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17 February 2011

Supermax Corporation

Getting a grip post FY10 results

RECOM	Buy
PRICE	RM4.24
MKT CAPITALISATION	RM1.44bn
BOARD	Main (Syariah)
SECTOR	Industrial
INDEX COMPONENT	KLCI, FBMSC, FBMS FBMEMAS

SUCB MK / SUPM.KL

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Investment highlights

- **Maintain BUY.** Following Supermax's analyst briefing, we trim FY11-12 EPS by 1.7-3.8% after lowering FY11 capacity by 8.7% to 19.85bn pieces of gloves, in line with its guidance. This reduces our target price RM6.80 to RM6.37, still based on a CY12 P/E of 11.6x or a 20% discount to Top Glove's target P/E of 14.5x. Although management expects latex rubber prices to retreat in 2H11 and take the 2011 average to RM7.50/kg, it is prepared for a 40-45% nitrile composition in its product mix if demand picks up. Despite the lower capacity in FY11, we retain our BUY rating as we believe the earnings momentum will continue in FY11-12, underpinned by a 3-year EPS CAGR of 7.7%. Potential re-rating catalysts include 1) the restart of its Sungai Buloh plant, 2) expanding nitrile production, and 3) higher distribution income. Supermax now offers FY11-13 dividend yields of 2.6-2.8%.
- **FY11 capacity clarified.** Supermax's FY11 capacity guidance of 19.85bn pieces of gloves (+12.8%) was a negative surprise, being lower than our expectations of 21.74bn pieces of gloves. But management did not make any changes to its FY12 capacity of 23.24bn pieces of gloves, which was a relief for us.
- **Rubber prices could fall in 2H11.** The company expects natural rubber latex to average RM7.50/kg in FY11, implying a drop from the current price level of c.RM10.60/kg. It thinks that prices could fall in 2H11 due to 1) the normalisation of tapping as wintering is now over, 2) easing of demand for rubber as glovemakers shift to nitrile, and 3) the release of inventory by traders and processors.
- **Distribution income to mitigate cost inflation.** To combat cost headwinds, Supermax aims to reduce its dependency on manufacturing income and raise distribution income from 40% of total sales to 50% in FY11-12. This would reduce the company's exposure to volatile raw material prices as the company would instead take a spread between manufacturers and end-users.

Key stock statistics

FYE Dec	2010	2011F
EPS (sen)	49.4	51.8
P/E (x)	8.6	8.2
Dividend/Share (sen)	10.0	11.0
NTA/Share (RM)	2.00	2.17
Book Value/Share (RM)	2.08	2.60
Issued Capital (m shares)		339.5
52-weeks Share Price Range (RM)		RM2.72/RM6.60
Major Shareholders:		%
Dato' Seri Stanley Thai and family		35.5
Employees Provident Fund		8.4

Per share data

FYE Dec	2008	2009	2010	2011F
Book Value (RM)	1.22	1.64	2.08	2.60
Cash Flow (sen)	15.6	66.4	42.1	55.0
Earnings (sen)	13.8	37.2	49.4	51.8
Dividend (sen)	2.6	8.8	10.0	11.0
Payout Ratio (%)	18.8	23.6	20.2	21.2
P/E (x)	30.7	11.4	8.6	8.2
P/Cash Flow (x)	27.2	6.4	10.1	7.7
P/Book Value (x)	3.5	2.6	2.0	1.6
Dividend Yield (%)	0.6	2.1	2.4	2.6
ROE (%)	11.7	26.0	25.9	21.7
Net Gearing (%)	90.0	31.5	16.2	3.2

Source: Company, CIMB estimates, Bloomberg

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Recent developments

FY10 results briefing. Supermax held an analyst briefing yesterday to discuss its FY10 financial results. The briefing was hosted by the company's CEO Dato' Seri Stanley Thai, director of corporate affairs Denis Low, and group accountant Andrew Lim. During the 2-hour briefing and lengthy Q&A, management touched upon the latest industry and company-related developments. While management indicated that it expects FY11 revenue to breach the RM1bn mark, it said that it would only give guidance on FY11 net profit after the release of its 2Q11 results which we believe could be later this year in August.

