Somboon Adv Tech SAT TB

THAILAND / AUTOMOBILES & COMPONENTS

TARGET	THB17.30
PRIOR TP	THB21.00
CLOSE	THB19.30
UP/DOWNSIDE	-10.4%

REDUCE

FROM BUY

INDUSTRY OUTLOOK ↑ CHANGE IN RECOMMENDATION

Limited upside, higher risk

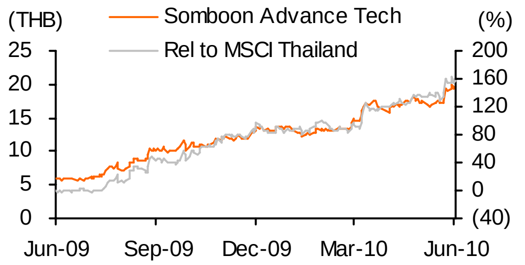
- **SAT has decided to embark on an aggressive expansion plan ...**
- **… which has forced it to rush into a more expensive capital call.**
- **We cut EPS by 13% to reflect dilution and a narrowing margin.**
- **Earnings turnaround already in price. Downgrade to REDUCE.**

HOW WE DIFFER FROM THE STREET

	BNP	Consensus	% Diff
Target Price (THB)	17.30	21.20	(18.4)
EPS 2010 (THB)	1.94	2.17	(10.6)
EPS 2011 (THB)	1.98	2.38	(16.8)
	Positive	Neutral	Negative
Market Recs.	10	4	0

KEY STOCK DATA

YE Dec (THB m)	2010E	2011E	2012E
Revenue	5,362	5,778	6,308
Rec. net profit	641	672	744
Recurring EPS (THB)	1.94	1.98	2.19
Prior rec. EPS (THB)	2.10	2.31	2.66
Chg. In EPS est. (%)	(7.8)	(14.6)	(17.6)
EPS growth (%)	101.6	2.1	10.7
Recurring P/E (x)	10.0	9.8	8.8
Dividend yield (%)	3.0	3.1	3.4
EV/EBITDA (x)	6.5	6.2	5.7
Price/book (x)	1.7	1.5	1.3
Net debt/Equity	65.0	58.1	50.1
ROE (%)	18.8	16.0	15.8



Share price performance	1 Month	3 Month	12 Month
Absolute (%)	12.0	34.3	235.0
Relative to country (%)	9.8	32.4	204.6

Next results	30-Aug-2010
Mkt cap (USD m)	202
3m avg daily turnover (USD m)	0.5
Free float (%)	49
Major shareholder	Somboon Holding Co Ltd (27%)
12m high/low (THB)	19.80/5.70
3m historic vol. (%)	34.4
ADR ticker	-
ADR closing price (USD)	-

Sources : Bloomberg consensus; Thanachart estimates

RECENT COMPANY & SECTOR RESEARCH

Getting back the glory .... 4 Jun 2010
Stepping on the gas.. 23 Mar 2010
Driving to a new dawn .... 12 Nov 2009

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Downgrade to REDUCE

Somboon Advance Technology's (SAT) share price has run up a hefty 49% YTD and now offers 10% potential downside to our new, lower THB17.30 TP, which is cut by 17.6% to reflect the dilution impact and dimmer margin outlook. We downgrade our rating for SAT to REDUCE from Buy because: 1) We aren't comfortable at all with its new expansion plan as it's quite aggressive while order backlog visibility is unclear. 2) We don't expect new capacity to generate enough income to cover rising depreciation expenses and the dilution impact. We cut our three-year EPS CAGR by 3% to 8%. 3) SAT's earnings turnaround is old news and we see no new catalysts.

A very aggressive expansion plan

SAT recently announced its aggressive new expansion plan to spend total capex of THB3.5b from 2010-12. A major part of this plan is to fork out THB1.2b on a new casting plant (ICP2) to double its casting capacity to 60,000 tonnes a year. This capex plan will force SAT to raise around THB650m in capital and take on additional loans of THB1.3b. We aren't comfortable with the plan at all as SAT has no new orders beyond those we have already factored in. Pinning its hopes on the Eco car project is too risky, in our view, as demand may not be strong enough to convince car makers to participate more into the project. At the same time, the Eco car margin is very thin at 20% less than normal. We also believe that gradual expansion, as SAT has done in the past, is cheaper and more effective at maintaining plant efficiency; hence, yielding a higher margin.

