

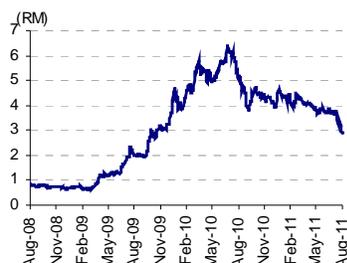
## Company Update

# Supermax

SUCB MK  
RM2.90

**BUY (maintain)**

**Price Target: RM4.36 (↓)**



### Price Performance

	1M	3M	12M
Absolute	-23.1%	-24.5%	-42.8%
Rel to KLCI	-18.3%	-21.2%	-45.6%

### Stock Data

Issued shares (m)	340.1
Mkt cap (RMm)	986.2
Avg daily vol - 6mth (m)	0.71
52-wk range (RM)	5.40-2.90
Est free float	64.0%
NTA per share (RM)	2.03
P/NTA (x)	1.43
Net cash/ (debt) (RMm) (2Q11)	(224.3)
ROE (FY11E)	14.7%
Derivatives	Nil

### Key Shareholders

Dato' Seri Stanley Thai	20.4%
Datin Seri Cheryl Tan	15.1%

### Earnings & Valuation Revisions

	11E	12E	13E
Prev EPS (sen)	32.4	42.6	50.7
Curr EPS (sen)	32.4	39.6	46.0
Chg (%)	-	-6.9%	-9.3%
Prev target price (RM)		4.85	
Curr target price (RM)		4.36	

Shakira Hatta  
(603) 2142 8158  
[shakira@affininvestmentbank.com.my](mailto:shakira@affininvestmentbank.com.my)

## Revamping capacity expansion plans

### 2QFY11 a better quarter on lower latex prices

Yesterday, we attended Supermax's 1HFY11 analyst briefing, hosted by Managing Director Dato' Seri Stanley Thai. To recap, Supermax reported a lower 1HFY11 core net profit of RM51m (-51.7% yoy), despite a +5.2% yoy increase in revenue. The dismal results were attributed to: 1) a +38.4% yoy surge in latex prices; 2) normalization of demand post-A(H1N1) virus outbreak, and; 3) +8.4% yoy appreciation of the RM against US\$. Sequentially, however, 2QFY11 core net profit grew by +9.2% qoq as latex prices eased by -4% qoq.

### Lower utilization rate due to decommissioning of lines for upgrading works

Supermax's 2QFY11 revenue fell by -1.4% qoq, attributed to a -7.6% decline in sales volume though partially offset by higher ASPs for nitrile gloves. Synthetic nitrile gloves accounted for 34% of total production, similar to 1QFY11 but higher than the 20% recorded in 2QFY10. We gather that the utilization rate in 2HFY11 averaged at c. 74%. This was, however, due to reduced production capacity from: 1) the decommissioning and upgrading of 12 lines in Lot 6070, and; 2) the conversion of the entire Lot 42 plant for the production of surgical gloves. The latter will boost Supermax's surgical glove production capacity from 30m pairs to 336m pairs. Initial contribution is expected by 4QFY11 – the plant will be fully operational by 1H2012.

### Delaying Glove City and building two new factories in its place

Due to infrastructure problems with gas pipes, management guided that capacity expansion plans for Glove City have been pushed back and will now only come onstream in FY14. We believe that part of the delay is also due to gas shortages. In the meantime, Supermax will be building two new plants (Lot 6059 and Lot 6058) next to its current factories in Meru, Klang, where gas is already available. Lot 6059 will have an annual production capacity of 2.6bn pieces, and will come onstream in FY12, while Lot 6058, with an annual production capacity of 1.2bn pieces, is scheduled for FY13. Total capex will amount to RM122m over the next 3 years, in line with our assumptions.

