



Chow Steel Industries (CHOW.BK/CHOW TB)

More risk than reward

Bt1.71

Neutral

from Outperform

Company update

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- **To book an insurance claim in 4Q12**
- **Revised down 2012-13 net profit by 56.0-57.0%**
- **Every 1% drop in metal spread would cause net profit to decline 8.2%**
- **Downgrade to Neutral from Outperform with our target price rolled over to 2013 at Bt1.90**

More downside risk ahead

Though we anticipate 2013 net profit to grow from Bt88mn in 2012 to Bt116mn, we have revised down our forecast by 56.0-57.0% due to lower than earlier expected sales volume and metal spread. In addition, the volatile scrap price would be an uncontrollable risk that would cause 2013 net profit to drop from the forecast. We forecast every 1% drop in metal spread to cause 2013 net profit to decline 8.2% from the forecast of Bt116mn. In addition, the limited upside to our rolled over 2013 target price of Bt1.90, we downgrade the counter to Neutral from Outperform.

Figure 1: Anticipate 4Q12 net profit of Bt42mn, up 228% YoY

Bt mn	4Q12F	4Q11	YoY (%)	3Q12	QoQ (%)
Sales	928	1,443	(35.7)	1,008	(8.0)
Costs of Sales	869	1,387	(37.4)	945	(8.1)
Gross Profit	59	56	6.0	63	(7.1)
SG&A Expense	24	28	(13.4)	24	(0.0)
EBIT	35	28	25.6	39	(11.4)
EBITDA	40	59	(32.3)	70	(43.5)
Interest Expense	24	28	(14.5)	23	2.7
Other Income (Exp.)	33	4	670.2	(36)	N.A.
Pre-tax Profit	44	4	1,018.7	(20)	N.A.
Minority Interest	(2)	(1)	46.5	(2)	0.0
Net Profit	42	13	228.3	(23)	N.A.
Normalized Profit (excl. forex & extra)	42	13	228.3	(23)	N.A.
EPS (Bt)	0.05	0.02	150.5	(0.03)	N.A.
Percent	4Q12F	4Q11	YoY (ppts)	3Q12	QoQ (ppts)
Gross profit margin	6.4	3.9	2.5	6.3	0.1
EBIT margin	3.8	1.9	1.8	3.9	(0.1)
EBITDA margin	4.3	4.1	0.2	7.0	(2.7)
Net margin	4.5	0.9	3.6	(2.2)	6.7

Source: Company data; KGI Securities (Thailand) estimates

To book an insurance claim in 4Q12

CHOW's 4Q12 sales are anticipated to drop 35.7% YoY to Bt928mn as its main customers, rolling mills, have high stockpiles and this should cause sales volume to drop 25.6% YoY to 53.0K tons and selling price to drop 12.9% YoY to Bt17.5/ton. However, margin is expected to improve 250bps to 6.4%, due mainly to the benefits from cheap raw materials during the quarter, and this should help drive 4Q12 EBIT up 25.6% YoY to Bt35.0mn. Moreover, the booking of around Bt33mn (90.0% of total damage cost of Bt36.7mn) from an insurance claim for a fire that happened on the second production line in 3Q12 should allow CHOW to report 228% YoY net profit growth in 4Q12 to Bt42.0mn.

Revised down 2012-13 net profit by 56.0-57.0%

We revised down our 2012 net profit forecast by 56.2% to Bt88mn. Local billet demand seems to be falling short which is contrary to the strong steel industry outlook in Thailand. This is because the rolling mills have high inventory periods of 3-6 months. As a result of delayed buying, we revised down CHOW's 2012 sales volume and selling price by 21.1% to 260K tons and 13.2% to Bt18.2/kg. For 2013, we anticipate lower stockpiles at rolling mills and a good outlook in the construction industry to help sales volume grow 11.5% YoY to 290K tons. In addition, metal spread is expected to widen 10bps to Bt5.5/kg which should help 2013 net profit grow 32.5% YoY to Bt116mn. This is 56.7% lower than our earlier forecast of Bt268mn due to sluggish sales growth and lower metal spread.

Figure 2: New assumptions

Bt mn	2012F		Change (%)	2013F		Change (%)
	Previous	Revised		Previous	Revised	
Total sales	6,662	4,722	(29.1)	7,299	5,363	(26.5)
Sales volume ('000 tons)	330	260	(21.1)	353	290	(17.8)
Selling price (Bt/kg)	21.0	18.2	(13.2)	21.6	18.6	(13.9)
Metal Spread (Bt/kg)	5.7	5.4	(5.9)	5.7	5.5	(4.0)
Gross margin (%)	6.8	6.3	(0.5)ppts	7.3	6.4	(0.9)ppts
Net profit	200	88	(56.2)	268	116	(56.7)

Source: Company data; KGI Securities (Thailand) estimates

Every 1% drop in metal spread would cause net profit to decline by 8.2%

A scrap shortage should no longer be a threat to CHOW as it has good relationships with foreign scrap producers to ensure alternative sourcing in the case of a domestic scrap shortage. Nevertheless, the volatile scrap price would be an uncontrollable risk that would cause 2013 net profit to drop from our forecast. Slower than expected growth in the local steel industry should push rolling mills to have high billet stockpiles. This could limit the growth of CHOW's sales volume and cause metal spread to drop. We forecast every 1% drop in metal spread to cause 2013 net profit to decline by 8.2% from the forecast of Bt116mn.

