Supermax Corporation

Time to join the party

OUTPERFORM ↔

Price: **RM2.00**

Target Price: **RM2.39** ↔

The key takeaways from Supermax Corporation's (SUPERMX) company visit includes: (i) expect margins improvement starting from 2QFY13 driven by ASPs hike to mitigate the effect of the minimum wage policy, (ii) new capacity from factory 6058 & 6059 to come on-stream by 4QFY13 instead of 3QFY13, and (iii) additional growth from 12 replacement lines and two new plants over FY13 and FY14. YTD, Supermx's share price is missing the party, underperforming its peers which rose an average 36%. We consider the under-performance unwarranted. Valuation-wise, the stock is also traded at steep discounts to its peers. Supermx's PERs at 9.5x and 8.5x on FY13 and FY14 EPS respectively, is at steep 40% discount to sector average despite offering net profit growth averaging 15% p.a in FY13 and FY14. We believe the lagging performance presents a buying opportunity. A re-rating of the stock is expected upon the release of its 2QFY13 results which we expect margins to improve and thus dispel market scepticism that Supermx is unable to implement cost pass through. Maintain Outperform. Our TP is RM2.39 based on 10.2x FY14E EPS. The targeted PER is +0.5SD above the 5-year historical average.

Expecting margins recovery starting from 2QFY13. Management has guided that 1QFY13 margin erosion is one-off and unlikely to recur. Instead, 2QFY13 results to be released in Aug 2013 is expected to show margins improvement compared to 1QFY13 as the lag effect in raising ASPs wore off starting from 2QFY13. Recall, 1QFY13 PBT margin fell 1.7% ppts to 11.5% from 13.1% in 4QFY12 due to higher labour expenses arising from minimum wage policy and the higher cost was not fully passed on to its customers. Typically, customers are given two to three months notice before new ASPs can take effect. As such, we are confident of margin recovery due to an estimated 3-5% increase in ASPs, already notified to customers in Jan 2012, which will kick in from the second quarter onwards.

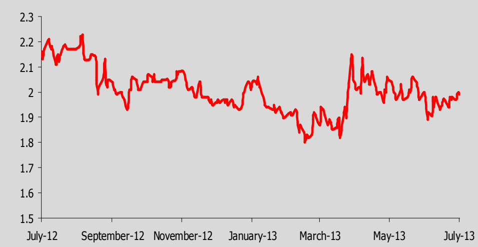
Beneficiary of weakening Ringgit against the US dollar. Supermx is a beneficiary of the weakening of the Ringgit since they do not hedge its US dollar receipts. Since sales are USD denominated, theoretically, a depreciating ringgit against the dollar will lead to more ringgit revenue receipts. The ringgit has weakened by 6% to RM3.18 from an average of RM2.99 against the dollar over the past several weeks. Ceteris paribus, a 1% depreciation of RM against USD will lead to an average 1%-2% increase in the net profit.

Growth expected from 12 replacement lines and 2 new plants over FY13 and FY14. On Lot 6070, the conversion of the old latex-based lines with 12 new nitrile lines with 1.43b pieces capacity is now commercially operational. For illustrative purposes, based on a net profit margin of 10%, ASPs of USD28/1000 pieces and 1.43b pieces, this would generate a total net profit of RM12m or 8% of FY13 net profit. The other two plants namely Lot 6059 and Lot 6058 are on track to commission commercial productions gradually, starting from 4Q 2013 instead of 3Q 2013. Lot 6059 and 6058 will have 24 and 16 production lines producing 3.2b and 2.2b pieces of nitrile gloves respectively. This will bring its total nitrile production capacity from 6.9b to 12.3b pieces p.a. or 52% of the total installed capacity. Due to strong demand for nitrile gloves, Supermx is currently facing an oversold position of two to three months. In the case of surgical gloves, we understand that the remaining lines are expected to commission sometime in 3QFY13 since the additional sterilization facility is available. All in, the surgical lines would produce a total of 336m pairs.

Trading at an average 40% discount to the sector average. Supermx's YTD share price performance (+3%) is missing the glove party compared to other players such as Kossan (+68%), Hartalega (+32%) and Topglv (+10%). We believe its lagging performance presents a buying opportunity. A re-rating of the stock is expected upon the release of the 2QFY13 results which we expect margins to improve and thus dispel market scepticism that Supermx is unable to implement cost pass through. Maintain Outperform.

Maintain forecast and TP of RM2.39. Despite the commissioning delay in Lot 6059 and Lot 6058 by one quarter from 4Q 2013 instead of 3Q 2013, we maintain our earnings forecast as we have yet to fully factor in contributions from both plants.