**Fig 1: Planned capacity expansion**

	No. of lines	Production capacity (bn pieces)
<b>As at end 2010</b>	<b>153</b>	<b>17.6</b>
Add: Lot 42	4	0.2
<b>As at end 2011</b>	<b>157</b>	<b>17.8</b>
Add: Lot 6059	26	2.6
<b>As at end 2012</b>	<b>183</b>	<b>20.4</b>
Add: Lot 6058	12	1.2
<b>As at end 2013</b>	<b>195</b>	<b>21.6</b>

Source: Company

### Earnings and valuation summary

FYE Dec	2009	2010	2011E	2012E	2013E
Revenue (RMm)	803.6	977.3	1,172.2	1,211.0	1,340.1
EBITDA (RMm)	163.7	181.5	124.0	136.9	158.5
Pretax profit (RMm)	151.5	183.8	118.2	149.7	174.0
Net profit (RMm)	126.6	158.9	106.0	134.8	156.6
EPS (sen)	37.2	46.7	31.2	39.6	46.0
EPS growth (%)	168.9	25.6	-33.3	27.1	16.2
PER (x)	7.8	6.2	9.3	7.3	6.3
Core net profit (RMm)	126.6	158.9	110.0	134.8	156.6
Core EPS (sen)	37.2	46.7	32.4	39.6	46.0
Core PER (x)	7.8	6.2	9.0	7.3	6.3
DPS (sen)	11.0	7.5	6.3	11.9	13.9
Dividend Yield (%)	3.8	2.6	2.2	4.1	4.8
EV/EBITDA (x)	7.1	6.5	9.4	8.4	7.2
Consensus profit (RMm)			123.6	144.7	152.8
Affin/Consensus (x)			0.9	0.9	1.0

### **Will demand shift back to NR gloves from nitrile gloves?**

In terms of demand, management once again highlighted the shift in demand from natural rubber (NR) gloves to nitrile gloves. The switch was triggered by higher ASPs of NR gloves, in tandem with the higher latex costs. Notwithstanding that, the recent softening of latex prices (-22% from its all time high of RM10.93/kg in April 2011) has put ASPs of certain types of NR gloves on par with ASPs of certain nitrile gloves. Coupled with the expectation that latex prices will retreat further to around RM7.50/kg by end-2011, management believes that demand will shift back to NR gloves. However, we note that the fourth quarter of the year is typically the start of wintering season – the subsequent reduced supply of latex may cause latex prices and, consequently, ASPs of NR gloves to rise again. Furthermore, although NBR prices have been rising, there is considerably less volatility when compared to latex price movements. Steadier NBR prices: 1) allow glove manufacturers to pass on incremental increases in input costs faster and more efficiently, and; 2) result in steadier ASPs, which allows customers to better manage their purchasing and inventory costs.

### **Additional key highlights**

Other key takeaways from the briefing:

- 1) Supermax has noticed a market trend towards super thin NR gloves, which require less latex. Should the trend continue, the reduced input of latex will ease cost pressures. Management stated RM5.00-5.50/kg as an ideal latex price.
- 2) The company is experiencing strong demand for surgical gloves in Brazil, after audits by the government revealed that certain surgical gloves imported by glove manufacturers had failed to meet established guidelines. As such, Supermax is fast tracking their supply of surgical gloves to Brazil, to meet the sudden surge in demand.
- 3) The government's recent biometric registration programme for foreign workers has resulted in a temporary shortage of factory workers. Essentially, the factory workers are leaving their current jobs, registering themselves and thereafter searching for higher-paying jobs elsewhere with their new 'legal' status. However, this will be resolved once the registration period ends.
- 4) Lastly, we gather that the effective tax rate from FY11 onwards may be lower than the 13.5% recorded in FY10. This is due to the incorporation of Supermax Global, the company's newly-established sales and marketing hub, in Bermuda. Bermuda is a known tax haven due to their differentiated tax system based upon import duties and payroll taxes.

