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23 February 2010

Supermax

Stretching exercises are on track

RECOM	Buy
PRICE	RM5.75
MKT CAPITALISATION	RM1.56bn
BOARD	Main (Syariah stock)
SECTOR	Industrial
INDEX COMPONENT	KLCI, FBMSC, FBMS FBMEMAS

SUCB MK / SUPM.KL

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Investment highlights

- Maintain BUY.** At its 4Q09 results briefing yesterday, management dwelt on the group's 4Q09 performance and provided updates on its plans and earnings potential. In light of the strong demand spillover from last year and current high latex prices, we have revised our ASP, latex price and margin assumptions, leading to 21-23% upgrades of our FY10-11 earnings. Our target price rises correspondingly from RM7.96 to RM9.65 as we continue to value the stock at a 20% discount to Top Glove's target P/E of 16.5x. We maintain our BUY call on Supermax based on the potential re-rating catalysts of continued growth of glove demand and capacity expansion. The stock remains one of our top picks for the sector.
- More on the 4Q09 results.** Supermax's management elaborated on the 4Q performance during the briefing. It explained that the 17.3% qoq drop in revenue came about mainly because some OEM customers who nominate their own shipping lines could not secure the necessary cargo container space. Consequently, about RM25m worth of packed goods ready for shipment had to be rolled over from Dec 09 to Jan 10. On top of that, production volumes fell 5% qoq due to the temporary labour shortage at its Lahat plant and water disruption at its Kamunting plant during the quarter. Despite all these problems, the group managed to increase its net profit by 10% qoq as high demand allowed it to adjust its selling prices and contribution from its associates rose 18% from RM11.3m in 3Q09 to RM13.4m in 4Q09.
- Capacity expansion for 2010 is on track.** Management indicated that its capacity expansion is progressing as scheduled. It expects to start commissioning the first six lines at its Meru plant in Mar this year. The rest of the 10 lines are targeted to be commissioned by Aug. These, along with the refurbishment works and new line replacements at its Lahat, Sungai Buloh and Melaka plants, will add 3.1bn pieces of capacity this year, taking its annual glove production capacity from 14.5bn pieces to 17.6bn pieces.

Key stock statistics

	2009	2010F
FYE Dec		
EPS (sen)	48.1	62.7
P/E (x)	12.0	9.2
Dividend/Share (sen)	10.9	13.0
NTA/Share (RM)	2.1	2.6
Book Value/Share (RM)	2.1	2.6
Issued Capital (m shares)		271.2
52-weeks Share Price Range (RM)	RM6.18/RM0.78	
Major Shareholders:	%	
Dato' Seri Thai Kim Sim, Stanley	20.4	
Datin Seri Tan Bee Geok, Cheryl	14.6	
Koperasi Permodalan Felda	5.5	

Per share data

	2007	2008	2009	2010F
FYE Dec				
Book Value (RM)	1.7	1.6	2.1	2.6
Cash Flow (sen)	32.0	37.3	87.9	59.8
Earnings (sen)	22.6	17.7	48.1	62.7
Dividend (sen)	3.0	3.2	10.9	13.0
Payout Ratio (%)	13.3	18.1	22.7	20.7
P/E (x)	25.4	32.5	12.0	9.2
P/Cash Flow (x)	18.0	15.4	6.5	9.6
P/Book Value (x)	3.5	3.6	2.8	2.2
Dividend Yield (%)	0.5	0.6	1.9	2.3
ROE (%)	17.9	11.7	26.6	27.0
Net Gearing (%)	87.9	90.0	31.5	14.4

Source: Company, CIMB estimates, Bloomberg

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Recent developments

Revenue... Supermax's management elaborated on the 4Q performance during the briefing. It explained that the 17.3% qoq drop in revenue from RM237.6m in 3Q09 to RM196.4m in 4Q09 (Figure 1) came about mainly because some OEM customers who nominate their own shipping lines could not secure the necessary cargo container space. Consequently, about RM25m worth of packed goods ready for shipment had to be rolled over from Dec 09 to Jan 10. This also resulted in inventories rising from RM84.6m in 3Q09 to RM105.8m in 4Q09.

