Talking Thailand #39

SET Outshines Amid Cloudy Global Markets

- Equities

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- **Thai equities down only 1% YTD, outperforming major markets** — We maintain our year-end 2011 targets at 1,150 for SET and 835 for SET50 − or +1 s.d. over mid-cycle PBV, at 2x for SET and 2.3x for SET50 − supported by liquidity and rising ROE. The ongoing ROE expansion is structural, driven by private investment and acquisitions financed by debt. The 0% 2-year USD funding program kindly provided by the US Federal Reserve and an appreciating THB support the ROE expansion. Near-term global uncertainties may stall the trend, but will not derail it. ROE expansion limits a market de-rating as BV continues to grow if earnings do not collapse.

- ***Déjà vu* policies limit runaway public deficit and inflation pressure** — As expected, the new government announced its policy priorities as being: corporate income tax cuts; a halt to the oil fund surcharge; off-budget financing being provided to low-income earners; and more irrigation projects. Novice ministers are struggling to deliver promised policies in a bureaucratic world complicated by regulations. Tax cuts are implementable, while spending may be delayed. The minimum wage policy (at least initially) will benefit only public sector hiring. Inflation fears, therefore, should subside with oil and food prices falling, paving the way for a rate pause.

- **Estimating the downside risk from a global slowdown** — Unlike in the 08-09 recession, we do not expect the earnings of Thailand's listed companies to be hit hard in a global slowdown, with our worst-case forecast for 2012 being a mere 8% decline, driven by lower oil prices and petrochemical spreads. Bank and Property earnings should be resilient, supported by corporate income tax cuts, a peaking in both inflation and interest rates, and a recovery in manufacturing activity in 2H11.

- **Strategy: Balancing Act** — Maintain O/W on the Bank and Property sectors. Within our Banks coverage, our focus is on consumer lenders. We substitute KTB with TISCO, AP with SPALI. Top Picks: KBANK, TISCO, PTT, PTTCH, SPALI, MINT, and TICON. Top Sells: IVL, TCAP, and TRUE.

Figure 1. Thailand – Top Picks

					2011E					
	Rating	Price (Bt)	Target (Bt)	Upside (%)	DY (%)	ETR (%)	P/E (x)	P/BV (x)	EV/EBITDA (x)	EPS Grth (%)
PTT.BK	1L	317.0	450.0	42.0	3.8	45.7	9.1	1.5	4.7	39.2
PTTC.BK	1L	129.0	210.0	62.8	4.3	67.1	8.8	1.6	6.4	113.2
TISCO.BK	1L	39.0	52.0	33.3	6.7	40.1	8.2	1.7	na	20.1
KBANf.BK	1L	125.0	170.0	36.0	3.0	39.0	11.5	2.0	na	29.9
MINT.BK	1L	12.4	18.9	52.4	2.3	54.8	17.7	2.3	10.0	85.1
SPAL.BK	1L	13.5	18.8	39.3	5.6	44.9	7.5	2.1	5.8	21.2
TICN.BK	1L	13.3	20.5	54.1	8.8	62.9	9.1	1.5	6.7	27.5

Source: Citi Investment Research and Analysis (CIRA) estimates (as of 26 August 2011)

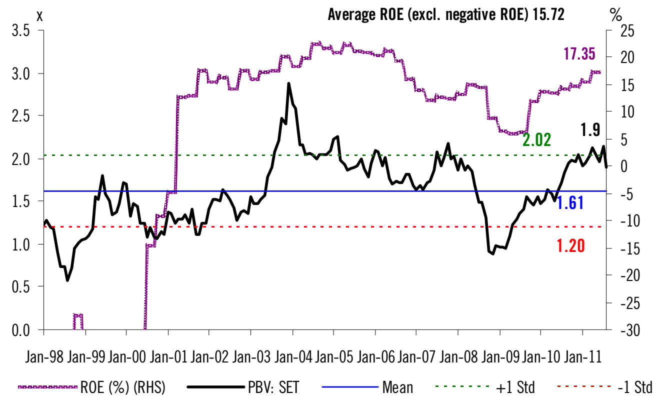
See Appendix A-1 for Analyst Certification, Important Disclosures and non-US research analyst disclosures.