### **Maintain BUY with a lower TP of RM4.36**

After taking into account the changes in production capacity in FY12-13, we lower our FY12-13 net earnings forecasts by -7-9%. No change to our FY11 net profit forecast. Maintain BUY, albeit with a lower target price of RM4.36 (previously, RM4.85), pegged to an unchanged PE target of 11x on CY12 EPS. Management also announced during the briefing that they will be increasing the dividend payout ratio from the current 20% to 30% from FY12 onwards. Thus, we raise our FY12-13 DPS forecasts from 8.6 sen and 10.2 sen to 11.9 sen and 13.9 sen, respectively. This translates into FY12-13 dividend yields of 4-5%. We remain positive on Supermax as: 1) sequential earnings decline appears to have bottomed out, signaling a turnaround; 2) stabilizing latex prices, which allow for a better cost-pass through rate, and; 3) attractive valuations (CY12 PE of 7.3x vs sector average of 9.5x and market PE of 13x). Key risks are: 1) a resurgence in latex prices; 2) overcapacity and excess supply from increased industry wide nitrile glove production, and; 3) further strengthening of the RM/US\$.

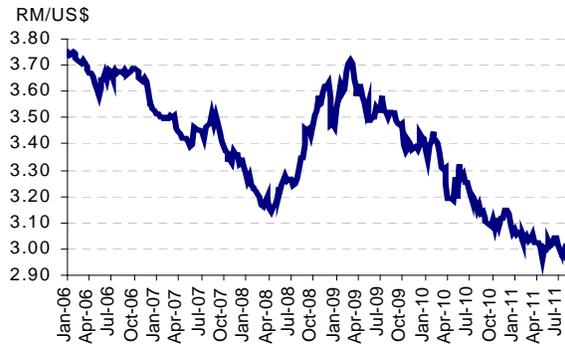
## Focus Charts

Fig 2: Latex price trend



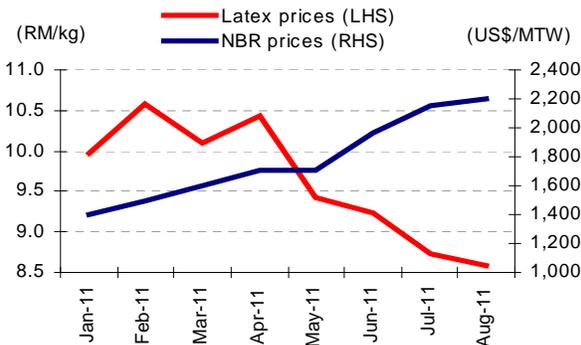
Source: Bloomberg

Fig 3: RM/US\$ exchange rate



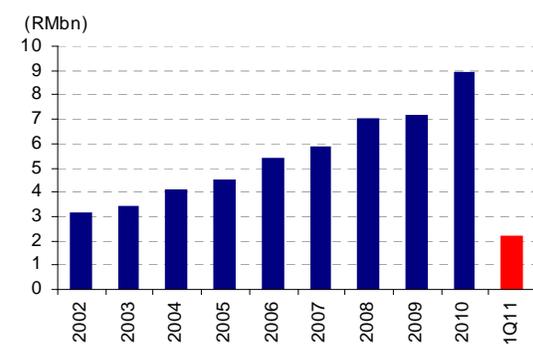
Source: Bloomberg

Fig 4: Average latex and NBR price trend



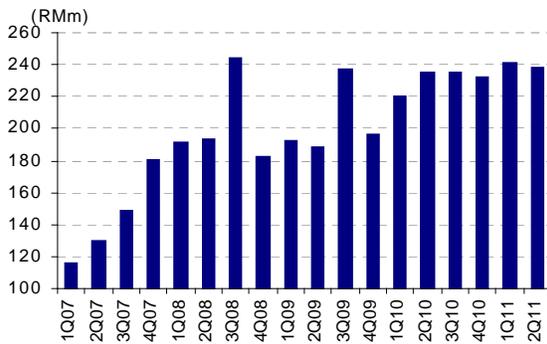
Source: Company

Fig 5: Malaysia's rubber glove exports



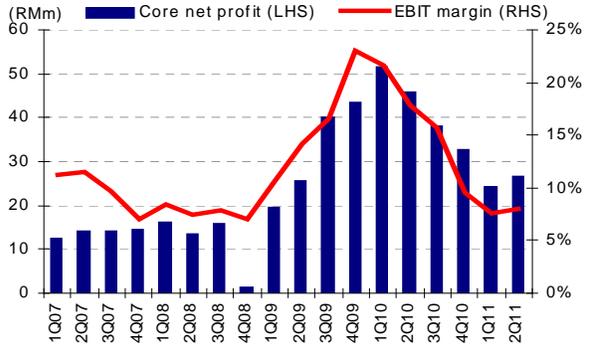
Source: MREPC

Fig 6: Quarterly revenue trend



Source: Company

