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15 April 2010

Supermax Corporation

Still in (g)love

RECOM	Buy
PRICE	RM6.98
MKT CAPITALISATION	RM1.89bn
BOARD	Main (Syariah stock)
SECTOR	Industrial
INDEX COMPONENT	KLCI, FBMSC, FBMS FBMEMAS

SUCB MK / SUPM.KL

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Investment highlights

- **Still in (g)love; maintain BUY.** Supermax is scheduled to release its 1QFY10 results during lunchtime on 19 April. Although no new capacity came onstream during the quarter, we estimate that net profit more than doubled yoy to around RM50m, thanks to strong demand. Given the expected stronger contributions in the coming quarters, we are likely to raise our FY10-12 earnings forecasts by 23-25% when the results are announced. For now, we also retain our target price of RM9.65, which is pegged to a 20% discount to Top Glove's target P/E of 16.5x. We think that the recent selldown of Supermax is unjustified given the resilient demand for rubber gloves and glove manufacturers' ability to pass on cost increases, be it latex, energy or even a weaker US\$. We maintain our BUY call on Supermax, premised on the potential re-rating catalysts of the anticipated strong 1Q results, continuing uptick in glove demand and upcoming capacity expansion. Supermax remain one of our top picks for the sector.
- **Positive stance remains.** Rubber glove stocks have come under selling pressure of late as investors fret about a repeat of the share price collapse in 2008 when investors assumed that record latex prices, high energy prices and a weakening US\$ would dampen glovemakers' earnings significantly. We think that the recent selldown of the stocks is unjustified given the resilient demand for rubber gloves and glove manufacturers' ability to pass on cost increases. Moreover, glove manufacturers proved their resilience against the 2008-9 global economic turmoil and earnings continued to rise despite the weakening US\$ and high costs during 2008. On average, the total net profit of the companies in our coverage increased 19.5% in FY08 and 65.3% in FY09. We strongly believe that industry prospects remain favourable and Supermax is one of the key beneficiaries. Given the additional capacity coming in during 2Q, we expect Supermax's core net profit to grow by at least 25% this year. The company's ROE improved to an impressive 27% last year. The company is also strengthening its balance sheet position, with net gearing falling to 31.5% in 2009 from 90% the year before.

Key stock statistics

	2009	2010F
FYE Dec		
EPS (sen)	48.1	62.7
P/E (x)	14.5	11.1
Dividend/Share (sen)	10.9	13.0
NTA/Share (RM)	2.1	2.6
Book Value/Share (RM)	2.1	2.6
Issued Capital (m shares)		271.4
52-weeks Share Price Range (RM)	RM7.45/RM1.06	
Major Shareholders:	%	
Dato' Seri Thai Kim Sim, Stanley	20.4	
Datin Seri Tan Bee Geok, Cheryl	14.6	
Koperasi Permodalan Felda	5.5	

Per share data

	2007	2008	2009	2010F
FYE Dec				
Book Value (RM)	1.7	1.6	2.1	2.6
Cash Flow (sen)	32.0	37.3	87.9	59.8
Earnings (sen)	22.6	17.7	48.1	62.7
Dividend (sen)	3.0	3.2	10.9	13.0
Payout Ratio (%)	13.3	18.1	22.7	20.7
P/E (x)	30.9	39.5	14.5	11.1
P/Cash Flow (x)	21.8	18.7	7.9	11.7
P/Book Value (x)	4.2	4.4	3.4	2.7
Dividend Yield (%)	0.4	0.5	1.6	1.9
ROE (%)	17.9	11.7	26.6	27.0
Net Gearing (%)	87.9	90.0	31.5	14.4

