Supermax Corporation

Full Steam Ahead!

OUTPERFORM ↔

Price: RM2.33

Target Price: RM2.82 ↔

We came away from a meeting which was hosted by Dato' Seri Stanley Thai feeling excited about Supermax's ("SUPERMX") growth prospects. We believe that SUPERMX is on track to deliver mid-double digits growth over the next two years. Our meeting included a visit to its two new plants followed by a briefing. The key takeaways from SUPERMX company visit include: (i) new plants progressing well, (ii) new capacity's net margin ranges between 9% to 11%; and (iii) new capacity from factory Lot 6058 & 6059 to come on-stream by 4Q13. Valuation-wise, the stock is trading at steep discounts to its peers. SUPERMX's PERs of 11x and 10x on FY13E EPS and FYE14 EPS respectively is at a steep 40% discount to sector average. This is unjustified given its potential net profit growth averaging 15% p.a in FY13E and FY14E. Maintain OUTPERFORM. Our TP is RM2.82 based on 12x FY14E EPS.

New plants progressing on track. Firstly, we visited Lot 6070 located in Meru, Klang (the conversion of the old latex-based lines into 12 new nitrile lines with 1.43b pieces capacity has started commercial production since 1Q13) where automation installations such as automated mechanical stripping system (removing nitrile gloves from moulds) and glove puller and stacker system are now fully operational. The only process which is yet to be automated is packing of gloves of which some fine-tuning is now currently undertaken before implementation. Looking ahead, once the manual labour of packing gloves in boxes is automated, total savings from automation of about 40-50% on the existing labour costs are expected or approximately RM20 to RM25m per annum. Specifically, SUPERMX achieved a cost saving of up to 60% from automated stripping and stacking implemented in its Kamunting plant. Subsequently, we were taken to the site of both Lot 6058 and Lot 6059 located directly at the back of Lot 6070 where building works is progressing and on track to be commercially ready between end 4Q13 to 1Q14. These new plants will have lines that are switch-able between natural rubber and nitrile glove production but have currently been earmarked for nitrile gloves in tandem with market demand.

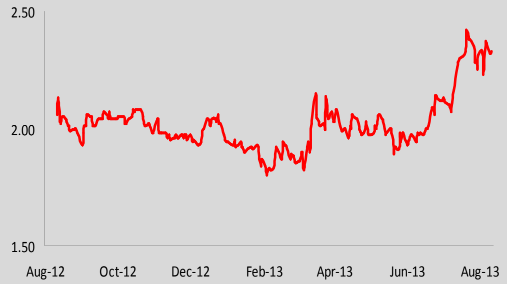
New capacity's net margin ranges between 9% to 11%. In anticipation of intense competition, management guided that average selling price (ASPs) for the new gloves capacity is priced such that net margin ranges between 9% and 11%. Although this is slightly below our 11.9% net margin forecast in FY14, we are not overly concerned. This is simply because SUPERMX is gradually automating its production processes starting from Lot 6070. Next, the two new plants in Lot 6058 and Lot 6059 in Meru, Klang when completed by early 1Q14 is expected to be fully automated from automated mechanical stripping to packing of gloves leading to improve production efficiency. As such, we believe overall margins could improve due to better productivity and efficiency from the new plants. Additionally, unlike other glove players, SUPERMX does not face the risk of high downtime on production lines since they do not cater much for clients requesting for a single product type and specification needs, thus reducing idle downtime from frequent machinery setting adjustments to accommodate such requirements.

Growth expected from 2 new plants going forward. The two plants namely Lot 6059 and Lot 6058 are on track to commission commercial productions gradually, between end 4Q13 or early 1Q14. 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 (including the 1.4bn in Lot 6070) 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. An estimated first twelve lines and 1.4-1.6b pieces of gloves are expected to come on stream between end 4Q13 and 1Q14. For illustrative purposes, assuming a net profit margin of 10%, ASPs of USD27/1000 pieces and 80% utilisation (based on 5.5b pieces), this would generate a total net profit of RM38m or 24% of FY14 net profit.

Beneficiary of weakening Ringgit against the US dollar. SUPERMX is a beneficiary of the weakening 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 10% to RM3.30 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.