Fig 7: Quarterly core net profit and EBIT margin trend



Source: Company

Fig 8: Peers comparison

Stock	Rating	Sh Pr (RM)	TP (RM)	Mkt Cap (RM m)	Year End	Core PE (x) CY11	Core PE (x) CY12	EPS growth (%) CY11	EPS growth (%) CY12	EV/EBITDA (x)	P/B (x)	ROE (%) FY11	ROE (%) FY12	Net Div Yield (%) FY11	Net Div Yield (%) FY12
Kossan	BUY	2.78	4.18	889	Dec	8.9	7.0	-11.7	26.3	5.3	1.4	20.8	22.2	2.5	3.2
Top Glove	REDUCE	4.97	4.62	3,074	Aug	23.7	18.4	-35.7	29.0	13.6	2.5	11.1	14.1	1.6	2.2
Supermax	BUY	2.90	4.36	986	Dec	9.0	7.3	-30.8	22.4	9.4	1.0	14.1	16.0	2.2	4.1
Hartalega	BUY	5.53	7.33	2,012	Mar	10.0	8.7	13.2	13.9	6.8	2.6	37.9	35.4	4.2	4.9
Adventa**	NR	1.65	na	252	Oct	11.5	10.3	-33.2	12.3	6.3	1.0	10.6	9.2	4.1	4.8
Latexx**	NR	1.60	na	357	Dec	5.4	5.1	1.8	4.2	3.6	1.5	21.6	20.4	5.0	5.2
<b>Simple average</b>						<b>11.4</b>	<b>9.5</b>	<b>-16.1</b>	<b>18.0</b>	<b>7.5</b>	<b>1.7</b>	<b>19.4</b>	<b>19.6</b>	<b>3.3</b>	<b>4.1</b>

\*\*based on consensus estimates

Source: Affin, Bloomberg

## FINANCIAL SUMMARY – SUPERMAX

### Profit & Loss Statement

FYE Dec (RMm)	2009	2010	2011E	2012E	2013E
Total revenue	803.6	977.3	1172.2	1211.0	1340.1
Operating expenses	(640.0)	(795.8)	(1048.2)	(1074.1)	(1181.6)
EBITDA	163.7	181.5	124.0	136.9	158.5
Depreciation	(31.9)	(26.0)	(32.8)	(35.1)	(36.3)
Amortisation	0.0	0.0	0.0	1.0	2.0
EBIT	131.7	155.5	91.2	101.7	122.2
Net interest income/(expense)	(22.3)	(13.9)	(12.5)	(11.3)	(10.1)
Associates' contribution	41.8	42.0	43.1	58.9	61.5
Others	0.2	0.3	0.4	0.4	0.5
Pretax profit	151.5	183.8	118.2	149.7	174.0
Tax	(24.9)	(24.9)	(12.2)	(15.0)	(17.4)
Minority interest	0.0	(0.0)	(0.0)	(0.0)	(0.0)
Net profit	126.6	158.9	106.0	134.8	156.6

