INITIATE COVERAGE

Dynasty Ceramic PLC

October 5, 2011

SCB Securities

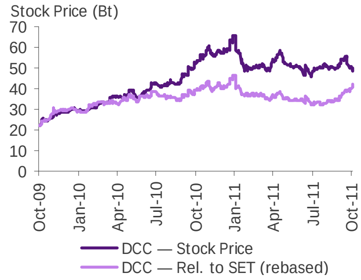
BUY

Stock Data

Last close (Oct 4) (Bt)	49.75
12-m target price (Bt)	60.0
Upside (Downside) to TP (%)	20.60
Mkt cap (Btbn)	20.30
Mkt cap (US$mn)	651

Bloomberg code	DCC TB
Reuters code	DCC.BK
Risk rating	L
Mkt cap (%) SET	0.29
Sector % SET	5.81
Shares issued (mn)	408
Par value (Bt)	1
12-m high / low (Bt)	49.8 / -2.3
Avg. daily 6m (US$mn)	0.87
Foreign limit / actual (%)	35 / 20
Free float (%)	43.0
Dividend policy (%)	≥ 70

Price Performance



Source: SET, SCBS Investment Research

Share performance

	1M	3M	12M
Absolute	-2.0	2.1	-4.3
Relative	22.1	30.1	7.8

Source: SET, SCBS Investment Research

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Worthwhile as a high yield play

- **To gain on improved market demand in tandem with LT upward trend in farm income and in ST, high season for construction/renovation**
- **Specifically, we also like DCC for: 1) its sales growth outperformance over the market; and 2) its margin expansion**
- **Expect 17% earnings CAGR in 2011-13 and high yield of 7.5% in 2012; Earnings upside of 7% in 2012 and 11% in 2013 from populist measures**
- **Initiate coverage with BUY with 12-month PT of Bt60**

Top line to edge up. Farm income grew at a moderate 3% YoY in 3Q11 and growth is expected to remain stable or rise in the long term, since production is unable to keep up with rising demand. This is good for DCC, with a high 73% correlation between farm income and sales (95% of its sales are in rural areas). The end of the rainy season and flooding will bring high season and higher demand for reconstruction and renovation. DCC's sales growth was impressive at 18% vs. the market at 8% in 2001-10, and it is set to outperform the market further (+10% vs. market at +5-7% in 2011-13F), backed by its strong distribution channel. Eighty-four percent of sales are via its outlets, which it plans to expand by 7-8% p.a. through 2018, providing greater product variety, faster service, better inventory management and more effective marketing campaigns.

Margin expansion. We expect gross margin to expand from 44% in 2011 to 45.4% in 2012 and 46.8% in 2013. This will be managed by two factors – a change in product mix and cost reductions. 1) Product mix is being changed via raising the proportion of sales from 16x16" ceramic floor tiles to 40% in 2012 and 50% in 2013 from 30% now, since the margin on this size is 6-8% above the 12x12". 2) Costs will be brought down by greater economies of scale when sales are higher, plus savings of 10% on pigment cost made possible by new technology and 6% on gas cost from a new body formula. It is also changing its method of depreciation from straight-line, which will lower expenses but have no effect on cash flow.

Expect strong earnings growth with high yield. Armed with an increase in sales volume and margin expansion, DCC has a strong earnings profile with 17% CAGR in 2011-13. With its net cash on hand and the absence of sizable investment, DCC aims to keep its 100% dividend payout ratio. This implies a compelling dividend yield of 6.4% in 2011 and 7.5% in 2012, above the annual average of 6.3% in 2002-10.

Upside potential from government policies. The government's plan to raise wages but cut corporate tax is a net positive and by our estimates will raise 2012 earnings by 7% and 2013's by 11%. Off the low 2011 base, earnings will improve with 24% earnings CAGR in 2011-13. Its dividend yield will also rise to 8.0% in 2012. There could be LT demand upside from other government policies such as rice pledging scheme.

