



Chow Steel Industries (CHOW.BK/CHOW TB)

Earnings up-cycle continues

Bt2.78	Outperform Maintained	Company Update
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- **Able to take advantage of lack of domestic middle-stream product**
- **Revised down 2012 net profit by 24.7% but this would still be up 36.3% YoY**
- **Maintain Outperform with a new target price of Bt3.35 (from Bt4.00)**

On the path to sustainable growth

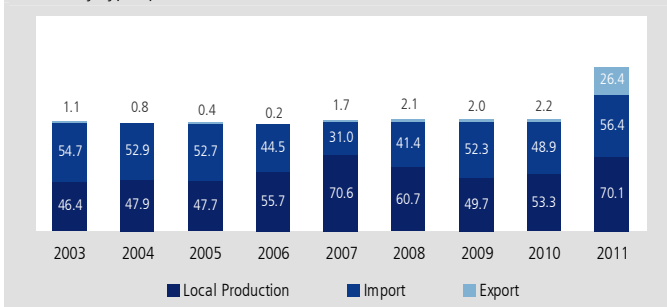
We maintain our Outperform rating on CHOW with a new target price of Bt3.35, from Bt4.00, as the lack of middle-stream products such as billet in Thailand would allow it to capture strong local demand. While we revised down our 2012 earnings forecast by 24.7% to Bt255mn, due to higher scrap and electricity costs in 2H12, we still expect net profit to rise 36.3% YoY as a result of capacity ramp up, ability to increase its selling price and zero tax rates.

Able to take advantage of lack of domestic middle-stream product

We expect Thailand's total steel demand to rise at least 5.0% from 14.6mn tons in 2012 thanks to massive investment from both the private and public sector. This should help drive demand for middle-stream products, such as billet, bloom and slab which are the main raw materials used in to produce finished steel. However, most of Thailand's steelmakers are in the intermediate and downstream segments, so there is insufficient local middle-stream product to meet the strong local demand. Even if Thai steelmakers increase their capacity, the country would be a net importer of billet, slab and bloom, which accounted for 56.4% of total 2011 consumption at 6mn tons. Being a leader in intermediate steel production, CHOW is set to benefit from the solid growth.

Figure 1: Thailand remains a net importer of billet

Breakdown of consumption of middle-stream products (billet, slab and bloom) by type, percent



Source: Company data; Iron and Steel Institute of Thailand

Capacity ramp up to boost 2012 sales 17.2% YoY

CHOW's 2012 sales should rise 17.2% from Bt5.6bn in 2011 to Bt6.6bn. The company is ramping up production rates of billet for both Phase I and Phase II from 65% in 2011 to 72% in 2012, In

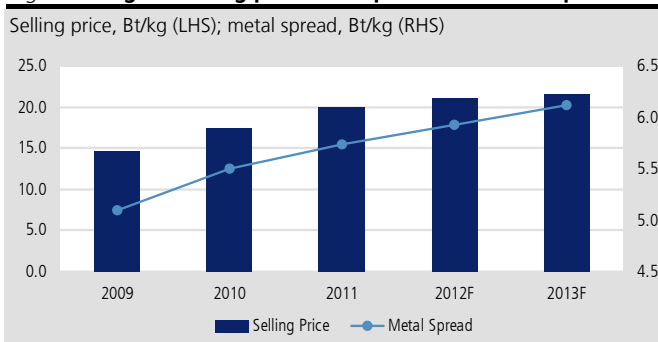
addition, after signing a contract with its main customer, a secure selling volume of 100K per ton could ensure that selling volume increases from 293,420 tons in 2011 to 324,000 tons in 2012. Meanwhile, the selling price is likely to increase from Bt20/kilo in 2011 to Bt21/kilo, underpinned by cost push in the global upstream steel market.

Figure 2: New assumptions

Bt mn	2012F			2013F		
	Previous	Revised	Change (%)	Previous	Revised	Change (%)
Total sales	6,662	6,662	0.0	7,299	7,299	0.0
Gross margin (%)	8.3	7.6	(0.7)ppts	8.4	7.7	(0.7)ppts
Net profit	339	255	(24.7)	387	297	(23.1)

Source: Company data; KGI Securities (Thailand) estimates

Figure 3: Higher selling price to help increase metal spread



Source: Company data; KGI Securities (Thailand) estimates

Revised down 2012 net profit by 24.7%

We revised down our forecast for CHOW's 2012 earnings by 24.7% to Bt255mn. The main reasons are higher scrap costs and a possible increase in electricity costs in 2H12, in tandem with the global oil price. This should cause the gross margin to drop below our earlier forecast of 8.3% to 7.6%, as electricity accounts for 50.0% of the company's conversion cost. However, even after the revision, the company's net profit is set to rise 36.3% YoY thanks to increased sales volume, lower interest rate and tax exemption under Thailand's Board of Investment privilege.

Valuation and Recommendation

Though we revised down our earnings forecast for in 2012 by 24.7%, we expect CHOW to post good net profit growth of 36.3% YoY in 2012. Given its good earnings momentum, we maintain a rating Outperform with a new target price of Bt3.35 (based on 10.5x PER).