### Balance Sheet Statement

FYE Dec (RMm)	2009	2010	2011E	2012E	2013E
Fixed assets	368.2	383.9	403.3	432.2	446.0
Other long term assets	195.9	230.9	230.9	269.6	316.0
<b>Total non-current assets</b>	<b>564.1</b>	<b>614.8</b>	<b>634.2</b>	<b>701.8</b>	<b>762.0</b>
Cash and equivalents	118.7	121.8	104.2	91.1	76.6
Stocks	116.2	116.0	154.5	158.7	174.6
Debtors	146.3	308.8	370.3	382.6	423.4
Other current assets	0.0	0.0	0.0	0.0	0.0
<b>Total current assets</b>	<b>381.2</b>	<b>546.5</b>	<b>629.1</b>	<b>632.4</b>	<b>674.7</b>
Creditors	72.5	133.8	178.3	183.1	201.5
Short term borrowings	129.0	154.1	138.7	124.8	112.3
Other current liabilities	12.2	1.6	1.6	1.6	1.6
<b>Total current liabilities</b>	<b>213.7</b>	<b>289.5</b>	<b>318.6</b>	<b>309.5</b>	<b>315.4</b>
Long term borrowings	165.8	158.6	142.7	128.5	115.6
Other long term liabilities	6.9	7.3	7.3	7.3	7.3
<b>Total long term liabilities</b>	<b>172.7</b>	<b>165.9</b>	<b>150.0</b>	<b>135.7</b>	<b>122.9</b>
<b>Shareholders' Funds</b>	<b>558.8</b>	<b>706.1</b>	<b>794.7</b>	<b>889.0</b>	<b>998.3</b>

### Cash Flow Statement

FYE Dec (RMm)	2009	2010	2011E	2012E	2013E
EBIT	131.7	155.5	91.2	101.7	122.2
Depreciation & amortisation	31.9	26.0	32.8	35.1	36.3
Working capital changes	72.2	(111.6)	(55.7)	(11.6)	(38.3)
Cash tax paid	(24.9)	(18.0)	(12.2)	(15.0)	(17.4)
Others	14.9	65.9	43.5	59.3	61.9
<b>Cashflow from operation:</b>	<b>225.9</b>	<b>117.8</b>	<b>99.7</b>	<b>169.6</b>	<b>164.6</b>
Capex	(17.4)	(49.1)	(52.2)	(64.1)	(50.0)
Disposal/(purchases)	0.0	0.0	0.0	(38.7)	(46.4)
Others	0.2	0.0	0.0	0.0	0.0
<b>Cash flow from investing</b>	<b>(17.2)</b>	<b>(49.1)</b>	<b>(52.2)</b>	<b>(102.8)</b>	<b>(96.4)</b>
Debt raised/(repaid)	(101.2)	17.9	(31.3)	(28.1)	(25.3)
Equity raised/(repaid)	27.0	(70.6)	0.0	0.0	0.0
Net interest income/(expense)	(22.3)	(13.9)	(12.5)	(11.3)	(10.1)
Dividends paid	(15.0)	(31.6)	(21.4)	(40.5)	(47.3)
Others	0.2	33.3	0.1	0.0	0.0
<b>Cash flow from financing</b>	<b>(111.3)</b>	<b>(64.9)</b>	<b>(65.1)</b>	<b>(79.9)</b>	<b>(82.7)</b>
<b>Free Cash Flow</b>	<b>208.5</b>	<b>68.7</b>	<b>47.5</b>	<b>105.5</b>	<b>114.6</b>

