

Hold

 Target price
RM3.00

 Price
RM3.25

Supermax Margin recovery

We are encouraged by the first signs of recovery in Supermax's operating and net margins in 3Q11 which had reverted to historical averages, after bottoming out in 1Q11. Management attributed this to higher sales volumes and lower costs. We have recently upgraded the stock to a Hold (from Sell).

- Revenue was up 14% qoq while earnings at the operating and normalized net level were up 56% and 16% respectively. Management attributed this to increased sales in both natural rubber and nitrile gloves and lower operating costs due to a decrease in latex prices and a more stable RM/USD exchange rate. According to management, average natural rubber latex prices decreased by 11% qoq to RM8.63/kg, which was slightly offset by nitrile latex prices increasing by 12% qoq to RM6.43/kg. The exchange rate was stable at RM3.02/US\$ for the past two quarters.
- On a yoy basis, revenue was up 15% due to higher output from both its new and refurbished production lines. However, both operating and normalized net profit fell 19% yoy. Although average latex prices have eased of its record high of RM10.93/kg in April 2011, it is still 23% higher than what it was in 3Q10 at RM6.99/kg. Currently, latex price is at RM7.94/kg. Furthermore, the exchange rate averaged RM3.16/US\$ over 3Q10 which was more favourable compared to 3Q11 at RM3.02/US\$.
- We are encouraged by the first sign of a pickup in margins, with operating margin improving to 11% in 3Q11, which is now at the historical average of 11% (2004-2008) versus 8% in 2Q11 and the extraordinary 15.7% achieved in 3Q10. Similarly, net margin improved to 11.4%, which is slightly above historical average of 11.2%. This compares to 11.2% in 2Q11 and 16.2% in 3Q10.
- Cumulatively, 9M11 earnings constituted 73% of our pretax profit and 80% of our normalized net profit forecasts. This was due to higher associates' contribution and lower effective tax rates than expected. It made up 73% of Bloomberg consensus' forecast. Management is guiding for full year profits of RM100-120m. Should there be a sustainable fall in latex price coupled with further strengthening of the US dollar over the next quarter, 4Q11 earnings would have a boost due to the time lag in passing through cost savings. However, we are not

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Supermax's Quarterly Earnings Trend

(RM m) FYE Dec	Mar-10	Jun-10	Sep-10	Dec-10	Mar-11	Jun-11	Sep-11	Change % qoq	% yoy	Cumulative 9M10	9M11	% chg	KAF FY11F	9M/F
Turnover	220.7	234.8	235.1	232.7	241.4	237.9	271.4	14	15	690.6	750.7	9	947.3	79
Operating profit	47.6	41.7	36.8	22.4	18.4	19.1	29.9	56	(19)	126.1	67.4	(47)	101.4	66
Operating margin (%)	21.6%	17.8%	15.7%	9.6%	7.6%	8.0%	11.0%			18.3%	9.0%		10.7%	
Finance costs	(3.7)	(3.3)	(3.7)	(2.3)	(3.3)	(2.2)	(4.8)	120	28	(10.8)	(10.2)	(5)	(17.1)	80
Associates	10.5	10.4	8.3	12.8	10.5	11.0	9.0	(16)	8	29.2	30.5	4	30.0	102
Exceptionals	-	-	-	-	-	(4.0)	-			-	(4.0)			
Pretax profit	54.3	48.8	41.4	32.8	25.6	23.9	34.1	43	(18)	144.5	83.7	(42)	114.3	73
Pretax margin (%)	24.6%	20.8%	17.6%	14.1%	10.6%	10.1%	12.6%			20.9%	11.1%		12.1%	
Tax	(2.8)	(3.0)	(3.3)	(0.1)	(1.2)	(1.3)	(3.2)	149	(4)	(9.1)	(5.7)	(37)	(11.4)	50
Minority interest				(0.0)	(0.0)	(0.0)	(0.0)							
Net profit	51.5	45.9	38.1	32.7	24.4	22.6	30.9	37	(19)	135.4	77.9	(42)	102.9	76
Net profit margin (%)	23.3%	19.5%	16.2%	14.1%	10.1%	9.5%	11.4%			19.6%	10.4%		10.9%	
Normalized net profit	51.5	45.9	38.1	32.7	24.4	26.6	30.9	16	(19)	135.4	81.9	(40)	102.9	80
Normalized net margin (%)	23.3%	19.5%	16.2%	14.1%	10.1%	11.2%	11.4%			19.6%	10.9%			
No. of shares (m)	339.5	339.5	339.5	340.1	340.1	340.1	340.1							
EPS (sen)	15.2	13.5	11.2	9.6	7.2	6.7	9.1	37	(19)	39.9	22.9	(43)	30.3	76
Net DPS (sen)	-	2.5	-	2.5	-	-	3.0	nm	nm	2.5	-	nm	4.9	-

Source: Company, KAF forecasts

Important disclosures can be found in the Disclosures Appendix.