EPS cut by 13%, three-year CAGR lowered to 8%

We cut our EPS projections by 8%, 15% and 18% in 2010-12 and by 7% on average thereafter, mainly to reflect our gross margin assumptions coming down by an average of 0.5% in 2010-12 and 0.6% thereafter and SAT's rising depreciation expenses. Factoring in the 13% dilution and the THB1.2b in extra capex, our TP takes a 17.6% hit, tumbling to THB17.30.

Earnings turnaround this year is old news

We were previously bullish on SAT's prospects as it's a prime beneficiary of robust car sales while its earnings have been turning around this year. But this is no longer news to the market. While we expect SAT's earnings growth momentum to peak in 1H10, going into next year when the full impacts of the dilution and rising depreciation expenses are felt, we forecast earnings growth of just 2% versus 13% for the market.

Downgrade to REDUCE

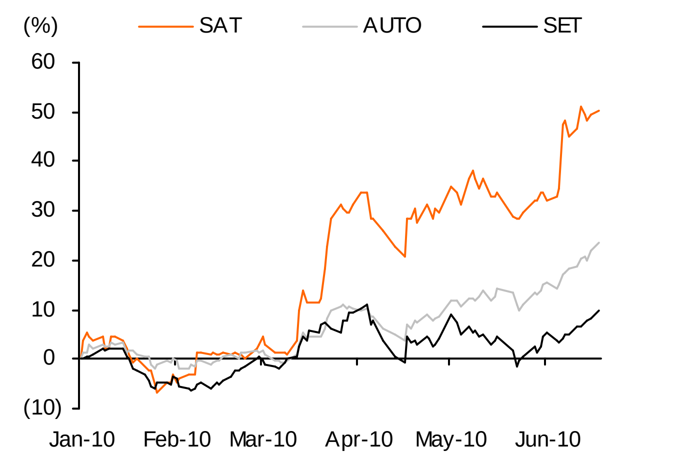
Somboon Advance Technology's (SAT) share price has run up a hefty 49% YTD and now offers 10% downside potential to our new, lower THB17.30/share TP which we've slashed by 17.6% to reflect the dilution impact and dimmer margin outlook. We downgrade our call to SELL from Buy for the following three reasons:

1 We aren't comfortable with SAT's new expansion plan as it's very aggressive while order backlog visibility isn't clear (please see the next section of this note for details).

2 We don't expect new capacity to generate enough earnings to cover its rising depreciation expenses and the share dilution impact. We cut our three-year EPS CAGR forecast by 3% to 8%.

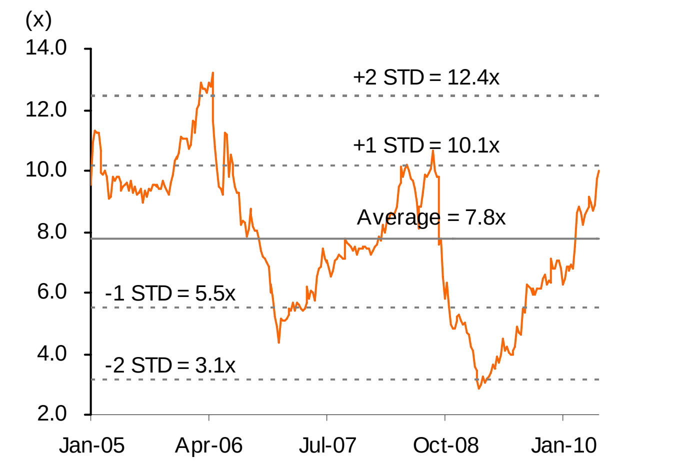
3 SAT's earnings turnaround is old news and there are no new catalysts in sight.

