HOLD (From: BUY)

Change in Recommendation

TP: Bt 89.00 (From: Bt 95.00)

Upside : 8.5%

17 JANUARY 2022

Small Cap Research

KCE Electronics Pcl (KCE TB)

Peaked expectations

Expectation for KCE's performance had been high on the delivery of new capacity to cater to overwhelming demand. But now, with the possible delay of its new plant and Omicron putting global auto demand at risk, we downgrade KCE to HOLD.

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Thanachart Securities

Downgrading to HOLD

KCE's share price is up by 583% from its 2020 low on the back of its strong earnings turnaround in 2020-21, the weakening baht and high expectations for growth in new capacity to cater to overwhelming demand. But we downgrade our rating on KCE to HOLD (from Buy) as we believe market expectations have peaked. ***First***, we cut our earnings by 6/7% in 2022-23F to reflect a delay in the opening of its new plant from 4Q22 to 1Q23 and higher industry capacity. ***Second***, we see a higher risk of a global economic slowdown, especially in developed markets and China, because of rising inflation and potentially rapid interest rate hikes cooling auto demand. ***Third***, KCE is trading in our view at the height of expectations at 27x PE vs. its 22x historical average since 2014 while our new DCF-based 12-month TP (2022F base year) of Bt89.0 (from Bt95.0) implies limited potential upside.

Maxed-out capacity this year

We recap on KCE's capacity expansions in Exhibit 1. One adjustment is a slight delay to its new factory's phase 1 capacity from 4Q22 to 1Q23. This means KCE will be running on its maxed-out capacity this year before new capacity is unlocked next year. This is actually not a serious negative factor in our view as KCE this year still has growth-driving factors of the full-year effect of its capacity hike in 2H21 and weak baht. It is more about market expectations that have already been running high. After our earnings cuts, we still project strong earnings growth of 58/53% in 2022-23F. Note that we also adjust down our 2021F number by 5% to reflect the risk from the new Omicron wave.

Strong industry with increasing risk factors

Overall strong industry demand and tight supply remain positive for KCE, which has orders fully booked into mid-2022. However, we see two emerging risk factors for the sector. On the demand side, the Omicron wave and potentially rapid increases in interest rates could slow down global auto demand this year. Exhibit 9 shows monthly global auto demand momentum and this has yet to reflect expected interest rate hikes in the US from March 2022F. On the supply side, new chip and PCB capacities will likely materialize in a big way from late 2022F onward.

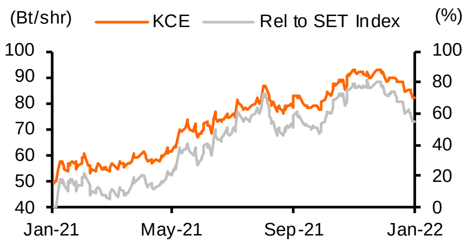
Valuation already re-rated

We still see KCE as a company with very strong fundamentals and a decent earnings growth outlook. However, we see its valuation (27x PE vs. historical average of 22x) as already having been re-rated to reflect these growth prospects. The stock is also trading near our TP of Bt89.0.

COMPANY VALUATION

Y/E Dec (Bt m)	2020A	2021F	2022F	2023F
Sales	11,527	14,813	17,968	20,414
Net profit	1,127	2,261	3,564	5,449
Consensus NP	—	2,428	3,382	4,369
Diff frm cons (%)	—	*(6.9)*	*5.4*	*24.7*
Norm profit	1,018	2,261	3,564	5,449
Prev. Norm profit	—	2,376	3,781	5,879
Chg frm prev (%)	—	*(4.8)*	*(5.7)*	*(7.3)*
Norm EPS (Bt)	0.9	1.9	3.0	4.6
Norm EPS grw (%)	15.6	122.1	57.6	52.9
Norm PE (x)	95.0	42.8	27.1	17.8
EV/EBITDA (x)	45.8	27.6	19.1	13.2
P/BV (x)	8.1	7.3	6.6	5.7
Div yield (%)	0.5	1.6	2.6	3.9
ROE (%)	8.6	17.9	25.4	34.2
Net D/E (%)	(0.0)	5.6	3.5	(3.7)

