BUY (Unchanged)

Change in Numbers

TP: Bt 23.50 (From: Bt 26.00)

Upside : 18.7%

31 AUGUST 2021

Small Cap Research

Ch. Karnchang Pcl (CK TB)

New backlog cycle

CK is our top sector pick. The company is seeing a major turnaround of its backlog cycle from a low of Bt29bn in 2020 to a Bt231bn peak in 2023F. Associates' earnings contributions have also started to turn around this year. At a 48% discount to its SOTP value vs. its 35% pre-COVID average, CK looks inexpensive to us. Reaffirm BUY.

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Thanachart Securities

Major backlog turnaround story

This is a part of the Construction Sector report, *Not all is lost,* dated 31 August 2021. CK is seeing a major backlog turnaround cycle. Its backlog bottomed at Bt29bn in 2020 and we project a peak of Bt231bn in 2023F. Key projects are 1) Bt23bn of work from the double-track railways; 2) the Bt81bn Luang Prabang hydropower plant; 3) Bt20bn of work from the Bt79bn South Purple Line; 4) the Bt96bn West Orange Line; and 5) Bt17bn of work from the Bt67bn Red Line extensions. Note that CK, under CK-STEC JV, is already the lowest bidder for #1 and a bid isn't required for #2, which is owned by its associate, CK Power (CKP TB, Bt5.55, BUY). We expect CKP to get a PPA for #2 in 1H22F. CK is also a potential winner for a part of the South Purple Line which has six separate contracts and the West Orange Line given its lengthy experience in building subway projects. We conservatively assume both lines to open for bidding in 2H22F.

Strongest earnings growth in the sector

We estimate CK's earnings CAGR at 56% in 2022-25F, driven not only by its construction business's earnings turnaround but also higher equity income from its associates' earnings recovery. Despite weak earnings from its 31%-owned Bangkok Expressway & Metro's (BEM TB, Bt8.55, BUY), we forecast CK's equity income to rise 2% this year driven by its 31%-owned CKP's earnings growth and to grow further by 54% in 2022F and 24% in 2023F driven by BEM's earnings rebound.

Too steep a discount, in our view

CK's share price has been trading at a discount to its associates' market value since 2017 when its construction business was weak and made losses due to a lower backlog value. The discount widened from 10-26% in 2017-18 to 54% in 2020. At a 48% discount now with the prospect of lower losses from the construction business due to the new backlog cycle and associates' earnings turnaround, CK looks inexpensive to us and we expect its discount to narrow down. Our DCF-derived SOTP-based 12-month TP is trimmed to Bt23.5 (from Bt26).

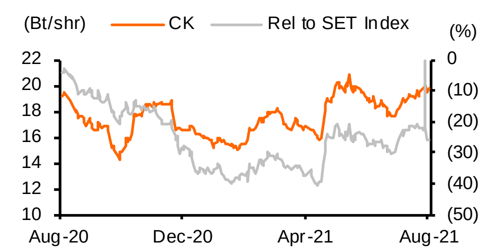
COVID impact no longer news

We cut our earnings for CK to a Bt335m loss (from a Bt518m profit) in 2021F, by 48% in 2022F and 25% in 2023F to reflect the COVID-19 impact as explained in our sector report. However, we reaffirm our BUY call on CK as our sector top pick. ***First,*** its earnings hiccup this year is not new news and 4Q21F earnings look to have bottomed out. ***Second,*** we expect CK to win the highest new work value in the sector over the next two years. ***Lastly,*** with its associates' earnings turnaround, we forecast CK to offer the strongest earnings growth over the next four years.