SET Outshines Amid Cloudy Global Market

Maintain 2011 SET and SET50 targets at 1,150 and 835

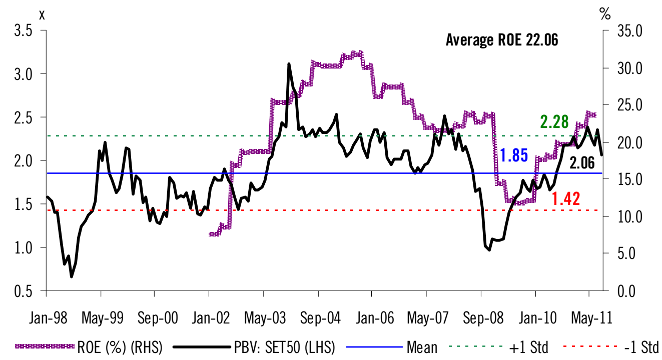
We maintain our year-end 2011 targets at 1,150 for SET and 835 for SET50 − or +1 s.d. over mid-cycle PBV, at 2x for SET and 2.3x for SET50 − supported by liquidity and rising ROE (Figure 2-3). The ongoing ROE expansion is structural, driven by private investment and acquisitions financed by debt. The 0% 2-year USD funding program kindly provided by the US Federal Reserve and an appreciating THB support the ROE expansion. Near-term global uncertainties may stall the trend, but will not derail it. ROE expansion limits a market de-rating as BV continues to grow if earnings do not collapse.

Figure 2. SET – PBV vs. ROE Post-97 crisis



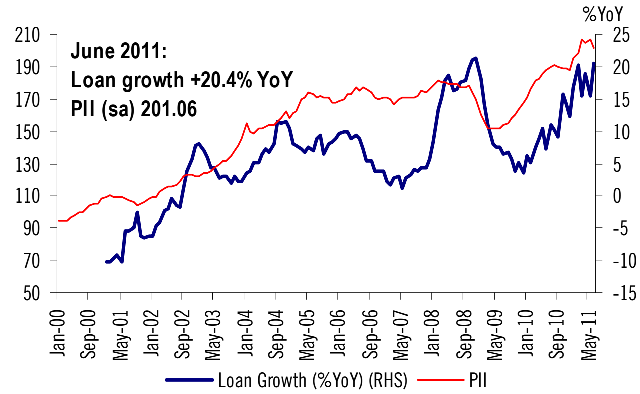
Source: Stock Exchange of Thailand (SET) and CIRA

Figure 3. SET50 – PBV vs. ROE Post-97 crisis



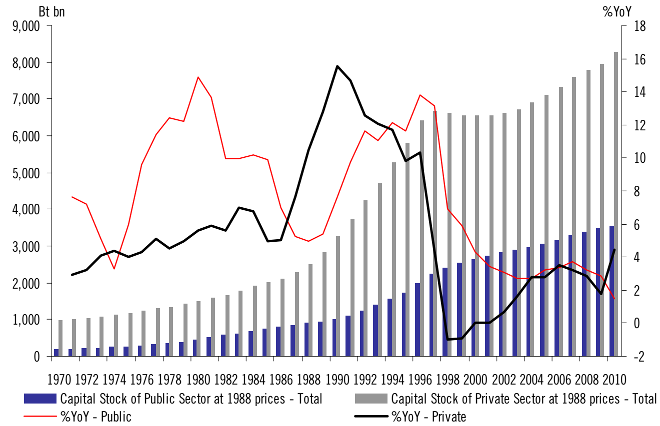
Source: SET and CIRA

Figure 4. Private Investment Index and Loan Growth



Source: Bank of Thailand (BOT)

Figure 5. Accelerating Private Capital Spending Vs. Weakening Public



Source: Office of the National Economic and Social Development Board (NEDB)

Ongoing global growth uncertainty has caused a ~10% correction in the SET since the end of July. We see the de-rating of SET as unjustified and as thus presenting a buying opportunity, with our expectation being for a decent ~10% return by yearend (Figure 6).

Figure 6. SET Was Hit Badly in August But (Along With Indonesia and Philippines) Has Outperformed Major Markets YTD

			Price			Change (%)	
Market	**Index**	**Ticker**	**25-Aug-11**	**31-Jul-11**	**31-Dec-10**	**YTD**	**from End-July**
Developed Markets							
US	S&P 500	.SPX	1,159.3	1,292.3	1,257.6	-7.8	-10.3
EU	DJ Stoxx 50 ETF	.STOXX50	2,159.8	2,510.9	2,586.5	-16.5	-14.0
Japan	Nikkei Stock Average 225	.N225	8,772.4	9,833.0	10,228.9	-14.2	-10.8
Emerging Markets							
Thailand	SET Composite Index	.SETI	1,025.0	1,133.5	1,032.8	-0.8	-9.6
Hong Kong	Hang Seng Index	.HSI	19,752.5	22,440.3	23,035.5	-14.3	-12.0
China	Shanghai Composite Index	.SSEC	2,615.3	2,701.7	2,808.1	-6.9	-3.2
Taiwan	Taiwan SE Weighted Index	.TWII	7,410.9	8,644.2	8,972.5	-17.4	-14.3
India	BSE Sensex	.BSESN	16,146.3	18,197.2	20,509.1	-21.3	-11.3
Korea	KOSPI Index	.KS11	1,764.6	2,133.2	2,051.0	-14.0	-17.3
Malaysia	Straits Times Index	.FTSTI	2,765.7	3,189.3	3,190.0	-13.3	-13.3
Indonesia	Jakarta Composite	.JKSE	3,844.4	4,130.8	3,703.5	3.8	-6.9
The Philippines	PSE Composite Index	.PSI	4,342.7	4,503.6	4,201.1	3.4	-3.6