Source: Company, CIMB estimates, Bloomberg

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

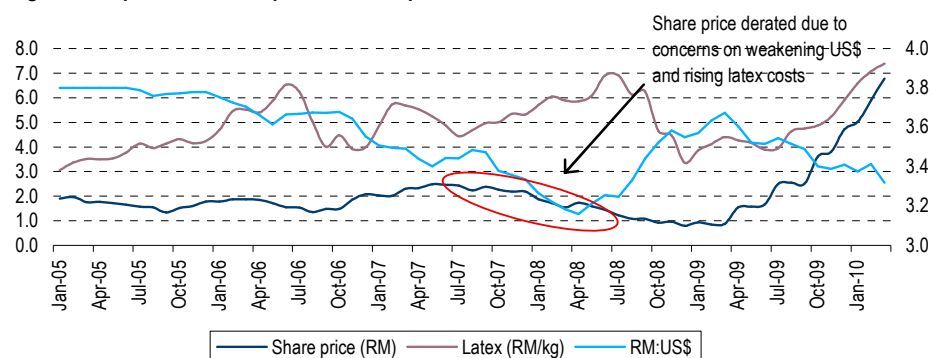
Recent developments in the sector

Sell-down of rubber glove stocks. Rubber glove stocks have been under selling pressure lately because of negative newsflow on the sector. These include the upturn of latex prices, strengthening ringgit and concerns over a potential industry glut.

Latex price at all-time high... Latex costs make up on average about 55% of glove manufacturers' costs. Latex prices have been rising this year and are now at an all-time high of RM7.60/kg. We gather from industry players that this is due to the tight supply in the market as well as the ongoing rubber wintering season.

... and weakening US\$ not a major concern. Given that almost 100% of Supermax's products are exported, the strengthening of the ringgit could have a negative impact on its revenue. Fortunately, it sources half of its latex from Thailand and pays in US\$, leading to a partial natural hedge for the company. Moreover, like other glove manufacturers, Supermax sells its products 1-2 months forward at ASPs based on the average latex price and RM:US\$ rate in the previous month. Selling prices are revised every month or as and when there is a sudden change in cost, for example, the revision of electricity and natural gas rates during mid-08 and early 2009. We, therefore, believe that a firmer ringgit and rising latex should have minimal impact on the bottomline. Any impact on margins would be temporary given the cost pass-through and revision of selling prices.

Figure 1: Supermax's share price vs. latex price and RM:US\$



Left-hand scale => Share price (RM) and Latex (RM/kg)
 Right-hand scale => RM:US\$ exchange rate

Source: Bloomberg, CIMB Research

Industry demand remains healthy. Investors' other major concern is reduced pricing power for glove manufacturers given the potential oversupply of gloves in the market. We do not think that this will be an issue because glove demand is increasing at an average rate of 8-10% per annum. Although glove manufacturers are expanding capacity in a big way, the additional capacity will only come in progressively. This leads us to believe that industry demand growth could be higher than last year's estimated 12% (Figure 2) as it was constrained by supply capacity since glove manufacturers were operating at maximum capacity. This led to a spillover of orders to 2010.

Real output estimated to be only 24.5bn pieces. Based on our coverage of the six biggest rubber glove companies in Malaysia, we estimate that industry capacity, which stood at 72.7bn pieces p.a. in 2009, will increase by about 35.1bn pieces or 48% over the next two years (Figure 3). However, the expansion is coming in progressively. Furthermore, most glove manufacturers can only run at about 85% utilisation as they require some downtime for maintenance. This, along with potential problems such as commissioning problems, delay in approvals for foreign labour, delay in equipment or approval for gas supply, underpins our assumption of around 70% utilisation on average. This implies an additional 24.5bn pieces of gloves in total for 2010 and 2011. Assuming 10% demand growth a year (Figure 4), the world will need additional 30.5bn pieces of gloves by end-2011. Assuming that the other smaller glove players in Thailand and Indonesia do not expand as fast as the companies under our coverage, which have about 50% global market share and are the most aggressive in expanding capacity and capturing market share, our projections suggest that the current capacity expansion by the six biggest Malaysian rubber glove players alone may not be

sufficient to meet future demand.

Glut not a worry for some time to come. Moreover, even if there is surplus capacity, it does not necessarily mean that the rubber glove companies will lose pricing power as they have been operating with excess capacity for many years with the exception of 2009 when there was a jump in demand due to H1N1. Furthermore, our projections assume base-case demand growth. Glove manufacturers still strongly believe that on top of the average annual demand of 8-10%, future growth could come in from the US healthcare reform and a surge in demand from major developing countries like China and India. All this ties in with our view that investors should not be unduly concerned about a slight surplus in capacity.

