Small Cap Research

Thanachart Securities

HOLD (Unchanged)

Change in Numbers

TP: Bt 60.00 (From: Bt 67.00)

Upside : 6.7%

5 JULY 2022

KCE Electronics Pcl (KCE TB)

Another hiccup

We expect KCE's 2Q22F earnings, though growing by 15% y-y/q-q, to disappoint the market on rising costs. Also, KCE is seeing advance orders shorten while it's being more cautious on demand for cars. We cut our earnings by 14% in 2022-23F and maintain HOLD.

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Cost hiccup

We expect KCE to report normalized earnings of Bt640m in 2Q22F. Despite still growing by 15% y-y/q-q, this is below our previous expectation of 25% y-y growth. The miss is due to lower gross margin on higher-than-expected costs. The Russia-Ukraine conflict has caused shortages of several supply-base products, pushing up material costs. Rising cost items for KCE include chemical substances used in PCB coating, copper foil prices and electricity after fuel-adjusted tariff (Ft) hikes. These costs are 30% of cost of goods sold and they rose by 10%-plus q-q in 2Q22F, on our estimate. Most of the costs have fallen from their March-April peaks but they remain elevated and electricity costs look set to continue to trend up this year.

Strong orders but shortened bookings

KCE still expects to run at full capacity to the end of this year and at near full capacity next year, taking into account the new factory due to open in 3Q23. This implies 20/15% sales growth in 2022-23F. KCE still foresees strong industry demand for electronic parts in cars and therefore market share gains. However, KCE's advance order bookings have fallen to a few months vs. five months seen in 2021. Global car sales fell by 10% y-y in 1H22 with Europe seeing a larger drop than other regions. KCE said it could delay opening its new factory if demand is weak.

Our more cautious assumptions

We cut our earnings for KCE by 14/14/15% in 2022-24F to reflect higher production costs and potentially weaker global auto demand from a slower global economy. Exhibit 3 shows our new assumptions. Due to the Russia-Ukraine conflict dragging on and sanctions on Russia that have lifted energy prices, inflation and interest rates around the world, we expect weaker global car sales. Also due to supply shortage fears, inventory days have been extended and inventories at car makers are higher than their historical average (Exhibit 4).

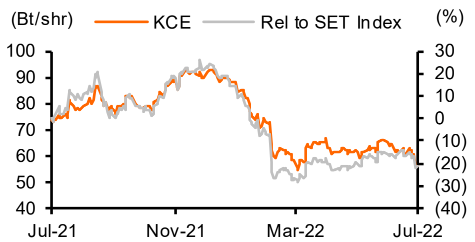
Maintaining HOLD

We maintain our HOLD call on KCE. We expect 2Q22F results to disappoint the market and earnings revisions by the Street to follow. We also foresee the high cost environment dragging on throughout the year. However, KCE's share price has already come down by 36% YTD and is 39% below its 2021 peak, so we see limited potential downside from here. The stock is fairly priced in our view trading at 20x 2023F PE against its EPS growth outlook of 21/23% in 2022-23F. We roll over our valuation base year to 2023F and after our earnings cuts, our DCF-based 12-month TP is revised down to Bt60/share (from Bt67).

COMPANY VALUATION

Y/E Dec (Bt m)	2021A	2022F	2023F	2024F
Sales	14,938	18,779	20,112	20,538
Net profit	2,426	2,695	3,317	3,751
Consensus NP	—	2,868	3,464	3,987
Diff frm cons (%)	—	*(6.0)*	*(4.2)*	*(5.9)*
Norm profit	2,237	2,695	3,317	3,751
Prev. Norm profit	—	3,131	3,871	4,421
Chg frm prev (%)	—	*(14.0)*	*(14.3)*	*(15.2)*
Norm EPS (Bt)	1.9	2.3	2.8	3.2
Norm EPS grw (%)	119.7	20.5	23.1	13.1
Norm PE (x)	29.7	24.6	20.0	17.7
EV/EBITDA (x)	20.2	16.2	13.6	12.0
P/BV (x)	5.0	4.5	4.2	3.8
Div yield (%)	1.1	2.8	3.5	4.0
ROE (%)	17.6	19.1	21.6	22.6
Net D/E (%)	8.7	5.6	3.1	(1.8)

