16 October 2009

Supermax

Supercharged

RECOM	Buy
PRICE	RM3.28
MKT CAPITALISATION	RM870.2m
BOARD	Main (Syariah stock)
SECTOR	Industrial
INDEX COMPONENT	KLCI, FBMSC, FBMS FBMEMAS

SUCB MK / SUPM.KL

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Results highlights

- **Above expectations; maintain BUY.** As highlighted in our preview on Tuesday, Supermax's 3Q09 results trumped expectations due to unexpectedly strong demand, greater operating efficiency and cost control. Annualised 9M09 net profit came in 23% above our projection, even better than the 15% outperformance we had predicted in our preview. The company also beat consensus numbers by 32%. The 2.5 sen tax-exempt interim dividend announced was within our expectations. We are upgrading our FY09-11 earnings by 36-47%. This pushes up our end-10 target price from RM4.28 to RM6.31, still pegged to 10.5x P/E, an unchanged 30% discount to Top Glove's target P/E, which is, in turn, based on our target market P/E of 15x. In view of the favourable outlook for the company, we retain our BUY call. Potential re-rating catalysts include these excellent results, the continuing uptick in glove demand and upcoming capacity expansion plans.
- **Supercharged.** Since A(H1N1) broke out earlier this year, Supermax's glove orders have been rising, leading to sales of 3.13bn pieces of gloves during 3Q09 compared to 3.02bn in 2Q09 and 2.79bn gloves in 3Q08. The stronger demand, increased operating efficiency, higher productivity, effective cost control and a higher share of profits from overseas distribution centres propelled 3Q net profit 55.7% qoq and 154.6% yoy higher.
- **Margin expansion.** Supermax is the second largest glove manufacturer in the country and also the biggest OBM glove manufacturer. The excess capacity that was available at the start of the year proved to be beneficial to the company as demand has outstripped supply since the A(H1N1) outbreak. Moreover, the strong demand enabled the company to command higher prices for its OBM gloves, leading to an expansion of its operating margins to 21.4% during the quarter compared to 19.0% in 2Q09 and 8.8% in 3Q08.

Key stock statistics

FYE Dec	2008	2009F
EPS (sen)	17.8	47.7
P/E (x)	18.5	6.9
Dividend/Share (sen)	3.2	9.0
NTA/Share (RM)	1.6	2.0
Book Value/Share (x)	1.6	2.0
Issued Capital (m shares)		265.3
52-weeks Share Price Range (RM)		RM3.43/RM0.78
Major Shareholders:		%
Dato' Seri Thai Kim Sim, Stanley		20.4
Datin Seri Tan Bee Geok, Cheryl		15.0
Lembaga Tabung Haji		7.9

Per share data

FYE Dec	2006	2007	2008	2009F
Book Value (RM)	1.1	1.7	1.6	2.0
Cash Flow (sen)	17.2	32.0	37.3	56.7
Earnings (sen)	17.6	22.6	17.8	47.7
Dividend (sen)	3.3	3.0	3.2	9.0
Payout Ratio (%)	18.5	13.3	18.0	18.9
P/E (x)	18.6	14.5	18.5	6.9
P/Cash Flow (x)	19.0	10.2	8.8	5.8
P/Book Value (x)	3.1	2.0	2.1	1.6
Dividend Yield (%)	1.0	0.9	1.0	2.7
ROE (%)	17.9	17.9	11.7	26.7
Net Gearing (%)	77.9	87.9	90.0	55.8

Source: Company, CIMB estimates, Bloomberg

Figure 1: Results comparison (RM m)

FYE Dec	3QFY09	3QFY08	% Change
Revenue	237.6	244.3	*(2.7)*
Operating Profit (EBIT)	50.8	21.5	*136.2*
Depreciation	(8.2)	(7.1)	*16.1*
Interest Expenses	(4.1)	(4.9)	*(16.4)*
Associates	11.3	2.4	*372.2*
Pretax Profit	46.7	16.6	181.4
Net Profit	40.2	15.8	154.6
Operating Margin	*21.4*	*8.8*	*142.8*
Pretax Margin	*19.7*	*6.8*	*189.4*
Net Margin	*16.9*	*6.5*	*161.8*

Source: Company, CIMB estimates

Figure 2: P&L analysis (RM m)

FYE Dec	2006	2007	2008	2009F
Revenue	400.3	574.3	811.8	974.4
Operating Profit (EBIT)	53.4	74.9	98.9	116.7
Depreciation	(13.0)	(19.9)	(28.8)	(32.9)
Interest Expenses	(12.7)	(15.3)	(20.3)	(34.1)
Pretax Profit	47.3	58.6	52.0	154.3
Effective Tax Rate (%)	*16.0*	*4.4*	*9.6*	*18.0*
Net Profit	39.7	55.9	47.0	126.5
Operating Margin (%)	*13.3*	*13.0*	*12.2*	*12.0*
Pretax Margin (%)	*11.8*	*10.2*	*6.4*	*15.8*
Net Margin (%)	*9.9*	*9.7*	*5.8*	*13.0*