Exhibit 1: Significantly Outperformed Market And Peers



Source: Bloomberg

Exhibit 2: Trades At Above-Average P/E



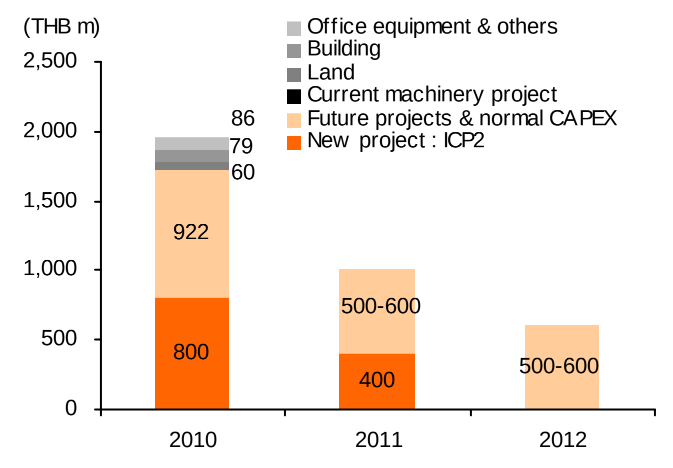
Sources: Bloomberg; Thanachart estimates

A very aggressive expansion plan

SAT recently revealed its new expansion plan to spend a total of THB3.5b in capex over the next three years. This includes investment of THB1.2b to build a new casting plant at Amata City Industrial Estate Rayong which would double its casting capacity to 60,000 tonnes a year.

This aggressive expansion will force SAT to raise capital by around THB650m and take on additional debt of THB1.3b. The fund raising is to be carried out via two means: 1) the issuance of 25m units of transferable subscription rights (TSR), SAT-T1, to existing shareholders who would then get the right to convert into SAT's new shares at THB14 per share; and 2) 15m shares in a private placement to local institutions where the offer price is subject to book building. The debt financing is to be supported by a Thai bank while there will also be a package to refinance its existing THB2b in outstanding loans from Bank of Ayudhya (BAY TB; Buy; TP: THB23) at 1% lower cost of funding. Exhibits 3-4 show SAT's new capex details and financing plan.

Exhibit 3: New Capex Details



Source: Somboon Advance Tech

Exhibit 4: Financing Plan

Uses of fund	(THB m)	Sources of fund	(THB m)
Current project in 2010	1,150	New term loans	1,300
ICP2 Project	1,200	Internal cash flow and new equity	2,200
New investment prospects	~1,150		
Approx. THB3,500m		**Approx. THB3,500m**	

Source: Somboon Advance Tech

We don't feel comfortable with the plan as there are no concrete new orders beyond those that we've already factored in. According to SAT, 70% of the new casting plant's production will be allocated mainly to Kubota orders (already in our expectation) and to partially replace current outsourcing work. The remaining 30% is to be aimed at the new Eco car project, which we aren't overly bullish about. We don't interpret the popularity of the Nissan *March* as guaranteeing the success of other Eco car projects. In our view, there is untapped demand in this segment and Nissan has simply managed to seize the first-mover advantage. As it remains uncertain whether demand will be as strong as we are seeing now, while car makers will have to commit to ramping up their production to 100,000 units within five years to be eligible for tax incentives, many car makers are showing a certain degree of reluctance to jump into the market and have been delaying their launch plans (see details in Exhibit 5). As we expect Eco car demand to only gradually kick in, this would leave SAT with excess capacity, lowering its plant efficiency and undermining its margin for the first few years.

Exhibit 5: Car Makers Have Delayed Their Eco Car Launches

Carmakers	Eco car project update
Nissan	Launching Nissan March in March 2010
Honda	Launching to be postponed from October 2010 to 3Q11
Toyota	Expected to launch probably by 2011
Mitsubishi	Launching to be postponed from 2010 to 2012
Suzuki	Launching to be postponed from 2010 to March 2012

Sources: Somboon Advance Tech; Thanachart estimates

EPS cut 13%, 3-yr EPS CAGR lowered to 8%

We cut our EPS forecasts by 8%, 15% and 18% in 2010-12 and by an average of 7% thereafter. The downward revisions are mainly to reflect a reduction in our gross margin assumptions by an average of 0.5% over 2010-12 and 0.6% thereafter along with SAT's rising depreciation expenses. Taking into account the 13% share dilution and the additional THB1.2b capex, our TP takes a big hit, tumbling by 17.6% to THB17.30/share.

