Khon Kaen Sugar Industry (KSL.BK/KSL TB)

Higher than expected cane volume

Bt13.50	Outperform	Company update
	Maintained	

Suchot Tirawannarat
66.2658.8888 Ext. 8852
suchott@kgi.co.th

- **Strong growth in FY2Q11 and expect even better in FY3Q11**
- **Revised up FY2011 net profit by 28.0% Bt1.27bn**
- **Rate Outperform with target of Bt15.40 (from Bt15.20)**

Earnings on an upswing

We are maintaining our positive view on KSL's near-term outlook. KSL's management guided that the company's earnings should continue to improve for FY2Q11 and FY3Q11 due to higher exports volume and less loss from derivatives. Higher cane volume from the company's four sugar mills should also support its gross margins. We revised up our FY2011 (November - October) net profit forecast by 28.0% to Bt1.27bn, but are maintaining our FY2012 forecast due to the concerns on the outlook of the global sugar market. Despite the upward revision, we revised our target price up only slightly as we re-rated our target PE down to 20x, from 25x, which is its long term PE (FY2007-present, excluding FY2010) on our less bullish outlook for FY2012. We maintain a rating of Outperform with a new target price of Bt15.40 (from Bt15.20).

Solid earnings growth in FY2Q11 and to peak in FY3Q11

We expect KSL's FY2Q11 net profit to grow 326% YoY and 199% QoQ to Bt432mn. The increase QoQ would be due to higher sales volume, as there is additional export volume in FY2Q11. Based on our talks with the company's investor relations, KSL's FY2Q11 sugar sales volume is expected to be around 120K tons, up from 84.3K tons last quarter. Meanwhile, there would be no big loss from derivatives like the Bt645mn loss that occurred last year. Nonetheless, FY2Q11 sales volume is expected to drop about 28.7% YoY as sales orders were shifted to FY3Q11. We therefore expect the company's FY3Q11 to be even better than FY2Q11 and should be the peak for this year.

Figure 1: **Solid earnings growth in FY2Q11 (February - April)**

Bt mn	FY2Q11	FY2Q10	YoY(%)	FY1Q10	QoQ (%)
Sales	3,334.0	3,917.9	(14.9)	2,610.0	27.7
COGS	(2,084.8)	(2,708.6)	(23.0)	(1,914.3)	8.9
Gross profit	1,236.7	1,209.3	2.3	695.7	77.8
SG&A	1,236.7	1,209.3	2.3	695.7	77.8
EBIT	777.5	826.0	(5.9)	303.3	156.3
Interest expense	(90.0)	(80.3)	12.0	(89.0)	1.2
Normalized profit	481.5	746.8	(35.5)	144.4	233.4
Extra Items	(50.0)	(645.4)	(92.3)	-	N.A.
Net profit	431.5	101.4	325.6	144.4	198.8
EPS (Bt)	0.28	0.07	325.6	0.09	198.8
Percent	**FY2Q11**	**FY2Q10**	**YoY (ppts)**	**FY1Q10**	**QoQ (ppts)**
Gross margin	37.1	30.9	6.2	26.7	10.4
SG&A to sales	37.1	30.9	6.2	26.7	10.4
EBIT margin	23.3	21.1	2.2	11.6	11.7
Net profit margin	12.9	2.6	10.4	5.5	7.4

Source: Company data; KGI Securities (Thailand) estimates

FY2011 cane volume higher than expected

Thanks to the La Nina event, Thailand's sugar cane production during FY2011 (November - October) increased 39.2% YoY to 95.3mn tons, based on information from the Office of the Cane and Sugar Board (OCSB) yesterday. Total cane volume this fiscal year is higher than our previous forecast of 80.0mn tons. The total cane volume of KSL's four sugar mills in Thailand is 6.17mn tons, up 40.0% YoY and higher than our previous assumption of 5.2mn tons. This would be positive to the company's sales volume and gross margin. We therefore revised up our FY2011 net profit forecast to Bt1.27bn from Bt1.0bn (Figure2).