Source: CIRA

Déjà vu policies limit public deficit and inflation pressure

PM Yingluck laid down her new government's priorities in the official policy statement presented to the Parliament last week. (Figure 7)

Among the priorities outlined:

1. Corporate income tax will be cut from 30% to 23% in 2012 and to 20% in 2013. This will benefit the Bank, Retail, and Property sectors, in which most companies are currently paying a 30% effective tax rate.

2. Oil fund surcharge has been temporarily exempted, as stated on Friday. Similar to what happened in 2H08, this will lower immediately the 4% headline CPI and therefore allow the Bank of Thailand to consider pausing the tightening process.

3. Various off-budget schemes by Specialized Financial Institutions (SFIs) will allow low-income households in urban and rural areas to restructure debts and access debt funding. The SFIs include the Government Saving Bank, SME Bank, Bank for Agriculture and Agricultural Cooperatives, National Housing Authority, and Government Housing Bank. All schemes will relieve debt servicing burdens and therefore improve purchasing power among low-income households.

4. Irrigation projects will be implemented to improve farming productivity and reduce flooding damage. However, implementation will be slowed as a result of the early election in July delaying the 2012 Budget process and implementation toward 1Q12, a quarter later than a normal budget cycle.

5. A promised minimum wage of Bt300/day and a Bt15k monthly starting salary for graduates were softened in the official statement, with implementation made conditional on them being "consistent with improving individual productivity".

   The government will likely, in our view, initially introduce the policy in the public sector and encourage the private sector to adjust accordingly over time through tri-party wage determination committees.

While wages will rise in response to rising inflation over the past three quarters, and at a higher rate than the annual average of 5% in the past 10 years, the increase will be nothing like the 30% one-off adjustment widely suggested by campaigners against the minimum age, and therefore will be less inflationary than feared (Figure 8).

6. Rail and other infrastructure projects are not on the priority list. Therefore, the spending and deficit will not shoot up, as previously projected in Talking Thailand #37 - First Thoughts on Policy Avalanche

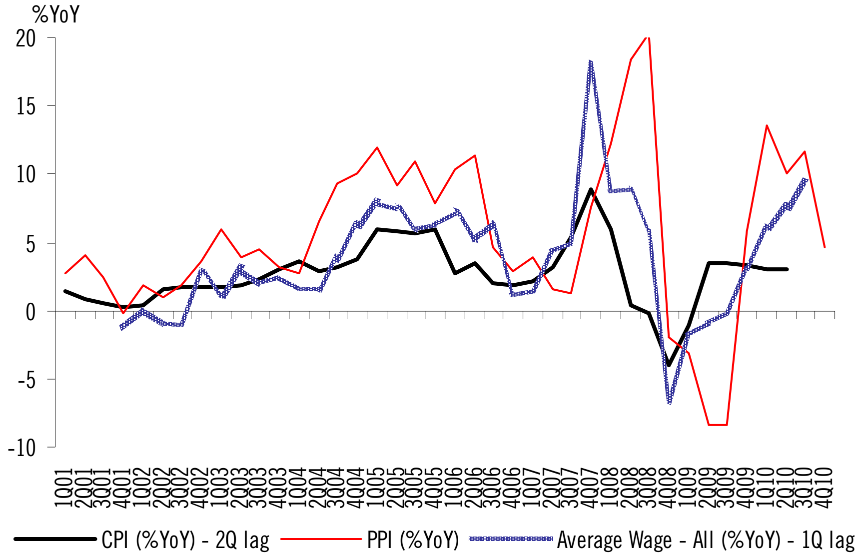
Overall, the policy implementation, while focused on spurring growth and improving income distribution, should not result in a runaway public deficit and wage-price spiral. This will allow the Bank of Thailand to consider a pause in its year-long monetary tightening.