...and volumes dropped qoq. On top of that, production volumes fell 5% qoq from 3.13bn pieces in 3Q09 to 2.98bn pieces in 4Q09 (Figure 2). This was due to the temporary labour shortage at its Lahat plant and water disruption at its Kamunting plant during the quarter. Despite all these problems, the group managed to increase its net profit by 10% qoq as high demand allowed it to adjust its selling prices and contribution from its associates rose 18% from RM11.3m in 3Q09 to RM13.4m in 4Q09.

Figure 1: Results comparison qoq (RM m)

FYE Dec	4QFY09	3QFY09	% Change
Revenue	196.4	237.6	(17.3)
Operating Profit (EBIT)	59.1	50.8	16.2
Depreciation	(8.4)	(8.2)	2.0
Interest Expenses	(8.5)	(4.1)	105.4
Associates	13.4	11.3	18.2
Pretax Profit	50.6	46.7	8.3
Net Profit	44.1	40.2	9.9
Operating Margin	30.1	21.4	40.5
Pretax Margin	25.8	19.7	31.0
Net Margin	22.5	16.9	32.9

Source: Company, CIMB estimates

Figure 2: Key statistics

	4QFY09	3QFY09	Change (%)
Production output (bn pieces)	2.98	3.13	(5.0)
Sales (RM m)	196.4	237.6	(17.3)
Inventories (RM m)	105.8	84.6	25.1

Source: Company, CIMB estimates

Increase in backlog orders in 4Q09... Recall that in its 3Q results briefing last year, Supermax said that it estimated that it would ship a total of 12.4bn pieces of gloves in 2009 against customers' orders totalling 17.5bn pieces. Because of shipping problems for some OEM customers, water problems and labour issues, the company did not meet its target, resulting in an order backlog of 5.4bn pieces as it went into 2010 compared to its earlier estimate of 5.1bn pieces.

... but expected to contribute positively in 1Q10. Shipment of the backlog is expected to contribute positively in 1Q10. The group mentioned that RM25m worth of goods originally scheduled for 4Q09 will be shipped during 1Q10. It has also managed to resolve the water disruption issue and has received 900 new permits for foreign workers.

Figure 3: Orders received by Supermax ('000 pieces)

Orders Received	2008	1Q09	2Q09	2009		Total
				3Q09	4Q09	
From Supermax & Seal Polymer's customers	13,500	3,050	4,000	4,000	3,800	14,850
From APLI's customers	2,640	330	330	330	330	1,320
H1N1	Nil	Nil	450	300	300	1,050
Total orders received	16,140	3,810	4,630	4,630	4,430	17,500
Total shipped	12,765	2,995	3,015	3,130	2,975	12,115
Back orders	3,375	815	1,615	1,500	1,455	5,385

Source: Company, CIMB Research

New subsidiary in Germany. The company recently set up Supermax Deutschland GmbH, 90% owned by Supermax. Germany is one of the key markets for rubber gloves in Europe. In recent years, Supermax has been directly distributing its gloves, especially OBM gloves, through APLI's German subsidiary. The establishment of its own subsidiary in Germany will allow Supermax to service its existing customers and penetrate further into the European market, especially developing countries within eastern Europe. It expects this subsidiary to contribute about RM2m net profit in FY10 and grow by about 25-30% annually.

Capacity expansion is on track. Management also indicated that its capacity expansion is progressing as scheduled. It is expected to start commissioning the first six lines at its Meru plant in Mar this year. The rest of the 10 lines are targeted to be commissioned by Aug. These, along with the refurbishment works and new line replacements at its Lahat, Sungai Buloh and Melaka plants, will add 3.1bn pieces of capacity this year, taking its annual glove production capacity from 14.5bn pieces to 17.6bn pieces. Earthworks for its glove city project will start in March this year instead of its earlier target of July. However, the target for commissioning remains 1H11. This first phase of this project will add capacity of 4.2bn gloves, taking its annual glove production capacity to 21.7bn pieces by 2011.

