

BUY (Unchanged) **TP: Bt 55.00** (From: Bt 67.00)

Change in Numbers **Upside: 77.4%**



Toyo-Thai Corporation Pcl (TTCL TB)

Earnings bottoming out

We cut our TP for TTCL to Bt55.0 from Bt67.0 as we see a higher risk from working on high-value low-margin EPC projects. But we believe the bad news has been factored into the share price while catalysts from the COD of the 120MW power project's phase 3, an EPC earnings turnaround & the MOA signing for the 1,280MW power project still look intact. BUY.



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TP downgraded to Bt55.0/share

We cut our 2014-16F earnings for TTCL by 18-33% for three major reasons. First, we lower our gross margin assumptions for TTCL's EPC business to 5.8-7.1% (from 10.5%) in 2014-16F to reflect greater risk from working on high-value, low-margin EPC projects. Secondly, we assume the MOA signing for the 1,280MW Myanmar project is delayed to early next year and that construction starts in 3Q15 (from 1Q15). Finally, we are more conservative on the 1,280MW power project's IRR and assume 13.5% (from 18.0%). Our 12-month DCF-derived SOTP-based TP falls to Bt55.0/share from Bt67.0.

Attractive valuation in our view

Despite the negatives outlined above, we reiterate our BUY call on TTCL and it is still in our top sector picks. We believe all the bad news has already been factored into the share price, which has fallen 24% from its April peak and has underperformed the SET by 29%. The shares now trade at 12.3-14.9x PE in 2015-16F, at the low end of their historical PE 2009-13 range of 12-28x. This is despite our expectation of re-rating factors from higher recurring earnings in 4Q14F with the scheduled COD of the 120MW Myanmar project's phase 3, potential new EPC work being awarded, and the MOA signing for the 1,280MW power project which we expect early next year.

More recurring income as a re-rating factor

We forecast the scheduled COD of the 120MW power project's phase 3 in 4Q14 to boost the project's gross profit and interest income to Bt774m a year from 2015 onward. Combined with equity income from Siam Solar Power (SSP) and dividend income from Navanakorn Electric, we project recurring gross profit from the power business to contribute 35% of TTCL's total gross profit in 2015. We see this as a re-rating factor as more recurring income should help to stabilize TTCL's earnings. Also, the 1,280MW Myanmar power project, despite a delay of almost a year, still looks to be on and is now in the last stage of documentation review. We factor in the MOA signing by early next year and value the project at Bt28.0/TTCL share out of our Bt55.0 TP.

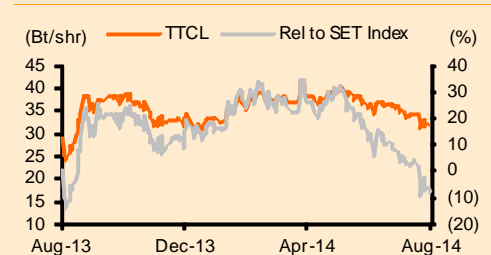
Expecting an EPC earnings recovery in 4Q14

TTCL has suffered an earnings hiccup due to cost overruns for the past four quarters. We see this as a result of its transformation from a small- to a medium-sized EPC contractor and its lack of experience in a new market, Qatar, recently. But we believe management has gained experience while potential new contracts, which management expects to win by the end of this year, are in countries where TTCL is now well established. This should allow TTCL to control costs more efficiently. These potential projects are in Vietnam, Malaysia and Qatar with a total value of US\$500m-700m. This is addition to the Bt60bn of potential EPC work for the 1,280MW power project.

COMPANY VALUATION

Y/E Dec (Bt m)	2013A	2014F	2015F	2016F
Sales	15,441	17,052	26,853	37,882
Net profit	655	617	1,167	1,410
Consensus NP	—	686	1,085	1,275
Diff frm cons (%)	—	(10.0)	7.6	10.6
Norm profit	655	617	1,167	1,410
Prev. Norm profit	—	921	1,423	1,753
Chg frm prev (%)	—	(33.0)	(18.0)	(19.6)
Norm EPS (Bt)	1.4	1.1	2.1	2.5
Norm EPS grw (%)	13.9	(19.2)	88.9	20.9
Norm PE (x)	22.7	28.1	14.9	12.3
EV/EBITDA (x)	15.5	19.8	10.8	9.4
P/BV (x)	2.8	3.1	2.7	2.4
Div yield (%)	2.3	1.8	3.4	4.1
ROE (%)	17.7	11.2	19.4	20.9
Net D/E (%)	(24.5)	(28.4)	(0.3)	19.4