Year to Mar	Sales (Bt mn)	Sales growth (%)	EBITDA (Bt mn)	NP (Bt mn)	EPS (Bt)	EPS growth (%)
2009	2,024	(11.3)	54	(173)	(0.3)	N.A.
2010	3,873	91.3	155	16	0.0	N.A.
2011	5,685	46.8	397	187	0.2	791.3
2012F	6,662	17.2	402	255	0.3	36.3
2013F	7,299	9.6	442	297	0.4	16.6

Year to Mar	GM (%)	EV/EBITDA (X)	PBV (X)	PER (X)	Dividend Yield (%)	ROAE (%)
2009	2.9	62.2	3.3	(9.6)	0.0	N.A.
2010	5.1	23.0	3.2	105.9	0.0	3.0
2011	6.9	8.0	1.7	11.9	3.6	14.4
2012F	7.6	8.1	1.5	8.7	5.0	17.3
2013F	7.7	7.1	1.4	7.5	5.8	17.9

Sector	52-week trading range (Bt)	Target Price (Bt/shr)	Upside/downside (%)	The percentile of excess return (%)	Dividend yield-12/12F (%)	Book value/shr-12/12F (Bt)	P/B-12/12F (x)	Net debt/equity-12/12F (%)
	1.36/05	3.35	80.5	5.0	1.8	1.5	71.8	

*The Company may be issuer of Derivative Warrants on these securities.


Balance Sheet

As of 31 Dec (Bt mn)	2009	2010	2011	2012F	2013F
Total Assets	2,469	2,784	3,196	3,174	3,293
Current Assets	964	1,196	1,646	1,333	1,471
Cash & ST Investments	9	62	614	189	239
Inventories	723	646	538	590	625
Accounts Receivable	205	410	435	475	520
Others	27	77	59	80	88
Non-current Assets	1,505	1,588	1,550	1,840	1,822
LT Investments	0	0	0	0	0
Net fixed Assets	1,468	1,486	1,512	1,798	1,779
Others	38	102	38	43	43
Total Liabilities	1,968	2,257	1,900	1,703	1,636
Current Liabilities	1,527	1,841	1,612	1,494	1,497
Accounts Payable	202	127	249	253	277
ST Borrowings	1,251	1,558	1,285	1,105	1,066
Others	74	156	78	137	154
Long-term Liabilities	441	416	289	209	139
Long-term Debts	441	416	288	132	66
Others	0	(0)	1	77	73
Shareholders' Equity	501	527	1,296	1,471	1,657
Common Stock	600	600	800	800	800
Capital Surplus	0	10	393	393	393
Retained Earnings	(99)	(83)	103	278	463
Preferred Stock	0	0	0	0	0

Source: Company data; KGI Securities (Thailand) estimates

Key Assumptions & Ratios

Year to 31 Dec (Bt mn)	2009	2010	2011	2012F	2013F
Forecast Drivers					
Selling Volume ('000 Tons)	143.6	229.2	293.4	324.0	346.5
Selling Price (Bt/kg)	14.6	17.4	20.0	21.0	21.6
Metal Spread (Bt/Kg)	5.1	5.5	5.7	5.9	6.1
Growth (% YoY)					
Sales	(11.3)	91.3	46.8	17.2	9.6
OP	N.A.	N.A.	368.6	9.1	11.6
EBITDA	(76.1)	188.4	155.4	1.4	9.8
NP	N.A.	N.A.	1,088.5	36.3	16.6
EPS	N.A.	N.A.	791.3	36.3	16.6
Profitability (%)					
Gross Margin	2.9	5.1	6.9	7.6	7.7
Operating Margin	(1.7)	1.6	5.0	4.6	4.7
EBITDA Margin	2.7	4.0	7.0	6.0	6.1
Net Profit Margin	(8.6)	0.4	3.3	3.8	4.1
ROAA	(1.3)	3.1	10.0	10.2	11.2
ROAE	N.A.	3.0	14.4	17.3	17.9
Stability					
Gross Debt/Equity (%)	392.6	436.5	148.0	116.7	99.5
Net Debt/Equity (%)	335.8	369.8	74.7	71.8	54.4
Interest Coverage (x)	(0.7)	1.1	2.6	4.6	5.6
Interest & ST Debt Coverage (x)	(0.1)	0.1	0.2	0.3	0.3
Cash Flow Interest Coverage (x)	1.0	(0.4)	4.1	3.5	5.3
Cash Flow/Interest & ST Debt (x)	0.1	(0.0)	0.3	0.2	0.3
Current Ratio (x)	0.6	0.6	1.0	0.9	1.0
Quick Ratio (x)	0.2	0.3	0.7	0.5	0.6
Net Debt (Bt mn)	1,683.3	1,911.8	959.6	1,047.9	893.7
Per Share Data (Bt)					
EPS	(0.3)	0.0	0.2	0.3	0.4
CFPS	(0.1)	0.1	0.4	0.4	0.5
BVPS	0.8	0.9	1.6	1.8	2.1
SPS	3.4	6.5	7.1	8.3	9.1
EBITDA/Share	0.1	0.3	0.5	0.5	0.6
DPS	0.0	0.0	0.1	0.1	0.2
Activity					
Asset Turnover (x)	0.8	1.5	1.9	2.1	2.3
Days Receivables	35.2	29.0	27.1	24.9	24.9
Days Inventory	132.7	68.0	40.8	33.5	32.9
Days Payable	22.1	16.3	12.9	14.9	14.4
Cash Cycle	145.7	80.6	55.0	43.5	43.4