Figure 7. Official Government Policy Priority List Presented to the Parliament on 24 Aug 2011

1	National unity and solidarity through the democratic process
	- compensate those affected during the past year riots
	- support the Independent Truth and Reconciliation Commission
2	Fight narcotic problem
3	Anti-corruption
4	Improve irrigation system to protect flooding and drought
5	Restore peace and safety in southern provinces
6	Improve international relationships and cooperation with neighboring countries
7	Lower cost of living and energy-led inflation hurting private sectors
	- exempt temporarily the Oil Fund surcharge and restructure energy prices to reflect their true costs
	- credit card and subsidy for taxi
	- oversee pricing process of goods & services to reflect fairness to both business operators and households
	- anti-monopoly to any unfair pricing
8	Lift household standards of living and improve macroeconomic balance
	- 3-Yr debt moratorium for farming households with debts < Bt 500k and restructure debts exceeding Bt500k
	- proceed to increase labor income above Bt 300/day and graduate salary above Bt15k/month, consistent with improving individual productivity and with reducing rising labor cost burden on business operators
	- increase subsidy to retirees from Bt500/month to Bt600/month for 60-69 age group, Bt700/month for 70-79 age group, Bt800/month for 80-89 age group, and Bt1,000/month for the rest.
	- tax incentives for first-time buyers of housing units and cars
9	Lower corporate income tax from 30% to 23% in 2012 and 20% in 2013 to meet AEC 2015
10	Promote low-income households' access to startup funding
	- increase Bt 1mn / village additional to all village funds
	- Women Support Fund Bt100mn / province
	- Bt 1bn fund / university as a venture capital fund for graduates
	- SML Village Fund
11	Lift agricultural prices and give farmers access to funding : Post-harvest financing for paddy
12	Promote tourism as the main source of revenue
13	Promote local products under OTOP program
14	Improve the national healthcare system
15	Provide free taplets to students as a pilot project
16	Promote widespread public participation in constitution amendment

Source: CIRA

Figure 8. PPI Leads CPI and Wage Increases by 1-2 Quarters



Source: Ministry of Commerce (MOC) and Bank of Thailand (BOT)

Estimating downside risk from global slowdown

A global downturn hits SET via declining exports, which hurt business and consumer confidence leading to lower consumption and investment activities, and to an equity de-rating due to massive repatriation of international investment and liquidity dislocation. This is what happened to SET in the 08-09 recession.

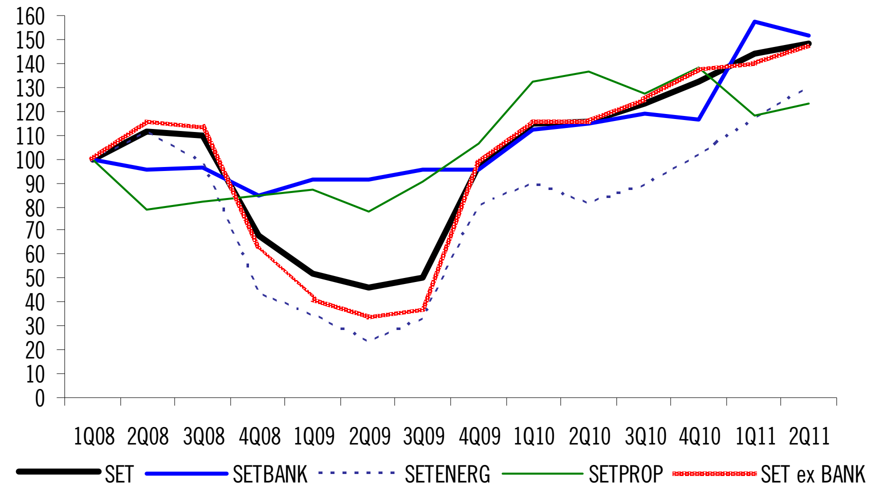
In the current global downturn with our baseline scenario of “no recession”, a market de-rating due to repatriation is unlikely given resilient growth momentum in Asia. However, a hit could come from export declines and earnings weakness in cyclical sectors such as Energy, Chemicals, and Materials.

According to Markus Rosgen, Citi’s Head of Pan Asia Equity Strategy, there is no statistically significant relationship between nominal GDP growth and earnings growth in Thailand. (Please see Pan Asia Strategy - Where To With Earnings?)

Unlike the 08-09 recession, we do not expect the earnings of listed companies to be hard hit, with a mere 8% decline in the worst case. (In such a scenario, we would expect a 20% earnings decline in the Energy, Petrochem, and Construction Material sectors, which have a total 38% market cap weight, and for earnings to be flat for other sectors). This is due to the following reasons:

1. During the 08-09 recession, SET net profits were badly hit by collapses in the oil price, GRM, and petrochemical spreads, pushing earnings down by ~55% and by ~70% for SETENERGY. During the period of 2Q08 and 1Q09, the Brent crude price and GRM fell 54%, while HDPE, PP, and PX spreads were down 10%, 32%, and 16%, respectively (Figure 9).

Figure 9. Net Profit (4-Quarter Trailing) for SET and Sectors* – rebased to 100



Note : * Annualized quarterly NP for SETBANK to avoid the effect of massive provision for IAS39 by Thai banks.
Source: SETSMART and CIRA

Based on Citi's latest oil price downgrade, 2012 Brent crude price is forecast to go down 19% to $86/bbl, from $106/bbl in FY11. A simple linear interpolation implies a ~20% earning decline this time.