Initiate coverage with a Buy rating. We tag DCC as a Buy. Our 12-month PT is Bt60, based on 17x theoretical PE (62% L-T ROE, 9.1% cost of equity and 3.5% growth). The stock is trading at 13.3x 12PE and 7.2x 12PBV (against a record high ROE at 54%), above historical average at 12x PE and 4.0x PBV (against ROE of 36%) in 2002-10.

Forecasts and valuation

Year to 31 Dec	Unit	2009	2010	2011F	2012F	2013F
Revenue	(Btmn)	5,884	6,513	7,131	7,890	8,729
EBITDA	(Btmn)	1,772	2,035	2,071	2,344	2,708
Core profit	(Btmn)	994	1,175	1,302	1,524	1,775
Reported profit	(Btmn)	994	1,175	1,302	1,524	1,775
Core EPS	(Bt)	2.44	2.88	3.19	3.74	4.35
DPS	(Bt)	2.08	2.88	3.19	3.74	4.35
P/E, core	(x)	20.4	17.3	15.6	13.3	11.4
EPS growth, core	(%)	49.7	18.2	10.8	17.1	16.5
P/BV, core	(x)	7.49	7.45	7.33	7.17	7.00
ROE	(%)	36.7	43.1	46.9	53.6	60.8
Dividend yield	(%)	4.2	5.8	6.4	7.5	8.7
EV/EBITDA	(x)	11.3	9.9	9.7	8.6	7.4

Source: SCBS Investment Research

Financial statement

Profit and Loss Statement (Btmn)

FY December 31	2009	2010	2011F	2012F	2013F
Total revenue	5,884	6,513	7,131	7,890	8,729
Cost of goods sold	3,384	3,630	3,995	4,308	4,647
Gross profit	2,500	2,883	3,137	3,582	4,082
SG&A	1,081	1,206	1,291	1,420	1,562
Other income	21	18	20	22	24
Interest expense	6	0	0	0	0
Pre-tax profit	1,434	1,695	1,866	2,184	2,543
Corporate tax	435	516	560	655	763
Equity a/c profits	0	0	0	0	0
Minority interests	(5)	(4)	(4)	(5)	(5)
Core profit	994	1,175	1,302	1,524	1,775
Extra-ordinary items	0	0	0	0	0
Net Profit	994	1,175	1,302	1,524	1,775
EBITDA	1,772	2,035	2,071	2,344	2,708
Core EPS (Bt)	2.44	2.88	3.19	3.74	4.35
Net EPS (Bt)	2.44	2.88	3.18	3.72	4.32
DPS (Bt)	2.08	2.88	3.19	3.74	4.35

Profit and Loss Statement (Btmn)

FY December 31	2Q10	3Q10	4Q10	1Q11	2Q11
Total revenue	1,690	1,380	1,482	2,018	1,856
Cost of goods sold	927	749	830	1,169	1,042
Gross profit	764	631	652	850	814
SG&A	308	270	291	334	334
Other income	6	2	6	3	9
Interest expense	0	0	0	0	0
Pre-tax profit	462	364	367	518	489
Corporate tax	141	112	119	153	150
Equity a/c profits	0	0	0	0	0
Minority interests	(1)	(1)	(1)	(1)	(2)
Core profit	320	250	247	364	337
Extra-ordinary items	0	0	0	0	0
Net Profit	320	250	247	364	337
EBITDA	546	450	453	606	525
Core EPS (Bt)	0.79	0.61	0.60	0.89	0.83
Net EPS (Bt)	0.79	0.61	0.60	0.89	0.83

Balance Sheet (Btmn)

