

19 July 2012 | Initiating coverage

Supermax Corporation Berhad

Super value on offer

BUY

Target Price (TP): RM2.48

INVESTMENT HIGHLIGHTS

- **World class latex glove producer.** SUPERMAX Corporation Berhad (Supermax) is a leading international manufacturer, distributor and marketer of high quality medical gloves. With brands like Supermax, Aurelia, Maxter, Medic-dent and Supergloves, it has developed a series of successful brands that are recognized around the world. Currently, Supermax ranks as the second largest glove manufacturer in the world with a total installed capacity of 17.6b pieces annually.
- **Global operation.** Currently, Supermax operates nine manufacturing plants based in Malaysia, which produce 17.6 billion pieces of gloves annually, equivalent to 11% of the world demand for latex examination gloves. Additionally, it owns six distribution centers cum corporate offices based in the USA, Brazil, Canada, Germany, Belgium, and the United Kingdom, and collaborates with 750 independent distributors around the world.
- **Focus shifting to nitrile.** By 2013, Supermax is looking to double its nitrile gloves production capacity from 5.2b pieces p.a. currently to 10.5b pieces p.a. This would translate to a total production mix of 52% from 35% currently.
- **Growth to be driven by distribution operations.** With distribution operations in 6 countries, Supermax is expected to generate its growth mainly from its distribution operations. In fact, it has highlighted global trading, sales and marketing to form a 3rd income stream for the group.
- **Impressive earnings and revenue growth.** Supermax has been able to achieve a commendable earnings and revenue growth over the last five years, with revenue recording a CAGR of 20.6% resulting in a net profit CAGR of 21.3% for the same period.
- **Consistent dividend policy.** Beginning from FY12 onwards, Supermax has revised its dividend policy upwards, with a relatively impressive dividend payout ratio of 30%. This should bode well for investors looking for steady income distribution over the long run.
- **Initiate coverage with a BUY call.** We are initiating our coverage on Supermax with a TP of RM2.48 derived from 11x PER FY13, based on its 3-year historical PE ratio average. We like the company due to its strong brand name, global operation, strong earnings growth and stable dividend policy. We believe the stock is undervalued at the current price, thus offering significant upside potential for price appreciation.

| RETURN STATS | |
|------------------------------|---------------------------|
| Price (18 Jul 12) | RM2.19 |
| Target Price | RM2.48 |
| Expected Share Price Return | +13.2% |
| Expected Dividend Yield | 3.1% |
| Expected Total Return | +16.3% |
| STOCK INFO | |
| KLCI | 1645.0 |
| Bursa / Bloomberg | 7106 / SUCB MK |
| Board / Sector | Main/ Industrial Products |
| Syariah Compliant | Yes |
| Issued shares (mil) | 680.2 |
| Par Value (RM) | 0.50 |
| Market cap. (RM'm) | 1,489.5 |
| Price over NA | 1.9x |
| 52-wk price Range | RM1.16–RM2.32 |
| Beta (against KLCI) | 1.39 |
| 3-mth Avg Daily Vol | 2.11m |
| 3-mth Avg Daily Value | RM4.06m |
| Major Shareholders | |
| Dato' Seri Stanley Thai | 20.44% |
| Datin Seri Cheryl Tan | 15.13% |
| EPF | 8.30% |
| Skagen Funds | 4.35% |

| INVESTMENT STATISTICS | | | | |
|--|-------|---------|---------|---------|
| FYE Mar | FY10 | FY11 | FY12E | FY13F |
| Revenue (RM'm) | 977.3 | 1,021.4 | 1,177.4 | 1,300.5 |
| EBIT (RM'm) | 155.5 | 89.8 | 134.9 | 158.1 |
| Pretax Profit (RM'm) | 183.8 | 112.1 | 157.1 | 180.3 |
| Net Profit (RM'm) | 158.9 | 104.2 | 133.6 | 153.2 |
| EPS (sen) | 23.37 | 15.32 | 19.64 | 22.53 |
| EPS growth (%) | 24.4% | -36.2% | 28.2% | 14.7% |
| PER(x) | 9.3 | 14.2 | 11.2 | 10.3 |
| Net Dividend (sen) | 2.5 | 2.38 | 5.89 | 6.76 |
| Net Dividend Yield (%) | 1.2% | 1.1% | 2.7% | 3.1% |
| <i>Source: Company, Forecasts by MIDFR</i> | | | | |