(Please see Uncommon Oil Market Ahead…Part II - Markets are winning out, prices are retreating)

However, toward 2012, most major Thai energy and petrochemical companies have volume growth from capacity expansions going live during 2010-12 to offset lower crude prices and petrochemical spreads. Therefore, any earnings decline would likely be less than what is suggested by a linear interpolation.

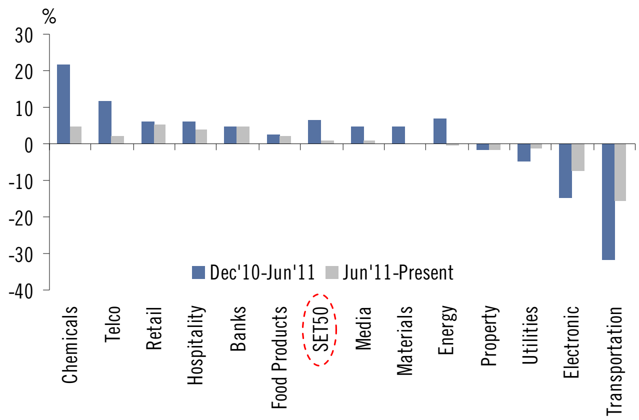
2. According to Citi's Thai banking analyst, Kritipas Siripassorn, a scenario of "no recession" and therefore "no massive interest rate cut" would result in bank earnings being flat (but not negative) in FY12E. (Please see Thailand Banks - Thaksinomics Rather than 2008 Déjà Vu)

3. Household spending, given the current resilience in consumer confidence, would likely keep the top-lines and earnings for Retail, Telco, and Property flat at worst.

4. Cuts to corporate income tax, if implemented, would lift Bank, Retail, and Property earnings by ~10%.

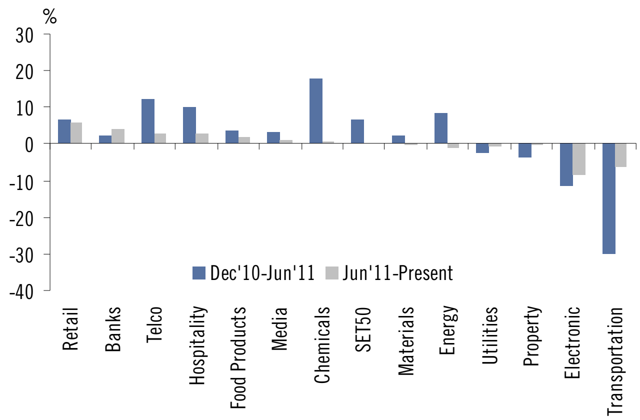
5. Earning revisions since end-June have been to the upside, with the exceptions of Electronics and Transportation. However, earnings downgrades have started for the Energy and Petrochemical sectors in the past couple of weeks, a trend that we expect to continue (Figures 10 and 11).

Figure 10. 2011E Earnings Revisions: Dec'10-1H11 vs. 1H11-Present



Source: Bloomberg and CIRA

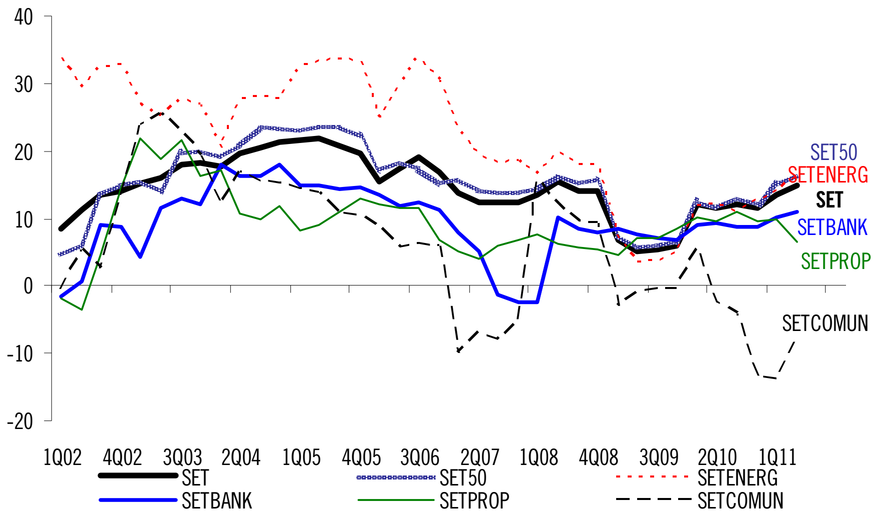
Figure 11. 2012E Earnings Revisions: Dec'10-1H11 vs. 1H11-Present