PRICE PERFORMANCE



COMPANY INFORMATION

Price as of 26-Aug-14 (Bt)	31.00
Market cap (US\$ m)	543.9
Listed shares (m shares)	560.0
Free float (%)	48.5
Avg daily turnover (US\$ m)	2.2
12M price H/L (Bt)	40.75/24.20
Sector	Construction
Major shareholder	Toyo Engineering Corp 23%

Sources: Bloomberg, Company data, Thanachart estimates

We cut our earnings forecasts by 18-33% in 2014-16 and TP to Bt55.0 due to...

...a delay in new contracts being awarded to TTCL ...

...lower EPC gross margin assumptions of 5.8-7.1%...

... and a cut in the 1,280MW project's IRR to 13.5%

TP downgraded to Bt55.0/share

We see Toyo-Thai Corporation's (TTCL) earnings hiccup over the past four quarters as being a result of its transition from being a small- to a regional mid-sized engineering, procurement and construction (EPC) contractor. Even though we believe management has already gained experience, we adopt more conservative assumptions to reflect higher risk from working on high-value, low-margin projects.

First, even though we maintain our new work value assumption of Bt15bn per year in 2014-16, we cut the proportion of revenue recognition from the new work value this year to 2% (from 17% previously) to reflect our expectation of the new contracts being awarded late in the year.

Secondly, we are more conservative in our assumptions for the 1,280MW Myanmar power project and we expect the MOA to be signed early next year and for construction to start in 3Q15 (from 1Q15 previously).

Thirdly, we lower our gross margin assumptions for the EPC business to 5.8% in 2014 and 7.1% in 2015-16 (from 10.5% previously) to reflect the recent cost overruns seen at the Qatar project and greater risk from working on high-value, low-margin projects.

Fourthly, we also turn more conservative on the IRR of the 1,280MW power project with an assumption of 13.5% (from 18.0% previously).

As a result, we cut our earnings projections for TTCL by 18-33% in 2014-16 and lower our 12-month DCF-derived SOTP-based TP to Bt55.0/share from Bt67.0.

Ex 1: Key Assumption Changes

	2014F	2015F	2016F
EPC revenues (Bt m)			
- New	15,030	20,073	19,062
- Old	17,272	18,073	18,770
- Change (%)	(13.0)	11.1	1.6
Construction revenues from concession arrangement (Bt m)			
- New	1,572	6,000	18,000
- Old	1,500	8,000	15,000
- Change (%)	4.8	(25.0)	20.0
Average gross margin (%)			
- New	8.5	8.9	8.1
- Old	10.5	10.5	10.5
- Change (%)	(2.0)	(1.6)	(2.4)
Net profit (Bt m)			
- New	617	1,167	1,410
- Old	921	1,423	1,753
- Change (%)	(33.0)	(18.0)	(19.6)

Source: Thanachart estimates

TTCL remains in our top sector picks list

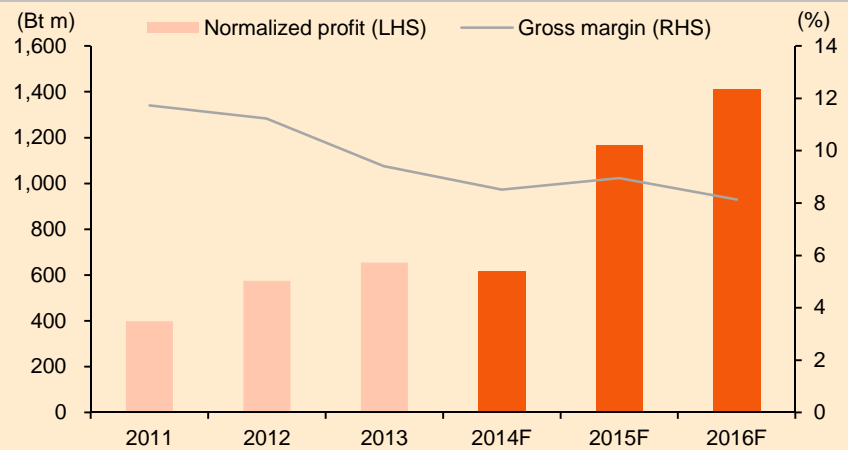
We expect an earnings recovery in 4Q14

Attractive valuation

However, we reiterate our BUY recommendation on TTCL and it is still in our top sector picks list as we believe all the bad news has already been factored into the share price while we still expect TTCL to enjoy the following catalysts which we believe the market is ignoring.

