>17.8</i>	<i>15.4</i>	<i>25.0</i>			18.2	18.3		
Depreciation	(10.4)	(12.8)	(13.1)	1.9	26.3	(32.0)	(38.5)	20.2	
EBIT	52.3	46.5	94.2	102.8	80.2	166.6	176.8	6.1	
<i>EBIT margin (%)</i>	<i>14.5</i>	<i>12.1</i>	<i>21.3</i>			15.0	14.7		
Interest expense	(4.5)	(4.6)	(3.5)	(23.7)	(22.3)	(13.8)	(12.3)	(10.7)	
Pre-tax profit	49.4	41.8	95.3	127.8	92.8	156.4	169.5	8.4	
<i>Pre-tax margin (%)</i>	<i>13.7</i>	<i>10.9</i>	<i>21.3</i>			14.0	14.1		
Tax	(14.5)	(11.8)	(22.9)	94.2	58.6	(46.8)	(42.2)	(9.7)	
<i>Effective tax rate (%)</i>	<i>29.2</i>	<i>28.2</i>	<i>24.1</i>			29.9	24.9		
Minority Interest	0.3	(0.1)	1.3	nm	nm	1.0	1.4	n.m	
Net profit	34.6	30.2	71.1	135.6	105.3	108.7	126.0	15.9	Beat expectations.
<i>Net margin (%)</i>	<i>9.6</i>	<i>7.8</i>	<i>15.9</i>			9.8	10.5		
Core net profit	34.6	30.2	71.1	135.6	105.3	102.2	126.0	23.3	Excludes MYR6.5m in insurance claims in 1H19.
<i>Core net margin (%)</i>	<i>9.6</i>	<i>7.8</i>	<i>15.9</i>			9.2	10.5		

Source: Company data, RHB

Beneficiary of a higher USD/MYR in 3QFY20. A stronger USD during the January-March period has been positive for Supermax, as almost all of its sales are booked in USD – this translates into higher MYR revenue. This is much higher than its cost component, in which only 60% of its raw material costs are USD-denominated.

Figure 2: USD/MYR trend



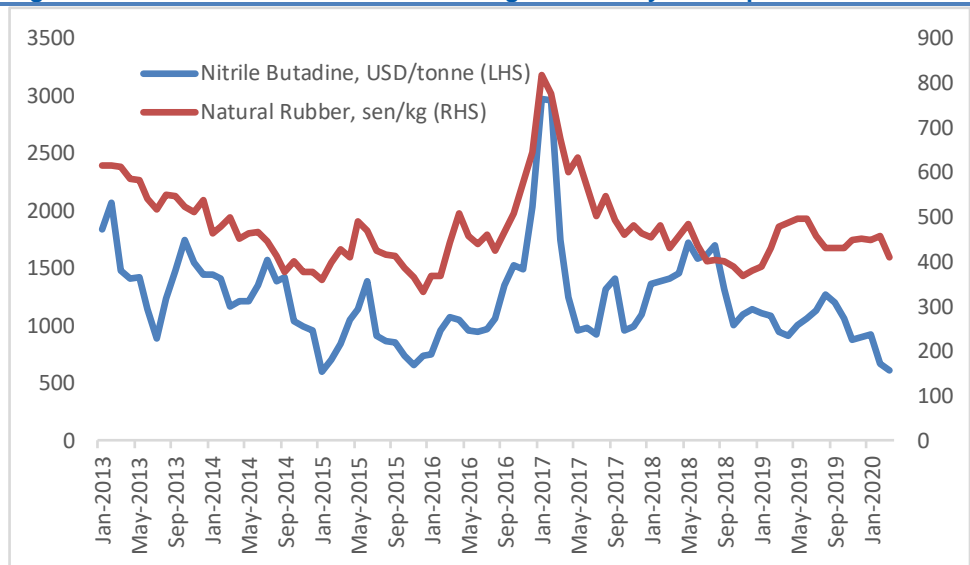
Source: Bloomberg

Margins expanded, as raw material prices (nitrile butadiene and latex) declined QoQ.

From USD895.00 per tonne as of end-Dec 2019, nitrile butadiene prices have dropped 32% QoQ to USD605.00 per tonne as of end-Mar 2020. We believe this was likely caused by the decline in crude oil prices. As a result, Supermax enjoyed lower raw material costs, as 50% of its products are nitrile gloves made from nitrile butadiene.

The remaining 50% consists of latex gloves, which are made from natural rubber. Note that natural rubber prices declined 9% during the January-March quarter. As a result, Supermax EBITDA margin expanded to 25% in 3QFY20, ie much better than 2QFY20 and 3QFY19's 15.4% and 17.8%.

