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COMPANY UPDATE

Thursday, August 23, 2012
FBM KLCI: 1,652.25
Sector: Manufacturing

Supermax Corporation Berhad

Double-Digit Earnings Growth Guidance Intact

TP: RM 2.65 *(+24.4%)*
Last traded: RM2.13
BUY

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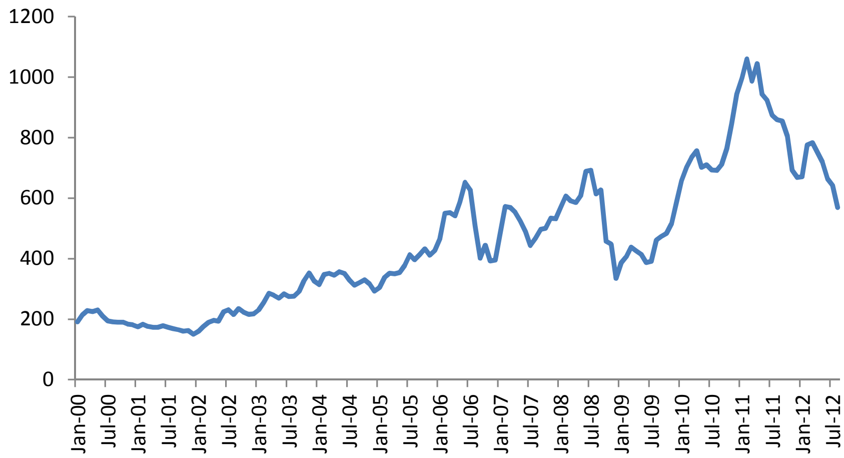
Supermax held an analyst briefing yesterday. Key takeaways from the meeting are as follows:

Price volatility envisaged

According to management, the Tripartite Rubber Council - made up of Malaysia, Thailand and Indonesia - the world's combined largest supplier of natural rubber could cause more volatility in rubber prices. Efforts to artificially support latex prices could however, fail as buyers increase their dependence on suppliers in Vietnam and Cambodia. Furthermore, demand from China has abated in tandem with the economic slowdown. As such, management foresees latex prices to continue easing to RM4.50 per kg by December 2012. That said, we note that average latex price currently trades between RM5.50 and RM5.60 per kg, thus bringing YTD average latex price to RM7.00 per kg. This is a steep 21% decline compared with average latex price of RM8.90 per kg in 2011. As such, we are lowering our latex price assumption from RM6.80 per kg for FY12/13/14 to RM6.50.

Figure 1: Latex price



Source: Malaysian Rubber Board, TA Research

Demand seen picking up

Demand for natural rubber appears to be picking up, especially with average selling prices (ASP) now a lot cheaper than a year ago. Additionally, Supermax is experiencing new growths in the demand and consumption of gloves from developing countries and emerging economies namely China, India and Indonesia. Bulk – or 40% - of Supermax' sales come from North America, followed by Europe at 28% while South and Central America account for close to 20% of total sales. Asia and the Middle East make up the balance of around 12%.

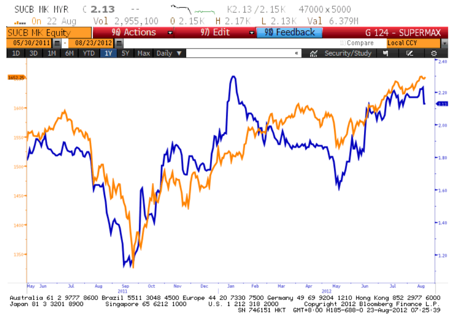
Share Information	
Bloomberg Code	SUCB MK
Stock Code	7106
Listing	Main Market
Share Cap (mn)	680.2
Market Cap (RMmn)	1448.7
Par Value	0.50
52-wk Hi/Lo (RM)	2.375/1.13
12-mth Avg Daily Vol ('000 shrs)	2659.9
Estimated Free Float (%)	48.8
Beta	1.5
Major Shareholders (%)	
	Dato' Seri Stanley Thai - 35.6
	EPF - 9.3

Forecast Revision		
	FY12	**FY13**
Forecast Revision (%)	2.8	3.5
Net profit (RMm)	126.0	149.5
Consensus	129.3	142.5
TA's / Consensus (%)	97.4	104.9
Previous Rating	Buy (Maintained)	

Financial Indicators		
	FY12	**FY13**
Net gearing (x)	0.4	0.3
CFPS (RM)	1.0	1.3
P/CFPS (x)	2.1	1.7
ROAA (%)	9.8	10.5
ROAE (%)	15.4	16.2
NTA/Share (RM)	2.5	2.8
Price/ NTA (x)	0.9	0.8