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making revisions at this juncture given the volatility in these macro trends.

- We believe earnings expectations are now more reasonable after a 42% cut in FY12F earnings by consensus since initial forecasts in 2010. Currently, consensus is forecasting a 21% growth in FY12F earnings versus management's guidance of 10-15% and our relatively conservative 5%.
- On our forecast, the stock trades at 10.1x FY12F PE and 1.3x P/B. On consensus forecasts, the stock trades at 8.1x FY12F PE and 1.2x P/B. This compares to its historical mean of 8.9x PE.
- We will continue to keep a close watch on latex price and US dollar movements, which could give upside bias to our forecasts should these trends turn favourable. We had recently upgraded the stock to a Hold (from Sell) with an unchanged target price of RM3.00, given that most negatives have been priced in at these levels, in our view.

Income statement

RMm	FY09A	FY10A	FY11F	FY12F	FY13F
Revenue	803.6	977.3	947.3	1004	1070
Cost of sales	-634.6	-795.8	-820.6	-871.0	-923.4
Operating costs	n/a	n/a	n/a	n/a	n/a
EBITDA	169.0	181.5	126.7	133.0	146.7
DDA & Impairment (ex gw)	-31.9	-26.0	-27.3	-29.3	-32.0
EBITA	137.1	155.5	99.4	103.7	114.8
Goodwill (amort/impaird)	n/a	n/a	n/a	n/a	n/a
EBIT	137.1	155.5	99.4	103.7	114.8
Net interest	-22.0	-13.6	-15.1	-15.2	-16.5
Associates (pre-tax)	n/a	n/a	n/a	n/a	n/a
Forex gain / (loss)	n/a	n/a	n/a	n/a	n/a
Exceptionals (pre-tax)	-5.37	0.00	0.00	0.00	0.00
Other pre-tax items	0.00	0.00	0.00	0.00	0.00
Reported PTP	109.7	141.9	84.3	88.5	98.3
Taxation	-24.9	-24.9	-11.4	-12.0	-15.1
Minority interests	n/a	n/a	n/a	n/a	n/a
Exceptionals (post-tax)	n/a	n/a	n/a	n/a	n/a
Other post-tax items	41.8	42.0	30.0	31.5	33.1
Reported net profit	126.6	159.0	102.9	108.0	116.3
Normalised Items Excl. GW	-5.37	0.00	0.00	0.00	0.00
Normalised net profit	132.0	159.0	102.9	108.0	116.3

Source: Company data, KAF forecasts

year to Dec

Balance sheet

RMm	FY09A	FY10A	FY11F	FY12F	FY13F
Cash & market secs (1)	118.7	97.4	150.8	164.1	178.8
Other current assets	262.5	347.7	317.0	335.3	356.2
Tangible fixed assets	373.4	393.1	421.7	459.5	501.4
Intang assets (incl gw)	28.7	28.7	28.7	28.7	28.7
Oth non-curr assets	162.0	198.5	228.5	260.0	293.1
Total assets	945.2	1065	1147	1248	1358
Short term debt (2)	124.8	153.8	153.8	153.8	153.8
Trade & oth current liab	88.9	65.9	64.1	67.6	71.7
Long term debt (3)	164.8	140.0	140.0	140.0	140.0
Oth non-current liab	7.95	14.2	19.9	25.9	33.4
Total liabilities	386.4	373.8	377.7	387.2	398.8
Total equity (incl min)	558.8	691.5	768.9	860.4	959.3
Total liab & sh equity	945.2	1065	1147	1248	1358
Net debt	170.9	196.4	143.0	129.6	114.9