Source: Company data; KGI Securities (Thailand) estimates

Profit & Loss

Year to 31 Dec (Bt mn)	2009	2010	2011	2012F	2013F
Sales	2,024	3,873	5,685	6,662	7,299
Cost of Goods Sold	1,967	3,675	5,294	6,154	6,736
Gross Profit	58	198	391	508	562
Operating Expenses	92	137	109	200	219
Operating Profit	(34)	60	282	308	343
Net Interest	(102)	(109)	(119)	(70)	(65)
Interest Income	0	0	0	0	0
Interest Expense	102	109	119	70	65
Net Investment Income/(Loss)	0	0	0	0	0
Net other Non-op. Income/(Loss)	3	20	16	17	18
Net Extraordinaries	(39.58)	44.23	8	1	1
Pretax Income	(173.33)	15.75	187	255	297
Income Taxes	0.00	0.00	0	0	0
Net Profit	(173.33)	15.75	187	255	297
EBITDA	53.90	155.45	397	402	442
EPS (Bt)	(0.29)	0.03	0.23	0.32	0.37

Source: Company data; KGI Securities (Thailand) estimates

Cash Flow

Year to 31 Dec (Bt mn)	2009	2010	2011	2012F	2013F
Operating Cash Flow	98	(47)	485	243	343
Net Profit	(173)	16	187	255	297
Depreciation & Amortization	88	95	115	95	99
Change in Working Capital	130	(204)	204	(87)	(56)
Others	53	46	(21)	(20)	3
Investment Cash Flow	(120)	(91)	(80)	(126)	(76)
Net CAPEX	(121)	(90)	(85)	(50)	(80)
Change in LT Investment	0	0	0	0	0
Change in Other Assets	1	(0)	5	(76)	4
Free Cash Flow	(22)	(138)	404	117	266
Financing Cash Flow	15	191	65	(541)	(217)
Change in Share Capital	0	0	581	0	0
Net Change in Debt	15	181	(528)	(461)	(105)
Change in Other LT Liab.	0	11	12	(80)	(112)
Net Cash Flow	(7)	53	469	(425)	50

Source: Company data; KGI Securities (Thailand) estimates

Rates of Return on Invested Capital

Year	1- $\frac{\text{COGS}}{\text{Revenue}}$	+ $\frac{\text{Depreciation}}{\text{Revenue}}$	+ $\frac{\text{Operating Exp.}}{\text{Revenue}}$	= $\frac{\text{Operating Margin}}{\text{Revenue}}$
2009	88.6%	2.3%	3.9%	5.2%
2010	97.1%	4.4%	4.6%	-6.1%
2011	94.9%	2.5%	3.6%	-0.9%
2012F	93.1%	2.0%	1.9%	2.9%
2013F	92.4%	1.4%	3.0%	3.3%

Year	1/ $\frac{\text{Working Capital}}{\text{Revenue}}$	+ $\frac{\text{Net PPE}}{\text{Revenue}}$	+ $\frac{\text{Other Assets}}{\text{Revenue}}$	= $\frac{\text{Capital Turnover}}{\text{Revenue}}$
2009	0.07	0.66	0.02	1.35
2010	0.00	0.73	0.02	1.34
2011	0.06	0.38	0.03	2.13
2012F	0.03	0.27	0.01	3.29
2013F	0.02	0.27	0.01	3.34

Year	$\frac{\text{Operating Margin}}{\text{Revenue}}$	x	$\frac{\text{Capital Turnover}}{\text{Revenue}}$	x	$\frac{\text{Cash Tax Rate}}{\text{Revenue}}$	= $\frac{\text{After-tax Return on Inv. Capital}}{\text{Revenue}}$
2009	5.2%		1.4		100.0	7.0
2010	-6.1%		1.3		100.0	-8.1
2011	-0.9%		2.1		100.0	-1.9
2012F	2.9%		3.3		100.0	9.7
2013F	3.3%		3.3		100.0	10.9

Source: Company data; KGI Securities (Thailand) estimates

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	Outperform (OP)	The stock's excess return* over the next twelve months is ranked in the top 40% of KGI's coverage universe in the related market (e.g. Thailand).
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	Restricted (R)	KGI policy and/or applicable law regulations preclude certain types of communications, including an investment recommendation, during the course of KGI's engagement in an investment banking transaction and in certain other circumstances.
		<i>* Excess return = 12M target price/current price-1</i>
	Note	When an analyst publishes a new report on a covered stock, we rank the stock's excess return with those of other stocks in KGI's coverage universe in the related market. We will assign a rating based on its ranking. If an analyst does not publish a new report on a covered stock, its rating will not be changed automatically.
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