COMPANY BACKGROUND

- 25 years of history.** The Supermax Group's history can be traced back to 1987, when it was founded by Dato' Seri Stanley Thai and his wife Datin Seri Cheryl Tan in 1987 as a trading business distributing latex gloves. In 1989, they started their first manufacturing facility with just a small team of employees. With a particular stress on branding, Supermax ventured into own brand manufacturing and became the first own brand manufacturing (OBM) latex glove manufacturer in the country when it launched its first brand, Supermax.
- Operation spans across continents.** Supermax currently exports its products to more than 146 countries worldwide in America, Europe, Middle East, Asia and the South Pacific. Currently, Supermax operates nine manufacturing plants based in Malaysia, which produce 17.6 billion pieces of gloves annually. This equals to 11% of the world demand for latex examination gloves. Additionally, it owns six distribution centers cum corporate offices based in the USA, Brazil, Canada, Germany, Belgium, and the United Kingdom, and collaborates with 750 independent distributors around the world.
- 2nd largest in the world.** Currently, Supermax ranks as the second largest glove manufacturer in the world with a total installed capacity of 17.6b pieces annually. Its market capitalization stands at RM1.5b.
- America the largest contributor to sales.** As of FY11, the bulk of Supermax's revenue came from the American continent, which made up 59.0% of its total sales. This was followed by Europe at 28.0%. Asia and Australia made up 7.0%, and the remaining was made up by sales to the African region.
- Growth led by sales to Asia and Australia.** However, in terms of growth, Asian and Australian region has had the most stellar performers, with sales to this region growing 21.9%yoy in FY11. Quite surprisingly, with the current economic condition in Europe, sales to this continent registered the second highest growth in FY11 at 12.5%. While still the biggest market, sales to the Americas contracted -0.5%yoy in FY11.
- Strong branding.** As of 2011, OBM made up 69.0% of the total sales of Supermax, an increase of 100 basis points from a year earlier, with the remaining 31.0% comprised of Original Equipment Manufacturing (OEM). This is contrary to the other major local players, which generally focus more on OEM. The strong emphasis on branding via the OBM business model gives Supermax a few competitive advantages over its competitors, with the major plus points being brand loyalty, stability and continuity of customers. Today, Supermax can boast having a few brands that has attained worldwide recognition, such as Supermax, Aurelia and Maxter.

FUTURE PLANS

- **Intensive R&D Research.** Supermax has been working with 2 teams of scientists in the US since 2011 comprising laboratory scientists and Dermatologists to develop new products. The R&D has started to bear fruit, with new patented glove products to be launched in 3Q 2012.
- **Aggressive surgical gloves market penetration.** Supermax is looking to grow its surgical gloves production volume by more than 10-fold, from 30m pairs p.a. currently to 336m pieces p.a. in 2012. This will be achieved through the additional capacity from the new lines to be commissioned in March 2012 in stages in its Lot 42 Plant in Sungai Buloh.
- **Focus shifting to nitrile.** By 2013, Supermax is looking to double its nitrile gloves production capacity from 5.2b pieces p.a. currently to 10.5b pieces p.a. This would translate to a total production mix of 52% from 35% currently. The additional capacity of nitrile gloves will come from the following plants:

Lot 6070 (Klang, Selangor)

- 1.43b gloves from the replacement of old lines with 12 new inter-switchable Nitrile / NR latex lines
- Commissioning in batches from 3Q 2012

Lot 6059

- Additional output of 2.64b nitrile gloves would be available when fully commissioned in FY2012/2013.

Lot 6058

- Additional output of 1.22b nitrile gloves would be available when fully commissioned in FY2013.

- **Growth to be driven by distribution operations.** With distribution operations in 6 countries, Supermax is expected to generate its growth mainly from its distribution operations. In fact, it has highlighted global trading, sales and marketing to form a 3rd income stream for the group. This means that in addition to undertake global trading, sales and marketing of its own gloves, Supermax is also engaging in the trading and marketing of glove types which are not currently produced by the group, as well as outsource other healthcare and medical devices to be cross-sold together with its own products.