Source: Bloomberg and CIRA

Overall, if earning downside risk is limited to ~10%, we expect BV accretion to continue at the rate of 5-15% (except for Telco) with rising ROE, and thereby limiting share price downside relating to a de-rating. (Figure 12)

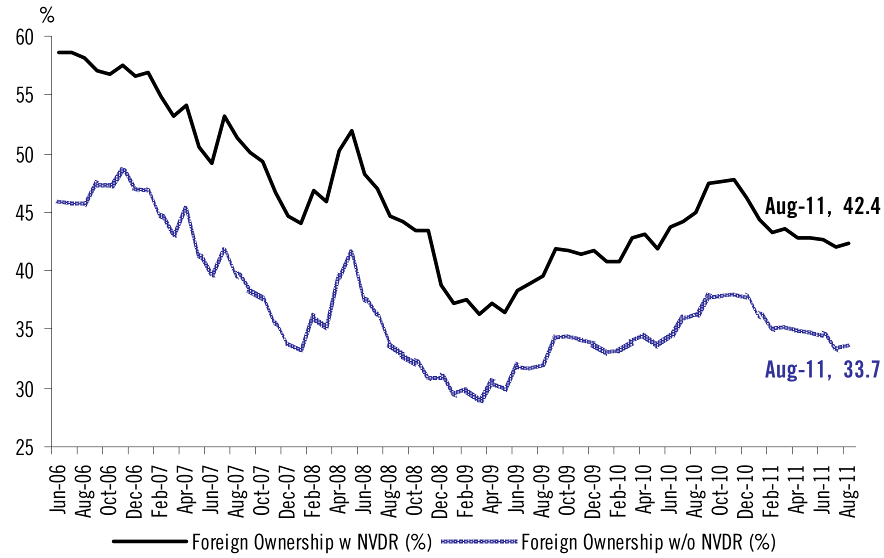
Figure 12. Rate of Book Value Accumulation (ROE – (PBV*DY)) Since 2002



Source: Bloomberg and CIRA

An orderly decline in foreign ownership in Thai listed companies over the past months seems to suggest no stampede for the exit. High exposure to the Bank, Materials, and Chemicals sectors supports our assessment of limited earnings downside from the current global downturn (Figures 13-14).

Figure 13. Foreign Ownership with NVDR



Source: SET

Figure 14. Foreign Ownership with NVDR

Top 5 Foreign Holding	Aug11/High	Current-Aug 11	High	High Month	Average
Bank	99.3	48.6	48.9	Apr-11	41.5
Materials	99.0	36.7	37.1	Jul-11	32.6
Chemicals	98.1	48.2	49.1	Apr-11	18.1
Health Care	94.5	22.8	24.1	Jul-07	19.2
Electronic	93.7	87.9	93.9	May-04	89.1
Bottom 3 Foreign Holding					
Transportation	54.2	20.0	36.8	Nov-03	25.6
Retail	72.9	35.1	48.1	Apr-06	40.8
Food Products	74.8	28.1	37.6	Jul-07	27.5

Top 5 Foreign Holding	Aug11/High	Current-Aug 11	High	High Month	Average
BEC.BK	100.0	43.0	43.0	Aug-11	33.9
RATC.BK	100.0	26.0	26.0	Aug-11	14.7
BLA.BK	99.3	48.6	48.9	May-11	41.5
KBANf.BK	99.2	74.7	75.3	Jul-11	64.8
SCCC.BK	99.1	49.7	50.1	Sep-10	25.4
Bottom 5 Foreign Holding					
TTA.BK	20.4	16.2	79.2	Jul-07	48.3
TRUE.BK	21.7	11.7	54.1	Sep-06	33.6
ITD.BK	25.1	12.5	49.8	May-08	27.9
TPC.BK	26.2	5.2	19.7	Nov-02	8.6
IRPC.BK	31.1	11.9	38.3	Nov-05	20.6