FY December 31	2009	2010	2011F	2012F	2013F
Total current assets	1,507	1,497	1,419	1,393	1,559
Total fixed assets	2,125	2,218	2,477	2,734	2,787
Total assets	3,632	3,715	3,895	4,127	4,346
Total loans	2	0	0	0	0
Total current liabilities	875	941	1,067	1,223	1,360
Total long-term liabilities	47	48	53	59	65
Total liabilities	922	989	1,120	1,282	1,425
Paid-up capital	408	408	408	408	408
Total equity	2,710	2,726	2,775	2,845	2,921
BVPS (Bt)	6.64	6.68	6.80	6.96	7.12

Balance Sheet (Btmn)

FY December 31	2Q10	3Q10	4Q10	1Q11	2Q11
Total current assets	1,701	1,369	1,497	2,059	1,531
Total fixed assets	2,200	2,249	2,218	2,301	2,501
Total assets	3,901	3,619	3,715	4,361	4,032
Total loans	0	0	0	1	6
Total current liabilities	1,014	807	941	1,215	1,148
Total long-term liabilities	48	48	48	136	136
Total liabilities	1,062	854	989	1,351	1,284
Paid-up capital	408	408	408	408	408
Total equity	2,839	2,764	2,726	3,009	2,748
BVPS (Bt)	6.96	6.77	6.68	7.38	6.74

Cash Flow Statement (Btmn)

FY December 31	2009	2010	2011F	2012F	2013F
Core Profit	994	1,175	1,302	1,524	1,775
Depreciation and amortization	332	339	205	160	165
Operating cash flow	1,900	1,562	1,787	1,969	2,071
Investing cash flow	(211)	(432)	(464)	(417)	(218)
Financing cash flow	(1,547)	(1,161)	(1,253)	(1,454)	(1,699)
Net cash flow	142	(31)	71	98	154

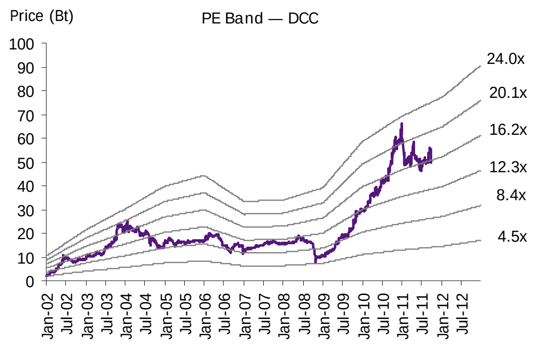
Main Assumptions

	2009	2010	2011F	2012F	2013F
Avg selling price (Bt/sqm)	126.0	128.3	129.5	131.4	133.4
Sales volume (mn sqm)	46.7	50.8	55.1	60.0	65.4
Capacities-year end (mn sqm)	45.0	51.0	61.2	68.4	68.4

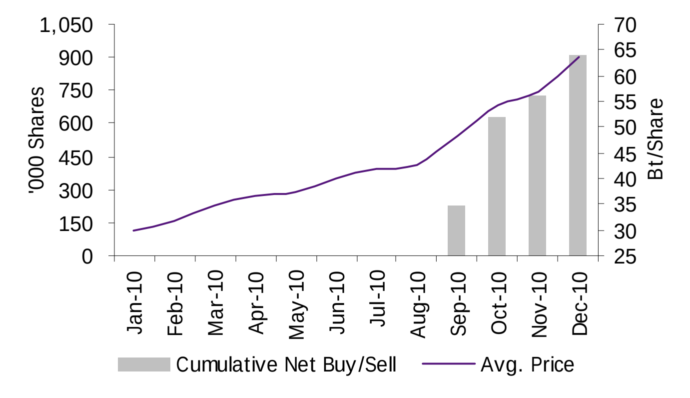
Key Financial Ratios

	2009	2010	2011F	2012F	2013F
Gross margin(%)	42.5	44.3	44.0	45.4	46.8
Operating margin(%)	24.1	25.8	25.9	27.4	28.9
EBITDA margin(%)	30.1	31.2	29.0	29.7	31.0
EBIT margin(%)	24.5	26.0	26.2	27.7	29.1
Net profit margin(%)	16.9	18.0	18.3	19.3	20.3
ROE (%)	37.2	43.7	47.6	54.3	61.6
ROA (%)	27.1	31.2	33.0	36.5	40.4
Net D/E (%)	(7.0)	(5.9)	(8.3)	(11.6)	(16.5)
Interest coverage (x)	317.9	12224.8	N.A.	N.A.	N.A.
Debt service coverage (x)	2.2	902.1	27463.0	N.A.	N.A.
Payout Ratio (%)	85.3	100.0	100.0	100.0	100.0