PRICE PERFORMANCE



COMPANY INFORMATION

Price: (Bt) *as of* 17-Jan-22	82.00
Market Cap (US$ m)	2,925.9
Listed Shares (m shares)	1,181.6
Free Float (%)	58.0
Avg. Daily Turnover (US$ m)	38.3
12M Price H/L (Bt)	93.00/49.50
Sector	Electronics
Major Shareholder	Ongkosit Family 24.9%

Sources: Bloomberg, Company data, Thanachart estimates

Downgrading to HOLD

We downgrade KCE to HOLD from Buy

We downgrade our rating on shares of KCE Electronics Pcl (KCE) to HOLD (from Buy) with a lower DCF-based 12-month TP, using 2022F as a base year, of Bt89/share (from Bt95). The reasons behind are downgrade are discussed below:

We expect the delay in its new plant's opening to miss market expectations

1) **Delayed new capacity to miss expectations:** We recap that KCE earlier planned to commence the first phase of its new capacity by 4Q22 after it expected its two existing factories, despite having already debottlenecked them during 2021, to see their utilization reach a maximum this year. However, because the design process now looks likely to take longer than it had expected, KCE plans to delay the launch of the new plant to early 2023. This implies KCE will be running at full capacity from early this year before being able to increase capacity again early next year. See the capacity timeline in Exhibit 1.

Ex 1: Capacity Timeline

	2021F	2022F	2023F	2024F
Year-end capacity growth	33%	0%	19%	16%
Effective capacity growth	18%	15%	16%	17%
US$ sales growth	25%	17%	18%	15%

Sources: Company data, Thanachart estimates

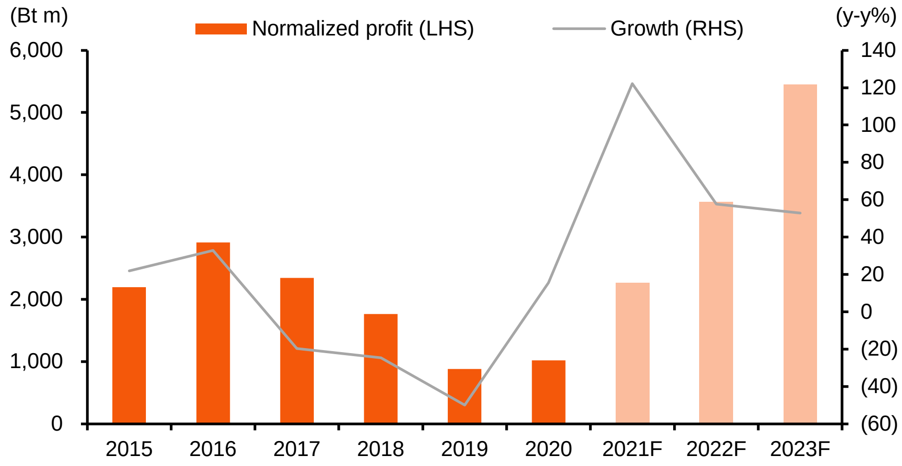
Though earnings are strong…

Actually, we do not view the capacity miss as a serious problem as we still expect KCE's earnings this year to be very strong. Though we cut our earnings estimates by 6/7% in 2021-23F, we still project KCE's EPS to grow by 58/53% in those years. The strong earnings growth is supported by the full-year impact of the extra debottlenecked capacity from its two existing facilities during 2H21, a recovery in global car sales, KCE's new orders, the weak baht against the US dollar and EBIT margin expanding from the operating leverage effect and a shift towards higher-margin new PCB products.

…KCE's share price has run up to reflect this

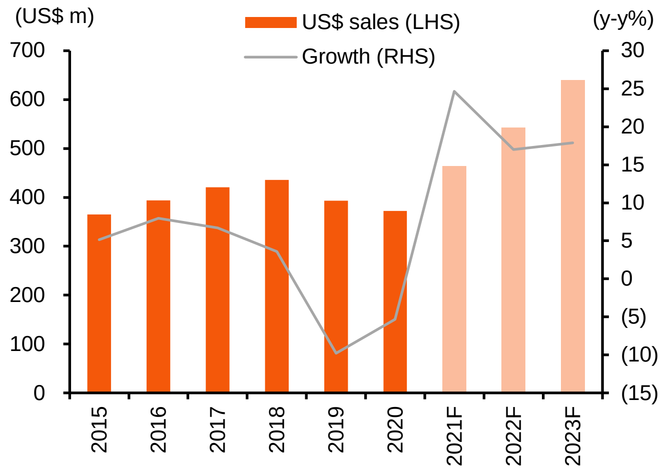
Our concern however lies mainly with the market's high expectations for KCE with any earnings downgrade momentum being negative for the share price. It is worth mentioning that KCE's share price jumped by 583% from the COVID-low in 2020 amid its strong earnings turnaround in 2020-21, the swift global car sales recovery, its market share gains, the weak baht trend and the expectation that KCE's extra capacity would be able to cater to very strong demand. KCE now trades at 27x PE vs. its 22x historical average since 2014.