COMPANY VALUATION

Y/E Dec (Bt m)	2020A	2021F	2022F	2023F
Sales	16,941	11,932	16,831	21,927
Net profit	612	191	564	1,054
Consensus NP	—	610	1,424	1,946
Diff frm cons (%)	—	*(68.7)*	*(60.4)*	*(45.9)*
Norm profit	337	(335)	564	1,054
Prev. Norm profit	—	518	1,088	1,408
Chg frm prev (%)	—	*na*	*(48.2)*	*(25.2)*
Norm EPS (Bt)	0.20	(0.20)	0.33	0.62
Norm EPS grw (%)	(65.0)	na	na	87.0
Norm PE (x)	99.5	na	59.5	31.8
EV/EBITDA (x)	227.7	na	315.3	121.3
P/BV (x)	1.3	1.3	1.3	1.2
Div yield (%)	1.0	0.2	0.7	1.3
ROE (%)	1.3	na	2.2	4.0
Net D/E (%)	131.8	117.7	112.3	104.4

PRICE PERFORMANCE



COMPANY INFORMATION

Price *as of* 30-Aug-21 (Bt)	19.80
Market Cap (US$ m)	1,033.3
Listed Shares (m shares)	1,693.9
Free Float (%)	65.1
Avg Daily Turnover (US$ m)	7.2
12M Price H/L (Bt)	20.90/14.30
Sector	Construction
Major Shareholder	Trivisvavet group 38.5%

Sources: Bloomberg, Company data, Thanachart estimates

Ex 1: Key Assumption Changes

	2019	2020	2021F	2022F	2023F
New work value (Bt bn)					
New	11.8	7.3	28.0	197.0	30.0
Old			29.0	200.0	10.0
Change (%)			*(3.4)*	*(1.5)*	*(200.0)*
Normalized profit (Bt m)					
New	963	337	(335)	564	1,054
Old			518	1,088	1,408
Change (%)			*na*	*(48.2)*	*(25.2)*
Gross margin (%)					
New	9.3	9.4	8.2	8.9	8.9
Old			7.7	8.5	8.5
Change (pp)			*0.5*	*0.4*	*0.4*

Source: Thanachart estimates

Ex 2: CK's Potential New Work Value

Project	Project Value (Bn)	Construction Value (Bn)	Chance (%)	New work in 2021F (Bn)	New work in 2022F (Bn)	New work in 2023F (Bn)
Backlog value as of end 2020				**26**		
Newly signed contracts						
Water Transmission Tunnel				5		
Others				1		
To be signed contracts						
Double-track Denchai - Chiang Khong's Contract 2,3	46	46	50	23	-	-
Luang Prabang Hydropower Plant	150	81	100	-	81	-
Potential projects						
South Purple Line	125	79	25	-	20	-
West Orange Line	129	96	100	-	96	-
Red Line Extension	103	67	25	-	-	17
Double-track Chira – Ubon	36	36	5	-	-	2
Double-track Khon Kaen - Nong Khai	25	25	5	-	-	1
Others	-	-	-	-	-	10
Total new work value		**430**		**28**	**197**	**30**
Backlog at year end				**45**	**226**	**231**

Sources: Company data, Thanachart estimates

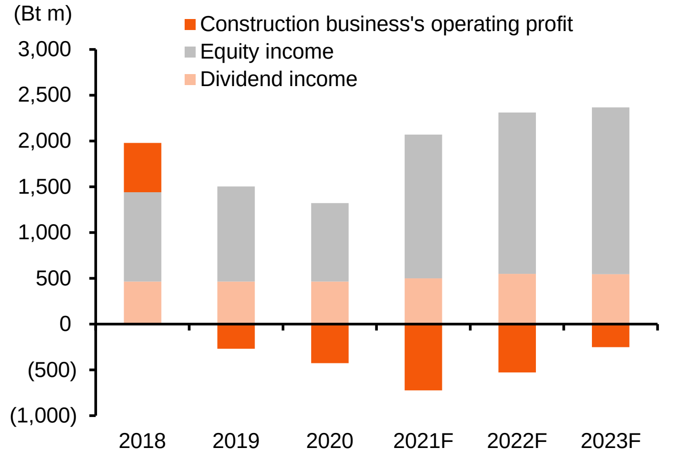
Ex 3: Our SOTP-Based Investment Equity Valuation Of CK