PBV Band Chart

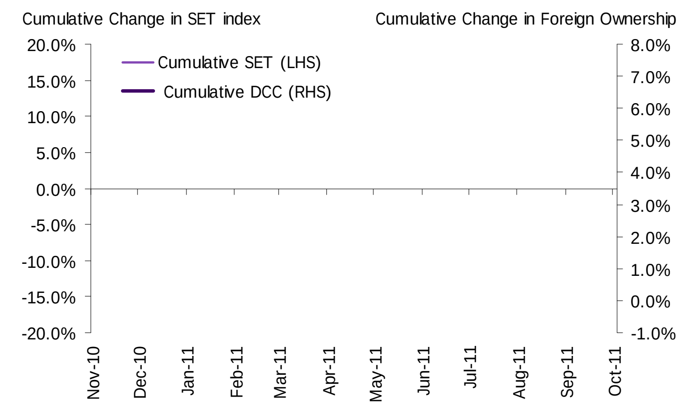


12-Month Cumulative directors trade



Source: SEC

12 Month cumulative chg in foreign ownership versus cumulative chg in SET index



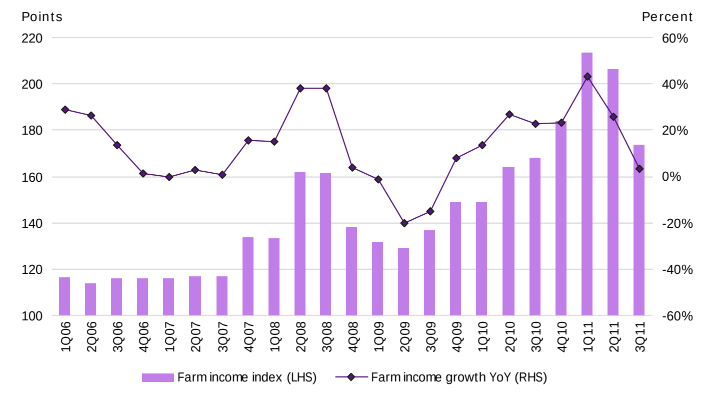
Source: SET, SCBS Investment Research

Top line to head up

LT industry demand set to grow further. Overall industry demand, moving in tandem with farm income, is now growing at a moderate level. In 3Q11, farm income growth was 3%, decelerating from double-digit growth in 2010-1H11 but the eighth consecutive quarter with positive growth since 4Q09. Longer term, we expect farm income to sustain at the current high levels or even rise further, since farm production cannot keep up with rising demand. With high correlation of 73% between farm income and DCC's sales volume (95% of its sales are in the rural areas), a move up in farm income is positive for the company.