Ex 2: Still Strong Earnings Trend Led By….



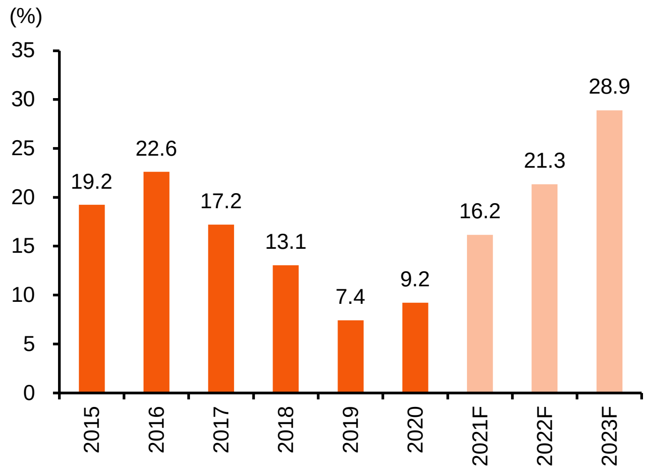
Sources: Company data, Thanachart estimates

Ex 3: Sales Growth…



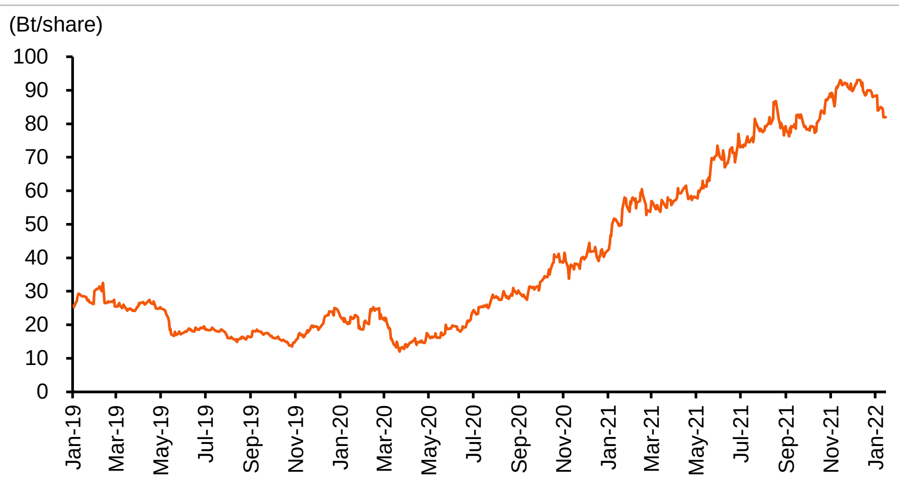
Sources: Company data, Thanachart estimates

Ex 4: …And Expanding EBIT Margin



Sources: Company data, Thanachart estimates

Ex 5: Share Price Has Surged



Source: Bloomberg

Ex 6: Our Key Assumptions

	2019	2020	2021F	2022F	2023F
Year-end capacity (Million sq ft per month)	2.7	2.7	3.6	3.6	4.3
Year-end capacity growth (%)	-	-	33.3	-	19.4
Effective capacity growth (Million sq ft per month)	2.7	2.7	3.1	3.6	4.2
Effective capacity growth (%)	-	-	18.0	15.3	16.2
Global car sales growth (%)	(4.0)	(15.0)	3.0	10.6	10.0
US$ Sales growth (%)	(9.8)	(5.3)	24.7	17.0	17.9
Baht/US$ assumption	31.0	31.3	31.9	33.1	31.9
Baht sales growth (%)	(13.5)	(4.7)	28.5	21.3	13.6
HDI proportion (%)	11.0	16.0	20.0	26.0	32.0
Gross margin (%)	20.3	21.8	28.6	32.9	39.1
SG&A to sales (%)	12.9	12.6	12.4	11.6	10.1