	% holding	Our TP	Fair value (Bt m)	30% discount* (Bt m)	Share price (Bt/share)	Market value (Bt m)
TTW	19.4%	14.00	10,837	7,586	12.00	9,289
BEM	31.3%	10.00	47,873	33,511	8.65	41,410
CKP	30.0%	7.50	18,291	12,804	5.65	13,779
Total			**77,001**	**53,900**		**64,478**
Per CK share (Bt)			**45.5**	**31.8**		**38.1**
Construction business's value (Bt)				**(8.3)**		
Our TP (Bt)				**23.5**		

Sources: Company data, Thanachart estimates

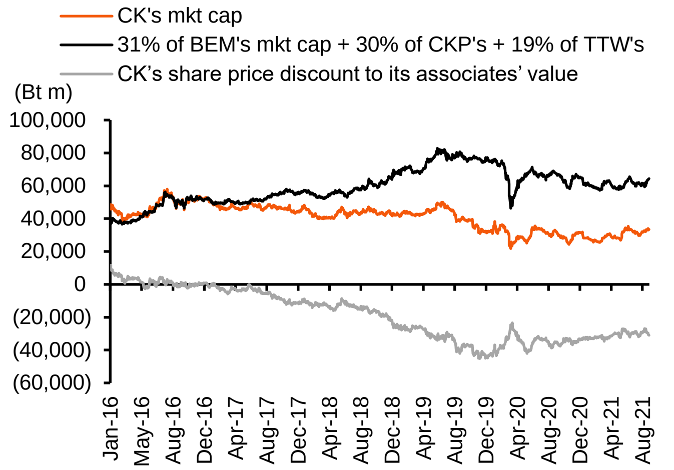
Note: *We assume a holding company discount of 30% to our fair value of CK's associates.

Ex 4: CK's Earnings Breakdown



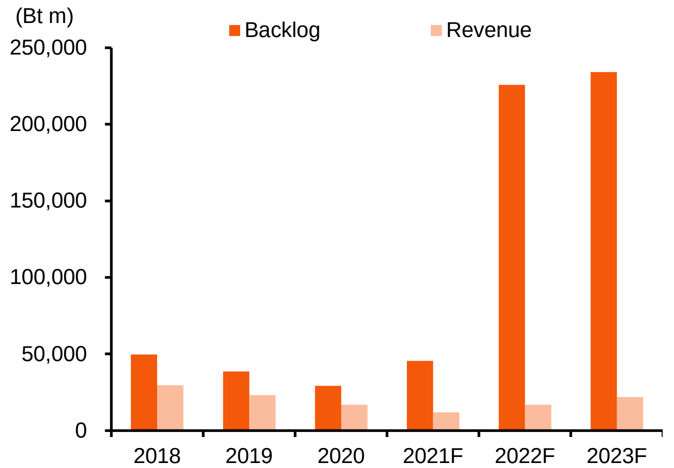
Sources: Company data, Thanachart estimates