Figure 2: **Revised up FY2011 net profit by forecast 28.3%**

	FY2011F		
	Revised	**Previous**	**(%) change**
Net profit (Bt mn)	1,266	1,000	28.3
Assumptions			
Cane Volume (tons)	6,170,000	5,200,000	18.7
Sugar output (tons)	635,510	535,600	18.7
Gross margin (%)	25.9	25.7	

Source: Company data; KGI Securities (Thailand) estimates

Risk to share price: 155mn warrant units

KSL's EPS may be diluted by the current 155mn warrant units that were able to be exercised to purchase shares for the first time on 15 March 2011. The warrant holders may exercise their rights on the 15th of March, June, September, and December. The last exercise date is 15 March 2013. The dilution effect on KSL's EPS is 9.3%. The warrant is currently deep in-the money as the exercise price of Bt10.00 is 30.0-35.0% below the current market price. However, we do not anticipate warrant holders to exercise their warrants in the near term given the bright earnings outlook for the company.

Valuation and Recommendation

With the bright earnings outlook in FY2Q11 and FY3Q11, we maintain a rating of Outperform on the counter with a new target price of Bt15.40, from Bt15.20, based on 11PE 20.0x, its long term average PE (FY2007-present, excluding FY2010). We re-rated our target PE to 20.0x from 25.0x as we believe sentiment in the global sugar market does not support the share price trading at a PE higher than its average. Global sugar prices have already passed their peak and are expected to drop next season as global supply is set to increase.

Year to Oct	Sales (Bt mn)	Sales growth (%)	EBITDA (Bt mn)	NP (Bt mn)	EPS (Bt)	EPS growth (%)
2008	10,768	20.8	1,843	860	0.55	2.8
2009	11,671	8.4	1,975	920	0.59	7.0
2010	12,071	3.4	1,924	159	0.10	(82.7)
2011F	15,449	28.0	2,759	1,266	0.77	652.3
2012F	15,135	(2.0)	2,515	1,146	0.67	(12.5)
Year to Oct	**GM (%)**	**EV/EBITDA (X)**	**Dividends Yield (%)**	**PBV (X)**	**PER (X)**	**ROAE (%)**
2008	24.6	14.5	1.6	2.0	24.3	8.5
2009	24.7	15.0	1.1	1.9	22.8	8.7
2010	23.9	15.6	0.7	2.3	131.9	1.5
2011F	25.9	15.7	1.7	2.1	17.5	12.1
2012F	25.2	11.1	1.5	1.9	20.0	9.9

Sector	Agriculture&Foods	52-week trading range (Bt)	10.4 - 14.5
12M target price (Bt/shr)	15.40	Mkt cap-Bt bn/US$ bn	20.9 /0.7
Upside/downside (%)	14.1	Outstanding shares (mn)	1,550.0
The percentile of excess return (%)	25.0	Free floating shares (mn)	330.9
Dividend yield-12/11F (%)	1.7	Foreign ownership (mn)	620.0
Book value/shr-12/11 (Bt)	6.5	3M avg. daily trading (mn)	2.54
P/B-12/11F (x)	2.1	Abs. performance (3,6,12M)(%)	4.7; -1.5; 20.5
Net debt/equity-12/11F (%)	84	Rel. performance (3,6,12M)(%)	3.7; 0.3; -9.5