Exhibit 6: Changes In Key Assumptions

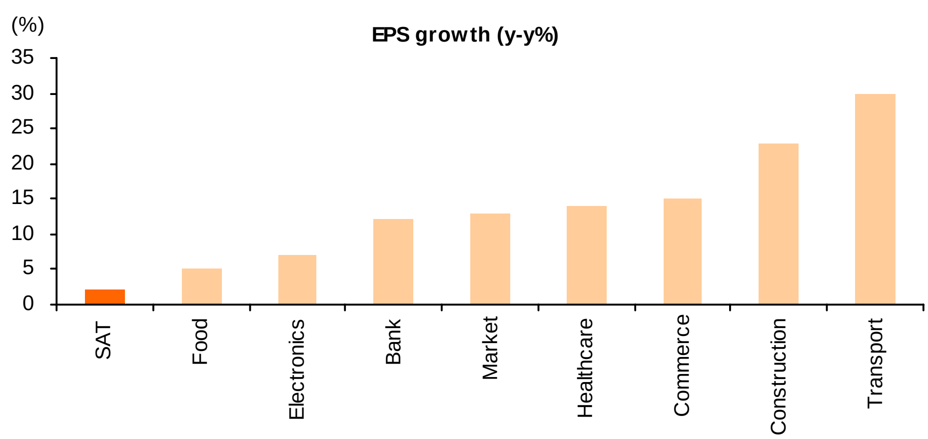
	2010E	2011E	2012E	2013-2015E	Comment
Net sales growth (%)					
New	24.83	7.75	9.18	7.36	We generously revise up sales post 2012 to reflect some eco car demand
Change	0.00	0.00	0.00	2.36	
Gross margin (%)					
New	20.84	20.28	20.13	20.23	We expect SAT's margin to be undermined by rising depreciation of new plant
Change	0.0	(0.6)	(0.8)	(0.6)	
Interest expenses (THB m)					
New	109	119	117	73	Interest saving from a refinancing plan is large enough to offset rising interest
Change (%)	(10.3)	(5.1)	11.4	34.0	burden to finance new plant during 2010E-11E
Capex (THB m)					
New	2,000	1,000	1,000	467	We revise up capex plan to be in-line with SAT's new expansion plan
Change (%)	81.8	38.9	100.0	(22.2)	

Source: Thanachart estimates

Earnings turnaround is old news

We had previously been bullish on SAT's prospects due to it being a prime beneficiary of robust car sales along with it enjoying an earnings turnaround this year. Local car sales have been very strong, surging by 53% in May and by 52% YTD, despite the political crisis reaching its peak over the period. This has been very positive for SAT and we project its sales to rebound by 25% this year from a 26% plunge in 2009 and for its earnings to more than double last year's. However, this is no longer news to the market. While we expect SAT's earnings growth momentum to peak in 1H10, going into next year when the full impacts of the share dilution and its rising depreciation expenses are felt, we forecast earnings growth of just 2% versus the market's 13%.