First, we expect TTCL's earnings to turn around from 4Q14 onward on the heels of the scheduled COD of the 120MW power project's phase 3, less of an impact from cost overruns at the Qatar project, and potential new EPC work contracts being awarded to TTCL late this year or early next year.

Ex 2: TTCL's Earnings Turnaround



Sources: Company data, Thanachart estimates

More recurring earnings should allow a re-rating

We believe the 1,280MW Myanmar project is still on

TTCL's PE valuation is attractive in our view

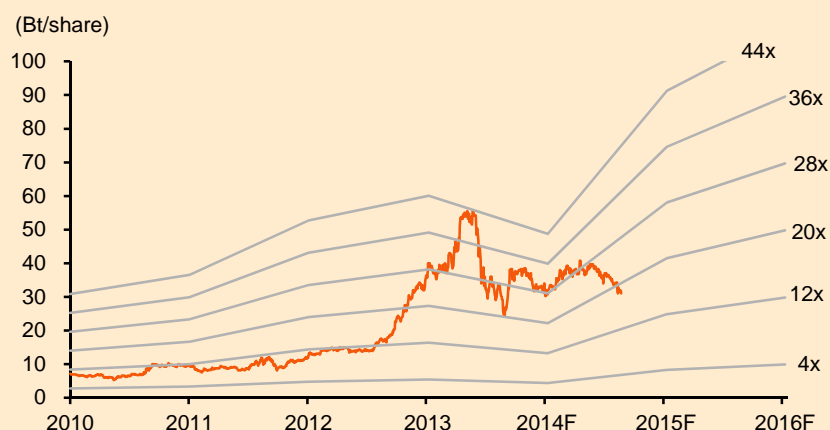
Secondly, we expect increased recurring earnings from the power business to act as a re-rating factor for TTCL's share price as this would not only boost TTCL's earnings but also help to stabilize its future performance.

Thirdly, despite a delay of almost a year, we believe the 1,280MW power project is still on and it is now in the final stage of documentation review by the Myanmar government. We factor in the MOA signing taking place in early 2015 even though management's guidance is for late 2014.

Finally, TTCL says the listing of a subsidiary on the Singapore stock market would follow after the MOA signing.

We therefore see the 24% collapse in TTCL's share price from its peak in April and 29% underperformance versus the Stock Exchange of Thailand (SET) so far this year as being overdone. We regard its shares, which are trading at 2015F and 2016F PE multiples of 14.9x and 12.3x, as inexpensive compared with their historical 2009-13 PE range of 12-28x. We believe the high PE multiple in mid-2013 was mainly because of expectations for the 1,280MW power plant project getting going. The continued delay of the project has put the share price under pressure even though we believe the project is still on. Given our forecast for a three-year EPS CAGR of 34% during 2015-17, TTCL's 2015F PE to three-year EPS CAGR ratio looks low at only 0.5x.

Ex 3: TTCL's PE Band Chart



Sources: Company data, Thanachart estimates

Of our TP for TTCL of Bt55.0 per share, we value TTCL's existing construction and power businesses at Bt27.0 per share and the 1,280MW power project at Bt28.0.

More recurring income as a re-rating factor

We forecast recurring gross profit from power business to rise to 35% of total in 2015

Kicked off in 2010, we expect TTCL's strategy to diversify its risky EPC business by investing in power projects and earning more recurring income to bear fruit in 2015. We also see it as a re-rating factor for TTCL's share price as it would not only boost the company's earnings but also help to stabilize its performance in the future.