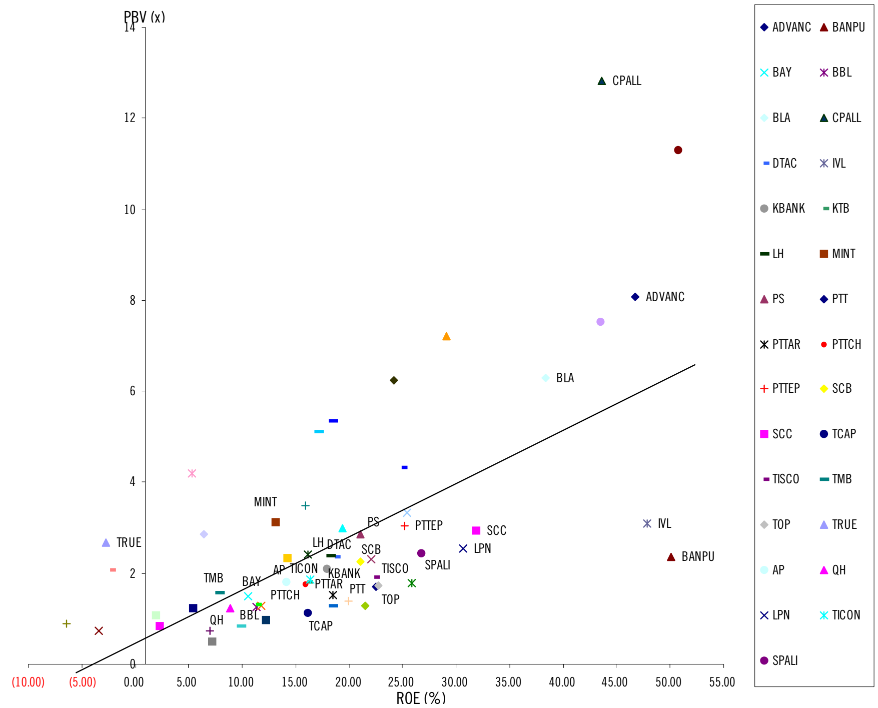
Source: SET

Strategy: Balancing Act

While earnings visibility is blurring, rising ROE above mid-cycle levels and BV accumulation should limit a de-rating and downside risk to SET. A careful search for value, i.e. PBV/ROE tradeoff, could prove a decent investment strategy.

A simple regression on PBV/ROE among listed companies offers some guidance to singling out relatively expensive names (above the regression line or PBV > Est PBV) and relatively attractive names (below the regression line or PBV < Est PBV) (Figures 15-17).

Figure 15. Distribution of PBV / ROE of SET50 Universe and the Estimated Regression Line



Source: CIRA

Figure 16. SET50 under Citi coverage with PBV – Estimated PBV and DY

Company	RIC code	Industry	Rating	(Current PBV - Est PBV)*	Dividend Yield 2012
BANPU	BANP.BK	Energy	1L	(4.34)	2.88
IVL	IVL.BK	Chemicals	3M	(3.34)	2.38
LPN	LPN.BK	Property	1L	(1.78)	6.00
TOP	TOP.BK	Energy	1L	(1.61)	5.05
PTT	PTT.BK	Energy	1L	(1.60)	3.81
SCC	SCC.BK	Materials	1L	(1.54)	4.14
SPALI	SPAL.BK	Property	1L	(1.41)	6.57
TCAP	TCAP.BK	Banks	3M	(1.41)	4.35
TISCO	TISCO.BK	Banks	1L	(1.39)	7.45
PTTAR	PTTAR.BK	Energy	1M	(1.30)	6.94
SCB	SCB.BK	Banks	1L	(0.87)	3.94
PTTCH	PTTC.BK	Chemicals	1L	(0.74)	5.53
KTB	KTB.BK	Banks	1L	(0.73)	4.58
TICON	TICN.BK	Property	1L	(0.71)	10.42
BBL	BBLf.BK	Banks	1L	(0.68)	4.26
KBANK	KBANf.BK	Banks	1L	(0.65)	3.66
PTTEP	PTTE.BK	Energy	3L	(0.60)	4.21
DTAC	DTAC.BK	Telecommunication	1L	(0.48)	6.66
AP	AP.BK	Property	1M	(0.46)	5.49
QH	QH.BK	Property	2L	(0.42)	5.13
LH	LH.BK	Property	2M	(0.41)	5.20
BAY	BAY.BK	Banks	3L	(0.34)	3.83
PS	PS.BK	Property	3M	(0.27)	4.33
TMB	TMB.BK	Banks	3L	0.05	2.39
MINT	MINT.BK	Health Care	1L	0.96	3.03
BLA	BLA.BK	Banks	2L	1.03	1.81
ADVANC	ADVA.BK	Telecommunication	1L	1.78	7.57
TRUE	TRUE.BK	Telecommunication	3H	2.46	0.00
CPALL	CPALL.BK	Retail	2M	6.92	3.36

Note : * (PBV – Estimated PBV) < 0 implies relatively attractive; > 0 implies relatively expensive