Exhibit 7: Growth Momentum Set To Peak In 1H10



Sources: Somboon Advance Tech; Thanachart estimates

FINANCIAL STATEMENTS

Somboon Adv Tech

Profit and Loss (THB m) Year Ending Dec	2008A	2009A	2010E	2011E	2012E
Revenue	5,814	4,295	5,362	5,778	6,308
Cost of sales ex depreciation	(4,298)	(3,095)	(3,760)	(4,031)	(4,425)
Gross profit ex depreciation	**1,517**	**1,201**	**1,602**	**1,747**	**1,883**
Other operating income	0	0	0	0	0
Operating costs	(371)	(350)	(401)	(421)	(442)
Operating EBITDA	**1,145**	**851**	**1,201**	**1,326**	**1,441**
Depreciation	(357)	(434)	(485)	(575)	(614)
Goodwill amortisation	0	0	0	0	0
Operating EBIT	**788**	**417**	**717**	**751**	**828**
Net financing costs	(129)	(113)	(106)	(115)	(115)
Associates	23	10	60	65	70
Recurring non operating income	88	45	80	87	95
Non recurring items	3	6	10	0	0
Profit before tax	**772**	**365**	**761**	**788**	**877**
Tax	(138)	(50)	(111)	(116)	(133)
Profit after tax	**635**	**314**	**651**	**672**	**744**
Minority interests	0	0	0	0	0
Preferred dividends	0	0	0	0	0
Other items	0	0	0	0	0
Reported net profit	**635**	**314**	**651**	**672**	**744**
Non recurring items & goodwill (net)	(3)	(6)	(10)	0	0
Recurring net profit	**631**	**308**	**641**	**672**	**744**
Per share (THB)					
Recurring EPS *	1.97	0.96	1.94	1.98	2.19
Reported EPS	1.98	0.98	1.97	1.98	2.19
DPS	0.30	0.00	0.57	0.59	0.66
Growth					
Revenue (%)	16.8	(26.1)	24.8	7.8	9.2
Operating EBITDA (%)	9.7	(25.7)	41.2	10.4	8.7
Operating EBIT (%)	6.8	(47.1)	71.9	4.8	10.2
Recurring EPS (%)	8.0	(51.2)	101.6	2.1	10.7
Reported EPS (%)	7.4	(50.5)	100.7	0.5	10.7
Operating performance					
Gross margin inc depreciation (%)	19.9	17.9	20.8	20.3	20.1
Operating EBITDA margin (%)	19.7	19.8	22.4	22.9	22.8
Operating EBIT margin (%)	13.6	9.7	13.4	13.0	13.1
Net margin (%)	10.9	7.2	12.0	11.6	11.8
Effective tax rate (%)	17.8	13.8	14.5	14.7	15.2
Dividend payout on recurring profit (%)	15.2	0.0	29.7	30.0	30.0
Interest cover (x)	6.9	4.2	8.1	7.8	8.6
Inventory days	44.1	56.4	35.7	35.1	34.9
Debtor days	59.1	83.3	70.6	72.3	71.8
Creditor days	67.9	92.8	74.9	79.0	78.5
Operating ROIC (%)	14.8	7.6	11.1	9.8	10.1
Operating ROIC – WACC (%)	4.1	(3.2)	0.2	(1.0)	(0.7)
ROIC (%)	15.7	8.0	12.4	11.1	11.4
ROIC – WACC (%)	5.0	(2.8)	1.6	0.3	0.6
ROE (%)	26.2	11.4	18.8	16.0	15.8
ROA (%)	12.5	6.5	10.3	9.3	9.5

** Pre exceptional, pre-goodwill and fully diluted*

Revenue growth resumes due to the better top-down outlook and new customer Kubota

We expect margin to be undermined via rising depreciation from its new plant and higher interest burden

Revenue By Division (THB m)	2008A	2009A	2010E	2011E	2012E
Sales	5,814	4,295	5,362	5,778	6,308

Sources: Somboon AdvTech; Thanachart estimates

Somboon Adv Tech

Cash Flow (THB m) Year Ending Dec	2008A	2009A	2010E	2011E	2012E
Recurring net profit	631	308	641	672	744
Depreciation	357	434	485	575	614
Associates & minorities	(23)	(10)	(60)	(65)	(70)
Other non-cash items	0	0	0	0	0
Recurring cash flow	**966**	**732**	**1,065**	**1,182**	**1,288**
Change in working capital	(96)	77	(4)	(46)	(62)
Capex - maintenance	(1,048)	(511)	(2,000)	(1,000)	(1,000)
Capex – new investment	0	0	0	0	0
Free cash flow to equity	**(178)**	**298**	**(939)**	**136**	**226**
Net acquisitions & disposals	4	6	60	65	70
Dividends paid	(210)	0	(195)	(198)	(212)
Non recurring cash flows	(48)	9	7	(2)	3
Net cash flow	**(432)**	**313**	**(1,067)**	**1**	**86**
Equity finance	0	0	635	0	0
Debt finance	352	(250)	477	(1)	(36)
Movement in cash	**(80)**	**63**	**45**	**0**	**50**
Per share (THB)					
Recurring cash flow per share	3.01	2.28	3.22	3.48	3.79
FCF to equity per share	(0.56)	0.93	(2.84)	0.40	0.66