Ex 4: TTCL's Gross Profit Breakdown

	1H14		2014F		2015F	
	(Bt m)	% proportion	(Bt m)	% proportion	(Bt m)	% proportion
Revenues						
EPC	9,528	88%	15,030	88%	20,073	75%
Power plant construction	1,172	11%	1,572	9%	6,000	22%
Electricity sales	165	2%	450	3%	780	3%
Total	10,865	100%	17,052	100%	26,853	100%
Costs						
EPC	9,098	90%	14,159	91%	18,654	76%
Power plant construction	999	10%	1,352	9%	5,640	23%
Electricity sales	32	0%	90	0%	156	1%
Total	10,129	100%	15,600	100%	24,450	100%
Gross profit						
		% margin		% margin		% margin
EPC	431	4.5%	871	5.8%	1,419	7.1%
Power plant construction	173	14.8%	220	14.0%	360	6.0%
Electricity sales	133	80.6%	360	80.0%	624	80.0%
Total	827	7.6%	1,451	8.5%	2,403	8.1%
Other recurring income						
		% margin		% margin		% margin
Interest income	90	—	150	—	150	—
Dividend & equity income	11	—	20	—	70	—
Total	928	—	1,621	—	2,623	—

Sources: Company data, Thanachart estimates

We forecast TTCL's power plant business to contribute 35% of total gross profit in 2015 for the following reasons:

First, we expect TTCL to receive Bt20m in equity income from 2014 onward through its 28% stake in the common shares of Siam Solar Power (SSP), an 8MW solar power plant. SSP contributed Bt11m of equity income to TTCL in 1H14.

Secondly, we forecast TTCL to obtain Bt50m of dividend income from 2015 onward through its 42% stake in the preferred shares of Navanakorn Electric, a 110MW power plant, which came on stream early this year.

Thirdly, we project TTCL to enjoy Bt624m in gross profit from electricity sales plus Bt150m of interest income from the 120MW power plant's operation in 2015. The project's single-cycle phases 1 and 2 with total capacity of 80MW already came on stream in late 2013 and they contributed Bt133m of electricity sales and Bt90m of interest income in 1H14. The project's combined cycle phase 3 with capacity of 40MW is now being test-run and TTCL expects it to have COD by 4Q14.

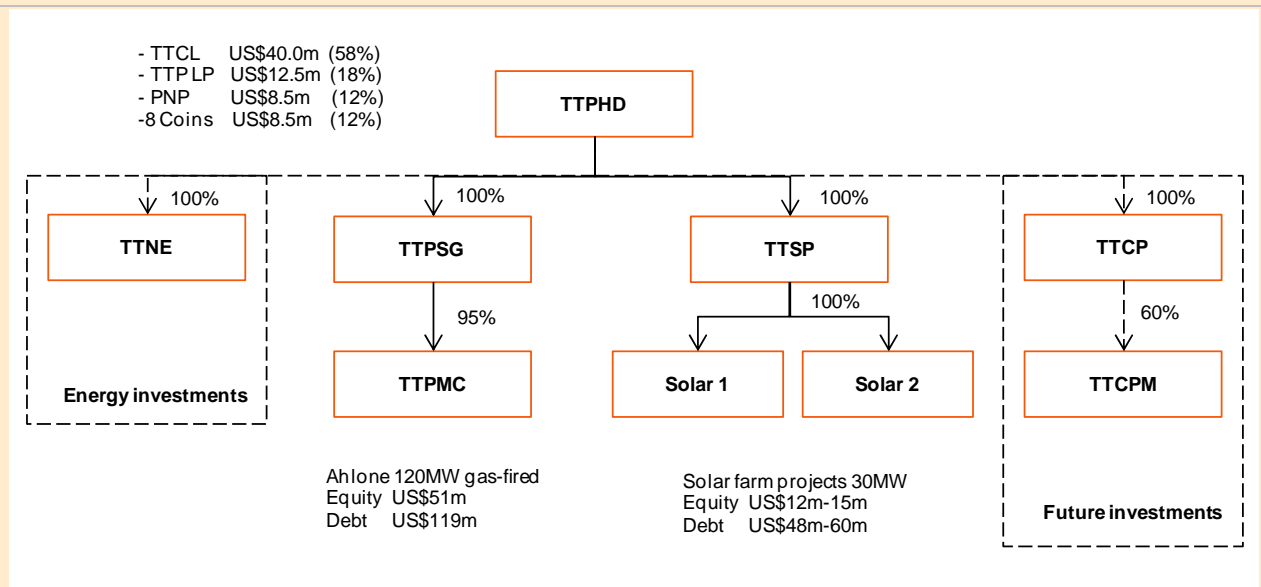
As for the 1,280MW Myanmar power project, despite it being delayed for almost a year, we believe the project is still on and it is now in final stage of documentation review by the Myanmar government. Management expects to sign the MOA by the end of this year or early next year.