FINANCIAL PERFORMANCE

- **Attractive dividend policy.** From FY12, Supermax has revised its dividend policy from a payout ratio of 20% to 30% of PAT. We see this as a positive move by the management, as investors would be able to enjoy part of their return on investment in the short term as well as share the growth of the company.
- **Consistently high ROE.** For the past five years, Supermax has been able to achieve double digit return on equity (ROE) every year, with the ROE for FY11 standing at 14.3%. This has mainly been driven by a strong net profit margin, which stood at 10.6% in FY11. We expect the strong performance to continue in the future, as we expect the profitability of the company to improve from the easing of the raw material prices and the strengthening of the greenback against MYR.
- **Impressive earnings and revenue growth.** Supermax has been able to achieve a commendable earnings and revenue growth over the last five years, with revenue recording a CAGR of 20.6% resulting in a net profit CAGR of 21.3% for the same period.

RISKS AND CONCERNS

- **Currency volatility.** As a major glove exporter, the bulk of the revenue of Supermax is denominated in USD. As such, any movement in the MYR/ USD exchange rate would impact the revenue and bottom line of Supermax significantly.
- **Rise in the raw material cost.** As a rubber glove manufacturing company, the cost of NR latex make up 60% of total production cost of the NR gloves, while the NBR latex make up 62% of nitrile gloves production cost. Therefore, the profitability of Supermax will largely be affected by the movement of prices in prices of these 2 main raw materials. As can be seen in 2011, the profitability of Supermax has been hampered by the escalating prices of these 2 material costs. However, as for the current financial year, the prices for NR latex and NBR latex have been trending downwards, driven by the declining demand from tyre makers as a result of the slowing down of the automotive industry in China, and the lower crude oil price.

VALUATION AND RECOMMENDATION

- **Initiate coverage with a BUY recommendation.** We are initiating our coverage of Supermax with a BUY recommendation with a target price of RM2.50, derived from a price earnings (PE) multiple of 11x based on FY13 EPS. This is consistent with its average 3-year historical PE ratio. Based on its track record, we are confident with the management's capability to maintain the company's solid revenue and earnings growth. Another fillip to the investment case is that the company is getting more dividend-friendly. It changed its dividend policy this year, increasing its dividend payout ratio to 30% from 20% previously. This increasing commitment to dividend partly reflects the presence of EPF as a substantial shareholder. At the current price, we believe that the stock price is undervalued, offering a significant upside potential for price appreciation.



| INCOME STATEMENT | | | | | BALANCE SHEET | | | | |
|------------------------|-------------|-------------|--------------|--------------|---------------------------------------|---------|---------|---------|---------|
| FYE 31 DEC (RM m) | 2010 | 2011 | 2012E | 2013F | FYE 31 DEC (RM m) | 2010 | 2011 | 2012E | 2013F |
| Revenue | 977.3 | 1,021.4 | 1,177.4 | 1,300.5 | Fixed asset | 387.9 | 402.2 | 473.9 | 523.5 |
| EBITDA | 181.5 | 113.9 | 158.9 | 182.1 | Total NCA | 620.3 | 664.4 | 765.0 | 845.0 |
| EBIT | 155.5 | 89.8 | 134.9 | 158.1 | Total CA | 445.1 | 541.1 | 589.0 | 650.6 |
| PBT | 183.8 | 112.1 | 157.1 | 180.3 | Total Assets | 1,065.4 | 1,205.4 | 1,354.0 | 1,495.6 |
| PAT | 159.0 | 104.1 | 133.6 | 153.2 | | | | | |
| EPS (sen) | 47.98 | 30.63 | 19.64 | 22.53 | Share capital | 170.0 | 170.0 | 340.1 | 340.1 |
| DPS (sen) | 5.00 | 4.75 | 5.89 | 6.76 | Total Equity | 691.5 | 769.0 | 866.6 | 957.2 |
| | | | | | Total NCL | 154.1 | 158.7 | 176.0 | 194.4 |
| Growth rate (%) | 2010 | 2011 | 2012E | 2013F | Total CL | 219.7 | 277.7 | 311.4 | 344.0 |
| Revenue | 21.6 | 4.5 | 15.3 | 10.5 | Total liabilities | 373.8 | 436.4 | 487.4 | 538.4 |
| EBITDA | 10.9 | -37.2 | 39.6 | 14.5 | Total Equity & Liabilities | 1,065.4 | 1,205.4 | 1,354.0 | 1,495.6 |
| EBIT | 18.0 | -42.2 | 50.3 | 17.1 | | | | | |
| PBT | 21.4 | -39.0 | 40.1 | 14.7 | | | | | |
| PAT | 25.6 | -34.5 | 28.4 | 14.7 | | | | | |