Ex 5: CK's Market Cap Vs. Its Associates' Market Cap



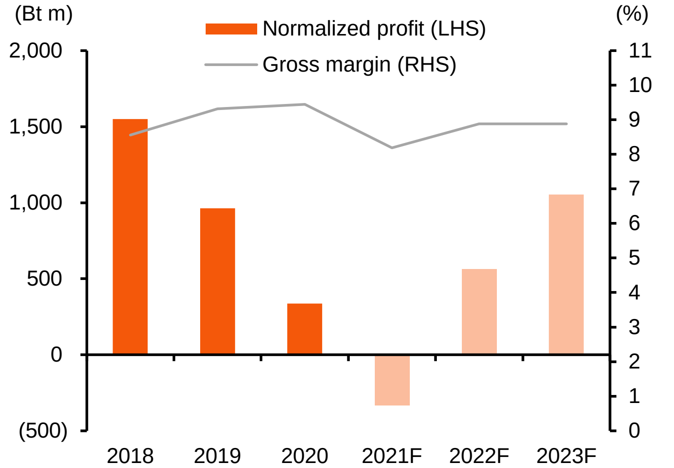
Source: Bloomberg

Ex 6: CK's Backlog Value Vs. Revenue



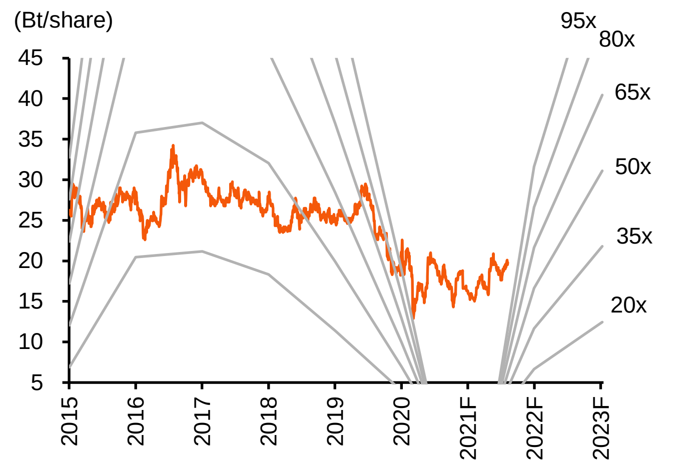
Sources: Company data, Thanachart estimates

Ex 7: CK's Gross Margin Vs. Earnings



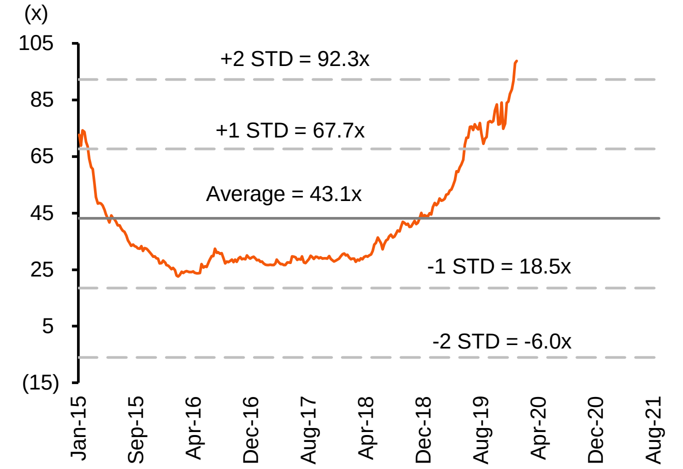
Sources: Company data, Thanachart estimates

Ex 8: CK's PE Band



Sources: Bloomberg, Thanachart estimates

Ex 9: CK's PE Standard Deviation



Sources: Bloomberg, Thanachart estimates

Ex 10: EV Of Construction Business

(Bt m)		2022F	2023F	2024F	2025F	2026F	2027F	2028F	2029F	2030F	2031F	2032F	Terminal Value
EBITDA		201	513	1,056	1,586	2,411	2,759	2,554	1,907	1,603	1,324	883	—
Free cash flow		84	285	724	993	1,532	2,160	2,715	2,528	1,996	1,855	1,118	18,458
PV of free cash flow		84	248	587	737	1,057	1,382	1,613	1,394	1,022	845	471	7,769
Risk-free rate (%)	2.5												
Market risk premium (%)	8.0												
Beta	1.0												
WACC (%)	7.3												
Terminal growth (%)	2.0												
Enterprise value - add investments	17,208												
Net debt (2021F)	30,765												
Minority interest	434												
Equity value	(13,992)												
# of shares (m)	1,694												
Equity value/share (Bt)	**(8.3)**												

Sum of the parts	% holding	(Bt m)
Enterprise value from construction business		**17,208**
Investment equity value		**53,900**
TTW	19.4%	7,586
BEM	31.3%	33,511
CKP	30.0%	12,804
Total enterprise value		**71,108**
(Less) Net debt		(30,765)
(Less) Minority interest		(434)
Total enterprise value		**39,909**
# of shares (fully diluted) (m shares)		1,694
Sum of the parts (Bt/share)		**23.6**

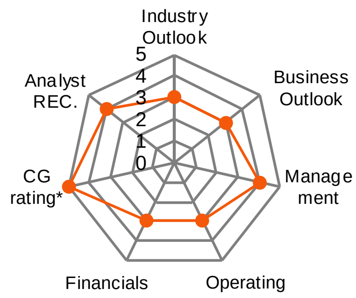
Sources: Company data, Thanachart estimates

COMPANY DESCRIPTION

Ch. Karnchang Pcl (CK) is one of Thailand's leading contractors and basic infrastructure developers. It has more than 30 years of experience in constructing large-scale infrastructure, building complexes and general civil work. The company has also been investing in the government's concession projects in order to expand its operations and generate steady long-term income.