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

Balance Sheet

Year to Oct (Bt mn)	2009	2010	2011F	2012F	2013F
Total Assets	20,418	23,153	26,252	26,015	26,439
Current Assets	3,786	3,542	6,330	6,380	7,090
Cash & ST Investments	435	211	218	821	1,121
Inventories	1,679	1,596	2,038	2,017	2,213
Accounts Receivable	600	549	952	933	1,017
Others	1,072	1,186	3,122	2,610	2,739
Non-current Assets	16,631	19,611	19,922	19,635	19,349
LT Investments	73	77	77	77	77
Net fixed Assets	15,437	18,372	18,682	18,396	18,110
Others	1,121	1,162	1,162	1,162	1,162
Total Liabilities	9,618	13,219	15,178	13,842	12,885
Current Liabilities	3,721	5,088	9,608	10,506	11,062
Accounts Payable	524	404	577	571	627
ST Borrowings	1,374	1,902	4,000	6,000	7,000
Others	1,823	2,782	5,030	3,934	3,435
Long-term Liabilities	5,897	8,131	5,570	3,336	1,822
Long-term Debts	5,882	8,118	5,555	3,321	1,807
Others	15	13	15	15	15
Shareholders' Equity	10,800	9,934	11,074	12,173	13,555
Common Stock	1,550	1,550	1,700	1,700	1,700
Capital Surplus	4,618	4,210	4,055	4,055	4,055
Retained Earnings	2,525	2,452	3,338	4,140	5,180
Preferred Stock	0	0	0	0	0

Source: Company data; KGI Securities (Thailand) estimates

Key Assumptions & Ratios

Year to Oct (Bt mn)	2009	2010	2011F	2012F	2013F
Key Drivers					
Sales Volume					
- Sugar ('000 Tons)	550.0	434.2	635.5	630.0	682.5
- Ethanol (mn Litre)	42.5	27.1	38.5	37.5	40.6
Price					
- Sugar ('000 THB / Ton)	15.5	17.7	16.6	14.3	14.1
- Ethanol (THB / Litre)	21.1	23.5	23.5	23.5	23.5
Growth (% YoY)					
Sales	8.4	3.4	28.0	(2.0)	9.0
EBIT	66.4	0.9	(8.2)	(10.7)	7.8
EBITDA	7.2	(2.6)	43.4	(8.8)	6.4
NP	7.0	(82.7)	697.8	(9.5)	29.6
EPS	7.0	(82.7)	652.3	(12.5)	29.6
Profitability (%)					
Gross Margin	24.7	23.9	25.9	25.2	24.7
Operating Margin	17.0	16.5	11.9	10.8	10.7
EBITDA Margin	16.9	15.9	17.9	16.6	16.2
Net Profit Margin	7.9	1.3	8.2	7.6	9.0
ROAA	4.9	0.7	5.1	4.4	5.7
ROAE	8.7	1.5	12.1	9.9	11.5
Stability					
Gross Debt/Equity (%)	66.3	100.9	86.3	76.6	65.0
Net Debt/Equity (%)	62.2	98.7	84.3	69.8	56.7
Interest Coverage (X)	6.4	4.5	5.2	5.1	23.9
Interest & ST Debt Coverage (X)	1.0	0.7	0.5	0.3	0.3
Cash Flow Interest Coverage (X)	7.4	1.7	2.5	4.2	19.4
Cash Flow/Interest & ST Debt (X)	1.1	0.3	0.2	0.3	0.2
Current Ratio (X)	1.0	0.7	0.7	0.6	0.6
Quick Ratio (X)	0.6	0.4	0.4	0.4	0.4
Net Debt (Bt mn)	6,721	9,808	9,337	8,501	7,686
Per Share Data (Bt)					
EPS	0.6	0.1	0.8	0.7	0.9
CFPS	0.8	0.4	1.1	1.0	1.2
BVPS	7.0	5.8	6.5	7.2	8.0
SPS	7.5	7.8	9.4	8.9	9.7
EBITDA/Share	1.2	1.2	1.1	1.6	1.5
DPS	0.2	0.1	0.2	0.2	0.3
Activity					
Asset Turnover (x)	0.6	0.6	0.6	0.6	0.6
Days Receivables	18.8	16.6	22.5	22.5	22.5
Days Inventory	52.5	48.3	48.2	48.6	48.9
Days Payable	21.8	16.0	18.4	18.4	18.4
Cash Cycle	49.5	48.8	52.2	52.7	53.0