Table 1: US Dental Market Share (Latex Glove)

| Brand | Market Share | Ranking |
|--------------|--------------|---------|
| Supermax | 9.2% | 1st |
| Microflex | 8.8% | 2nd |
| Cranberry | 6.0% | 3rd |
| Dash Medical | 5.2% | 4th |
| Ansell | 3.8% | 5th |

Chart 1: Export markets

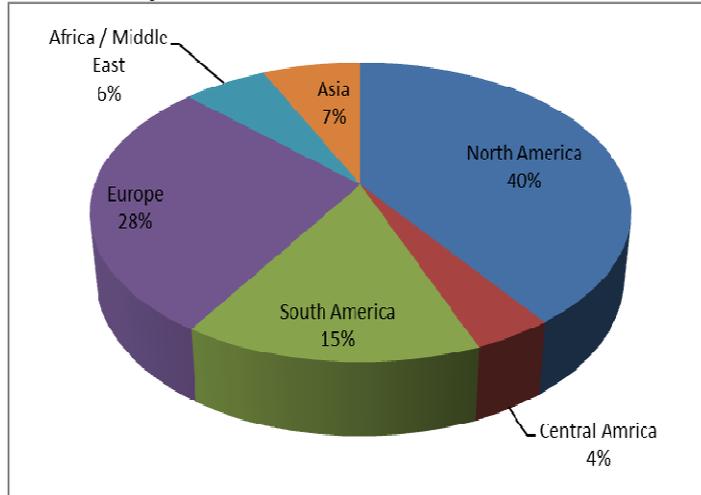
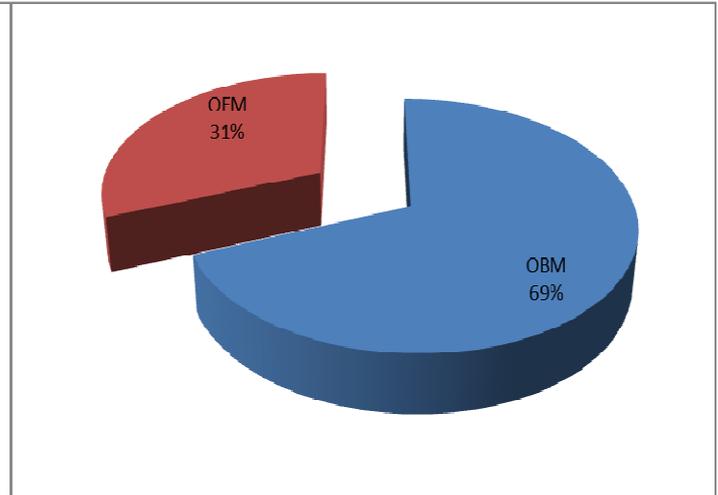