Sources: Company data, Thanachart estimates

Ex 7: Our Earnings Adjustments

	2019	2020	2021F	2022F	2023F
Sales (US$ m)					
New	393	372	464	543	640
Old			472	560	670
Change (%)			*(1.7)*	*(3.0)*	*(4.5)*
Bt/US$					
New	*31.1*	31.3	31.9	33.1	31.9
Old			31.6	31.8	31.0
Sales (Bt m)					
New	12,097	11,527	14,813	17,968	20,414
Old			14,921	17,798	20,775
Change (%)			*(0.7)*	*1.0*	*(1.7)*
Gross margin (%)					
New	20.3	21.8	28.6	32.9	39.1
Old			29.2	34.1	40.3
Change (pp)			*(0.6)*	*(1.2)*	*(1.3)*
SG&A/sales (%)					
New	12.9	12.6	12.4	11.6	10.1
Old			12.3	11.3	9.7
Change (pp)			*0.1*	*0.3*	*0.4*
Normalized profit (Bt m)					
New	881	1,018	2,261	3,564	5,449
Old			2,376	3,781	5,879
Change (%)			*(4.8)*	*(5.7)*	*(7.3)*

Sources: Company data, Thanachart estimates

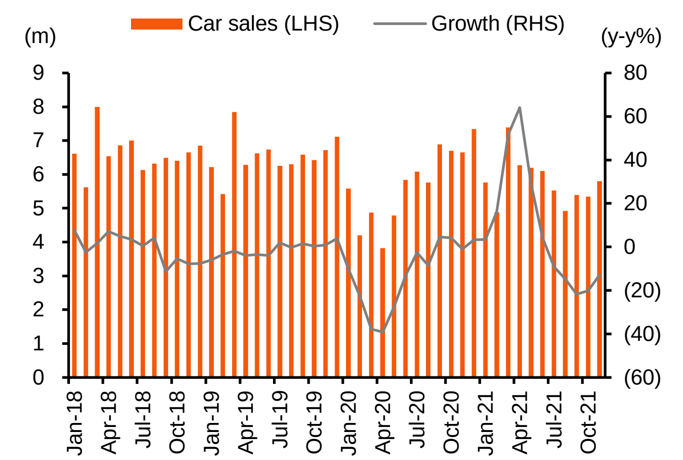
Risks for global electronics industry on both the demand and supply sides

2) **Strong capacity but increasing risk factors:** So far, KCE is continuing to enjoy robust industry demand and tight supply. However, we now see potential risks on both the demand and supply sides of the industry.

For demand, the new Omicron strain of the coronavirus and likely increasing interest rates are negative in terms of demand for cars. This comes on top of the slowdown in major economies such as China and the US from the latter part of 2021. Exhibit 9 shows falling monthly global car sales which have yet to reflect the impact from Omicron and the likely increase in interest rates. Note that KCE so far has yet to see any pullback in orders from its clients and its orders so far imply that the company will operate at full utilization into June this year, its longest historical lead time. That said, any softening in demand can cause car makers to destock their inventories after having stocked up car parts during 2021 despite weak global car sales due to the global chip shortage, expecting strong demand for cars post the shortage.

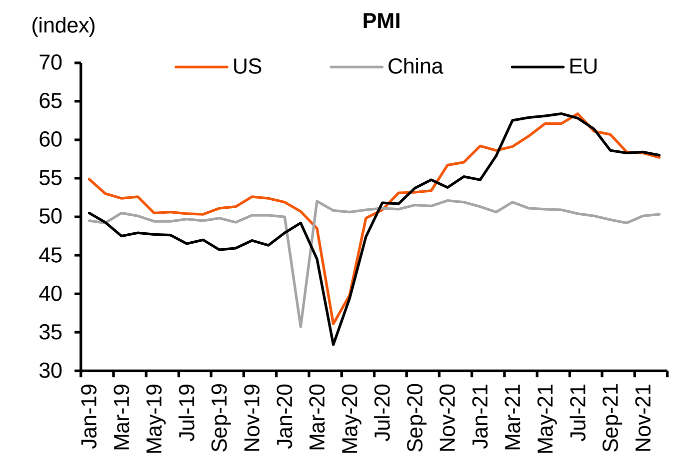
IHS, a leading independent research house, forecasts global car sales to recover by 10% this year after only 3% growth in 2021 (global chip shortage) and -15% in 2020 (COVID lockdown) amid the global chip shortage, in line with our expectation.