To recap, the project is to build a 1,280MW ultra supercritical coal-fired power plant, which is the most efficient and environmental friendly, in Mon State, Myanmar. The investment cost is US\$2.6bn, of which US\$2bn is to be funded by loans with the rest coming from TTCL's internal cash flow, partners and the listing of a subsidiary on the Singapore stock market. We expect the project IRR to be 13.5% with the COD in late 2018. Out of our Bt55.0 TP, we value the 1,280MW power project at Bt28.0 per TTCL share.

We expect Bt774m in gross profit in 2015 after COD of 120MW project's phase 3 in 4Q14

Out of our Bt55.0 TP, we value the 1,280MW project at Bt28.0

Ex 5: Despite A Delay, We Believe The 1,280MW Myanmar Power Project Is Still On



Source: Company data

Expecting an EPC earnings recovery in 4Q14

Even though stepping up to medium-sized projects should allow TTCL to grow in the future, during the transition period it has caused TTCL to face: 1) one-time legal and administrative fees from setting up new offices in Malaysia, Singapore, the US and Myanmar in 3Q13, 2) cost overruns from procurement for the domestic power project in 4Q13, and 3) cost overruns from the construction of the Qatar project in 2Q14.

However, we now expect TTCL's earnings from the EPC business to turn around from 4Q14 onward on the back of the following reasons:

First, even though the Qatar project now offers only a 1% gross margin, the remaining value is less than Bt2bn versus TTCL's total backlog value of Bt17bn at the end of 2Q14.

Secondly, most of the current backlog value is now from domestic projects which should allow TTCL to control costs more efficiently.

Thirdly, most of the potential new work value of US\$500m-700m by the end of this year or early next year is from projects in Vietnam, Malaysia and Qatar where TTCL is now well established.

Please also note that we factor in the Bt60bn of EPC work value for the 1,280MW Myanmar power project starting to be recognized as revenue from 3Q15 onward with a gross margin of 6%. This is compared with a gross margin of 14.8% in 1H14 from the EPC work for the 120MW power project.

We forecast EPC earnings to recover in 4Q14

US\$500m-700m of potential new work value by early next year

Ex 6: TTCL's Existing Backlog Value

Backlog by industry		
Industry	Projects	Remaining value (Bt m)
Power	5	12,270
Petrochem	5	1,090
Fertilizer	3	970
Utility	1	1,330
Other	2	1,480
Total	16	17,140

Backlog by location		
Location	Projects	Remaining value (Bt m)
Domestic	8	12,540
Overseas	8	4,600
Total	16	17,140

Source: Company data

Ex 7: TTCL's Potential Project Proposals

Potential proposals by industry		
Industry	Projects	Project value (Bt m)
Petrochem	11	54,304
Power	6	84,800
Others	4	30,720
Total	21	169,824

Potential proposals by location		
Location	Projects	Project value (Bt m)
Domestic	6	23,904
Overseas	15	145,920
Total	21	169,824

Source: Company data

Ex 8: 12-month DCF-derived SOTP TP Calculation

(Bt m)	2014F	2015F	2016F	2017F	2018F	2019F	2020F	2021F	2022F	2023F	2024F	Terminal value
EBITDA	786	1,606	2,021	2,159	1,630	1,420	1,533	1,544	1,555	1,566	1,577	—
Free cash flow	798	1,295	1,910	1,876	844	1,470	2,216	1,804	1,279	1,290	1,301	13,838
PV of free cash flow	—	1,291	1,534	1,350	544	849	1,147	837	532	481	434	4,618
Risk-free rate (%)	4.5											
Market risk premium (%)	7.5											
Beta	1.1											
WACC (%)	11.6											
Terminal growth (%)	2.0											
Enterprise value	13,618											
Net debt (2014F)	(1,787)											
Minority interest	648											
Equity value	14,757											
# of shares	560											
Equity value/share (Bt)	26											
Sum of the parts												(Bt m)
Enterprise value from construction business												13,618
Investment equity value												15,811
1,280MW power plant in Myanmar								28%				15,811
Total enterprise value												29,428
(Less) Net debt												(1,787)
(Less) Minority interest												648
Total enterprise value												30,567
# of shares (fully diluted) (m shares)												560
Sum of the parts (Bt)												55