Trading at an average 40% discount to the sector average. SUPERMX's YTD share price performance (+20%) is still lagging other players such as Kossan (+90%), Hartalega (+40%) and Topglv (+10%). Since our upgrade report in Feb 2013, the stock has risen by 20%. A re-rating of the stock is imminent as the latest 2Q13 results registered margin improvement, which dispelled market scepticism that SUPERMX may be unable to implement cost pass-through to counter the higher cost from the minimum wage. Maintain OUTPERFORM with a TP of RM2.82 based on 12x FY14 EPS (The targeted PER is at +1.0SD level above the 5-year historical average).

Share Price Performance



KLCI	1,724.21
YTD KLCI chg	2.1%
YTD stock price chg	20.7%

Stock Information

Bloomberg Ticker	SUCB MK Equity
Market Cap (RM m)	1,582.4
Issued shares	679.2
52-week range (H)	2.44
52-week range (L)	1.79
3-mth avg daily vol:	2,699,795
Free Float	59%
Beta	1.2

Major Shareholders

KIM SIM THAI	20.5%
BEE GEOK TAN	15.2%
EPF	5.0%

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)		137.7	155.3
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)	13.0	11.1	9.9
PBV (X)	1.8	1.6	1.5
Net Gearing (%)	18.3	11.3	6.3
Net Div. Yield (%)	2.1	2.7	3.0

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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

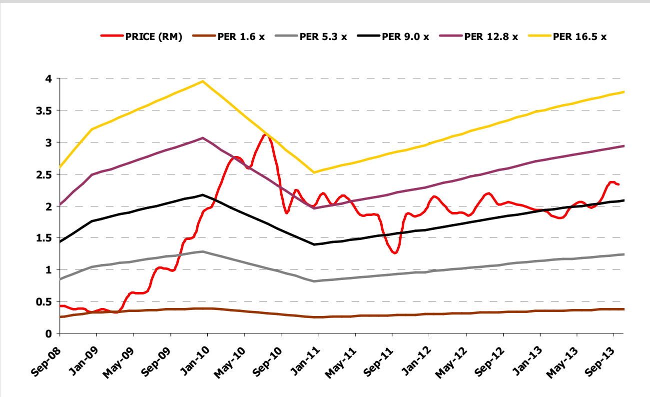
FY Dec (RM m)	2010A	2011A	2012A	2013E	2014E
Operating CF	46.9	43.6	167.8	123.0	119.6
Investing CF	(46.1)	(38.1)	(68.1)	(60.0)	(60.0)
Financing CF	(21.6)	0.6	(81.0)	(13.0)	(17.9)
Change In Cash	(20.8)	6.0	18.6	50.1	41.7
Free CF	0.3	5.4	99.7	63.0	59.6

Financial Data & Ratios

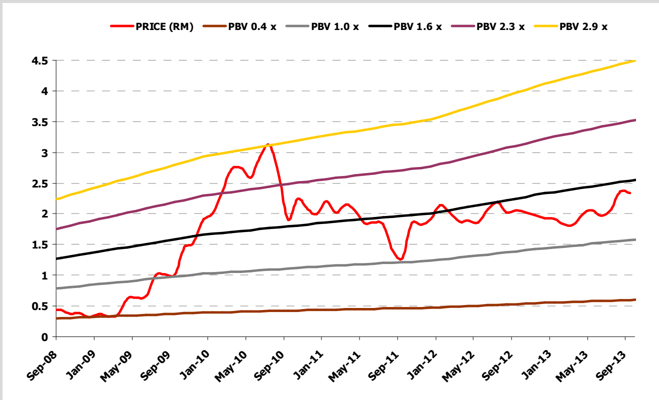
FY Dec (RM m)	2010A	2011A	2012A	2013E	2014E
Growth					
Turnover (%)	21.6%	4.5%	2.6%	14.5%	11.7%
EBITDA (%)	-9.7%	-36.9%	32.2%	17.4%	11.7%
Operating Profit (%)	-14.2%	-41.9%	40.6%	20.0%	12.4%
PBT (%)	92.5%	-39.0%	25.3%	17.6%	11.4%
Core Net Profit (%)	88.1%	-34.5%	16.9%	17.6%	11.4%
Profitability (%)					
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)	10.0	15.2	13.0	11.1	9.9
Net Div. Yield (%)	3.2	0.8	2.1	2.7	3.0
P/BV (x)	2.4	2.1	1.8	1.6	1.5

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.***

Published and printed by:

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