Source: Thanachart

COMPANY RATING



Rating Scale	
Excellent	**5**
Good	**4**
Fair	**3**
Weak	**2**
Very Weak	**1**
None	**0**

Source: Thanachart; * CG Rating

THANACHART'S SWOT ANALYSIS

S — Strength

- One of the Big Four contractors in Thailand and categorized as class-A in terms of being qualified to bid for most large-scale investments.
- Business diversification into infrastructure investments to stabilize its long-term earnings.

W — Weakness

- Most of CK's revenues come from projects it has to bid for, and there are no guarantees it will win these bids.
- CK's interest expenses are high, leading to a significant risk of earnings losses if revenues fall.
- The construction business is labour-intensive, so there are risks of higher labor costs and labor shortages.

O — Opportunity

- Thailand is in the infrastructure investment cycle.
- Its exposure to high-potential projects abroad, especially hydroelectric work in Laos.

T — Threat

- The Covid-19 impacts and the government's time-consuming implementation processes could cause delays to Thailand's infrastructure investment.
- Volatility in building material prices is another risk.

CONSENSUS COMPARISON

	Consensus	Thanachart	Diff
Target price (Bt)	23.56	23.50	0%
Net profit 21F (Bt m)	610	191	-69%
Net profit 22F (Bt m)	1,424	564	-60%
Consensus REC	**BUY: 16**	**HOLD: 0**	**SELL: 0**

HOW ARE WE DIFFERENT FROM THE STREET?

- Our 2022F earnings are 60% lower than the Bloomberg consensus estimates, which we believe is due to us having a more conservative view on revenue and gross margins due to delays in mega project bids and the labour shortage.
- However, our SOTP-based TP is in line with other brokers', which we attribute to us having a more bullish view on its associates' business prospects.

Sources: Bloomberg consensus, Thanachart estimates

RISKS TO OUR INVESTMENT CASE

- The key downside risk to our call would be if the government's infrastructure investment projects cannot be implemented, as this would likely prompt us to adjust down our new work value assumptions.
- Building material expenses account for 50-60% of CK's total costs. Therefore, adverse fluctuations in prices present a secondary downside risk to our earnings forecasts.
- The weak economy could have a significant negative impact upon people's confidence and new investments.

Source: Thanachart

We forecast CK's earnings to turn around next year…

…driven by higher earnings contributions from its associates

We also expect a recovery in CK's construction business…

…driven by higher backlog value from mega-project bids in 2021-23F

INCOME STATEMENT

FY ending Dec (Bt m)	2019A	2020A	2021F	2022F	2023F
Sales	23,189	16,941	11,932	16,831	21,927
Cost of sales	21,028	15,341	10,955	15,336	19,979
Gross profit	**2,161**	**1,601**	**977**	**1,495**	**1,948**
% gross margin	9.3%	9.4%	8.2%	8.9%	8.9%
Selling & administration expenses	2,430	2,027	2,028	2,020	2,193
Operating profit	**(268)**	**(427)**	**(1,052)**	**(524)**	**(244)**
% operating margin	-1.2%	-2.5%	-8.8%	-3.1%	-1.1%
Depreciation & amortization	526	726	694	726	758
EBITDA	**258**	**299**	**(358)**	**201**	**513**
% EBITDA margin	1.1%	1.8%	-3.0%	1.2%	2.3%
Non-operating income	1,560	1,226	1,190	1,113	1,010
Non-operating expenses	0	0	0	0	0
Interest expense	(1,226)	(1,276)	(1,338)	(1,356)	(1,362)
Pre-tax profit	**65**	**(477)**	**(1,200)**	**(768)**	**(596)**
Income tax	126	28	0	0	0
After-tax profit	**(61)**	**(505)**	**(1,200)**	**(768)**	**(596)**
% net margin	-0.3%	-3.0%	-10.1%	-4.6%	-2.7%
Shares in affiliates' Earnings	1,039	857	875	1,346	1,669
Minority interests	(15)	(15)	(10)	(15)	(19)
Extraordinary items	815	275	526	0	0
NET PROFIT	**1,778**	**612**	**191**	**564**	**1,054**
Normalized profit	**963**	**337**	**(335)**	**564**	**1,054**
EPS (Bt)	1.0	0.4	0.1	0.3	0.6
Normalized EPS (Bt)	0.6	0.2	(0.2)	0.3	0.6