Ex 8: Monthly Global Car Sales



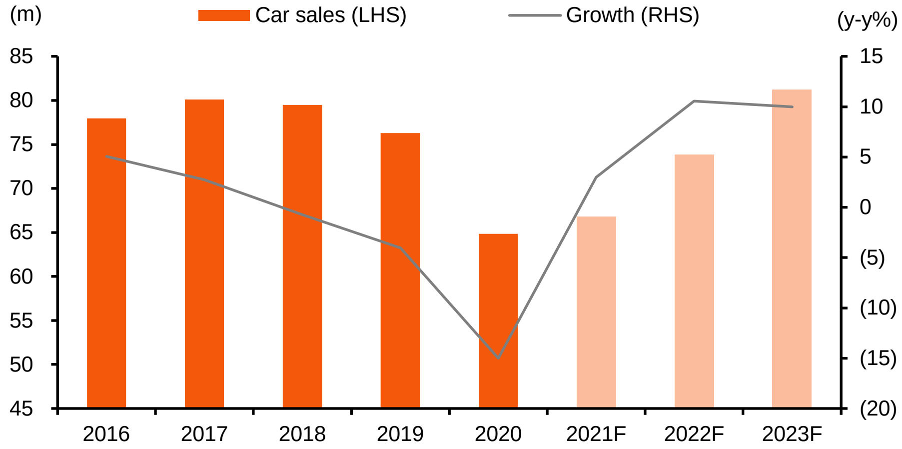
Source: Bloomberg

Ex 9: Growth Slowdown In Major Markets



Source: Bloomberg

Ex 10: Annual Global Car Sales Forecasts



Sources: IHS, Bloomberg, Thanachart compilation

For supply, significant new capacities from auto-related chip and PCB operators look set to come online from 2022 onward. So far, we actually don't regard this as a concern because the planned new supply is to support overwhelming demand. We recap that auto parts makers' expectation for strong demand is based not only on a strong recovery in global car sales but also the rising electronic parts content in cars. We discussed this in detail in *KCE – New capacity taken up, dated 25 October 2021*. However, in line with the potential risks we mentioned earlier, any shortfall to the expectations for strong demand would pose a risk of the industry having excess capacity.

Ex 11: 12-month DCF-based TP Calculation Using A Base Year of 2022F

(Bt m)		2022F	2023F	2024F	2025F	2026F	2027F	2028F	2029F	2030F	2031F	2032F	Terminal Value
EBITDA		5,084	7,252	8,864	10,407	11,909	13,024	14,056	15,115	16,114	16,950	17,804	—
Free cash flow		2,414	4,448	5,948	8,433	9,741	10,959	11,928	12,863	13,755	14,603	14,685	163,492
PV of free cash flow		2,407	3,666	4,447	5,723	5,868	5,966	5,866	5,716	5,523	5,298	4,583	51,019
Risk-free rate (%)	2.5												
Market risk premium (%)	8.0												
Beta	1.1												
WACC (%)	10.2												
Terminal growth (%)	2.0												
Enterprise value - add investments	106,081												
Net debt (2021F)	750												
Minority interest	57												
Equity value	105,274												
# of shares (m) *	1,180												
Target price/share (Bt)	**89**												