Management ready to switch to nitrile. Management reiterated its commitment to nitrile, indicating that 70% of production lines are interchangeable between natural rubber and nitrile gloves. We believe this gives the company greater flexibility to switch between natural rubber and nitrile depending on demand. Over the past few months, Supermax has increased nitrile from 24% of total capacity to 30%. The company said that it has the ability to increase nitrile production quickly to 40-45% of total capacity should demand prove stronger than expected.

Expects nitrile margins to trend down. While Supermax remains ready to increase its nitrile output, management conceded that margins for nitrile gloves are expected to trend lower. It expects nitrile operating margins to fall from 15-18% to 11-15% in FY11. We believe the margin compression is due to overcapacity in the nitrile markets that Supermax operates in and aggressive pricing by new entrants to the nitrile market.

FY11 capacity expansion clarified... Management expects FY11 total capacity to be 19.85bn pieces of gloves, a 12.8% increase from FY10's 17.59bn pieces. We expect the higher capacity to come from Phase 1 of Glove City (1.04bn pieces natural rubber gloves) and Factory #10 at Lot 6058 (1.22bn pieces of nitrile powder-free gloves). Management is fast tracking the latter given the robust demand for nitrile powder-free gloves. Capital expenditure for Factory #10 is expected to be RM66.1m, which is within our expectations.

...but lower than our forecast. Management's capacity guidance for FY11 was a negative surprise to us, being lower than our expectations of 21.74bn pieces of gloves. But management did not make any changes to its FY12 capacity of 23.24bn pieces of gloves, which is a relief.

Distribution income to mitigate cost inflation. To battle rising raw material costs, Supermax aims to reduce its dependency on manufacturing income and focus more on its distribution business. Currently, distribution accounts for 40% of the group's sales but management hopes to increase this to 50% in FY11-12. In our view, this would reduce Supermax's exposure to volatile raw material prices as the company would take a spread between manufacturers and consumers. Supermax has set up two companies to help expand its distribution reach, namely Supermax International Sdn Bhd and Supermax Global Ltd. Supermax International has been set up as a regional distribution company in Malaysia while Supermax Global is registered in Bermuda. Both entities will enjoy attractive tax rates and help Supermax offset rising raw material cost at its manufacturing division.

Rubber prices could fall in 2H11. Supermax expects natural rubber latex price to average RM7.50/kg in FY11, implying a drop in prices from their current level of c.RM10.57-10.60/kg. It indicated that the following would help push prices lower in 2H11 1) normalisation of tapping as the wintering season is now over, 2) a shift from natural rubber to nitrile, which would help ease demand for natural rubber latex, and 3) release of inventory by traders and processors in Cambodia and Vietnam which have limited storage space.

Earnings outlook

Adjusting forecasts for lower capacity. We cut our FY11-12 EPS numbers by 3.8-1.7% to 51.8-57.6 sen to reflect a more conservative capacity expansion programme, as indicated during the briefing. While the scaled-down capacity expansion will mitigate fears of oversupply, it reduces our growth expectations for Supermax. However, we make no changes to our FY13 EPS of 61.6 sen, which means that our 3-year EPS forecast of 7.7% is intact.

Figure 2: P&L analysis (RM m)

FYE Dec	2008	2009	2010	2011F
Revenue	811.8	803.6	923.3	1,093.8
Operating Profit (EBIT)	98.9	169.0	228.0	214.2
Depreciation	(28.8)	(31.9)	(34.0)	(45.6)
Interest Expenses	(20.3)	(22.3)	(11.5)	(16.2)
Pretax Profit	52.0	151.5	177.4	195.9
Effective Tax Rate (%)	9.6	16.4	5.3	10.0
Net Profit	47.0	126.6	168.0	176.3
Operating Margin (%)	12.2	21.0	24.7	19.6
Pretax Margin (%)	6.4	18.8	19.2	17.9
Net Margin (%)	5.8	15.8	18.2	16.1

Source: Company, CIMB estimates

Recommendation

Valuations remain undemanding. Supermax is trading at a CY12 P/E of just 7.4x, which is about 40% lower than the market's forward P/E of 12.7x. Its valuations are undemanding given its 3-year EPS CAGR of 7.7%, which is well-supported by the steady global demand growth of 8% p.a. for natural rubber gloves and 15% for nitrile gloves. Also, the stock's earnings are backed by long-term structural trends in the sector such as 1) the modernisation of the healthcare sector in China and India, 2) increasing hygiene awareness in emerging countries, and 3) increased medical coverage for 32m uninsured Americans as part of the US healthcare reform bill.