Figure 2: World demand for rubber gloves

	Demand (bn pieces)	Growth	
		%	Absolute (bn pcs)
1999	49.5	n/a	n/a
2000	54.5	10%	5.0
2001	60.0	10%	5.5
2002	70.0	17%	10.0
2003	80.0	14%	10.0
2004	90.0	13%	10.0
2005	100.0	11%	10.0
2006	112.0	12%	12.0
2007	123.0	10%	11.0
2008	129.7	5%	6.7
2009	145.3	12%	15.6

Source: CIMB Research

Figure 3: Capacity expansion (bn pieces p.a.)

	2009		2010		2011		Growth in 2 years		
	Absolute	(%)	Absolute	(%)	Absolute	(%)	Absolute	(%)	
Adventa	3.5	5.2	1.7	49%	6.9	1.7	33%	3.4	97%
Hartalega	6.2	8.4	2.2	35%	9.9	1.5	18%	3.7	59%
Kossan Rubber	11.0	14.5	3.5	32%	17.5	3.0	21%	6.5	59%
Latexx Partners	6.0	9.0	3.0	50%	10.5	1.5	17%	4.5	75%
Supermax	14.5	17.6	3.1	21%	21.7	4.2	24%	7.3	50%
Top Glove	31.5	35.3	3.8	12%	41.3	6.1	17%	9.8	31%
Total	72.7	89.9	17.2	24%	107.8	17.9	20%	35.1	48%

Source: Companies, CIMB Research

Figure 4: Demand-supply scenario analysis

	Growth Assumptions									
	6%		8%		10%		12%		14%	
	Addition	Total	Addition	Total	Addition	Total	Addition	Total	Addition	Total
2010F	8.7	154.0	11.6	156.9	14.5	159.8	17.4	162.7	20.3	165.6
2011F	9.2	163.2	12.6	169.4	16.0	175.8	19.5	182.2	23.2	188.8
Total additional demand in two years	18.0		24.2		30.5		37.0		43.5	

Additional capacity of 35bn pieces

@ 60% utilisation ~ 21bn	Excess supply	Excess demand	Excess demand	Excess demand	Excess demand
@ 70% utilisation ~ 25bn	Excess supply	Excess supply	Excess demand	Excess demand	Excess demand
@ 80% utilisation - 28bn	Excess supply	Excess supply	Excess demand	Excess demand	Excess demand

Source: CIMB Research

Still has back orders to clear. For Supermax, its capacity expansion is on track. It will start testing the first few lines at its Meru plant this month. The company mentioned that it had to turn down many orders as demand is still strong and it does not have sufficient capacity. It still has to clear back orders from last year totalling 5.4bn pieces. The company mentioned that due to the current high prices, some of the customers which placed the orders that are backlogged now prefer to defer their shipment to the later part of this year where prices are expected to stabilise. Supermax estimates that the earliest possible timeline for it to clear the order backlog is towards the end of 3Q this year.

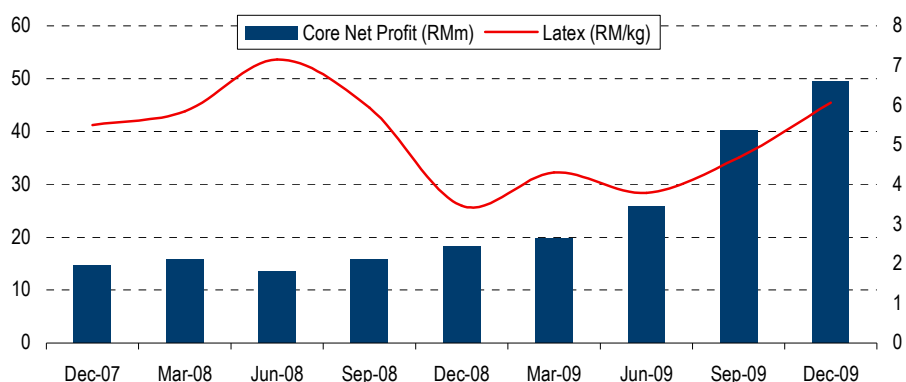
Figure 5: Supermax's back orders ('000 pieces)