Valuation and Recommendation

Though we expect earnings in 2013 to recover, the downside risk from uncontrollable steel prices could cause net profit to drop from our forecast. In addition, given the limited upside to our rolled over 2013 target price of Bt1.90, we downgrade the counter to Neutral from Outperform.

Year to Dec	Sales (Bt mn)	Sales growth (%)	EBITDA (Bt mn)	NP (Bt mn)	EPS (Bt)	EPS growth (%)
2010	3,873	91.3	155	16	0.0	N.A.
2011	5,685	46.8	397	187	0.2	791.3
2012F	4,722	(16.9)	297	88	0.1	(53.1)
2013F	5,363	13.6	326	116	0.1	32.5
2014F	5,772	7.6	346	133	0.2	14.7
Year to Dec	GM (%)	EV/EBITDA (X)	PBV (X)	PER (X)	Dividend Yield (%)	ROAE (%)
2010	5.1	18.9	2.0	65.2	0.0	3.0
2011	6.9	5.9	1.1	7.3	5.8	14.4
2012F	6.3	10.3	1.1	15.6	2.6	6.7
2013F	6.4	9.1	1.0	11.8	3.4	8.4
2014F	6.4	8.3	0.9	10.3	3.9	9.0
Sector	Mai 52-week trading range (Bt)					
12M target price (Bt/shr)	1.90	Mkt cap-Bt bn/US\$ bn				1.36/0.05
Upside/downside (%)	11.1	Outstanding shares (mn)				800
The percentile of excess return (%)	36.1	Free floating shares (mn)				290
Dividend yield-12/12F (%)	2.6	Foreign ownership (mn)				40
Book value/shr-12/12F (Bt)	1.6	3M avg. daily trading (mn)				1
P/B-12/12F (x)	1.1	Abs. performance (3,6,12M)(%)				-19.8; -9.6; -44.1
Net debt/equity-12/12F (%)	131.6	Rel. performance (3,6,12M)(%)				-32.8; -32.7; -61

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


Balance Sheet

As of 31 Dec (Bt mn)	2010	2011	2012F	2013F	2014F
Total Assets	2,784	3,196	3,326	3,335	3,376
Current Assets	1,196	1,646	1,615	1,805	1,830
Cash & ST Investments	62	614	37	45	52
Inventories	646	538	879	922	962
Accounts Receivable	410	435	543	570	585
Others	77	59	156	268	231
Non-current Assets	1,588	1,550	1,711	1,530	1,546
LT Investments	0	0	0	0	0
Net fixed Assets	1,486	1,512	1,420	1,322	1,222
Others	102	38	291	209	324
Total Liabilities	2,257	1,900	2,021	1,950	1,904
Current Liabilities	1,841	1,612	1,842	1,881	1,846
Accounts Payable	127	249	133	261	222
ST Borrowings	1,558	1,285	1,605	1,566	1,566
Others	156	78	104	54	58
Long-term Liabilities	416	289	179	69	58
Long-term Debts	416	288	132	66	0
Others	(0)	1	47	3	58
Shareholders' Equity	527	1,296	1,304	1,385	1,472
Common Stock	600	800	800	800	800
Capital Surplus	10	393	393	393	394
Retained Earnings	(83)	103	111	192	278
Preferred Stock	0	0	0	0	0