BALANCE SHEET

FY ending Dec (Bt m)	2019A	2020A	2021F	2022F	2023F
ASSETS:					
Current assets:	18,953	19,834	18,866	22,435	25,908
Cash & cash equivalent	9,160	7,767	10,000	10,000	10,000
Account receivables	3,643	3,659	2,779	3,920	5,106
Inventories	3,751	5,757	4,202	5,882	7,389
Others	2,400	2,650	1,885	2,633	3,412
Investments & loans	51,255	50,366	47,866	45,366	42,866
Net fixed assets	11,164	11,194	11,300	11,375	11,417
Other assets	1,213	1,381	1,013	1,382	1,766
Total assets	**82,586**	**82,774**	**79,045**	**80,559**	**81,957**
LIABILITIES:					
Current liabilities:	17,909	14,758	13,577	14,454	15,176
Account payables	13,950	10,631	9,605	10,504	11,221
Bank overdraft & ST loans	1,874	147	0	0	0
Current LT debt	1,525	3,670	3,669	3,593	3,483
Others current liabilities	559	309	303	356	471
Total LT debt	**33,605**	**38,586**	**37,096**	**36,330**	**35,222**
Others LT liabilities	3,259	3,160	2,239	3,140	4,077
Total liabilities	**54,773**	**56,503**	**52,912**	**53,924**	**54,475**
Minority interest	420	424	434	449	468
Preferreds shares	0	0	0	0	0
Paid-up capital	1,694	1,694	1,694	1,694	1,694
Share premium	4,869	4,869	4,869	4,869	4,869
Warrants	0	0	0	0	0
Surplus	6,341	4,572	4,572	4,572	4,572
Retained earnings	**14,488**	**14,711**	**14,563**	**15,050**	**15,879**
Shareholders' equity	27,393	25,847	25,699	26,186	27,014
Liabilities & equity	**82,586**	**82,774**	**79,045**	**80,559**	**81,957**

Sources: Company data, Thanachart estimates

CK now trades 48% below its associates' market value…

…which we believe is unjustified

CASH FLOW STATEMENT

FY ending Dec (Bt m)	2019A	2020A	2021F	2022F	2023F
Earnings before tax	65	(477)	(1,200)	(768)	(596)
Tax paid	(121)	(51)	3	0	5
Depreciation & amortization	526	726	694	726	758
Chg In w orking capital	2,165	(5,342)	1,409	(1,922)	(1,977)
Chg In other CA & CL / minorities	3,212	461	1,630	651	1,000
Cash flow from operations	**5,847**	**(4,683)**	**2,537**	**(1,313)**	**(810)**
Capex	(1,902)	(756)	(800)	(800)	(800)
Right of use	0	(121)	(5)	(5)	(5)
ST loans & investments	214	(8)	0	0	0
LT loans & investments	(5,165)	889	2,500	2,500	2,500
Adj for asset revaluation	0	0	0	0	0
Chg In other assets & liabilities	730	45	(22)	537	558
Cash flow from investments	**(6,124)**	**49**	**1,673**	**2,232**	**2,253**
Debt financing	308	5,399	(1,638)	(842)	(1,218)
Capital increase	0	0	0	0	0
Dividends paid	(847)	(339)	(339)	(76)	(225)
Warrants & other surplus	1,041	(1,819)	0	0	0
Cash flow from financing	**502**	**3,241**	**(1,977)**	**(919)**	**(1,443)**
Free cash flow	**3,945**	**(5,439)**	**1,737**	**(2,113)**	**(1,610)**