Sources: Company data, Thanachart estimates

COMPANY DESCRIPTION

Toyo-Thai Corporation Pcl (TTCL) was the first all-round engineering firm in Thailand. It was incorporated in 1985 in a JV between Italian-Thai Development Pcl, one of the biggest contractors in Thailand, and Toyo Engineering Corp, a top international engineering firm in Japan. TTCL is an integrated contractor providing integrated design and engineering, procurement of equipment and materials, and construction (integrated EPC) services for turnkey projects, mainly to the petrochemical, chemical and petroleum industries.

Source: Thanachart

THANACHART'S SWOT ANALYSIS

S — Strength

- Cost competitiveness due to low engineer costs in Thailand.
- The power plant investment with recurring income to cushion volatility of the EPC business.
- Strong support from major shareholders, such as Toyo Engineering and Chiyoda, which are international EPC contractors.

O — Opportunity

- TTCL's exposure to overseas work boosts its chances of enjoying the AEC investment boom story.
- The increasing need for infrastructure development to fuel economic growth in Southeast Asian countries.

CONSENSUS COMPARISON

	Consensus	Thanachart	Diff
Target price (Bt)	38.50	55.00	43%
Net profit 14F (Bt m)	686	617	-10%
Net profit 15F (Bt m)	1,085	1,167	8%

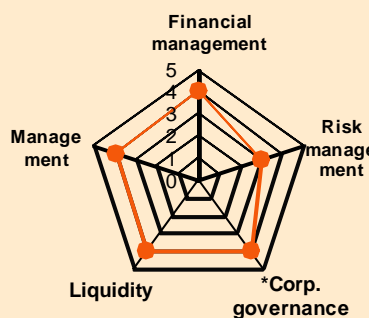
Consensus REC BUY: 7 HOLD: 1 SELL: 2

HOW ARE WE DIFFERENT FROM THE STREET?

- Our net profit forecast for this year is lower than the consensus as we are more conservative in our gross margin assumption.
- But our TP is 43% above the Street's as we incorporate the 1,280MW power plant project.

Sources: Bloomberg consensus, Thanachart estimates

COMPANY RATING



Rating Scale

Very Strong	5
Strong	4
Good	3
Fair	2
Weak	1
None	0

Source: Thanachart; *CG Awards

W — Weakness

- TTCL is only qualified to bid for projects with a value of less than US\$500m.
- The engineering business is labor-intensive. Thus, there are risks of higher engineer costs and shortages of engineers.

T — Threat

- Political instability in foreign countries.
- Unforeseeable costs from overseas projects
- Global economic volatility and the down-cycle in the petrochemical industry could cause delays to new investments.

RISKS TO OUR INVESTMENT CASE

- Given that the petrochemical industry is cyclical and highly dependent on global economic fluctuations, delays to new investments in the sector would have a significant impact on TTCL's future backlog.
- TTCL's core value is experienced engineers who can work on design and engineering work. Movement of these engineers with the AEC's launch in 2015 could have an impact on its operation.
- If the Myanmar project doesn't materialize, then our TP would fall to Bt27.0.