Chart 2: Sales mix



Source: Company, Forecasts by MIDFR

Chart 3: Sales composition on market segment

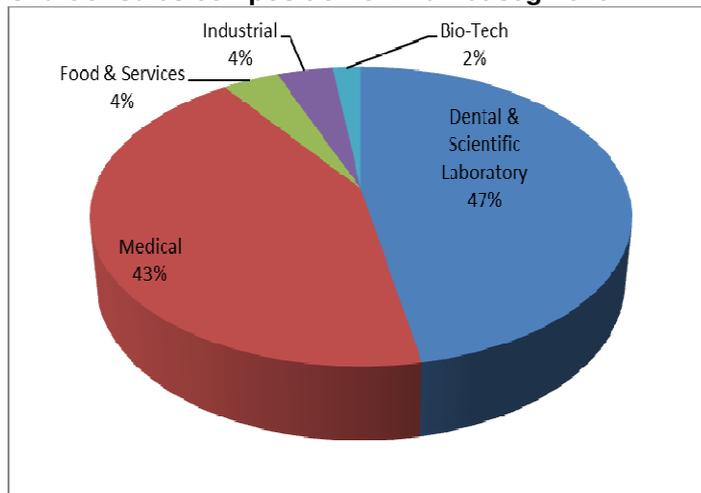
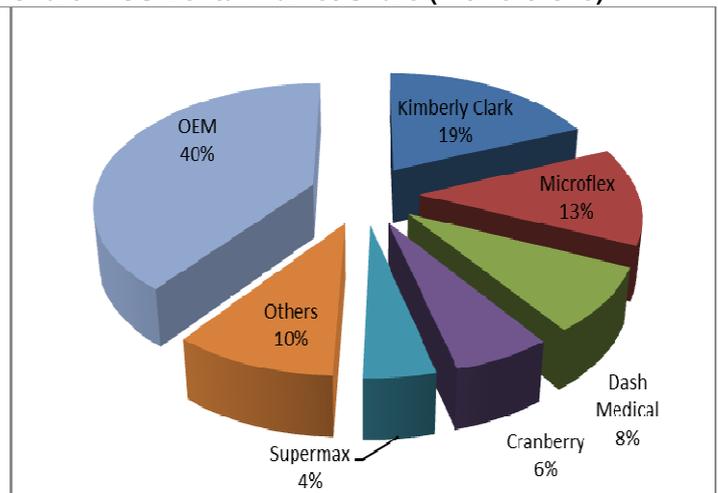
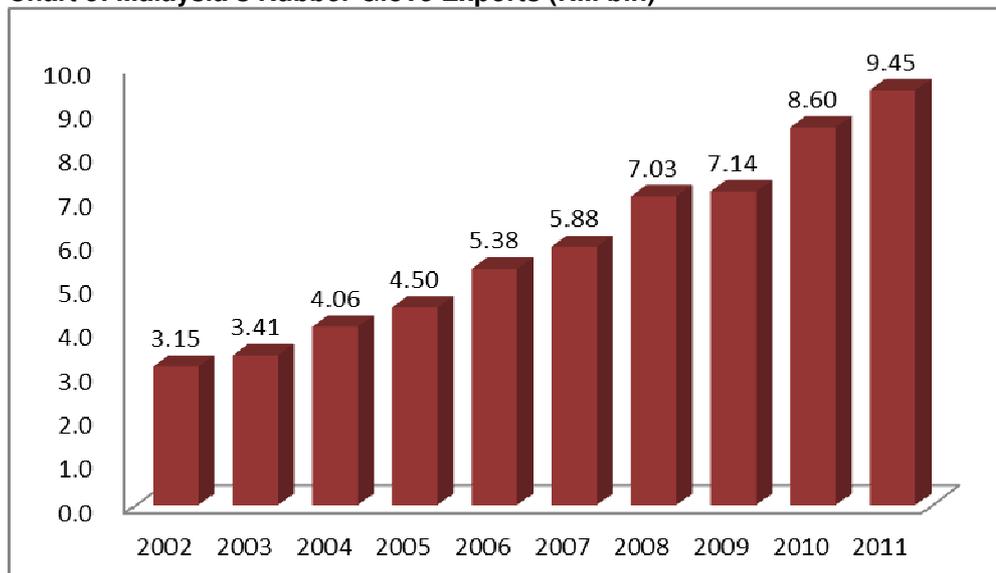


Chart 4: US Dental Market Share (Nitrile Glove)



Source: Company, Forecasts by MIDFR

Chart 5: Malaysia's Rubber Glove Exports (RM bln)



DAILY PRICE CHART



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MIDF AMANAH INVESTMENT BANK : GUIDE TO RECOMMENDATIONS

STOCK RECOMMENDATIONS

| | |
|--------------|--|
| BUY | Total return is expected to be >15% over the next 12 months. |
| TRADING BUY | Stock price is expected to <i>rise</i> by >15% within 3-months after a Trading Buy rating has been assigned due to positive newsflow. |
| NEUTRAL | Total return is expected to be between -15% and +15% over the next 12 months. |
| SELL | Total return is expected to be <15% over the next 12 months. |
| TRADING SELL | Stock price is expected to <i>fall</i> by >15% within 3-months after a Trading Sell rating has been assigned due to negative newsflow. |

SECTOR RECOMMENDATIONS

| | |
|----------|--|
| POSITIVE | The sector is expected to outperform the overall market over the next 12 months. |
| NEUTRAL | The sector is to perform in line with the overall market over the next 12 months. |
| NEGATIVE | The sector is expected to underperform the overall market over the next 12 months. |