

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

Earnings continue to grow

Bt13.40
Outperform
Company update

Maintained

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- **Earnings to continue to grow next quarter**
- **Revised up FY2011 earnings to Bt1.46bn, from Bt1.27bn**
- **Expect 2011/12 world sugar surplus of 6.48mn tons, from 1.63mn tons last year**
- **Rate Outperform with new target of Bt17.20**

Earnings to continue to grow next quarter

The overall tone at yesterday's analyst meeting was positive. KSL's management guided that FY3Q11 (May - October) sugar sales volume should increase to 263K tons, up 120% QoQ. This would help the FY3Q11 bottom-line continue to grow and reach a record high. However, earnings from the company's power plant and sugar plants overseas should soften HoH in 2H11 as it is the low season. Additionally, management anticipates FY2012 cane volume to increase to 7.0mn tons, from 6.17mn tons in this fiscal year. We, therefore, revised up our net profit forecasts for FY2011 to Bt1.46bn and FY2012 to Bt1.36bn, from Bt1.27bn and Bt1.15bn, respectively. We maintain a rating of Outperform on the counter with a new target price of Bt17.20, from Bt15.40, based on 11PE of 20x, which is the historical average PE (FY2007-present, excluding FY2010).

Earnings outlook for 2H11 (May - October)

As we mentioned in our previous report, KSL's sugar sales volume shifted from FY2Q11 to FY3Q11. Based on information from management, the company's 2H11 local sugar mills should have sales volume of 388K tons, up 89.0% HoH. Given an average export price (raw sugar) of Bt18K/tons, similar to FY2Q11, we roughly estimate profit contribution from its Thai sugar business to be around Bt800-900mn, up from Bt264mn in 1H11. Nonetheless, other business units would soften HoH due to;

- i) Total sugar volume from oversea sugar mills, Laos and Cambodia, was sold in FY2Q11, while there is administration expense of around Bt50mn per quarter. Thus we anticipate loss from operation of Bt30-50mn for the full year, though there was profit of Bt71mn in 1H11.
- ii) Earnings from KSL's power plant business would drop significantly as it is the low season. We expect 2H11 earnings for the power plant to drop to around Bt75mn, from Bt226mn in 1H11.

Revised up FY2011 and FY2012 earnings

We revised up KSL's FY2011 earnings to Bt1.46bn from Bt1.27bn. Management guided that loss from the overseas mills should be around Bt50mn, which is below our previous expectation of Bt100mn. Second, we revised up our gross margin assumption to 26.4%, from 25.9% as the gross margin in 1H11 was higher than

expected. We also revised up our FY2012 net profit forecast to Bt1.36bn from Bt1.15bn. Although we expect KSL's FY2012 average export prices to be US\$0.25/lbs, down from US\$0.28/lbs in this fiscal year, KSL's FY2012 cane volume is expected to increase to 7.0mn tons, from 6.17mn tons in this fiscal year. This is due to i) expected Thai cane volume to increase 5.6% YoY (see details below), and ii) production capacity ramp up 25.0% from Bo-Ploy phase II.

Expect world sugar surplus to increase in 2011/12

The US Department of Agriculture (USDA) expects sugar output to increase 4.7% YoY in 2011/12 to 168.5mn tons, while world consumption is expected to increase only 1.7%. Thus 2011/12 surplus is expected to increase to 6.48mn tons, up from 1.63mn tons last year. Meanwhile, the Office of Agricultural Economics (OAE) expects Thai cane plantation to increase to 8.0mn rai in 2011/12, up 2.6% YoY, while cane volume should increase 5.6% YoY to 105.1mn tons. This is supported by the government from i) higher support prices starting in 2010/11, ii) government approval of an increase in sugar mills from 49 mills to 59 mills, over the next five years, and iii) subsidized government loans for grower machinery purchases.

We believe world sugar prices peaked in early 2011, but they should remain high, between US\$0.22/lbs to US\$0.28/lbs, or an average of US\$0.25/lbs, mainly due to the weak US dollar and stronger oil price outlook.