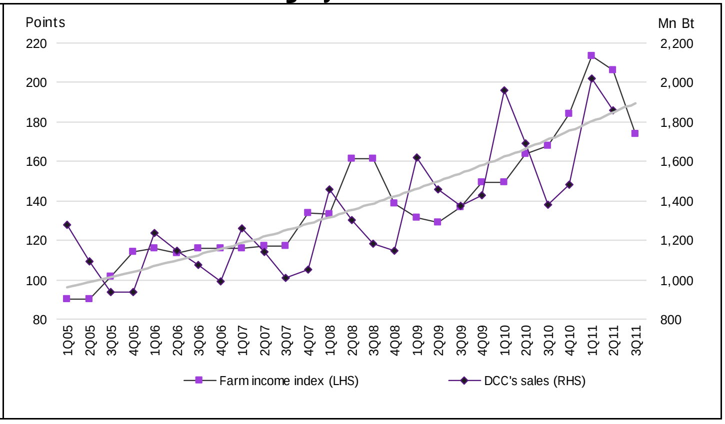
Upcoming high season to spur sales volume in ST. Overall demand is also expected to come up in the near term (4Q11-1Q12), backed by the high season for construction as well as the need for reconstruction/renovation activities after the end of flooding. This year, the floods forced only one outlet to close – much better than last year, when seven had to shut their doors, suggesting this year the impact of flooding on sales will be much less.

Chart 1: Farm income grew in 3Q11, though slower



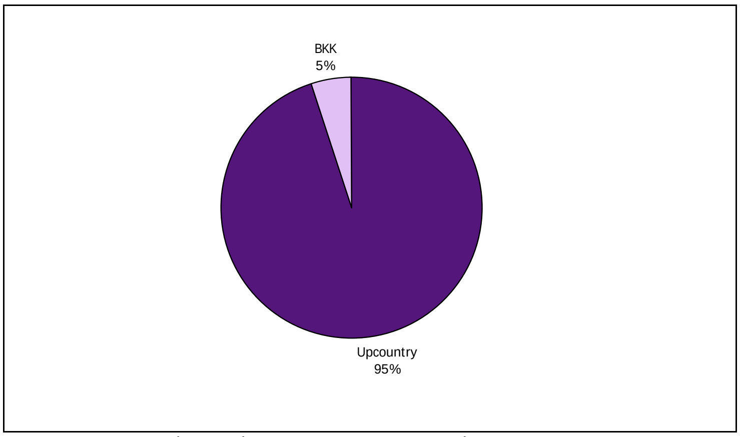
Source: BoT and SCBS Investment Research

Chart 2: DCC's sales highly correlated with farm income



Source: BoT, company data and SCBS Investment Research

Chart 3: Most of DCC's sales comes from rural areas

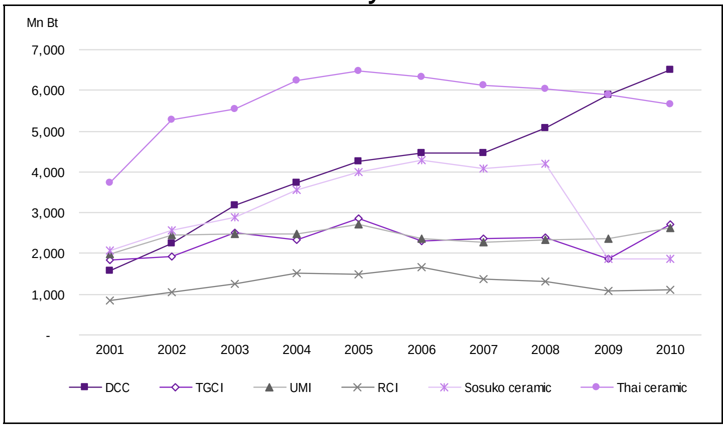


Source: Company data and SCBS Investment Research

Distribution channel powers sales. We like DCC's business model, grounded in a strong distribution channel that supports market expansion. Looking back over 2001-10, DCC managed average annual sales growth of 18%, outdoing the growth for its industry – both domestic and exports - of 8%. This led DCC's market share up steadily from 13% in 2001 to 32% (including domestic and export markets) and 40% (domestic market) in 2010. DCC has also become the market leader in the industry. The increase in the proportion of sales made through its outlets was pivotal, as it made possible a greater product variety, faster service, better inventory management and more effective marketing campaigns. Of its sales, 84% comes from outlets, followed by 7% from agents, 7% from franchisees and 2% from exports.