Source: Thanachart

FINANCIAL SUMMARY

Income Statement						(consolidated) Quarterly Earnings					(consolidated)	
FY ending Dec (Bt m)	2012A	2013A	2014F	2015F	2016F		2Q13	3Q13	4Q13	1Q14	2Q14	
Sales	11,358	15,441	17,052	26,853	37,882	Sales	3,896	4,082	4,676	4,871	5,993	
Cost of sales	10,083	13,987	15,600	24,450	34,798	Cost of sales	3,519	3,642	4,412	4,385	5,744	
Gross profit	1,276	1,453	1,451	2,403	3,084	Gross profit	376	440	264	486	250	
SG&A	677	662	716	859	1,136	SG&A	90	259	104	234	139	
Operating profit	598	791	735	1,544	1,947	Operating profit	287	181	160	253	111	
Depre & amortization	24	77	51	62	73	Depre & amortization	6	38	27	11	10	
EBITDA	622	868	786	1,606	2,021	EBITDA	293	219	187	263	122	
Other income	164	24	168	219	216	Other income	88	7	5	45	45	
Other expenses	0	0	0	0	0	Other expenses	0	0	0	0	0	
Interest expense	0	(27)	(50)	(79)	(164)	Interest expense	(2)	(12)	(13)	(4)	(15)	
Pre-tax profit	763	788	854	1,684	2,000	Pre-tax profit	373	175	152	293	141	
Income tax	189	162	196	387	460	Income tax	98	27	31	(11)	67	
After-tax profit	574	626	657	1,297	1,540	After-tax profit	274	148	121	304	74	
Equity income	1	6	20	20	20	Equity income	10	(1)	(2)	(0)	6	
Minority interests	(0)	23	(60)	(150)	(150)	Minority interests	(2)	9	7	(31)	8	
Extraordinary items	(2)	0	0	0	0	Extraordinary items	0	0	4	(61)	0	
NET PROFIT	573	655	617	1,167	1,410	NET PROFIT	282	157	130	211	89	
Normalized profit	575	655	617	1,167	1,410	Normalized profit	282	157	126	272	89	
EPS (Bt)	12	14	11	2.1	2.5	EPS (Bt)	0.6	0.3	0.3	0.4	0.2	
Normalized EPS (Bt)	12	14	11	2.1	2.5	Normalized EPS (Bt)	0.6	0.3	0.3	0.6	0.2	
Balance Sheet						(consolidated) Financial Ratios And Valuations						
FY ending Dec (Bt m)	2012A	2013A	2014F	2015F	2016F		2012A	2013A	2014F	2015F	2016F	
Cash & equivalent	2,295	2,388	3,216	2,500	2,500	Norm profit (y-y%)	44.1	13.9	(5.7)	88.9	20.9	
A/C receivables	3,195	5,975	7,008	11,036	15,568	Normalized EPS (%)	44.1	13.9	(19.2)	88.9	20.9	
Inventories	142	1,435	2,137	3,349	4,767	Net profit (y-y%)	43.6	14.2	(5.7)	88.9	20.9	
Other current assets	57	125	138	218	307	EPS (%)	43.6	14.2	(19.2)	88.9	20.9	
Investment	61	67	67	67	67	Dividend payout (%)	53.6	51.3	50.0	50.0	50.0	
Fixed assets	970	282	331	368	395	Gross margin (%)	11.2	9.4	8.5	8.9	8.1	
Other assets	939	4,580	5,057	7,965	11,236	Operating margin (%)	5.3	5.1	4.3	5.7	5.1	
Total assets	7,659	14,852	17,954	25,503	34,839	EBITDA margin (%)	5.5	5.6	4.6	6.0	5.3	
S-T debt	0	934	429	743	1,221	Net margin (%)	5.1	4.1	3.9	4.8	4.1	
A/C payables	4,661	7,439	9,403	14,737	20,974	ROA (%)	7.9	5.8	3.8	5.4	4.7	
Other current liabilities	445	187	437	507	843	ROE (%)	30.9	17.7	11.2	19.4	20.9	
L-T debt	0	0	1,000	1,734	2,849	Net D/E (x)	(10)	(0.2)	(0.3)	(0.0)	0.2	
Other liabilities	232	356	393	619	873	Norm PE (x)	25.9	22.7	28.1	14.9	12.3	
Total liabilities	5,338	8,915	11,662	18,340	26,761	Norm PE at TP (x)	45.9	40.3	49.9	26.4	21.8	
Minority interest	263	588	648	798	948	PE (x)	26.0	22.7	28.1	14.9	12.3	
Shareholders' equity	2,057	5,349	5,644	6,365	7,131	EV/EBITDA (x)	20.2	15.5	19.8	10.8	9.4	
Working capital	(1,324)	(28)	(258)	(352)	(639)	P/BV (x)	7.2	2.8	3.1	2.7	2.4	
Total debt	0	934	1,429	2,477	4,071	Dividend yield (%)	2.1	2.3	1.8	3.4	4.1	
Net debt	(2,295)	(1,454)	(1,787)	(23)	1,571	BV/share (Bt)	4.3	11.1	10.1	11.4	12.7	
Free cash flow	(255)	54	1,096	1,363	2,068	DPS (Bt)	0.6	0.7	0.6	1.0	1.3	
Year End Shares (m)	480	480	560	560	560							

Sources: Company data, Thanachart estimates

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