Sources: Company data, Thanachart estimates

Note: * We assume full dilution impact from outstanding ESOP shares

Valuation Comparison

Ex 12: Valuation Comparison With Regional Peers

Name	BBG code	Country	EPS growth 21F (%)	EPS growth 22F (%)	PE 21F (x)	PE 22F (x)	P/BV 21F (x)	P/BV 22F (x)	EV/EBITDA 21F (%)	EV/EBITDA 22F (%)	Div. yield 21F (%)	Div. yield 22F (%)
TTM Technologies Inc	TTMI US	USA	13.0	12.3	12.3	10.9	1.1	1.1	7.3	6.8	na	na
Chin-Poon Industrial	2355 TT	Taiwan	792.9	18.5	35.5	29.9	1.0	1.0	10.9	8.6	1.7	1.8
Tripod Technology Corp	3044 TT	Taiwan	(2.6)	10.0	11.1	10.1	1.7	1.6	5.9	5.1	5.8	6.6
CMK Corp	6958 JP	Japan	na	118.4	23.7	10.9	0.8	0.7	7.9	5.4	0.9	1.8
Meiko Electronics	6787 JP	Japan	98.9	19.5	13.0	10.9	2.5	2.1	9.3	8.7	0.9	1.0
Delta Electronics	DELTA TB	Thailand	(10.1)	41.6	76.0	54.6	12.8	11.5	57.9	42.5	0.7	1.1
SVI Pcl	SVI TB	Thailand	48.5	1.6	17.2	16.9	3.8	3.4	13.6	12.8	1.7	2.0
Hana Microelectronics	HANA TB*	Thailand	48.6	31.9	24.2	18.3	2.8	2.6	15.7	12.2	2.4	3.2
KCE Electronics	KCE TB*	Thailand	122.1	57.6	42.8	27.1	7.3	6.6	27.6	19.1	1.6	2.6
Average			**138.9**	**34.6**	**28.4**	**21.1**	**3.8**	**3.4**	**17.3**	**13.5**	**2.0**	**2.5**

Source: Bloomberg

Note: *Thanachart estimates, using Thanachart normalized EPS

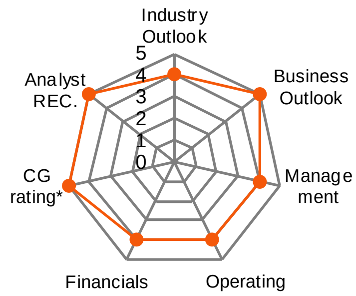
Based on 17-Jan-2022 closing prices

COMPANY DESCRIPTION

KCE Electronics Public Company Limited (KCE) and its subsidiaries manufacture and export double-sided and multi-layer printed circuit boards (PCBs) under the KCE trademark. The company has five manufacturing bases: three PCB factories, one laminate factory and one chemical factory in four locations in Thailand. KCE is one of the leading global suppliers of PCBs to the automotive sector, and these account for more than 70% of its total sales.

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

- Sustainable earnings from the automotive sector.
- Completed upstream to downstream business integration.
- Lowest-cost automotive PCB manufacturer.

W — Weakness

- Capital-intensive business, particularly for machinery.
- Revenue still concentrated with a few large customers.

O — Opportunity

- Potential penetration of the Japanese market.
- Positive growth outlook in the automotive electronics industry.
- Expanding into other industries such as industrial and high-end consumer products.

T — Threat

- Unexpected external events (i.e. floods, political turmoil) could disrupt KCE's operations.
- Delay in construction of factories could significantly affect the time frames for the qualification process by customers.

CONSENSUS COMPARISON

	Consensus	Thanachart	Diff
Target price (Bt)	104.87	89.00	-15%
Net profit 21F (Bt m)	2,428	2,261	-7%
Net profit 22F (Bt m)	3,382	3,564	5%
Consensus REC	**BUY: 14**	**HOLD: 0**	**SELL: 1**

HOW ARE WE DIFFERENT FROM THE STREET?

- Our TP is lower than the Bloomberg consensus number, which we attribute to us having a more conservative assumption for growth in global car sales.

Sources: Bloomberg consensus, Thanachart estimates

RISKS TO OUR INVESTMENT CASE

- A slower-or-faster-than-expected turnaround in the global automotive market presents the key downside/upside risk to our projections and TP.
- A significant rise/fall in copper-related prices presents a secondary downside/upside risk to our estimates.
- Drastic currency fluctuations with a strong/weak Thai baht relative to the US$ present another downside/upside risk to our numbers.