Share Price Performance



KLCI	1,781.2
YTD KLCI chg	+5.5%
YTD stock price chg	+3.6%

Stock Information

Bloomberg Ticker	SUCB MK Equity
Market Cap (RM m)	1,358
Issued shares	679.2
52-week range (H)	2.25
52-week range (L)	1.79
3-mth avg daily vol:	2,889,813
Free Float	53%
Beta	1.4

Major Shareholders

THAI KIM SIM	20.5%
TAN BEE GEOK	15.2%

Summary Earnings Table

FY Dec (RM'm)	**2012A**	**2013E**	**2014E**
Turnover	1048.2	1200.1	1340.2
EBIT	126.7	152.4	171.2
PBT	140.2	165.2	184.1
Net Profit (NP)	121.8	143.2	159.6
Consensus (NP)		138.8	158.2
Earnings Revision		N.A.	N.A.
EPS (sen)	17.9	21.1	23.5
EPS growth (%)	17.0	17.6	11.4
NDPS (sen)	5.0	6.3	7.0
BVPS (RM)	1.29	1.43	1.60
PER (X)	10.1	9.5	8.5
PBV (X)	1.6	1.4	1.3
Net Gearing (%)	18.3	11.3	6.3
Net Div. Yield (%)	2.6	3.3	3.7

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Income Statement

FY Dec (RM m)	2010A	2011A	2012A	2013E	2014E
Revenue	977.3	1021.4	1048.2	1200.1	1340.2
EBITDA	181.4	114.4	151.3	177.6	198.3
Depreciation	-26.0	-24.1	-24.3	-25.2	-27.1
Operating Profit	155.5	90.4	127.0	152.4	171.2
Other Income	0.3	0.0	0.0	0.0	0.0
Interest Exp	-13.9	-13.1	-9.9	-11.2	-11.2
Associate	42.0	34.8	23.4	24.1	24.1
Exceptional Items	0.0	0.0	0.0	0.0	0.0
PBT	183.8	112.1	140.5	165.2	184.1
Taxation	-24.9	-8.1	-18.7	-22.0	-24.5
Minority Interest	0.0	0.1	0.0	0.0	0.0
Net Profit	158.9	104.2	121.8	143.2	159.6

Balance Sheet

FY Dec (RM m)	2010A	2011A	2012A	2013E	2014E
Fixed Assets	387.9	402.2	450.5	461.0	493.8
Investments in associates	193.5	228.4	251.7	251.7	251.7
Intangible Assets	28.7	28.7	28.7	28.7	28.7
Other FA	10.1	5.1	2.4	2.4	2.4
Inventories	133.1	223.1	233.6	272.5	298.7
Receivables	119.4	115.6	171.8	197.5	211.6
Other CA	95.2	97.8	0.0	0.0	0.0
Cash	97.4	104.5	122.3	173.2	214.8
Total Assets	1065.4	1205.4	1261.1	1387.0	1501.9
Payables	40.1	60.0	48.7	51.3	66.1
ST Borrowings	155.1	190.5	142.1	142.1	142.1
Other ST Liability	24.5	27.3	41.0	64.1	52.5
LT Borrowings	140.5	140.5	141.2	141.2	141.2
Other LT Liability	13.6	18.2	12.4	12.4	12.4
Minorities Int.	0.1	-0.1	0.0	0.0	0.0
Net Assets	**691.5**	**769.1**	**875.7**	**976.0**	**1087.7**
Share Capital	170.0	170.0	340.1	340.1	340.1
Reserves	521.4	599.1	535.7	635.9	747.6
Equity	**691.5**	**769.1**	**875.7**	**976.0**	**1087.7**

Cashflow Statement

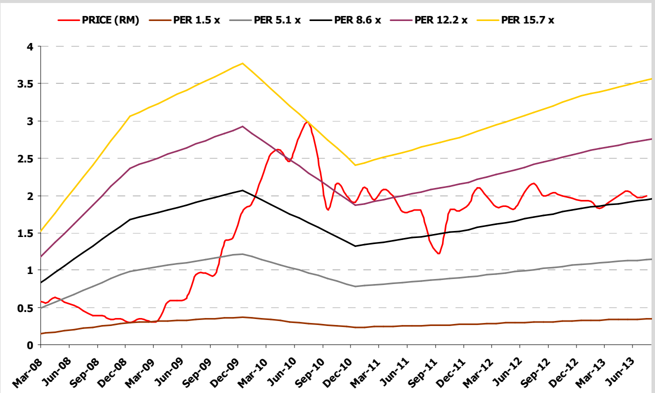
FY Dec (RM m)	2010A	2011A	2012A	2013E	2014E
Operating CF	46.9	43.6	167.8	123.0	119.6
Investing CF	(46.1)	(38.1)	(68.1)	(60.0)	(60.0)
Financing CF	(21.6)	0.6	(81.0)	(13.0)	(17.9)
Change In Cash	(20.8)	6.0	18.6	50.1	41.7
Free CF	0.3	5.4	99.7	63.0	59.6