Aggressive capex plan

Balance Sheet (THB m) Year Ending Dec	2008A	2009A	2010E	2011E	2012E
Working capital assets	1,705	1,400	1,551	1,674	1,829
Working capital liabilities	(1,203)	(944)	(1,140)	(1,232)	(1,348)
Net working capital	**502**	**456**	**411**	**443**	**481**
Tangible fixed assets	4,177	4,254	5,770	6,195	6,581
Operating invested capital	**4,679**	**4,711**	**6,181**	**6,638**	**7,062**
Goodwill	0	0	0	0	0
Other intangible assets	0	0	0	0	0
Investments	138	141	141	141	141
Other assets	216	202	252	271	296
Invested capital	**5,033**	**5,054**	**6,574**	**7,050**	**7,500**
Cash & equivalents	(125)	(195)	(250)	(250)	(300)
Short term debt	899	658	367	367	362
Long term debt *	1,698	1,690	2,457	2,457	2,425
Net debt	**2,472**	**2,153**	**2,574**	**2,574**	**2,487**
Deferred tax	0	0	0	0	0
Other liabilities	0	33	41	44	48
Total equity	2,561	2,868	3,959	4,432	4,964
Minority interests	0	0	0	0	0
Invested capital	**5,033**	**5,054**	**6,574**	**7,050**	**7,500**

** includes convertibles and preferred stock which is being treated as debt*

	2008A	2009A	2010E	2011E	2012E
Per share (THB)					
Book value per share	7.98	8.94	11.64	13.04	14.60
Tangible book value per share	7.98	8.94	11.64	13.04	14.60
Financial strength					
Net debt/equity (%)	96.5	75.1	65.0	58.1	50.1
Net debt/total assets (%)	38.9	34.8	32.3	30.2	27.2
Current ratio (x)	0.9	1.0	1.2	1.2	1.2
CF interest cover (x)	(0.4)	3.6	(7.9)	2.2	3.0

Valuation	2008A	2009A	2010E	2011E	2012E
Recurring P/E (x) *	9.8	20.1	10.0	9.8	8.8
Recurring P/E @ target price (x) *	8.8	18.0	8.9	8.8	7.9
Reported P/E (x)	9.8	19.7	9.8	9.8	8.8
Dividend yield (%)	1.6	0.0	3.0	3.1	3.4
P/CF (x)	6.4	8.5	6.0	5.6	5.1
P/FCF (x)	(34.8)	20.8	(6.8)	48.3	29.0
Price/book (x)	2.4	2.2	1.7	1.5	1.3
Price/tangible book (x)	2.4	2.2	1.7	1.5	1.3
EV/EBITDA (x) **	6.7	9.4	6.5	6.2	5.7
EV/EBITDA @ target price (x) **	6.2	8.7	6.0	5.7	5.2
EV/invested capital (x)	1.7	1.7	1.4	1.3	1.2

** Pre exceptional, pre-goodwill and fully diluted*
*** EBITDA includes associate income and recurring non-operating income*

The counter is no longer dirt cheap while the risks also look higher

Sources: Somboon AdvTech; Thanachart estimates

DISCLAIMERS & DISCLOSURES

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Unless otherwise specified, these recommendations are set with a 12-month horizon. Thus, it is possible that future price volatility may cause a temporary mismatch between upside/downside for a stock based on market price and the formal recommendation.

*In most cases, the target price will equal the analyst's assessment of the current fair value of the stock. However, if the analyst doesn't think the market will reassess the stock over the specified time horizon due to a lack of events or catalysts, then the target price may differ from fair value. In most cases, therefore, our recommendation is an assessment of the mismatch between current market price and our assessment of current fair value.

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