Orders Received	2008	1Q09	2009			Total
			2Q09	3Q09	4Q09	
From Supermax & Seal Polymer's customers	13,500	3,050	4,000	4,000	3,800	14,850
From APLI's customers	2,640	330	330	330	330	1,320
H1N1	Nil	Nil	450	300	300	1,050
Total orders received	16,140	3,810	4,630	4,630	4,430	17,500
Total shipped	12,765	2,995	3,015	3,130	2,975	12,115
Back orders	3,375	815	1,615	1,500	1,455	5,385
*Back orders against shipment	26%	27%	54%	48%	49%	44%

Source: Company, CIMB Research

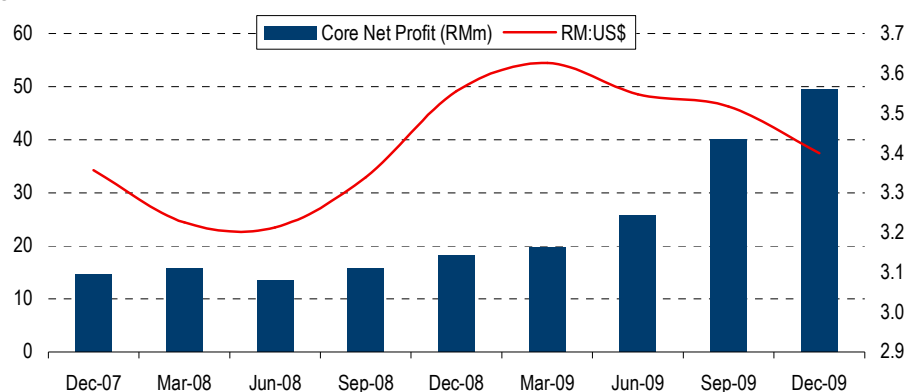
Positive stance remains. We remain positive on the rubber glove sector. As highlighted in the sector update we issued on 24 March 2010, investors are concerned about a repeat of the share price collapse in 2008 when investors assumed that record latex prices, high energy prices and a weakening US\$ would dampen glovemakers' earnings significantly. We think that the recent selldown of the stocks is unjustified given the resilient demand for rubber gloves and glove manufacturers' ability to pass on cost increases. Moreover, glove manufacturers proved their resilience against the 2008-9 global economic turmoil and earnings continued to rise despite the weakening US\$ and high costs during 2008. We have checked with industry players and they concur with our view. As Figures 6-8 show, Supermax's earnings and margins remained intact or even improved over the past few years despite rising latex costs and a volatile RM:US\$. On average, the total net profit of the companies in our coverage increased 19.5% in FY08 and 65.3% in FY09. Given that no capacity was added in the past two years and new capacity is expected to contribute in 2H this year, we expect Supermax's core net profit to grow by at least 25% this year.

Figure 6: Core net profit vs. latex price



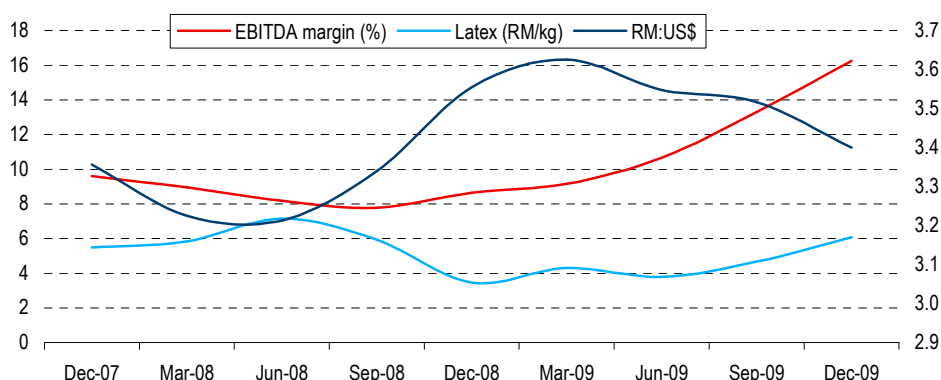
Source: Company, Bloomberg, CIMB Research

Figure 7: Core net profit vs. RM:US\$



Source: Company, Bloomberg, CIMB Research

Figure 8: EBITDA margin vs. latex price and RM:US\$



Source: Company, Bloomberg, CIMB Research

Earnings outlook

Higher earnings yoy and qoq. Supermax is scheduled to release its 1Q10 results during lunchtime on 19 April. Although no new capacity was added during the quarter, we gathered that backlog shipments of RM25m from 4Q09 were recognised in 1Q this year. In 4Q, the company had also incurred a one-off interest expense of RM5.4m arising from its early redemption of bonds due to mature in 2012. Taking all this into account along with the potential adjustment of selling prices due to higher latex prices and a weakening US\$, we estimate that the company could report a net profit of around RM50m in 1Q, which is more than double 1Q09 earnings and about 13% higher than 4Q09.