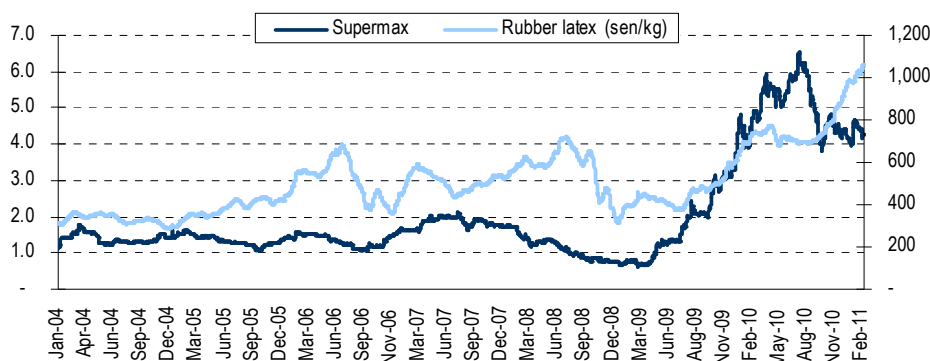
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Figure 3: World glove demand

Demand (bn)	2009E	2010E	2011F	2012F	2013F	2014F	2015F	'10-'15 CAGR
Natural rubber	108.0	116.6	126.0	136.0	146.9	158.7	171.4	8.0%
Nitrile	32.0	36.8	42.3	48.7	56.0	64.4	74.0	15.0%
Subtotal	140.0	150.0	168.3	184.7	202.9	223.1	245.4	10.3%
Vinyl	74.4	80.0	86.0	92.5	99.4	106.8	114.9	7.5%
Total	214.4	230.0	254.3	277.2	302.3	329.9	360.3	9.4%
Demand (%)	2009E	2010E	2011F	2012F	2013F	2014F	2015F	% pts chg
Natural rubber	50.4%	50.7%	49.5%	49.1%	48.6%	48.1%	47.6%	-3.1%
Nitrile	14.9%	16.0%	16.6%	17.6%	18.5%	19.5%	20.5%	4.5%
Subtotal	65.3%	65.2%	66.2%	66.6%	67.1%	67.6%	68.1%	2.9%
Vinyl	34.7%	34.8%	33.8%	33.4%	32.9%	32.4%	31.9%	-2.9%
Total	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	-

Source: Bloomberg

Figure 4: Share price and rubber latex chart (RM)



Source: Bloomberg

Financial summary

FYE Dec	2009	2010	2011F	2012F	2013F
Revenue (RM m)	803.6	923.3	1,093.8	1,400.1	1,570.7
EBITDA (RM m)	169.0	228.0	214.2	243.0	267.9
EBITDA margins (%)	21.0	24.7	19.6	17.4	17.1
Pretax profit (RM m)	151.5	177.4	195.9	217.7	232.9
Net profit (RM m)	126.6	168.2	176.3	195.9	209.6
EPS (sen)	37.2	49.4	51.8	57.6	61.6
EPS growth (%)	+169%	+33%	+5%	+11%	+7%
P/E (x)	11.4	8.6	8.2	7.4	6.9
Core EPS (sen)	38.8	49.4	51.8	57.6	61.6
Core EPS growth (%)	+107%	+27%	+5%	+11%	+7%
Core P/E (x)	10.9	8.6	8.2	7.4	6.9
Gross DPS (sen)	8.8	10.0	11.0	12.0	12.0
Dividend yield (%)	2.1	2.4	2.6	2.8	2.8
P/NTA (x)	2.7	2.0	1.7	1.4	1.2
ROE (%)	26.0	26.0	21.7	20.2	18.4
Net gearing (%)	31.5	16.2	3.2	-	-
Net cash per share (RM)	(0.52)	(0.35)	(0.08)	0.13	0.51
P/CF (x)		20.3	11.9	13.4	-
EV/EBITDA (x)		6.7	6.8	5.6	4.7
% change in EPS estimates		-	-1.7%	-3.8%	-
CIMB/Consensus (x)		0.94	0.98	0.98	0.97

Source: Company, CIMB Research, Bloomberg

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