VALUATION

FY ending Dec	2019A	2020A	2021F	2022F	2023F
Normalized PE (x)	34.8	99.5	na	59.5	31.8
Normalized PE - at target price (x)	41.3	118.1	na	70.6	37.8
PE (x)	18.9	54.8	175.8	59.5	31.8
PE - at target price (x)	22.4	65.0	208.7	70.6	37.8
EV/EBITDA (x)	238.1	227.7	na	315.3	121.3
EV/EBITDA - at target price (x)	262.4	248.6	na	346.5	133.5
P/BV (x)	1.2	1.3	1.3	1.3	1.2
P/BV - at target price (x)	1.5	1.5	1.5	1.5	1.5
P/CFO (x)	5.7	(7.2)	13.2	(25.5)	(41.4)
Price/sales (x)	1.4	2.0	2.8	2.0	1.5
Dividend yield (%)	2.0	1.0	0.2	0.7	1.3
FCF Yield (%)	11.8	(16.2)	5.2	(6.3)	(4.8)
(Bt)					
Normalized EPS	0.6	0.2	(0.2)	0.3	0.6
EPS	1.0	0.4	0.1	0.3	0.6
DPS	0.4	0.2	0.0	0.1	0.2
BV/share	16.2	15.3	15.2	15.5	15.9
CFO/share	3.5	(2.8)	1.5	(0.8)	(0.5)
FCF/share	2.3	(3.2)	1.0	(1.2)	(1.0)

Sources: Company data, Thanachart estimates

We expect net D/E ratio to fall further to 1.1x in 2022F and 1x in 2023F from 2.7x in 2011

FINANCIAL RATIOS

FY ending Dec	2019A	2020A	2021F	2022F	2023F
Growth Rate					
Sales (%)	(21.4)	(26.9)	(29.6)	41.1	30.3
Net profit (%)	(28.7)	(65.6)	(68.8)	195.5	87.0
EPS (%)	(28.7)	(65.6)	(68.8)	195.5	87.0
Normalized profit (%)	(37.9)	(65.0)	na	na	87.0
Normalized EPS (%)	(37.9)	(65.0)	na	na	87.0
Dividend payout ratio (%)	38.1	55.3	40.0	40.0	40.0
Operating performance					
Gross margin (%)	9.3	9.4	8.2	8.9	8.9
Operating margin (%)	(1.2)	(2.5)	(8.8)	(3.1)	(1.1)
EBITDA margin (%)	1.1	1.8	(3.0)	1.2	2.3
Net margin (%)	(0.3)	(3.0)	(10.1)	(4.6)	(2.7)
D/E (incl. minor) (x)	1.3	1.6	1.6	1.5	1.4
Net D/E (incl. minor) (x)	1.0	1.3	1.2	1.1	1.0
Interest coverage - EBIT (x)	na	na	na	na	na
Interest coverage - EBITDA (x)	0.2	0.2	na	0.1	0.4
ROA - using norm profit (%)	1.2	0.4	na	0.7	1.3
ROE - using norm profit (%)	3.6	1.3	na	2.2	4.0
DuPont					
ROE - using after tax profit (%)	na	na	na	na	na
- asset turnover (x)	0.3	0.2	0.1	0.2	0.3
- operating margin (%)	5.6	na	na	na	na
- leverage (x)	3.1	3.1	3.1	3.1	3.1
- interest burden (%)	5.1	(59.6)	(866.8)	(130.5)	(77.9)
- tax burden (%)	na	na	na	na	na
WACC (%)	7.3	7.3	7.3	7.3	7.3
ROIC (%)	0.5	(0.8)	(1.4)	(0.7)	(0.3)
NOPAT (Bt m)	250	(427)	(841)	(419)	(196)
invested capital (Bt m)	55,237	60,483	56,464	56,109	55,719

Sources: Company data, Thanachart estimates

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For sectors, an “Overweight” sector weighting is used when we have BUYs on majority of the stocks under our coverage by market cap. “Underweight” is used when we have SELLs on majority of the stocks we cover by market cap. “Neutral” is used when there are relatively equal weightings of BUYs and SELLs.

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