Earnings under review. Recently, the company announced that it was looking at achieving RM168m net profit which is just 1% short of our current forecast of RM170m. Given the potential strong numbers to be announced by the company next week, we are keeping our earnings under review. We expect stronger contributions in the remaining quarters and flag the likelihood of 23-25% upgrades in our FY10-12 earnings forecasts when the results are announced. We are conservatively looking at quarterly earnings in the range of RM50m-RM55m for the next three quarters.

Figure 9: P&L analysis (RM m)

FYE Dec	2007	2008	2009	2010F
Revenue	574.3	811.8	814.8	1,183.2
Operating Profit (EBIT)	74.9	98.9	164.0	203.2
Depreciation	(19.9)	(28.8)	(31.6)	(32.7)
Interest Expenses	(15.3)	(20.3)	(16.7)	(14.3)
Pretax Profit	58.6	52.0	152.1	200.1
Effective Tax Rate (%)	4.4	9.6	14.7	15.0
Net Profit	55.9	47.0	129.8	170.1
Operating Margin (%)	13.0	12.2	20.1	17.2
Pretax Margin (%)	10.2	6.4	18.7	16.9
Net Margin (%)	9.7	5.8	15.9	14.4

Source: Company, CIMB estimates

Recommendation

Still in (g)love. Supermax is trading at a forward P/E of only 9.6x, a 22% discount to its historical peak of 12.3x. As the share price scaled a new all-time high recently, we anticipated a sell-down of this stock along with other rubber glove stocks. While we view the sell-down as healthy, we do not think the concerns which drove the fall were justified given the resilient demand for rubber gloves and glove manufacturers' ability to pass on cost increases, be it latex, energy or even a weaker US\$. We believe that Supermax deserves to trade above its historical peak given its size (second largest in terms of capacity), liquidity (the most liquid rubber glove stock), earnings consistency (strong earnings since APLI write-off) and strong prospects for its OBM gloves and overseas distribution centres.

More upside to rubber glove stocks. Supermax will be the first among its peers to release its 1Q10 results. We expect a strong performance by the company on both qoq and yoy basis. We also think that there could be some surprises from the rest of the companies which are due to release their results next month. There could be revisions to our earnings forecasts for these companies too.

Figure 10: Upcoming quarterly results announcement

Company	FYE	Quarter under review	Announcement date*
Hartalega	March	4Q	11-May
Kossan	December	1Q	End May
Latexx	December	1Q	3-May
Supermax	December	1Q	19-Apr

* Tentative

Source: Companies, CIMB Research

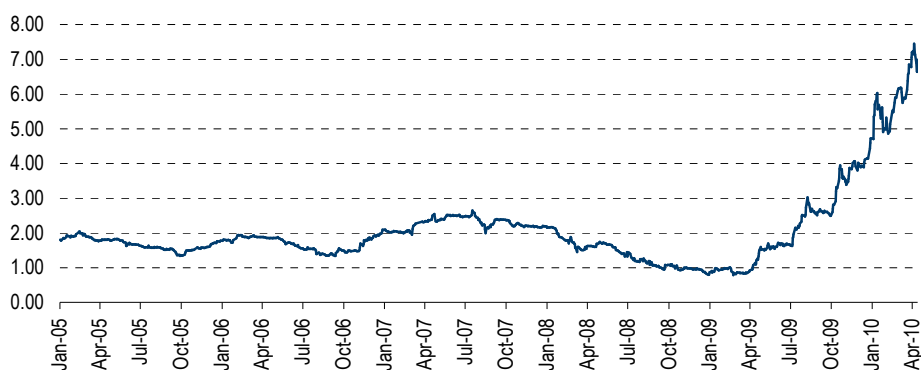
Maintain BUY. We strongly believe that industry prospects remain favourable and Supermax is one of the key beneficiaries. We maintain our BUY call on Supermax. The current share price weakness is a great buying opportunity as the strong results next week will assuage investors' fears. Our earnings forecasts and target price are under review and FY10-12 earnings may be raised by 23-25%. For now, our target price remains intact at RM9.65, still pegged to a 20% discount to Top Glove's target P/E of 16.5x. The stock will go ex of its proposed 1-to-4 bonus issue by the end of June. This will enhance the stock's liquidity and make it more affordable in terms of absolute cost. Potential re-rating catalysts include the anticipated strong 1Q results, continuing uptick in glove demand and upcoming capacity expansion. Supermax remains one of our top picks for the glove sector. Investors with a high risk appetite can consider Supermax's two call warrants (Figure 11).

