



## Chow Steel Industries (CHOW.BK/CHOW TB)

Earnings set to recover in 2H12

<b>Bt1.88</b>	<b>Outperform</b> Maintained	<b>Company update</b>
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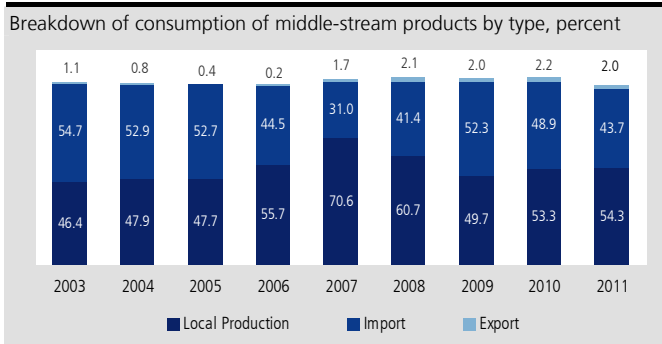
Nat Panassutrakorn  
 66.2658.8888 Ext. 8849  
 natp@kgi.co.th

- **Sluggish global economy to impact local steel price, not billet demand**
- **Revised down 2012 net profit by 21.4% due to poor 1Q12 earnings**
- **Rate Outperform with a new target price of Bt2.60, from Bt3.35**

### Better earnings outlook with healthy financial status

Though we revised down our 2012 net profit forecast for CHOW by 21.4% to Bt200mn due to its poor 1Q12 earnings, we believe the share price has already priced in the bad news. The lack of local billet production should mean CHOW's billet will be in great demand and help support its sale growth from 2Q12 onward. In addition, a cost plus policy, lower interest rate and a tax exemption would help underpin its 2H12 earnings and should help them rebound a strong 164% HoH. Given the earnings recovery and healthy financial status, we maintain a rating of Outperform on the counter with a new target price of Bt2.60, from Bt3.35 (based on 10.5x PER).

Figure 1: Thailand is a net importer of billet



Source: Company data; Iron and Steel Institute of Thailand

### Sluggish global economy to impact local steel price, not billet demand

Wire rod price has dropped almost 11.7% from its peak in 2011 to US\$660/ton due to concerns about the slowdown in the global economy, particularly in China's consumption which accounts for 45-50% of global consumption. Nevertheless, this should not impact local intermediate industry (billet, slab and bloom) as local production of intermediate products is insufficient with strong local demand. Thailand has remained a net importer of intermediate products, which account for 40-50% of total local consumption. We believe CHOW would benefit most from the hefty local demand as the leader in intermediate steel production with a maximum off-peak annual capacity of 450,000 tons or 35.4% of Thailand's total capacity.

Figure 2: New assumptions

Bt mn	2012F		Change (%)	2013F		Change (%)
	Previous	Revised		Previous	Revised	
Total sales	6,662	6,662	0.0	7,299	7,299	0.0
Spread (Bt/Kg)	5.92	5.69	(4.0)	6.12	5.74	(6.1)
Gross margin (%)	7.6	6.8	(0.8)ppts	7.7	7.3	(0.4)ppts
Net profit	255	200	(21.4)	297	268	(9.9)

Source: Company data; KGI Securities (Thailand) estimates

### 2H12 earnings set to rebound a strong 164% HoH

CHOW reported a disappointing 1Q12 result of Bt10mn, down 90.1% YoY as a high scrap price caused the metal spread (billet-scrap price) to drop to Bt5.00/kg. Nevertheless, we expect 2H12 earnings to rebound a strong 164% HoH to Bt145mn thanks to i) a high utilization rate of 73% to help meet strong local demand, ii) enhanced metal spread to more than Bt5.0-6.0/kg from the cost plus policy, and iii) benefits of low interest rate after listing in mai from 7.0-8.0% p.a. to around 4.0-4.5%.

### Revised down 2012 net profit by 21.4% to Bt200mn

We revised down our 2012 earnings forecast for CHOW by 21.4% to Bt255mn. The main reason is a squeezed gross profit margin from 7.6% to 6.8% due to higher scrap costs and an increase of another 10% in electricity costs in 2H12 which accounts for 50.0% of the company's conversion cost. However, even after the revision, the net profit is set to rise 7.1% YoY thanks to increased sales volume of 12.4% to 329K tons, lower interest rate and tax exemption under Thailand's Board of Investment privilege.

### Healthy financial status allows CHOW to pay steady dividend

Good earnings momentum would continue from 2Q12 onward and help improve CHOW's financial status and allow it to repay existing debt consistently. Its D/E ratio has fallen substantially from 4.4x in 2010 to 1.5x 2011 and 1.2x in 2012. With the bright earnings outlook set to continue, we anticipate CHOW to pay a steady dividend at Bt0.1-0.12/share during 2012-13, implying a dividend yield of 5.0-6.0% p.a.