Source: Company data; KGI Securities (Thailand) estimates

Profit & Loss

Year to Oct (Bt mn)	2009	2010	2011F	2012F	2013F
Sales	11,671	12,071	15,449	15,135	16,504
Cost of Goods Sold	8,783	9,191	11,441	11,320	12,422
Gross Profit	2,888	2,881	4,008	3,815	4,082
Operating Expenses	908	883	2,175	2,178	2,317
Operating Profit	1,979	1,997	1,833	1,637	1,765
Net Interest	(246)	(343)	(439)	(395)	(91)
Interest Income	0	0	0	0	0
Interest Expense	246	343	439	395	91
Net Investment Income/(Loss)	1	6	0	0	0
Net other Non-op. Income/(Loss)	349	309	441	378	413
Net Extraordinaries	(61)	(912)	(110)	(69)	(79)
Pretax Income	1,338	1,188	1,835	1,620	2,086
Income Taxes	357	118	459	405	522
Net Profit	920	159	1,266	1,146	1,485
EBITDA	1,975	1,924	2,759	2,515	2,677
EPS (Bt)	0.59	0.10	0.77	0.67	0.87

Source: Company data; KGI Securities (Thailand) estimates

Cash Flow

Year to Oct (Bt mn)	2009	2010	2011F	2012F	2013F
Operating Cash Flow	**1,823**	**565**	**1,078**	**1,680**	**1,760**
Net Profit	920	159	1,266	1,146	1,485
Depreciation & Amortization	391	393	485	500	500
Change in Working Capital	512	14	(673)	35	(225)
Others	0	0	0	0	0
Investment Cash Flow	**(3,584)**	**(2,959)**	**(1,900)**	**(500)**	**(500)**
Net CAPEX	(3,790)	(3,165)	(1,900)	(500)	(500)
Change in LT Investment	(68)	4	0	0	0
Change in Other Assets	274	202	0	0	0
Free Cash Flow	**(1,761)**	**(2,394)**	**(822)**	**1,180**	**1,260**
Financing Cash Flow	**2,123**	**2,859**	**1,039**	**(234)**	**(514)**
Change in Share Capital	0	0	1,500	0	0
Net Change in Debt	2,133	2,862	(463)	(234)	(514)
Change in Other LT Liab.	(10)	(2)	2	0	0
Net Cash Flow	**362**	**466**	**218**	**946**	**746**

Source: Company data; KGI Securities (Thailand) estimates

Rates of Return on Invested Capital

Year to Oct	1- COGS / Revenue	+ Depreciation / Revenue	+ Operating Exp. / Revenue	= Operating Margin
2009	75.3%	3.3%	14.2%	7.2%
2010	76.1%	3.3%	13.7%	6.9%
2011F	74.1%	3.1%	14.1%	8.7%
2012F	74.8%	3.3%	14.4%	7.5%
2013F	75.3%	3.0%	14.0%	7.7%

Year to Oct	1/ Working Capital / Revenue	+ Net PPE / Revenue	+ Other Assets / Revenue	= Capital Turnover
2009	0.0	1.3	0.5	0.6
2010	-0.1	1.5	0.4	0.6
2011F	-0.2	1.2	0.5	0.7
2012F	-0.3	1.2	0.5	0.7
2013F	-0.2	1.1	0.5	0.7

Year to Oct	Operating Margin	x Capital Turnover	x Cash Tax Rate	= After-tax Return on Inv. Capital
2009	7.2%	0.6	73.3%	3.0%
2010	6.9%	0.6	90.1%	3.5%
2011F	8.7%	0.7	75.0%	4.4%
2012F	7.5%	0.7	75.0%	3.9%
2013F	7.7%	0.7	75.0%	4.2%

Source: Company data; KGI Securities (Thailand) estimates

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