PRICE PERFORMANCE



COMPANY INFORMATION

Price: (Bt) *as of* 5-Jul-22	56.25
Market Cap (US$ m)	1,855.7
Listed Shares (m shares)	1,181.8
Free Float (%)	59.0
Avg. Daily Turnover (US$ m)	27.0
12M Price H/L (Bt)	93.00/54.75
Sector	Electronics
Major Shareholder	Ongkosit Family 25.4%

Sources: Bloomberg, Company data, Thanachart estimates

Maintaining HOLD

We maintain our HOLD rating on KCE

We maintain our HOLD rating on shares of KCE Electronics Pcl (KCE) and revise down our DCF-based 12-month TP to Bt60/share from Bt67 after cutting our earnings estimates and rolling over our valuation base year to 2023F from 2022F.

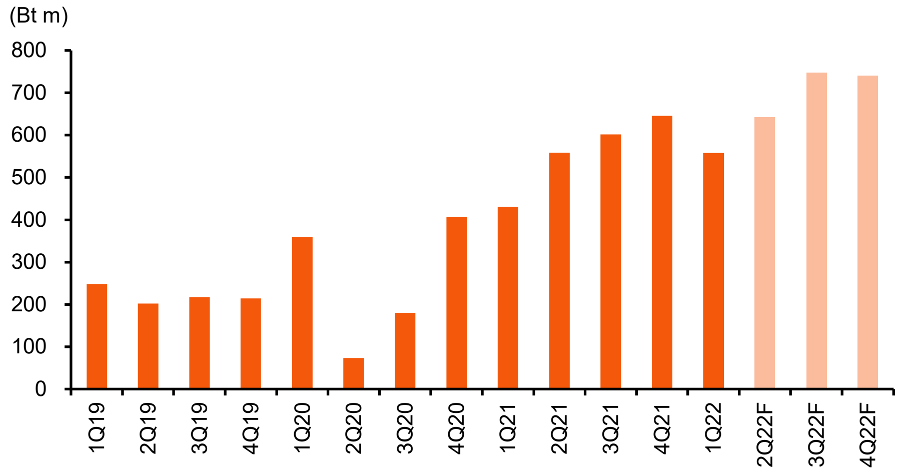
First, we expect 2Q22F results to disappoint the market

First, we expect KCE to report normalized earnings of Bt640m in 2Q22F, increasing by 15% y-y/q-q. This is 10% below our previous expectation. We forecast KCE's sales to jump by 35% y-y in the quarter but gross margin to fall by 4.6% to 24.4% on the back of a higher-than-expected jump in costs.

We recap here that KCE experienced a hiccup with its new production machinery at both its plants between 4Q21 and 1Q22. Looking to 2Q22, KCE has fully resolved the machinery problem but now faces another hiccup from a spike in costs. Rising cost items for KCE include chemical substances used in printed circuit board (PCB) coating while the copper foil making cost has also increased sharply. KCE's electricity costs have also jumped due to the upward revision of Thailand's fuel-adjustment tariff (Ft) structure. These costs account for around 30% of KCE's cost of goods sold and they have increased by 10%-plus q-q. The sharp rise in costs began after the Russia-Ukraine conflict began and sanctions on Russia resulted in shortages of supply-base products.

Looking to 3Q22F, KCE expects a better performance but it likely be weaker than its previous expectation. While we foresee KCE's new machinery's efficiency reaching nearly 100% in 3Q22F from close to 90% in 2Q22F, costs remain higher than expected although they have fallen from the peak seen during April. Also, we expect electricity prices to continue increasing throughout the year.