Figure 11: Details of call warrants

	7106CA CIMBB	7106CB OSK IB
Bloomberg code	7106CA CIMBB	7106CB OSK IB
Issuer	CIMB Bank	OSK Investment Bank
Type	European-style	European-style
Settlement	Cash-settled	Cash-settled
Exercise ratio (CW:SUCB share)	8CW-to-1	10CW-to-1
Exercise price	RM5.60	RM6.50
Issue price	RM0.175	RM0.150
Expiry date	10-Mar-11	4-Feb-11

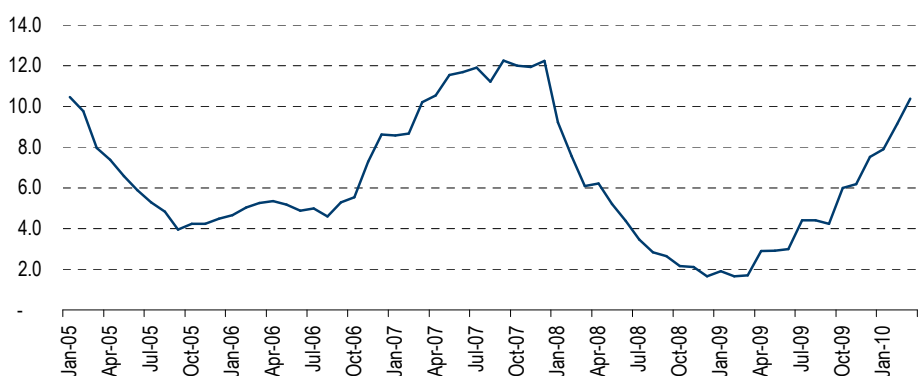
Source: Bloomberg, Bursa Malaysia

Figure 12: Share price chart (RM)



Source: Bloomberg

Figure 13: 12-month forward P/E (X)



Source: CIMB Research

Financial summary

FYE Dec	2008	2009	2010F	2011F	2012F
Revenue (RM m)	811.8	814.8	1,183.2	1,417.4	1,571.4
EBITDA (RM m)	98.9	164.0	203.2	241.1	268.2
EBITDA margins (%)	12.2%	20.1%	17.2%	17.0%	17.1%
Pretax profit (RM m)	52.0	152.1	200.1	233.2	248.0
Net profit (RM m)	47.0	129.8	170.1	198.2	210.8
EPS (sen)	17.7	48.1	62.7	73.1	77.7
EPS growth (%)	-22%	+172%	+30%	+17%	+6%
P/E (x)	39.5	14.5	11.1	9.6	9.0
Core EPS (sen)	23.3	49.8	62.7	73.1	77.7
Core EPS growth (%)	+3%	+114%	+26%	+17%	+6%
Core P/E (x)	29.9	14.0	11.1	9.6	9.0
Gross DPS (sen)	3.2	10.9	13.0	16.0	18.0
Dividend yield (%)	0.5%	1.6%	1.9%	2.3%	2.6%
P/NTA (x)	4.4	3.4	2.7	2.2	1.8
ROE (%)	11.7%	26.6%	27.0%	25.3%	22.1%
Net gearing (%)	90.0%	31.5%	14.4%	3.6%	2.9%
P/CF (x)	72.5	16.7	19.8	13.1	22.0
EV/EBITDA (x)	21.6	11.8	9.2	7.5	6.8
% change in EPS estimates			-	-	-
CIMB/Consensus (x)			1.02	1.05	0.89

Source: Company, CIMB Research, Reuters Estimates

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