Key risks

Fluctuation in sugar price. The current surge in sugar price was mainly due to delayed shipments from Brazil. If Brazil, which is the world's largest exporter, resumes normal export, sugar prices may drop from the current level of around US\$0.27/lbs.

Thai cane volume might lower than expected in 2011/12.

Thailand's 2010/11 cane volume reached a record high of 95mn tons thanks to the La Nina event. However, the La Nina weather has passed so 2011/12 rain is likely to be lower than last fiscal year.

Valuation and Recommendation

Given the bright outlook for earnings in the near term, we maintain a rating of Outperform on the counter with a new target price of Bt17.20, from Bt15.40, based on 11PE 20.0x, its long term average PE (FY2007-present, excluding FY2010).

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	15,667	29.8	3,021	1,462	0.86	740.2
2012F	16,431	4.9	2,808	1,363	0.80	(6.8)
Year to Oct	GM (%)	EV/EBITDA (X)	Dividends Yield (%)	PBV (X)	PER (X)	ROAE (%)
2008	24.6	14.4	1.6	2.0	24.2	8.5
2009	24.7	14.9	1.1	1.9	22.6	8.7
2010	23.9	15.5	0.7	2.3	130.9	1.5
2011F	26.4	15.6	1.9	2.0	15.6	13.8
2012F	25.5	10.3	1.8	1.8	16.7	11.5
Sector	Agriculture&Foods				52-week trading range (Bt)	
12M target price (Bt/shr)	17.20				Mkt cap-Bt bn/US\$ bn	10.4 - 14.5
Upside/downside (%)	28.4				Outstanding shares (mn)	20.8/0.7
The percentile of excess return (%)	61.0				Free floating shares (mn)	1,550.0
Dividend yield-12/10F (%)	0.7				Foreign ownership (mn)	330.9
Book value/shr-12/11 (Bt)	6.6				3M avg. daily trading (mn)	620.0
P/B-12/11F (x)	2.0				Abs. performance (3,6,12M)(%)	2.93
Net debt/equity-12/11F (%)	82				Rel. performance (3,6,12M)(%)	0.8; 3.9; 8.1
						1.8; 3.6; -14.8