### Valuation and Recommendation

We believe CHOW's share price has already reflected the bad news. With earnings set to recover from 2Q12 onward, we maintain a rating of Outperform on the counter with a target price of Bt2.60, from 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	348	200	0.3	7.1
2013F	7,299	9.6	413	268	0.3	33.7
Year to Mar	GM (%)	EV/EBITDA (X)	PBV (X)	PER (X)	Dividend Yield (%)	ROAE (%)
2009	2.9	52.2	2.3	(6.5)	0.0	N.A.
2010	5.1	19.6	2.2	71.6	0.0	3.0
2011	6.9	6.2	1.2	8.0	5.3	14.4
2012F	6.8	7.5	1.1	7.5	5.3	14.1
2013F	7.3	5.9	0.9	5.6	6.4	16.7
Sector	Metal 52-week trading range (Bt)					1.7-3
12M target price (Bt/shr)	2.60	Mkt cap-Bt bn/US\$ bn				1.50/05
Upside/downside (%)	38.3	Outstanding shares (mn)				800
The percentile of excess return (%)	88.0	Free floating shares (mn)				200
Dividend yield-12/12F (%)	5.3	Foreign ownership (mn)				N.A.
Book value/shr-12/12F (Bt)	1.8	3M avg. daily trading (mn)				N.A.
P/B-12/12F (x)	1.1	Abs. performance (3,6,12M)(%)				N.A.
Net debt/equity-12/12F (%)	77.8	Rel. performance (3,6,12M)(%)				N.A.

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


**Balance Sheet**

As of 31 Dec (Bt mn)	2009	2010	2011	2012F	2013F
<b>Total Assets</b>	<b>2,469</b>	<b>2,784</b>	<b>3,196</b>	<b>3,122</b>	<b>3,243</b>
<b>Current Assets</b>	964	1,196	1,646	1,281	1,422
Cash & ST Investments	9	62	614	145	201
Inventories	723	646	538	595	627
Accounts Receivable	205	410	435	475	520
Others	27	77	59	67	73
<b>Non-current Assets</b>	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
<b>Total Liabilities</b>	<b>1,968</b>	<b>2,257</b>	<b>1,900</b>	<b>1,705</b>	<b>1,639</b>
<b>Current Liabilities</b>	1,527	1,841	1,612	1,497	1,500
Accounts Payable	202	127	249	255	280
ST Borrowings	1,251	1,558	1,285	1,105	1,066
Others	74	156	78	137	154
<b>Long-term Liabilities</b>	441	416	289	208	139
Long-term Debts	441	416	288	132	66
Others	0	(0)	1	76	73
<b>Shareholders' Equity</b>	<b>501</b>	<b>527</b>	<b>1,296</b>	<b>1,417</b>	<b>1,605</b>
Common Stock	600	600	800	800	800
Capital Surplus	0	10	393	393	393
Retained Earnings	(99)	(83)	103	223	411
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
<b>Forecast Drivers</b>					
Selling Volume ('000 Tons)	143.6	229.2	293.4	329.7	352.7
Metal Spread (Bt/Kg)	5.1	5.5	5.7	5.7	5.7
<b>Growth (% YoY)</b>					
Sales	(11.3)	91.3	46.8	17.2	9.6
OP	N.A.	N.A.	368.6	(10.3)	24.0
EBITDA	(76.1)	188.4	155.4	(12.4)	18.6
NP	N.A.	N.A.	1,088.5	7.1	33.7
EPS	N.A.	N.A.	791.3	7.1	33.7
<b>Profitability (%)</b>					
Gross Margin	2.9	5.1	6.9	6.8	7.3
Operating Margin	(1.7)	1.6	5.0	3.8	4.3
EBITDA Margin	2.7	4.0	7.0	5.2	5.7
Net Profit Margin	(8.6)	0.4	3.3	3.0	3.7
ROAA	(1.3)	3.1	10.0	8.5	10.4
ROAE	N.A.	3.0	14.4	14.1	16.7
<b>Stability</b>					
Gross Debt/Equity (%)	392.6	436.5	148.0	121.4	102.9
Net Debt/Equity (%)	335.8	369.8	74.7	77.8	58.5
Interest Coverage (x)	(0.7)	1.1	2.6	3.9	5.1
Interest & ST Debt Coverage (x)	(0.1)	0.1	0.2	0.2	0.3
Cash Flow Interest Coverage (x)	1.0	(0.4)	4.1	2.8	4.9
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	0.9
Quick Ratio (x)	0.2	0.3	0.7	0.5	0.5
Net Debt (Bt mn)	1,683.3	1,911.8	959.6	1,092.0	930.9
<b>Per Share Data (Bt)</b>					
EPS	(0.3)	0.0	0.2	0.3	0.3
CFPS	(0.1)	0.1	0.4	0.4	0.5
BVPS	0.8	0.9	1.6	1.8	2.0
SPS	3.4	6.5	7.1	8.3	9.1
EBITDA/Share	0.1	0.3	0.5	0.4	0.5
DPS	0.0	0.0	0.1	0.1	0.1
<b>Activity</b>					
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	33.3	33.0
Days Payable	22.1	16.3	12.9	14.8	14.4
Cash Cycle	145.7	80.6	55.0	43.4	43.4