Ex 1: Quarterly Performance



Sources: Company data, Thanachart estimates

We cut our earnings by 14/14/15% in 2022-24F

Second, we revise down our earnings estimates by 14% this year and by 14/15% in 2023-23F on higher production costs and weaker demand for cars given the slow global economy. We expect KCE to operate at near-full capacity and to generate 17% sales growth in 2022F but we estimate only 8% sales growth in 2023F vs. KCE's 15% expectation. KCE plans to open its new factory in 3Q23. It expects to operate at near full capacity as KCE expects for a strong industry demand for electronic parts in cars and market share gains.

Ex 2: Key Assumption Revisions

	2020	2021	2022F	2023F	2024F
Sales (US$ m)					
New	372	469	547	590	640
Old			539	596	644
Change (%)			*1.5*	*(1.0)*	*(0.7)*
Bt/US$					
New	31.3	32.0	34.3	34.1	32.1
Old			33.8	33.3	32.1
Sales (Bt m)					
New	11,527	14,938	18,779	20,112	20,538
Old			18,227	19,835	20,677
Change (%)			*3.0*	*1.4*	*(0.7)*
Gross margin (%)					
New	21.8	26.6	26.7	28.4	29.9
Old			30.0	31.7	33.2
Change (pp)			*(3.3)*	*(3.3)*	*(3.3)*
SG&A/sales (%)					
New	12.6	11.1	11.1	10.4	10.0
Old			11.3	10.5	9.9
Change (pp)			*(0.2)*	*(0.1)*	*0.0*
Normalized profit (Bt m)					
New	1,018	2,237	2,695	3,317	3,751
Old			3,131	3,871	4,421
Change (%)			*(14.0)*	*(14.3)*	*(15.2)*

Sources: Company data, Thanachart estimates

Ex 3: Our Assumptions

	2020	2021	2022F	2023F	2024F
Year-end capacity (million sq ft per month)	2.7	3.0	3.3	4.0	4.0
Year-end capacity growth (%)	-	11.1	10.0	21.2	-
Effective capacity (million sq ft per month)	2.7	2.8	3.2	3.7	4.0
Effective capacity growth (%)	-	1.9	17.3	13.2	9.6
Global car sales growth (%)	(15.0)	3.0	5.0	5.0	3.0
US$ sales growth (%)	(5.3)	25.9	16.8	7.7	8.5
Baht/US$ assumption	31.3	31.9	34.3	34.1	32.1
Baht sales growth (%)	(4.7)	29.6	25.7	7.1	2.1
HDI proportion (%)	16.0	20.0	26.0	32.0	35.0
Gross margin (%)	21.8	26.6	26.7	28.4	29.9
SG&A to sales (%)	12.6	11.1	11.1	10.4	10.0

Sources: Company data, Thanachart estimates

Our more caution assumption reflects our view of weaker demand for cars as a result of the global slowdown and inflationary pressure. Also, Exhibit 4 shows that inventories at car makers are higher than their historical averages after they stocked up on auto parts-related products, including PCB-based products, to try to avoid the global parts shortage seen since 2021. We see the risk of weaker car demand causing car makers to destock their inventories and this eventually resulting in weak orders for KCE.

Ex 4: Leading Car Makers' Inventory Days

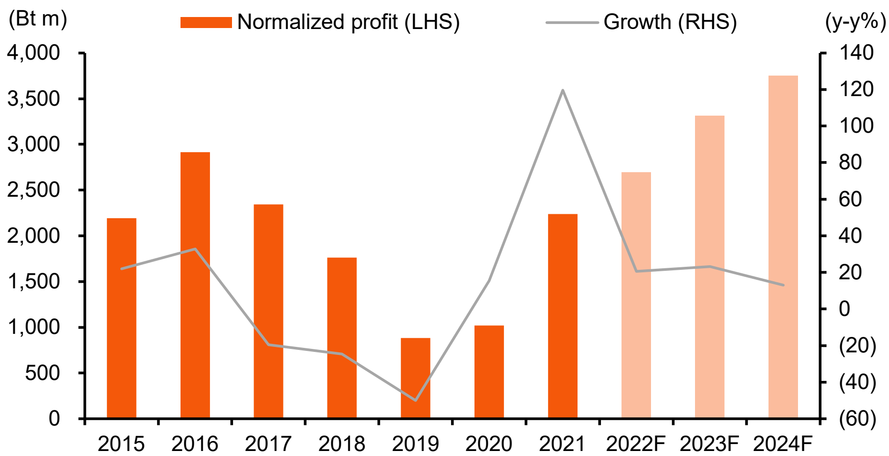
	Inventory Days	
	1Q22	6-year Average
Volkswagen	82.5	83.1
GM	46.9	39.5
Daimler	98.2	84.5
Ford	41.9	30.7
BMW	70.9	66.3
Toyota	48.2	38.8
Honda	54.7	48.0