Figure 3: Raw material costs declined during the January-March period



Source: Bloomberg

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Industry lead times have increased to 10 months. Our industry channel checks reveal that lead times have increased significantly in the past one month. This is likely caused by a surge in demand of at least 50%, based on our estimates.

On supply side, the industry is only able to expand by a maximum of 10% in the next three months in a best case scenario. This was caused by the Movement Control Order, which has significantly slowed down construction of new manufacturing plants. As a result, this has caused lead times to increase to 10 months. This is a significant increase when compared to 3-4 months seen in April.

In short, the demand-supply dynamics have tightened up, with buyers willing to wait until Jan 2021 for orders to arrive. Under such market condition, an ASP rise is inevitable, and it will be across the board for all gloves companies, in our view.

Valuation. In our DCF valuation, we have increased FCFF assumptions in line with the better earnings prospects. This was driven by a higher ASP outlook. We have also lowered our WACC assumptions, as Beta for the stock has declined.

Our DCF-derived TP of MYR6.08 reflects a forward P/E of 28.6x. While this is higher than its peak of 24.4x, we believe this is justified, as the counter is still at a 20% discount against its peers' average. Supermax also has a higher ASP increase potential due to the 50% product exposure to the OBM segment.

Figure 4: DCF valuation

FYE Dec (MYR m)	FY21F	FY22F	FY23F	FY24F	FY25F	FY26F	FY27F	FY28F	FY29F	FY30F	Terminal
CFO	421	442	421	489	529	541	581	622	649	668	
+ Interest (1 - tax rate)	(8)	(8)	(7)	(6)	(6)	(5)	(4)	(4)	(3)	(3)	
- capital expenditure	(150)	(150)	(150)	(150)	(150)	(150)	(150)	(150)	(150)	(150)	
Free cash flow to firm (FCFF)	263	284	265	333	373	386	426	468	495	515	13,486
Discount factor	0.92	0.85	0.78	0.72	0.66	0.61	0.56	0.51	0.47	0.44	0.44
PV of FCFF	242	241	206	239	246	234	238	241	235	224	5,877
Risk-free	4.0%										
Beta	0.81										
Cost of Equity	8.8%										
WACC	8.0%										
Terminal growth	4.0%										
Enterprise value (MYR m)	8,224										
Cash	218										
- Debt	(473)										
Equity value (MYR m)	7,970										
Number of shares (m)	1309.90										
TP (MYR)	6.08										

Source: RHB

Figure 5: Sector demand-supply estimates

Pieces (m)	2017	2018	2019	2020F	2021F
Hartalega	30,000	33,000	36,600	40,100	44,100
Growth (%)	39.5%	10.0%	10.9%	9.6%	10.0%
Kossan	22,000	26,500	29,000	32,000	35,000
Growth (%)	0.0%	20.5%	9.4%	10.3%	9.4%
Top Glove	51,600	60,500	70,100	76,000	84,000
Growth (%)	15.7%	17.2%	15.9%	8.4%	10.5%
Supermax	23,400	22,000	21,700	25,700	27,700
Growth (%)	10.9%	(6.0%)	(1.4%)	18.4%	7.8%
Sri Trang Gloves (Thailand)	21,000	21,000	25,000	27,000	30,000
Growth (%)	NA	NA	19.0%	8.0%	11.1%
Estimated capacity	148,001	163,000	182,401	200,800	220,800
Supply growth	13.7%	10.1%	11.9%	10.1%	10.0%
Demand growth	8.6%	7.9%	8-10%	15-18%	8-10%

- ◆ Our capacity supply assumptions may be less aggressive than glove producers' plans
- ◆ Our key assumption: Rational capacity expansion, in which producers will balance between volume growth and margins

Source: Bloomberg

Recommendation Chart



Date	Recommendation	Target Price	Price
2020-05-13	Buy	3.90	3.60
2020-03-15	Buy	1.86	1.71
2020-02-26	Buy	1.86	1.70
2020-01-23	Buy	1.86	1.52
2019-11-29	Neutral	1.50	1.34
2019-09-03	Neutral	1.61	1.46
2019-07-19	Buy	1.88	1.62
2019-05-15	Buy	1.88	1.57
2019-02-13	Buy	1.85	1.61

Source: RHB, Bloomberg

Source: RHB, Bloomberg

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Buy:	Share price may exceed 10% over the next 12 months
Trading Buy:	Share price may exceed 15% over the next 3 months, however longer-term outlook remains uncertain
Neutral:	Share price may fall within the range of +/- 10% over the next 12 months
Take Profit:	Target price has been attained. Look to accumulate at lower levels
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Not Rated:	Stock is not within regular research coverage

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