Source: CIRA

Figure 17. SET50 Universe outside Citi coverage with PBV – Estimated PBV and DY

Company	RIC code	Industry	Rating	(Current PBV - Est PBV)*	Dividend Yield 2012
STA	STA.BK	Agribusiness	NR	(1.94)	5.10
ESSO	ESSO.BK	Energy	NR	(1.89)	7.49
DELTA	DELT.BK	Electronic	NR	(1.59)	8.56
HANA	HANA.BK	Electronic	NR	(1.53)	7.39
KK	KK.BK	Banks	NR	(1.09)	7.29
TTW	TTW.BK	Utilities	NR	(0.95)	7.40
TPIPL	TPIP.BK	Materials	NR	(0.93)	2.26
EGCO	EGCO.BK	Utilities	NR	(0.92)	5.90
IRPC	IRPC.BK	Energy	NR	(0.70)	5.29
CCET	CCET.BK	Electronic	NR	(0.67)	6.28
RATCH	RATC.BK	Utilities	NR	(0.62)	5.45
CPF	CPF.BK	Food Products	NR	(0.35)	4.51
TUF	TUF.BK	Food Products	NR	(0.10)	2.30
PSL	PSL.BK	Transportation	NR	0.00	4.96
AOT	AOT.BK	Transportation	NR	0.02	3.23
GLOW	GLOW.BK	Utilities	NR	0.03	4.85
SCCC	SCCC.BK	Materials	NR	0.05	6.54
BTS	BTS.BK	Transportation	NR	0.29	2.66
SSI	SSI.BK	Materials	NR	0.63	3.88
BH	BH.BK	Health Care	NR	0.72	2.99
BGH	BGH.BK	Health Care	NR	0.98	2.14
THAI	THAI.BK	Transportation	NR	1.13	4.68
KSL	KSL.BK	Food Products	NR	1.52	2.80
DCC	DCC.BK	Materials	NR	1.64	7.46
ITD	ITD.BK	Construction	NR	1.80	0.60
BIGC	BIGC.BK	Retail	NR	2.48	2.37
ROBINS	ROBIN.BK	Retail	NR	2.53	2.01
MAKRO	MAKR.BK	Retail	NR	2.73	4.36
CPN	CPN.BK	Property	NR	3.01	1.46
HMPRO	HMPR.BK	Retail	NR	3.09	2.97
BEC	BEC.BK	Media	NR	4.52	5.28

Note : * (PBV – Estimated PBV) < 0 implies relatively attractive; > 0 implies relatively expensive

Source: Bloomberg

We combine this with our fundamental view that

1. Inflation and interest rates have peaked
2. The private investment up-cycle will be ongoing, driven by FDI and corporate re-leveraging
3. Corporate income tax rates will be cut

We maintain our O/W on the Bank and Property sectors which we see as benefiting from corporate income tax cuts, a peak in interest rates, and a potential tax incentive scheme to encourage household durable spending. (Please see Thai Residential Property - At an Inflection Point and Supalai PCL (SPAL.BK) - Initiate at Buy: Rerating Story Has Its Legs)

Also, we pick PTT and PTTCH on value and limited earning downside cushioned by volume growth toward 2012.

Among Banks, we shift our preference to consumer lenders, with the inclusion among our Top Buys of TISCO, at the expense of KTB, while in Property we switch out of AP and into SPALI.

Top Picks: KBANK, TISCO, PTT, PTTCH, SPALI, MINT, and TICON.

Top Sells: IVL, TCAP, and TRUE.

Figure 18. Strategist's Top Buys and Sells (26 August 2011)

	RIC	CIRA Analyst Rating	Current Price (Bt)	Target Price (Bt)	Upside (%)	2011E Valuations DY (%)	ETR (%)	P/E (x)	P/BV (x)	EV/EBITDA (x)	EPSGrowth (%)
Top Buys											
PTT	PTT.BK	1L	317.0	450.0	42.0	3.8	45.7	9.1	1.5	4.7	39.2
PTT Chemical	PTTC.BK	1L	129.0	210.0	62.8	4.3	67.1	8.8	1.6	6.4	113.2
TISCO Financial Group	TISCO.BK	1L	39.0	52.0	33.3	6.7	40.1	8.2	1.7	na	20.1
Kasikornbank	KBANf.BK	1L	125.0	170.0	36.0	3.0	39.0	11.5	2.0	na	29.9
Minor International	MINT.BK	1L	12.4	18.9	52.4	2.3	54.8	17.7	2.3	10.0	85.1
Supalai PCL	SPAL.BK	1L	13.5	18.8	39.3	5.6	44.9	7.5	2.1	5.8	21.2
TICON Industrial Connection	TICN.BK	1L	13.3	20.5	54.1	8.8	62.9	9.1	1.5	6.7	27.5
Average						**4.9**		**10.3**	**1.8**	**6.7**	**48.0**
Top Sells											
Indorama Ventures	IVL.BK	3M	37.0	44.0	18.9	2.7	21.6	9.3	2.5	8.2	69.2
Thanachart Capital	TCAP.BK	3M	29.5	33.0	11.9	4.4	16.3	7.2	1.0	na	-7.5
True Corp	TRUE.BK	3H	3.8	2.7	-28.9	0.0	-28.9	nm	2.5	6.2	-164.1
Average						**2.4**		**8.3**	**2.0**	**7.2**	**-34.1**

Source: CIRA Estimates

Appendix A-1

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