Source: Bloomberg

KCE looks fairly valued on 20x PE against 23% EPS growth in 2023F.

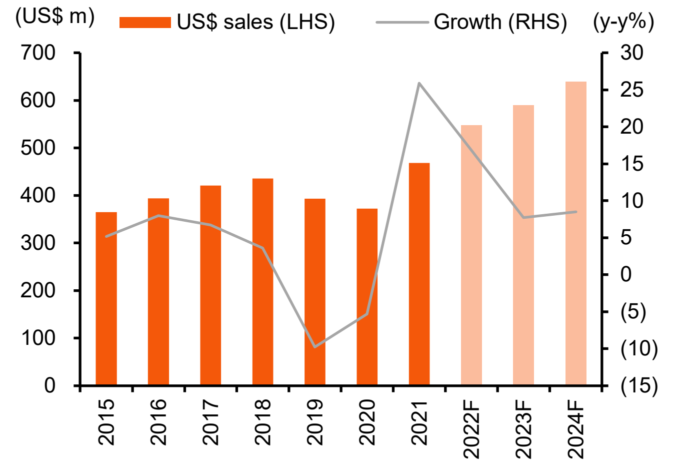
Lastly, KCE's share price has fallen by 39% from its peak in 2021 and by 36% YTD to trade at 20x PE multiples in 2023F, which we see as fairly priced given its EPS growth profile of 23%. Despite the softening industry, we expect KCE to gain market share and generate 17/8% US dollar sales growth in 2022-23F. With the operating leverage effect and a higher contribution from normal PCBs with more layers and high-density interconnector (HDI) PCBs, we estimate KCE's EBIT margin to increase to 20% in 2024F from 16% in 2021.

Ex 5: Earnings Growth



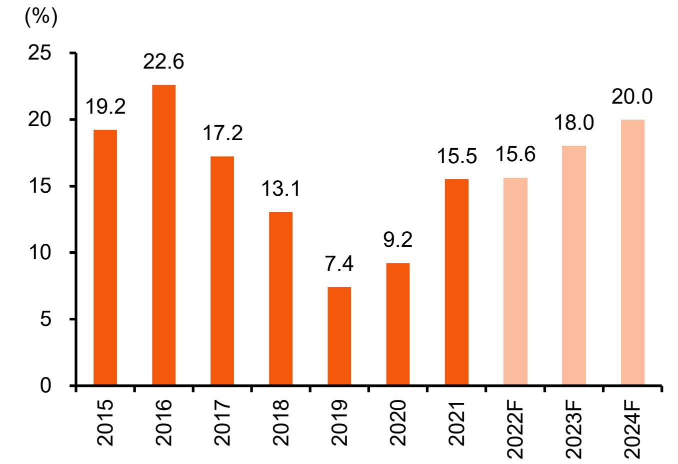
Sources: Company data, Thanachart estimates

Ex 6: Sales Growth



Sources: Company data; Thanachart estimates

Ex 7: EBIT Margin



Sources: Company data; Thanachart estimates

Ex 8: 12-month DCF-based TP Calculation Using A Base Year of 2023F

(Bt m)		2023F	2024F	2025F	2026F	2027F	2028F	2029F	2030F	2031F	2032F	2033F	Terminal Value
EBITDA		4,905	5,484	6,104	7,008	7,875	8,748	9,496	10,061	10,647	11,256	11,586	—
Free cash flow		2,488	3,326	4,606	5,463	6,286	7,057	7,795	8,377	8,901	9,445	9,228	105,896
PV of free cash flow		2,481	2,753	3,424	3,678	3,834	3,897	3,900	3,796	3,654	3,511	2,959	33,952
Risk-free rate (%)	2.5												
Market risk premium (%)	8.0												
Beta	1.1												
WACC (%)	9.9												
Terminal growth (%)	2.0												
Enterprise value - add investments	71,837												
Net debt (2022F)	830												
Minority interest	67												
Equity value	70,940												
# of shares (m) *	1,180												
Target price/share (Bt)	**60**												