Source: Thanachart

With multiple supporting factors, we expect strong earnings growth…

INCOME STATEMENT

FY ending Dec (Bt m)	2019A	2020A	2021F	2022F	2023F
Sales	12,097	11,527	14,813	17,968	20,414
Cost of sales	9,644	9,015	10,582	12,051	12,442
Gross profit	**2,454**	**2,512**	**4,231**	**5,916**	**7,972**
% gross margin	20.3%	21.8%	28.6%	32.9%	39.1%
Selling & administration expenses	1,555	1,449	1,836	2,081	2,071
Operating profit	**898**	**1,063**	**2,396**	**3,836**	**5,901**
% operating margin	7.4%	9.2%	16.2%	21.3%	28.9%
Depreciation & amortization	1,015	1,048	1,138	1,251	1,354
EBITDA	**1,913**	**2,111**	**3,534**	**5,087**	**7,255**
% EBITDA margin	15.8%	18.3%	23.9%	28.3%	35.5%
Non-operating income	92	106	100	102	104
Non-operating expenses	0	0	0	0	0
Interest expense	(61)	(57)	(75)	(100)	(98)
Pre-tax profit	**929**	**1,111**	**2,421**	**3,838**	**5,907**
Income tax	52	87	165	279	463
After-tax profit	**877**	**1,024**	**2,256**	**3,559**	**5,444**
% net margin	7.2%	8.9%	15.2%	19.8%	26.7%
Shares in affiliates' Earnings	19	10	10	11	11
Minority interests	(15)	(16)	(5)	(6)	(7)
Extraordinary items	53	109	0	0	0
NET PROFIT	**934**	**1,127**	**2,261**	**3,564**	**5,449**
Normalized profit	**881**	**1,018**	**2,261**	**3,564**	**5,449**
EPS (Bt)	0.8	1.0	1.9	3.0	4.6
Normalized EPS (Bt)	0.7	0.9	1.9	3.0	4.6

BALANCE SHEET

FY ending Dec (Bt m)	2019A	2020A	2021F	2022F	2023F
ASSETS:					
Current assets:	6,719	8,185	9,711	11,357	12,352
Cash & cash equivalent	957	2,347	2,500	3,000	3,200
Account receivables	2,973	3,174	4,079	4,948	5,622
Inventories	2,701	2,594	3,044	3,302	3,409
Others	88	69	88	107	121
Investments & loans	199	187	187	187	187
Net fixed assets	8,839	8,107	9,011	9,472	9,833
Other assets	744	898	1,169	1,429	1,634
Total assets	**16,501**	**17,377**	**20,079**	**22,445**	**24,006**
LIABILITIES:					
Current liabilities:	3,651	4,216	5,176	5,795	5,252
Account payables	2,293	2,458	2,885	3,286	3,392
Bank overdraft & ST loans	1,067	1,283	1,777	1,922	1,400
Current LT debt	259	387	442	478	348
Others current liabilities	33	88	72	109	112
Total LT debt	**724**	**676**	**1,031**	**1,115**	**812**
Others LT liabilities	364	423	570	702	808
Total liabilities	**4,739**	**5,315**	**6,777**	**7,612**	**6,872**
Minority interest	50	52	57	63	70
Preferreds shares	0	0	0	0	0
Paid-up capital	586	589	590	590	590
Share premium	1,907	2,050	2,050	2,050	2,050
Warrants	0	0	0	0	0
Surplus	(70)	(64)	(64)	(64)	(64)
Retained earnings	**9,290**	**9,434**	**10,668**	**12,193**	**14,487**
Shareholders' equity	11,712	12,010	13,244	14,770	17,064
Liabilities & equity	**16,501**	**17,377**	**20,079**	**22,445**	**24,006**

Sources: Company data, Thanachart estimates

CASH FLOW STATEMENT

FY ending Dec (Bt m)	2019A	2020A	2021F	2022F	2023F
Earnings before tax	929	1,111	2,421	3,838	5,907
Tax paid	(48)	(32)	(177)	(241)	(461)
Depreciation & amortization	1,015	1,048	1,138	1,251	1,354
Chg In w orking capital	288	70	(927)	(726)	(674)
Chg In other CA & CL / minorities	(42)	21	(13)	(8)	(3)
Cash flow from operations	**2,142**	**2,218**	**2,441**	**4,114**	**6,123**
Capex	(453)	(277)	(2,000)	(1,667)	(1,667)
Right of use	0	(13)	(20)	(20)	(20)
ST loans & investments	0	0	0	0	0
LT loans & investments	6	12	0	0	0
Adj for asset revaluation	0	0	0	0	0
Chg In other assets & liabilities	(58)	(125)	(146)	(153)	(127)
Cash flow from investments	**(505)**	**(404)**	**(2,166)**	**(1,840)**	**(1,814)**
Debt financing	(889)	405	904	264	(955)
Capital increase	0	146	1	0	0
Dividends paid	(1,136)	(952)	(1,027)	(2,039)	(3,155)
Warrants & other surplus	(37)	(24)	0	0	0
Cash flow from financing	**(2,062)**	**(424)**	**(122)**	**(1,774)**	**(4,109)**
Free cash flow	**1,689**	**1,941**	**441**	**2,447**	**4,457**