Earnings outlook

Earnings and.... Rubber glove prices vary according to type of material used (natural rubber latex or nitrile), grade (medical or food), weight (3mil, 4mil, 5 mil or 6mil) and size (XS, S, M, L, XL). Based on the group's total revenue and the number of gloves sold, we estimate that a box of rubber gloves was sold at US\$23.7 per box in 2009 when latex price averaged RM4.51/kg. Latex prices are back to an all-time high of around RM7.20/kg (Figure 5). We are revising our latex price assumption from RM5.00-5.10/kg to RM5.80-5.90/kg. We are also revising our ASP assumptions from US\$23-24 per box of 1,000 gloves to US\$26-27 per box given the higher latex costs. Given the strong demand for rubber gloves and higher pricing power for glove manufacturers, we are now assuming higher FY10-11 net profit margins of 14.0-14.4% instead of 10.8-12.1%. All these adjustments increase our FY10-11 earnings numbers by 21-23%.

... dividend figures raised. Supermax intends to maintain its dividend payout ratio of 20% per annum. Taking into account our earnings upgrade, we revise our FY10-11 DPS forecasts from 10.5-12.5 sen to 13-16 sen. The company said that it will distribute as special dividends any extraordinary profits achieved in the future, as it did for FY09 when its net profit came in at RM129.8m, exceeding its internal target of RM117m. For 2010, the company indicated that it should be able to achieve a minimum net profit of RM168m, in line with our revised forecast.

Figure 4: P&L analysis (RM m)

FYE Dec	2007	2008	2009	2010F
Revenue	574.3	811.8	814.8	1,183.2
Operating Profit (EBIT)	74.9	98.9	164.0	203.2
Depreciation	(19.9)	(28.8)	(31.6)	(32.7)
Interest Expenses	(15.3)	(20.3)	(16.7)	(14.3)
Pretax Profit	58.6	52.0	152.1	200.1
Effective Tax Rate (%)	4.4	9.6	14.7	15.0
Net Profit	55.9	47.0	129.8	170.1
Operating Margin (%)	13.0	12.2	20.1	17.2
Pretax Margin (%)	10.2	6.4	18.7	16.9
Net Margin (%)	9.7	5.8	15.9	14.4

Source: Company, CIMB estimates

Figure 5: Latex price trend (sen/kg)



Source: Bloomberg

Recommendation

Using our revised earnings, we derive a new target price of RM9.65 (RM7.96 previously), pegged to a P/E of 13.2x which is based on an unchanged 20% discount to Top Glove's target P/E of 16.5x. We maintain our BUY call on Supermax based on the potential re-rating catalysts of continued growth of glove demand and capacity expansion. The stock remains one of our top picks for the sector.

Figure 6: Share price chart (RM)



Source: Bloomberg

Financial summary

FYE Dec	2008	2009	2010F	2011F	2012F
Revenue (RM m)	811.8	814.8	1,183.2	1,417.4	1,571.4
EBITDA (RM m)	98.9	164.0	203.2	241.1	268.2
EBITDA margins (%)	12.2%	20.1%	17.2%	17.0%	17.1%
Pretax profit (RM m)	52.0	152.1	200.1	233.2	248.0
Net profit (RM m)	47.0	129.8	170.1	198.2	210.8
EPS (sen)	17.7	48.1	62.7	73.1	77.7
EPS growth (%)	-21.9%	172.3%	30.4%	16.5%	6.3%
P/E (x)	32.5	12.0	9.2	7.9	7.4
Core EPS (sen)	23.3	49.8	62.7	73.1	77.7
Core EPS growth (%)	3.1%	113.5%	25.9%	16.5%	6.3%
Core P/E (x)	24.6	11.5	9.2	7.9	7.4
Gross DPS (sen)	3.2	10.9	13.0	16.0	18.0
Dividend yield (%)	0.6%	1.9%	2.3%	2.8%	3.1%
P/NTA (x)	3.6	2.8	2.2	1.8	1.5
ROE (%)	11.7%	26.6%	27.0%	25.3%	22.1%
Net gearing (%)	90.0%	31.5%	14.4%	3.6%	2.9%
P/CF (x)	59.7	13.8	16.3	10.8	18.2
EV/EBITDA (x)	18.3	9.8	7.6	6.2	5.6
% change in EPS estimates			20.8%	22.5%	N/A
CIMB/Consensus (x)			1.20	1.24	N/A

Source: Company, CIMB/CIMB-GK Research, Reuters Estimates

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