Sources: Company data, Thanachart estimates

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

Ex 9: Valuation Comparison With Regional Peers

Name	BBG code	Country	EPS growth 22F (%)	EPS growth 23F (%)	— PE — 22F (x)	— PE — 23F (x)	— P/BV — 22F (x)	— P/BV — 23F (x)	EV/EBITDA 22F (%)	EV/EBITDA 23F (%)	— Div. yield — 22F (%)	— Div. yield — 23F (%)
TTM Technologies Inc	TTMI US	USA	0.1	18.1	9.5	8.0	na	na	5.8	5.4	na	na
Chin-Poon Industrial	2355 TT	Taiwan	15.5	44.1	28.5	19.8	0.7	0.7	7.9	5.4	1.6	3.0
Tripod Technology Corp	3044 TT	Taiwan	9.5	18.4	8.6	7.3	1.3	1.2	4.4	3.8	7.3	8.6
CMK Corp	6958 JP	Japan	2.7	30.1	8.7	6.7	0.4	0.4	5.3	4.3	3.2	4.8
Meiko Electronics	6787 JP	Japan	8.7	15.5	6.5	5.6	1.2	1.0	5.9	5.1	1.6	1.7
Delta Electronics	DELTA TB	Thailand	42.4	19.0	41.4	26.6	8.4	7.4	31.3	26.8	1.1	1.3
SVI Pcl	SVI TB	Thailand	(16.3)	18.8	12.0	10.1	2.4	2.1	10.6	9.2	8.9	3.7
Hana Microelectronics	HANA TB*	Thailand	7.0	8.1	12.4	11.5	1.3	1.2	7.3	6.6	5.4	5.7
KCE Electronics	KCE TB*	Thailand	20.5	23.1	24.6	20.0	4.5	4.2	16.2	13.6	2.8	3.5
Average			**10.0**	**21.7**	**16.9**	**12.8**	**2.5**	**2.3**	**10.5**	**8.9**	**4.0**	**4.0**

Source: Bloomberg

Note: *Thanachart estimates, using Thanachart normalized EPS

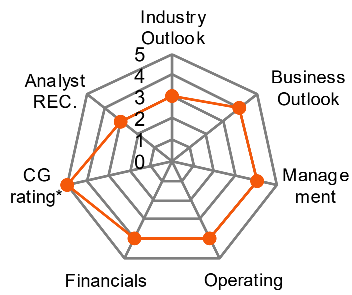
Based on 5-Jul-2022 closing prices

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)	71.57	60.00	-16%
Net profit 22F (Bt m)	2,868	2,695	-6%
Net profit 23F (Bt m)	3,464	3,317	-4%
Consensus REC	**BUY: 12**	**HOLD: 3**	**SELL: 0**