Source: Company, CIMB estimates

Recent developments

Expansion plans brought forward. In response to the changing environment and strong global demand, management has decided to bring forward some of next year's capital expenditure plans to Nov 09. Instead of starting in Jan 2010, it will start putting in 12 new production lines at its plant in Meru, Klang next month. It targets to complete it by 1Q10. Supermax will probably incur half of the RM24m capex for these lines by the end of this year, which will allow it to claim for reinvestment allowance and reduce its tax payments. Management indicated that the full infrastructure, including the supply of natural gas and other utilities, is already in place, which will expedite the installation of the new lines and machinery.

Gearing up for higher demand. Besides the Meru plant, the company intends to improve the operating efficiency of its other plants. This includes the ongoing refurbishment and upgrade of the old production lines at the plant in Lahat. The upgrade is expected to lead to higher productivity, which will bring down the cost per unit and increase profits. Next year, the company intends to refurbish some old lines and put in some new ones at its Malacca and Sungai Buloh plants, taking its annual glove production capacity to 17.7bn pieces by mid-2010. On top of that, Supermax is firm on its plans to build a glove city on a 36.8-acre plot in Bukit Kapar, Klang. Preliminarily, it is looking at commencement of construction of the first plant with an annual capacity of 3bn pieces of gloves in 2011.

Earnings outlook

Demand to remain strong. For the past decade, global rubber glove demand has racked up consistent growth of about 8-10% per annum. Moreover, the outbreak of diseases such as AIDS, bird flu, SARS and more recently, A(H1N1) influenza has resulted in more hygiene awareness and increasing healthcare spending by governments around the world. Supermax believes that this trend will continue and the company is optimistic that the strong demand trend witnessed since the outbreak of A(H1N1) will spill over to 2010.

Earnings upgrade. Judging from the strong pick-up in demand and the potential improvements in earnings and margins, Supermax looks well on course for a strong FY09. We believe that earnings in the final quarter could be even better than 3Q's as we gathered that Supermax's goods are booked up to Feb next year. Taking this and the ongoing upgrading works into account, we think that the company might even reach 90% utilisation in 4Q as compared to 86% in 3Q. In light of this, we now upgrade our FY09-11 earnings by 36-47% as we adjust for higher utilisation rates and lower our cost assumptions. We are also revising our FY09-11 dividend per share from 7-8 sen to 9-12 sen.

Figure 3 Share price chart (RM)

Source: Bloomberg

Recommendation

Maintain BUY. Using our revised earnings, we derive a new end-10 target price of RM6.31, higher than our recently rolled over price of RM4.28. Note that we retain our valuation basis of 10.5x P/E, an unchanged 30% discount to Top Glove's target P/E, which is, in turn, based on our target market P/E of 15x. In view of the favourable outlook for the company, we retain our BUY call. Potential re-rating catalysts include these excellent results, the continuing uptick in glove demand and Supermax's capacity expansion plans. With the lowest CY10 P/E of 6.3x against the sector average of 8.9x, the stock still offers the cheapest exposure to the rubber glove sector and remains one of our top two picks for the sector.

Financial summary

FYE Dec	2007	2008	2009F	2010F	2011F
Revenue (RM m)	574.3	811.8	974.4	1,224.3	1,451.4
EBITDA (RM m)	74.9	98.9	183.5	206.0	234.6
EBITDA margins (%)	13.0%	12.2%	18.8%	16.8%	16.2%
Pretax profit (RM m)	58.6	52.0	154.3	167.7	187.7
Net profit (RM m)	55.9	47.0	126.5	137.5	159.5
EPS (sen)	22.6	17.8	47.7	51.8	60.1
EPS growth (%)	+30%	-22%	+168%	+9%	+16%
P/E (x)	14.5	18.5	6.9	6.3	5.5
Core EPS (sen)	22.6	23.5	47.7	51.8	60.1
Core EPS growth (%)	+30%	+4%	+103%	+9%	+16%
Core P/E (x)	14.5	14.0	6.9	6.3	5.5
Gross DPS (sen)	3.0	3.2	9.0	10.0	12.0
Dividend yield (%)	0.9%	1.0%	2.7%	3.0%	3.7%
P/NTA (x)	2.0	2.1	1.6	1.3	1.1
ROE (%)	17.9%	11.7%	26.7%	23.3%	22.3%
Net gearing (%)	87.9%	90.0%	55.8%	31.3%	22.4%
P/CF (x)	56.1	33.9	6.1	3.8	8.7
EV/EBITDA (x)	14.2	11.6	5.9	4.8	4.1
% change in EPS estimates			36.7%	35.5%	47.4%
CIMB/Consensus (x)			1.49	1.45	1.63

Source: Company, CIMB Research, Reuters Estimates

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