...but it looks priced in to us with KCE's 27x PE for 2022F

VALUATION

FY ending Dec	2019A	2020A	2021F	2022F	2023F
Normalized PE (x)	109.8	95.0	42.8	27.1	17.8
Normalized PE - at target price (x)	119.2	103.1	46.4	29.5	19.3
PE (x)	103.5	85.9	42.8	27.1	17.8
PE - at target price (x)	112.4	93.2	46.4	29.5	19.3
EV/EBITDA (x)	51.1	45.8	27.6	19.1	13.2
EV/EBITDA - at target price (x)	55.5	49.7	29.9	20.7	14.4
P/BV (x)	8.3	8.1	7.3	6.6	5.7
P/BV - at target price (x)	9.0	8.7	7.9	7.1	6.2
P/CFO (x)	45.2	43.6	39.6	23.5	15.8
Price/sales (x)	8.0	8.4	6.5	5.4	4.7
Dividend yield (%)	0.9	0.5	1.6	2.6	3.9
FCF Yield (%)	1.7	2.0	0.5	2.5	4.6
(Bt)					
Normalized EPS	0.7	0.9	1.9	3.0	4.6
EPS	0.8	1.0	1.9	3.0	4.6
DPS	0.8	0.4	1.3	2.1	3.2
BV/share	9.9	10.2	11.2	12.5	14.5
CFO/share	1.8	1.9	2.1	3.5	5.2
FCF/share	1.4	1.6	0.4	2.1	3.8

Sources: Company data, Thanachart estimates

Profitability is strong as it is the lowest-cost producer in the industry

FINANCIAL RATIOS

FY ending Dec	2019A	2020A	2021F	2022F	2023F
Growth Rate					
Sales (%)	(13.5)	(4.7)	28.5	21.3	13.6
Net profit (%)	(53.6)	20.6	100.6	57.6	52.9
EPS (%)	(53.6)	20.6	100.6	57.6	52.9
Normalized profit (%)	(50.0)	15.6	122.1	57.6	52.9
Normalized EPS (%)	(50.0)	15.6	122.1	57.6	52.9
Dividend payout ratio (%)	96.3	41.9	70.0	70.0	70.0
Operating performance					
Gross margin (%)	20.3	21.8	28.6	32.9	39.1
Operating margin (%)	7.4	9.2	16.2	21.3	28.9
EBITDA margin (%)	15.8	18.3	23.9	28.3	35.5
Net margin (%)	7.2	8.9	15.2	19.8	26.7
D/E (incl. minor) (x)	0.2	0.2	0.2	0.2	0.1
Net D/E (incl. minor) (x)	0.1	(0.0)	0.1	0.0	(0.0)
Interest coverage - EBIT (x)	14.7	18.5	31.9	38.4	60.1
Interest coverage - EBITDA (x)	31.3	36.7	47.0	50.9	73.9
ROA - using norm profit (%)	5.1	6.0	12.1	16.8	23.5
ROE - using norm profit (%)	7.4	8.6	17.9	25.4	34.2
DuPont					
ROE - using after tax profit (%)	7.4	8.6	17.9	25.4	34.2
- asset turnover (x)	0.7	0.7	0.8	0.8	0.9
- operating margin (%)	8.2	10.1	16.8	21.9	29.4
- leverage (x)	1.5	1.4	1.5	1.5	1.5
- interest burden (%)	93.8	95.1	97.0	97.5	98.4
- tax burden (%)	94.4	92.2	93.2	92.7	92.2
WACC (%)	10.2	10.2	10.2	10.2	10.2
ROIC (%)	6.2	7.7	18.6	25.4	35.6
NOPAT (Bt m)	848	980	2,232	3,557	5,439
invested capital (Bt m)	12,805	12,009	13,995	15,285	16,424

Sources: Company data, Thanachart estimates

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