### Key Financial Ratios and Margins

FYE Dec (RMm)	2009	2010	2011E	2012E	2013E
<b>Growth</b>					
Revenue (%)	(1.0)	21.6	19.9	3.3	10.7
EBITDA (%)	65.4	10.9	(31.7)	10.4	15.8
Core net profit (%)	169.3	25.6	(33.3)	27.1	16.2
<b>Profitability</b>					
EBITDA margin (%)	20.4	18.6	10.6	11.3	11.8
PBT margin (%)	18.8	18.8	10.1	12.4	13.0
Net profit margin (%)	15.8	16.3	9.0	11.1	11.7
Effective tax rate (%)	16.4	13.5	10.3	10.0	10.0
ROA (%)	13.4	13.7	8.4	10.1	10.9
Core ROE (%)	26.0	25.1	14.7	16.0	16.6
ROCE (%)	15.9	16.6	8.7	9.2	10.3
Dividend payout ratio (%)	29.6	16.0	20.2	30.0	30.2
<b>Liquidity</b>					
Current ratio (x)	1.8	1.9	2.0	2.0	2.1
Op. cash flow (RMm)	225.9	117.8	99.7	169.6	164.6
Free cashflow (RMm)	208.5	68.7	47.5	105.5	114.6
FCF/share (sen)	61.3	20.2	14.0	31.0	33.7
<b>Asset management</b>					
Debtors turnover (days)	64	113	113	113	113
Stock turnover (days)	79	63	63	63	63
Creditors turnover (days)	26	65	65	65	65
<b>Capital structure</b>					
Core ROA (%)	13.4	13.7	8.7	10.1	10.9
ROCE (%)	15.9	16.6	8.7	9.2	10.3

### Quarterly Profit & Loss

FYE 31 Dec (RMm)	2Q10	3Q10	4Q10	1Q11	2Q11
Revenue	234.8	235.1	232.7	241.4	237.9
Operating expenses	(193.1)	(198.5)	(210.3)	(222.9)	(218.8)
EBITDA	0.0	0.0	0.0	0.0	0.0
Depreciation	0.0	0.0	0.0	0.0	0.0
EBIT	41.7	36.9	22.3	18.4	15.1
Net int income/(expense)	(3.3)	(3.7)	(2.3)	(3.3)	(2.2)
Associates' contribution	10.4	8.3	12.8	10.5	11.0
Exceptional Items	3.0	4.0	5.0	6.0	7.0
Pretax profit	48.8	41.4	32.8	25.6	23.9
Tax	(3.0)	(3.3)	(0.1)	(1.2)	(1.3)
Minority interest	0.0	(0.0)	(0.0)	(0.0)	(0.0)
Net profit	45.9	38.1	32.7	24.4	22.6
Core net profit	45.9	38.1	32.7	24.4	22.6
<b>Margins (%)</b>					
EBIT	17.8	15.7	9.6	7.6	6.4
PBT	20.8	17.6	14.1	10.6	10.1
Net profit	19.5	16.2	14.1	10.1	9.5

## Equity Rating Structure and Definitions

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<b>BUY</b>	Total return is expected to exceed +15% over a 12-month period
<b>TRADING BUY (TR BUY)</b>	Total return is expected to exceed +15% over a 3-month period due to short-term positive development, but fundamentals are not strong enough to warrant a Buy call. This is to cater to investors who are willing to take on higher risks
<b>ADD</b>	Total return is expected to be between 0% to +15% over a 12-month period
<b>REDUCE</b>	Total return is expected to be between 0% to -15% over a 12-month period
<b>TRADING SELL (TR SELL)</b>	Total return is expected to exceed -15% over a 3-month period due to short-term negative development, but fundamentals are strong enough to avoid a Sell call. This is to cater to investors who are willing to take on higher risks
<b>SELL</b>	Total return is expected to be below -15% over a 12-month period
<b>NOT RATED</b>	Affin Investment Bank does not provide research coverage or rating for this company. Report is intended as information only and not as a recommendation
<b>OVERWEIGHT</b>	Industry, as defined by the analyst's coverage universe, is expected to outperform the KLCI benchmark over the next 12 months
<b>NEUTRAL</b>	Industry, as defined by the analyst's coverage universe, is expected to perform inline with the KLCI benchmark over the next 12 months
<b>UNDERWEIGHT</b>	Industry, as defined by the analyst's coverage universe is expected to under-perform the KLCI benchmark over the next 12 months

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[www.affininvestmentbank.com.my](http://www.affininvestmentbank.com.my)

Email : [research@affininvestmentbank.com.my](mailto:research@affininvestmentbank.com.my)

Tel : 603-2143 8668

Fax : 603-2145 3005