Source: Company data; KGI Securities (Thailand) estimates

Key Ratios & Drivers

Year to 31 Dec (Bt mn)	2010	2011	2012F	2013F	2014F
Forecast Drivers					
Selling Volume ('000 Tons)	229.2	293.4	260.0	290.0	306.0
Selling Price (Bt/kg)	17.4	19.5	18.2	18.6	19.0
Metal Spread (Bt/Kg)	5.5	5.7	5.4	5.5	5.5
Growth (% YoY)					
Sales	91.3	46.8	(16.9)	13.6	7.6
OP	N.A.	368.6	(36.2)	15.3	9.4
EBITDA	188.4	155.4	(25.2)	9.7	6.4
NP	N.A.	1,088.5	(53.1)	32.5	14.7
EPS	N.A.	791.3	(53.1)	32.5	14.7
Profitability (%)					
Gross Margin	5.1	6.9	6.3	6.4	6.4
Operating Margin	1.6	5.0	3.8	3.9	3.9
EBITDA Margin	4.0	7.0	6.3	6.1	6.0
Net Profit Margin	0.4	3.3	1.9	2.2	2.3
ROAA	3.1	10.0	5.7	6.5	7.0
ROAE	3.0	14.4	6.7	8.4	9.0
Stability					
Gross Debt/Equity (%)	436.5	148.0	156.5	142.1	130.5
Net Debt/Equity (%)	369.8	74.7	131.6	115.7	103.8
Interest Coverage (x)	1.1	2.6	1.9	2.2	2.3
Interest & ST Debt Coverage (x)	0.1	0.2	0.1	0.1	0.1
Cash Flow Interest Coverage (x)	(0.4)	4.1	(4.8)	1.2	1.9
Cash Flow/Interest & ST Debt (x)	(0.0)	0.3	(0.3)	0.1	0.1
Current Ratio (x)	0.6	1.0	0.9	1.0	1.0
Quick Ratio (x)	0.3	0.7	0.4	0.5	0.5
Net Debt (Bt mn)	1,911.8	959.6	1,699.8	1,587.4	1,514.2
Per Share Data (Bt)					
EPS	0.0	0.2	0.1	0.1	0.2
CFPS	0.1	0.4	0.3	0.3	0.3
BVPS	0.9	1.6	1.6	1.7	1.8
SPS	6.5	7.1	5.9	6.7	7.2
EBITDA/Share	0.3	0.5	0.4	0.4	0.4
DPS	0.0	0.1	0.0	0.1	0.1
Activity					
Asset Turnover (x)	1.5	1.9	1.4	1.6	1.7
Days Receivables	29.0	27.1	37.8	37.9	36.5
Days Inventory	68.0	40.8	58.5	65.4	63.6
Days Payable	16.3	12.9	15.8	14.3	16.3
Cash Cycle	80.6	55.0	80.5	89.0	83.8

Source: Company data; KGI Securities (Thailand) estimates

Profit & Loss

Year to 31 Dec (Bt mn)	2010	2011	2012F	2013F	2014F
Sales	3,873	5,685	4,722	5,363	5,772
Cost of Goods Sold	3,675	5,294	4,425	5,022	5,401
Gross Profit	198	391	297	342	371
Operating Expenses	137	109	117	134	144
Operating Profit	60	282	180	207	227
Net Interest	(109)	(119)	(97)	(100)	(103)
Interest Income	0	0	0	0	0
Interest Expense	109	119	97	100	103
Net Investment Income/(Loss)	0	0	0	0	0
Net other Non-op. Income/(Loss)	20	16	5	8	9
Net Extraordinaries	44	8	1	1	1
Pretax Income	16	187	88	116	133
Income Taxes	0	0	0	0	0
Net Profit	16	187	88	116	133
EBITDA	155	397	297	326	346
EPS (Bt)	0.03	0.23	0.11	0.15	0.17

Source: Company data; KGI Securities (Thailand) estimates

Cash Flow

Year to 31 Dec (Bt mn)	2010	2011	2012F	2013F	2014F
Operating Cash Flow	(47)	485	(469)	123	195
Net Profit	16	187	88	116	133
Depreciation & Amortization	95	115	117	118	119
Change in Working Capital	(204)	204	(564)	58	(94)
Others	46	(21)	(110)	(170)	37
Investment Cash Flow	(91)	(80)	(67)	24	(75)
Net CAPEX	(90)	(85)	(20)	(20)	(20)
Change in LT Investment	0	0	0	0	0
Change in Other Assets	(0)	5	(47)	44	(55)
Free Cash Flow	(138)	404	(535)	147	120
Financing Cash Flow	191	65	(41)	(140)	(112)
Change in Share Capital	0	581	0	0	0
Net Change in Debt	181	(528)	39	(105)	(66)
Change in Other LT Liab.	11	12	(80)	(35)	(46)
Net Cash Flow	53	469	(577)	8	7

Source: Company data; KGI Securities (Thailand) estimates

Rates of Return on Invested Capital

Year	1- $\frac{\text{COGS}}{\text{Revenue}}$	+ $\frac{\text{Depreciation}}{\text{Revenue}}$	+ $\frac{\text{Operating Exp.}}{\text{Revenue}}$	= $\frac{\text{Operating Margin}}{\text{Revenue}}$
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	93.7%	2.5%	2.5%	1.3%
2014F	93.6%	2.2%	2.5%	1.7%
Year	1/ $\frac{\text{Working Capital}}{\text{Revenue}}$	+ $\frac{\text{Net PPE}}{\text{Revenue}}$	+ $\frac{\text{Other Assets}}{\text{Revenue}}$	= $\frac{\text{Capital Turnover}}{\text{Revenue}}$
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	0.08	0.30	0.06	2.28
2014F	0.05	0.25	0.04	3.00
Year	$\frac{\text{Operating Margin}}{\text{Revenue}}$	x $\frac{\text{Capital Turnover}}{\text{Revenue}}$	x $\frac{\text{Cash Tax Rate}}{\text{Revenue}}$	= $\frac{\text{After-tax Return on Inv. Capital}}{\text{Revenue}}$
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	1.3%	2.3	100.0	3.0
2014F	1.7%	3.0	100.0	5.0

Source: Company data; KGI Securities (Thailand) estimates

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		<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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