Source: Company data, KAF forecasts

year ended Dec

Cash flow statement

RMm	FY09A	FY10A	FY11F	FY12F	FY13F
EBITDA	169.0	181.5	126.7	133.0	146.7
Change in working capital	75.0	-94.9	28.9	-14.8	-16.8
Net interest (pd) / rec	0.21	0.33	2.03	2.71	3.24
Taxes paid	-13.1	-24.5	-5.72	-6.00	-7.55
Other oper cash items	-5.24	-0.14	0.00	0.00	0.00
Cash flow from ops (1)	225.9	62.3	151.9	115.0	125.6
Capex (2)	-17.2	-46.6	-56.0	-67.1	-73.9
Disposals/(acquisitions)	0.00	0.56	0.00	0.00	0.00
Other investing cash flow	0.00	0.00	0.00	0.00	0.00
Cash flow from invest (3)	-17.2	-46.1	-56.0	-67.1	-73.9
Incr / (decr) in equity	27.0	5.73	0.00	0.00	0.00
Incr / (decr) in debt	-102.3	2.72	0.00	0.00	0.00
Ordinary dividend paid	-15.0	-31.6	-25.5	-16.5	-17.3
Preferred dividends (4)	n/a	n/a	n/a	n/a	n/a
Other financing cash flow	-21.1	-13.9	-17.1	-17.9	-19.7
Cash flow from fin (5)	-111.5	-37.0	-42.6	-34.4	-37.0
Forex & disc ops (6)	0.25	0.16	0.00	0.00	0.00
Inc/(decr) cash (1+3+5+6)	97.4	-20.6	53.4	13.4	14.7
Equity FCF (1+2+4)	208.6	15.7	96.0	47.8	51.7

Source: Company data, KAF forecasts

year to Dec

Recommendation structure

Absolute performance, long term (fundamental) recommendation: The recommendation is based on implied upside/downside for the stock from the target price and only reflects capital appreciation. A Buy/Sell implies upside/downside of 10% or more and a Hold less than 10%.

Performance parameters and horizon: Given the volatility of share prices and our pre-disposition not to change recommendations frequently, these performance parameters should be interpreted flexibly. Performance in this context only reflects capital appreciation and the horizon is 12 months.

Market or sector view: This view is the responsibility of the strategy team and a relative call on the performance of the market/sector relative to the region. Overweight/Underweight implies upside/downside of 10% or more and Neutral implies less than 10% upside/downside.

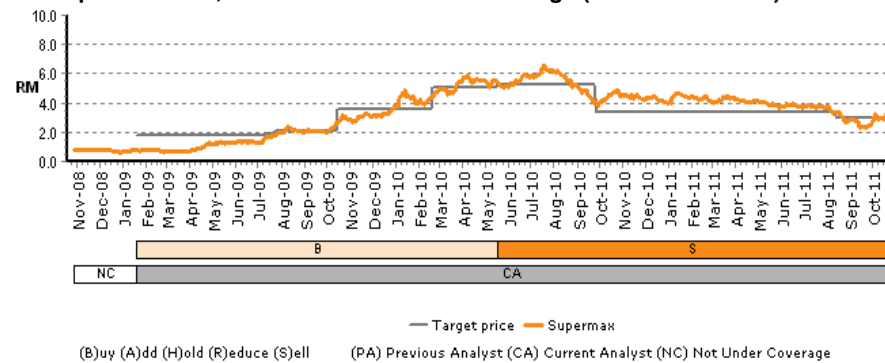
Target price: The target price is the level the stock should currently trade at if the market were to accept the analyst's view of the stock and if the necessary catalysts were in place to effect this change in perception within the performance horizon. In this way, therefore, the target price abstracts from the need to take a view on the market or sector. If it is felt that the catalysts are not fully in place to effect a re-rating of the stock to its warranted value, the target price will differ from 'fair' value.

Valuation and risks to target price

Supermax (RIC: SUPM.KL, Rec: Hold, CP: RM3.22, TP: RM3.00): We value the company using the Gordon growth model. Upside risks to target price include: 1) higher pricing power than expected; 2) sustainable fall in latex prices; 3) strengthening of the US dollar. Downside risks include: 1) oversupply situation causing limited pricing power, 2) unsustainable latex price declines and 3) further weakening of the US dollar.

Supermax coverage data (SUPM.KL, SUCB MK)

Stock performance, recommendations and coverage (as at 25 Oct 2011)



Trading recommendation history

Date	Rec	Analyst
n/a	n/a	n/a

Source: KAF

Price perf (at Close 24 Oct 2011)

	(1M)	(3M)	(12M)
Price (RM)	2.37	3.78	4.74
Absolute (%)	35.9	-14.8	-32.1
Rel market (%)	28.0	-8.1	-30.2
Rel sector (%)	30.8	-4.1	-25.1

Source: Bloomberg
Market: KL Composite
Sector: Medical Supplies

Diana Teo started covering this stock on 19 Jan 09. The recommendation structure changed from October 2010. Historic coverage data prior to the change shows Buy and Outperform ratings as Buys and Sell and Underperform ratings as Sells.
Source: KAF

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