Financial Data & Ratios

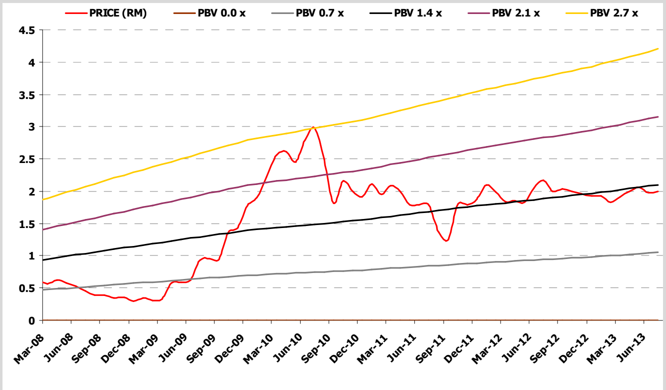
FY Dec (RM m)	2010A	2011A	2012A	2013E	2014E
Growth					
Turnover (%)	21.6%	4.5%	2.6%	14.5%	11.7%
EBITDA (%)	-9.7%	-36.9%	32.2%	17.4%	11.7%
Operating Profit (%)	-14.2%	-41.9%	40.6%	20.0%	12.4%
PBT (%)	92.5%	-39.0%	25.3%	17.6%	11.4%
Core Net Profit (%)	88.1%	-34.5%	16.9%	17.6%	11.4%
Profitability (%)					
EBITDA Margin	18.6%	11.2%	14.4%	14.8%	14.8%
Operating Margin	15.9%	8.8%	12.1%	12.7%	12.8%
PBT Margin	18.8%	11.0%	13.4%	13.8%	13.7%
Core Net Margin	16.3%	10.2%	11.6%	11.9%	11.9%
Effective Tax Rate	13.5%	7.2%	13.3%	13.3%	13.3%
ROA	14.9%	8.6%	9.7%	10.3%	10.6%
ROE	23.0%	13.5%	13.9%	14.7%	14.7%
DuPont Analysis					
Net Margin (%)	16.3%	10.2%	11.6%	11.9%	11.9%
Assets Turnover (x)	1.1	1.2	1.2	1.2	1.1
Leverage Factor (x)	1.5	1.6	1.4	1.4	1.4
ROE (%)	23.0%	13.5%	13.9%	14.7%	14.7%
Leverage					
Debt/Asset (x)	0.3	0.3	0.2	0.2	0.2
Debt/Equity (x)	0.4	0.4	0.3	0.3	0.3
Net Cash/(Debt)	28.7	29.4	18.4	11.3	6.3
Net Debt/Equity (x)	28.7	29.4	18.4	11.3	6.3
Valuations					
EPS (sen)	23.4	15.3	17.9	21.1	23.5
NDPS (sen)	7.5	4.8	5.0	6.3	7.0
BVPS (RM)	1.0	1.1	1.3	1.4	1.6
PER (x)	8.6	13.1	11.2	9.5	8.5
Net Div. Yield (%)	3.8	0.9	2.5	3.2	3.5
P/BV (x)	2.1	1.8	1.6	1.4	1.3

Source: Kenanga Research

Fwd PER Band



Fwd PBV Band



Source: Kenanga Research

Stock Ratings are defined as follows:

Stock Recommendations

OUTPERFORM : A particular stock's Expected Total Return is MORE than 10%
(An approximation to the 5-year annualised Total Return of FBMKLCI of 10.2%)
MARKET PERFORM: A particular stock's Expected Total Return is WITHIN the range of 3% to 10%
UNDERPERFORM : A particular stock's Expected Total Return is LESS than 3%
(An approximation to the 12-month Fixed Deposit Rate of 3.15% as a proxy to Risk-Free Rate)

Sector Recommendations***

OVERWEIGHT : A particular stock's Expected Total Return is MORE than 10%
(An approximation to the 5-year annualised Total Return of FBMKLCI of 10.2%)
NEUTRAL : A particular stock's Expected Total Return is WITHIN the range of 3% to 10%
UNDERWEIGHT : A particular stock's Expected Total Return is LESS than 3%
(An approximation to the 12-month Fixed Deposit Rate of 3.15% as a proxy to Risk-Free Rate)

******Sector recommendations are defined based on market capitalisation weighted average expected total return for stocks under our coverage.***

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