Source: Company data; KGI Securities (Thailand) estimates

**Profit & Loss**

Year to 31 Dec (Bt mn)	2009	2010	2011	2012F	2013F
<b>Sales</b>	<b>2,024</b>	<b>3,873</b>	<b>5,685</b>	<b>6,662</b>	<b>7,299</b>
Cost of Goods Sold	1,967	3,675	5,294	6,209	6,766
<b>Gross Profit</b>	<b>58</b>	<b>198</b>	<b>391</b>	<b>453</b>	<b>533</b>
Operating Expenses	92	137	109	200	219
<b>Operating Profit</b>	<b>(34)</b>	<b>60</b>	<b>282</b>	<b>253</b>	<b>314</b>
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 Extraordinary	(39.58)	44.23	8	1	1
Pretax Income	(173.33)	15.75	187	200	268
Income Taxes	0.00	0.00	0	0	0
<b>Net Profit</b>	<b>(173.33)</b>	<b>15.75</b>	<b>187</b>	<b>200</b>	<b>268</b>
EBITDA	53.90	155.45	397	348	413
<b>EPS (Bt)</b>	<b>(0.29)</b>	<b>0.03</b>	<b>0.23</b>	<b>0.25</b>	<b>0.33</b>

Source: Company data; KGI Securities (Thailand) estimates

**Cash Flow**

Year to 31 Dec (Bt mn)	2009	2010	2011	2012F	2013F
<b>Operating Cash Flow</b>	98	(47)	485	198	318
Net Profit	(173)	16	187	200	268
Depreciation & Amortization	88	95	115	95	99
Change in Working Capital	130	(204)	204	(90)	(53)
Others	53	46	(21)	(7)	4
<b>Investment Cash Flow</b>	(120)	(91)	(80)	(126)	(77)
Net CAPEX	(121)	(90)	(85)	(50)	(80)
Change in LT Investment	0	0	0	0	0
Change in Other Assets	1	(0)	5	(76)	3
<b>Free Cash Flow</b>	(22)	(138)	404	73	241
<b>Financing Cash Flow</b>	15	191	65	(541)	(185)
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)	(80)
<b>Net Cash Flow</b>	(7)	53	469	(469)	56

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	93.2%	1.4%	3.0%	2.4%

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	2.4%		3.3		100.0	8.2

Source: Company data; KGI Securities (Thailand) estimates

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

<b>Thailand Research</b>	<b>Name</b>	<b>Abbr.</b>	<b>Sector Coverage</b>	<b>Ext.</b>	<b>Email</b>
	Itphong Saengtubtim	IS	Head of Research	8840	itphongs@kgi.co.th
General line:	Rakpong Chaisuparakul	RC	Strategist	8845	rakpongc@kgi.co.th
66.2658.8888	Pongtham Danwungderm	PD	Petrochemical, refinery	8859	pongthamd@kgi.co.th
	Adisak Kamool	AK	Retail strategist	8843	adisakk@kgi.co.th
	Phatipak Navawatana	PN	Telecom, media, healthcare	8847	phatipakn@kgi.co.th
	Nat Panassutrakorn	NP	Construction material, contractor, consumer	8849	natp@kgi.co.th
	Pragrom Pathomboorn	PP	Economist	8846	pragromp@kgi.co.th
	Thaninee Satirareungchai, CFA	TS	Banking	8851	thaninees@kgi.co.th
	Pongpat Siripipat	PS	Derivatives	8844	pongpats@kgi.co.th
	Suchada Thiemthnog	ST	Derivatives program trading	8852	suchadat@kgi.co.th
	Piyathida Vongvivathchai	PV	Oil & Gas, coal mining, utilities	8856	piyathidav@kgi.co.th
	Tareetip Wongsangpaiboon	TW	Residential property, industrial estates	8855	tareetipw@kgi.co.th

<b>ASEAN Sales</b>	<b>Name</b>	<b>Abbr.</b>	<b>Sector Coverage</b>	<b>Ext.</b>	<b>Email</b>
General line:	Danny Komolrit	DK	Thailand sales	8090	dannyk@kgi.co.th
66.2658.8888	Kannikar Pradisesorn	KP	Thailand sales	8081	kannikarp@kgi.co.th
	Datenusorn Rungruang	DR	Thailand sales	8082	datenusornr@kgi.co.th

*The toll-free line for clients in HK and Singapore: 800.0800.5008*

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

Locations	China	Taiwan
	<b>Shanghai</b> Room 1907-1909, Tower A, No. 100 Zynyi Road, Shanghai, PRC 200051  <b>Shenzhen</b> Room 24D1, 24/F, A Unit, Zhen Ye Building, 2014 Bao'annan Road, Shenzhen PRC 518008	KGI Securities 700 Mingshui Road, Taipei, Taiwan Telephone 886.2.2181.8888 Facsimile 886.2.8501.1691
	Hong Kong	Thailand
	41/F Central Plaza, 18 Harbour Road, Wanchai, Hong Kong Telephone 852.2878.6888 Facsimile 852.2878.6800	KGI Securities (Thailand) Plc. 8th - 11th floors, Asia Centre Building 173 South Sathorn Road, Bangkok 10120, Thailand Telephone 66.2658.8888 Facsimile 66.2658.8014

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