Share Performance (%)		
Price Change	**SUCB**	**FBM KLCI**
1 mth	(2.7)	1.3
3 mth	15.6	4.5
6 mth	6.4	5.3
12 mth	54.8	14.2

(12-Mth) **Share Price** relative to the **FBM KLCI**



Source: Bloomberg

More competition for the nitrile glove segment

As we had anticipated, management yesterday reinforced our view that competition in the nitrile gloves segment continues to escalate due to new capacity coming onstream along with fresh competition from new players coming out of China and Korea. That said, management envisages a glut in the supply of nitrile glove from 2014. Furthermore, with nitrile material prices expected to rebound from around USD1,200 per MTW currently to USD1,500 per MTW by year-end, Supermax expects margins in this segment to remain competitive, i.e. narrowing to between 11% to 15% from +20% last year.

M&A activities to accelerate

Bulk of these M&As would involve smaller players, such as the acquisition of GMP Medicare Sdn Bhd (GMP) by Top Glove and the recent takeover of Adventa by Aspion Sdn Bhd. We also understand from sources that several listed entities are up for grabs. In any case, the management of Supermax noted the group prefers expanding organically. As such, there are no plans in the near future for any M&A for Supermax. This comes after several harrowing experiences such as the acquisition of APLI back in February 2005.

Strengthening the distribution channels

Moving forward, Supermax' strategies to grow its earnings remain intact. First, management is consistent in driving the growth of its distribution operation in Germany, US, Canada, Brazil and the UK. The group recently acquired a land in the US to build its National Distribution Headquarters (HQ) for the region. The completed HQ will have a total built up area of 225,000 sq. ft. Completion of the East Wing (first phase) is scheduled for 2Q 2013. Here, Supermax expects to be able to carry additional new product lines to cater for the US market as well as capture a higher marker share of nitrile gloves in the US dental market.

New processing plant in Brazil

Plans are also underway to venture in the processing of Surgical Gloves in Latin America, a move which will help the group to capitalize on the region’s duty free status and make the group’s product more competitive in the region. To recap, Brazil raised the import tariffs of latex gloves from 16% to 35% to protect the local glove manufacturers last year. As such, we understand that plans for a manufacturing presence should augur well for the group given that Supermax currently has some 35% share of the market in Brazil. According to management, the group is still assessing the feasibility of establishing a factory which includes related facilities for processing, packaging and sterilisation of gloves.

Acceleration of manufacturing and process automation

Acceleration of manufacturing and process automation for the entire Supermax group is expected to be completed in the next 12 months. This is to help cushion earnings from the implementation of the minimum wage policy coupled with potential hike in gas prices. Labour and fuel accounts for 7% and 11% of group’s total cost breakdown. A total of RM65.8mn has been budgeted to complete the manufacturing and process automation for all the plants. According to management, the group would be able to save some 60% or RM27mn per year of existing labour costs upon completion of this exercise. Elsewhere, expansion plans to raise production to 21.6bn pieces from 17.6bn currently is ongoing. Phase 1 of the glove city project is expected to be completed by FY2014.

Double-digit earnings growth guidance

Management's 20% earnings growth targeted for FY12 remains unchanged. Our revised earnings forecast for FY12/13/14 is also within management guidance. Note that the change to our estimates incorporate: 1) cost savings from FY13 due to the automation exercise, 2) cut in latex price assumption from RM6.80 per kg to RM6.50 per kg, along with a 3) reduction in average ASP from RM26.50 to RM23.20. Taken together, we are seeing a 2-3% increase in earlier FY12/13/14 net profit forecasts of RM122.5/144.4/158.3mn to RM126.0/149.5/162.7mn respectively.

TP revised to RM2.65, BUY

Based on our revised earnings, we also adjust our TP for Supermax to RM2.65 from RM2.50. Our valuation is premised on the industry's targeted PE multiple of 12x to Supermax's FY13e EPS of 22.0 sen. BUY maintained.

Table 1: Earnings Summary

FYE Dec	2010	2011	2012F	2013F	2014F
Turnover	977.3	1026.9	990.5	1050.0	1050.0
Pretax profit	183.8	113.0	148.2	175.8	191.4
Net profit	159.0	106.0	126.0	149.5	162.7
Net profit - adjusted	159.0	106.0	126.0	149.5	162.7
EPS	23.4	15.6	18.5	22.0	23.9
EPS - adjusted	23.4	15.6	18.5	22.0	23.9
EPS growth (%)	25.5	(33.3)	18.8	18.7	8.9
PER	9.1	13.7	11.5	9.7	8.9
Dividend (sen)	3.7	3.2	3.5	3.5	3.5
Dividend yield (%)	1.8	1.5	1.6	1.6	1.6

for TA SECURITIES HOLDINGS BERHAD(14948-M)

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