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)	2020A	2021A	2022F	2023F	2024F
Sales	11,527	14,938	18,779	20,112	20,538
Cost of sales	9,015	10,965	13,760	14,398	14,387
Gross profit	**2,512**	**3,973**	**5,019**	**5,714**	**6,151**
% gross margin	21.8%	26.6%	26.7%	28.4%	29.9%
Selling & administration expenses	1,449	1,656	2,085	2,092	2,052
Operating profit	**1,063**	**2,317**	**2,934**	**3,623**	**4,099**
% operating margin	9.2%	15.5%	15.6%	18.0%	20.0%
Depreciation & amortization	1,049	1,024	1,206	1,282	1,384
EBITDA	**2,112**	**3,341**	**4,140**	**4,905**	**5,484**
% EBITDA margin	18.3%	22.4%	22.0%	24.4%	26.7%
Non-operating income	106	202	105	107	110
Non-operating expenses	0	0	0	0	0
Interest expense	(57)	(44)	(94)	(101)	(104)
Pre-tax profit	**1,111**	**2,475**	**2,945**	**3,629**	**4,105**
Income tax	87	221	263	325	367
After-tax profit	**1,024**	**2,254**	**2,681**	**3,304**	**3,738**
% net margin	8.9%	15.1%	14.3%	16.4%	18.2%
Shares in affiliates' Earnings	10	17	18	19	20
Minority interests	(16)	(35)	(5)	(6)	(7)
Extraordinary items	109	190	0	0	0
NET PROFIT	**1,127**	**2,426**	**2,695**	**3,317**	**3,751**
Normalized profit	**1,018**	**2,237**	**2,695**	**3,317**	**3,751**
EPS (Bt)	1.0	2.1	2.3	2.8	3.2
Normalized EPS (Bt)	0.9	1.9	2.3	2.8	3.2

BALANCE SHEET

FY ending Dec (Bt m)	2020A	2021A	2022F	2023F	2024F
ASSETS:					
Current assets:	8,185	11,794	14,196	15,376	15,699
Cash & cash equivalent	2,347	2,482	2,500	3,000	3,200
Account receivables	3,174	4,394	5,524	5,916	6,042
Inventories	2,594	4,841	6,076	6,357	6,352
Others	69	76	96	102	105
Investments & loans	187	195	195	195	195
Net fixed assets	8,107	8,979	8,617	9,047	9,378
Other assets	898	983	1,250	1,356	1,404
Total assets	**17,377**	**21,951**	**24,258**	**25,974**	**26,675**
LIABILITIES:					
Current liabilities:	4,216	6,948	7,824	8,220	7,797
Account payables	2,458	4,246	5,328	5,575	5,571
Bank overdraft & ST loans	1,283	1,798	1,638	1,718	1,420
Current LT debt	387	740	674	708	585
Others current liabilities	88	164	183	219	222
Total LT debt	**676**	**1,117**	**1,018**	**1,067**	**882**
Others LT liabilities	423	444	573	624	649
Total liabilities	**5,315**	**8,509**	**9,414**	**9,912**	**9,328**
Minority interest	52	62	67	73	80
Preferreds shares	0	0	0	0	0
Paid-up capital	589	591	590	590	590
Share premium	2,050	2,146	2,146	2,146	2,146
Warrants	0	(0)	(0)	(0)	(0)
Surplus	(64)	(37)	(37)	(37)	(37)
Retained earnings	**9,434**	**10,680**	**12,077**	**13,290**	**14,568**
Shareholders' equity	12,010	13,380	14,777	15,990	17,267
Liabilities & equity	**17,377**	**21,951**	**24,258**	**25,974**	**26,675**

Sources: Company data, Thanachart estimates

KCE's growth looks fairly priced in to us with 20x PE for 2023F

CASH FLOW STATEMENT

FY ending Dec (Bt m)	2020A	2021A	2022F	2023F	2024F
Earnings before tax	1,111	2,475	2,945	3,629	4,105
Tax paid	(32)	(149)	(253)	(297)	(371)
Depreciation & amortization	1,049	1,024	1,206	1,282	1,384
Chg In working capital	70	(1,679)	(1,282)	(427)	(125)
Chg In other CA & CL / minorities	0	(41)	7	21	25
Cash flow from operations	**2,199**	**1,631**	**2,623**	**4,208**	**5,018**
Capex	(278)	(1,854)	(800)	(1,667)	(1,667)
Right of use	(13)	(7)	(20)	(20)	(20)
ST loans & investments	0	0	0	0	0
LT loans & investments	12	(8)	0	0	0
Adj for asset revaluation	0	0	0	0	0
Chg In other assets & liabilities	(105)	(69)	(163)	(81)	(51)
Cash flow from investments	**(385)**	**(1,938)**	**(983)**	**(1,767)**	**(1,737)**
Debt financing	405	1,498	(324)	163	(607)
Capital increase	146	98	(1)	0	0
Dividends paid	(952)	(1,206)	(1,297)	(2,104)	(2,474)
Warrants & other surplus	(24)	52	0	0	0
Cash flow from financing	**(424)**	**442**	**(1,622)**	**(1,941)**	**(3,081)**
Free cash flow	**1,921**	**(223)**	**1,823**	**2,542**	**3,352**