*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	26,422	26,497	26,903
Current Assets	3,786	3,542	6,500	6,861	7,554
Cash & ST Investments	435	211	331	913	1,380
Inventories	1,679	1,596	2,053	2,181	2,299
Accounts Receivable	600	549	966	1,013	1,058
Others	1,072	1,186	3,150	2,755	2,816
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	15,210	14,034	12,986
Current Liabilities	3,721	5,088	9,640	10,698	11,164
Accounts Payable	524	404	582	618	651
ST Borrowings	1,374	1,902	4,000	6,000	7,000
Others	1,823	2,782	5,058	4,080	3,513
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	11,211	12,463	13,917
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	3,475	4,429	5,542
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	647.9	735.0	756.0
- Ethanol (mn Litre)	42.5	27.1	38.5	43.7	45.0
Price					
- Sugar ('000 THB / Ton)	15.5	17.7	16.6	15.0	14.9
- Ethanol (THB / Litre)	21.1	23.5	23.5	23.5	23.5
Growth (% YoY)					
Sales	8.4	3.4	29.8	4.9	4.5
EBIT	66.4	0.9	4.6	(9.2)	(0.6)
EBITDA	7.2	(2.6)	57.1	(7.1)	0.3
NP	7.0	(82.7)	821.5	(6.8)	16.6
EPS	7.0	(82.7)	740.2	(6.8)	16.6
Profitability (%)					
Gross Margin	24.7	23.9	26.4	25.5	24.8
Operating Margin	17.0	16.5	13.3	11.5	11.0
EBITDA Margin	16.9	15.9	19.3	17.1	16.4
Net Profit Margin	7.9	1.3	9.3	8.3	9.3
ROAA	4.9	0.7	5.9	5.2	6.0
ROAE	8.7	1.5	13.8	11.5	12.0
Stability					
Gross Debt/Equity (%)	66.3	100.9	85.2	74.8	63.3
Net Debt/Equity (%)	62.2	98.7	82.3	67.5	53.4
Interest Coverage (X)	6.4	4.5	5.8	5.8	25.5
Interest & ST Debt Coverage (X)	1.0	0.7	0.6	0.4	0.3
Cash Flow Interest Coverage (X)	7.4	1.7	2.8	4.3	21.5
Cash Flow/Interest & ST Debt (X)	1.1	0.3	0.3	0.3	0.3
Current Ratio (X)	1.0	0.7	0.7	0.6	0.7
Quick Ratio (X)	0.6	0.4	0.5	0.4	0.5
Net Debt (Bt mn)	6,721	9,808	9,224	8,408	7,427
Per Share Data (Bt)					
EPS	0.6	0.1	0.9	0.8	0.9
CFPS	0.8	0.4	1.3	1.1	1.2
BVPS	7.0	5.8	6.6	7.3	8.2
SPS	7.5	7.8	9.2	9.7	10.1
EBITDA/Share	1.2	1.2	1.1	1.8	1.7
DPS	0.2	0.1	0.3	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	47.8	48.4	48.9
Days Payable	21.8	16.0	18.4	18.4	18.4
Cash Cycle	49.5	48.8	51.9	52.5	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	15,667	16,431	17,168
Cost of Goods Sold	8,783	9,191	11,524	12,239	12,905
Gross Profit	2,888	2,881	4,143	4,192	4,263
Operating Expenses	908	883	2,053	2,294	2,377
Operating Profit	1,979	1,997	2,090	1,897	1,886
Net Interest	(246)	(343)	(440)	(399)	(91)
Interest Income	0	0	0	0	0
Interest Expense	246	343	440	399	91
Net Investment Income/(Loss)	1	6	0	0	0
Net other Non-op. Income/(Loss)	349	309	447	411	429
Net Extraordinaries	(61)	(912)	(110)	(69)	(79)
Pretax Income	1,338	1,188	2,097	1,909	2,225
Income Taxes	357	118	524	477	556
Net Profit	920	159	1,462	1,363	1,589
EBITDA	1,975	1,924	3,021	2,808	2,815
EPS (Bt)	0.59	0.10	0.86	0.80	0.93

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	1,251	1,724	1,958
Net Profit	920	159	1,462	1,363	1,589
Depreciation & Amortization	391	393	485	500	500
Change in Working Capital	512	14	(696)	(138)	(130)
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)	(649)	1,224	1,458
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	390	990	944

Source: Company data; KGI Securities (Thailand) estimates

Rates of Return on Invested Capital

Year to Oct	1- $\frac{\text{COGS Revenue}}{\text{Revenue}}$	+ $\frac{\text{Depreciation Revenue}}{\text{Revenue}}$	+ $\frac{\text{Operating Exp. Revenue}}{\text{Revenue}}$	= Operating Margin
2009	75.3%	3.3%	14.2%	7.2%
2010	76.1%	3.3%	13.7%	6.9%
2011F	73.6%	3.1%	13.1%	10.2%
2012F	74.5%	3.0%	14.0%	8.5%
2013F	75.2%	2.9%	13.8%	8.1%
Year to Oct	1/ $\frac{\text{Working Capital Revenue}}{\text{Revenue}}$	+ $\frac{\text{Net PPE Revenue}}{\text{Revenue}}$	+ $\frac{\text{Other Assets Revenue}}{\text{Revenue}}$	= 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	-0.2	1.1	0.5	0.7
2013F	-0.2	1.1	0.5	0.7
Year to Oct	$\frac{\text{Operating Margin}}{\text{Revenue}}$	x $\frac{\text{Capital Turnover}}{\text{Revenue}}$	x $\frac{\text{Cash Tax Rate}}{\text{Revenue}}$	= 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	10.2%	0.7	75.0%	5.2%
2012F	8.5%	0.7	75.0%	4.6%
2013F	8.1%	0.7	75.0%	4.5%

Source: Company data; KGI Securities (Thailand) estimates

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