VALUATION

FY ending Dec	2020A	2021A	2022F	2023F	2024F
Normalized PE (x)	65.2	29.7	24.6	20.0	17.7
Normalized PE - at target price (x)	69.5	31.7	26.3	21.3	18.9
PE (x)	58.9	27.4	24.6	20.0	17.7
PE - at target price (x)	62.8	29.2	26.3	21.3	18.9
EV/EBITDA (x)	31.4	20.2	16.2	13.6	12.0
EV/EBITDA - at target price (x)	33.5	21.5	17.3	14.5	12.9
P/BV (x)	5.5	5.0	4.5	4.2	3.8
P/BV - at target price (x)	5.9	5.3	4.8	4.4	4.1
P/CFO (x)	30.2	40.7	25.3	15.8	13.2
Price/sales (x)	5.8	4.5	3.5	3.3	3.2
Dividend yield (%)	1.4	1.1	2.8	3.5	4.0
FCF Yield (%)	2.9	(0.3)	2.7	3.8	5.1
(Bt)					
Normalized EPS	0.9	1.9	2.3	2.8	3.2
EPS	1.0	2.1	2.3	2.8	3.2
DPS	0.8	0.6	1.6	2.0	2.2
BV/share	10.2	11.3	12.5	13.6	14.6
CFO/share	1.9	1.4	2.2	3.6	4.3
FCF/share	1.6	(0.2)	1.5	2.2	2.8

Sources: Company data, Thanachart estimates

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

FINANCIAL RATIOS

FY ending Dec	2020A	2021A	2022F	2023F	2024F
Growth Rate					
Sales (%)	(4.7)	29.6	25.7	7.1	2.1
Net profit (%)	20.6	115.3	11.1	23.1	13.1
EPS (%)	20.6	115.3	11.1	23.1	13.1
Normalized profit (%)	15.6	119.7	20.5	23.1	13.1
Normalized EPS (%)	15.6	119.7	20.5	23.1	13.1
Dividend payout ratio (%)	83.8	29.2	70.0	70.0	70.0
Operating performance					
Gross margin (%)	21.8	26.6	26.7	28.4	29.9
Operating margin (%)	9.2	15.5	15.6	18.0	20.0
EBITDA margin (%)	18.3	22.4	22.0	24.4	26.7
Net margin (%)	8.9	15.1	14.3	16.4	18.2
D/E (incl. minor) (x)	0.2	0.3	0.2	0.2	0.2
Net D/E (incl. minor) (x)	(0.0)	0.1	0.1	0.0	(0.0)
Interest coverage - EBIT (x)	18.5	53.0	31.1	35.7	39.6
Interest coverage - EBITDA (x)	36.7	76.4	43.9	48.4	52.9
ROA - using norm profit (%)	6.0	11.4	11.7	13.2	14.2
ROE - using norm profit (%)	8.6	17.6	19.1	21.6	22.6
DuPont					
ROE - using after tax profit (%)	8.6	17.8	19.0	21.5	22.5
- asset turnover (x)	0.7	0.8	0.8	0.8	0.8
- operating margin (%)	10.1	16.9	16.2	18.5	20.5
- leverage (x)	1.4	1.5	1.6	1.6	1.6
- interest burden (%)	95.1	98.3	96.9	97.3	97.5
- tax burden (%)	92.2	91.1	91.1	91.1	91.1
WACC (%)	9.9	9.9	9.9	9.9	9.9
ROIC (%)	7.7	17.6	18.4	21.1	22.6
NOPAT (Bt m)	980	2,110	2,671	3,298	3,733
invested capital (Bt m)	12,009	14,553	15,607	16,483	16,953

Sources: Company data, Thanachart estimates

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