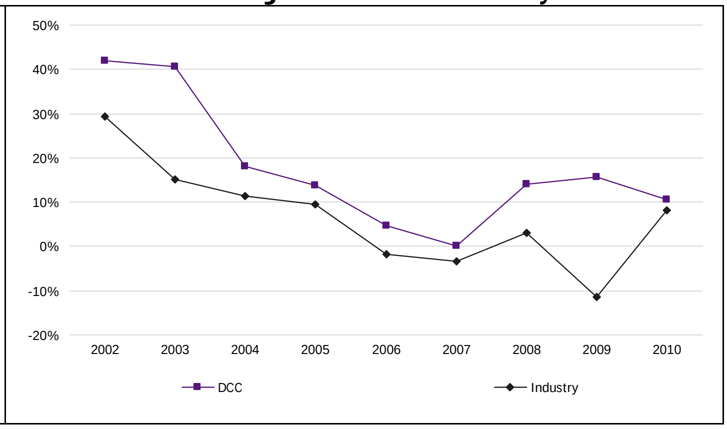
Looking ahead, backed by DCC's concrete expansion in its distribution channels in the medium to long term, we expect sales growth to average 10% in 2011-13F, continuing to outdo the market average of 5-7%. From ~200 outlets in 2010, DCC plans to add 17 in 2011 and 15 in 2012. Longer term, it plans bring the number of outlets to 350 in 2018, implying annual growth of 7-8%

Chart 4: DCC became industry market leader in 2010



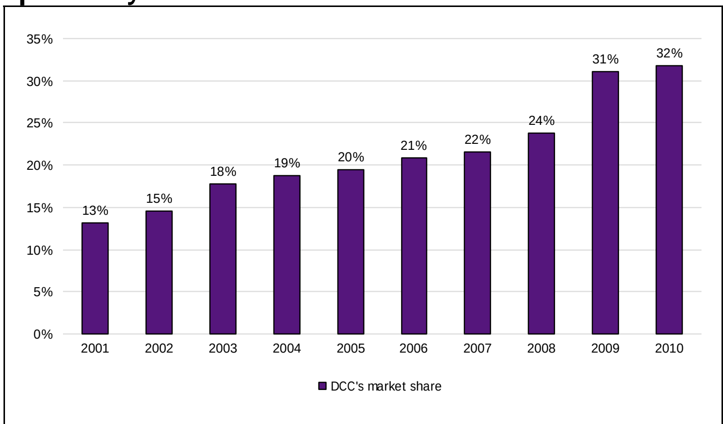
Source: SCBS Investment Research

Chart 5: DCC's sales growth outdid industry in 2001-10



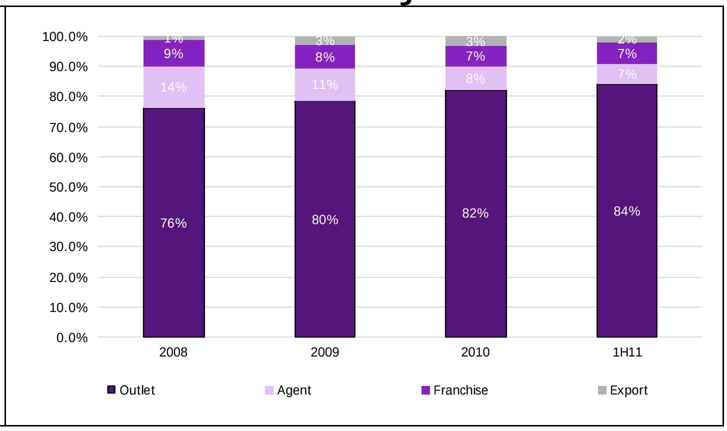
Source: SCBS Investment Research

Chart 6: DCC's market share continued to rise in the past ten years from 13% in 2001 to 32% in 2010



Source: SCBS Investment Research

Chart 7: Key success factor is its strong distribution channel with most sales through outlets



Source: Company data and SCBS Investment Research

Margin expansion story

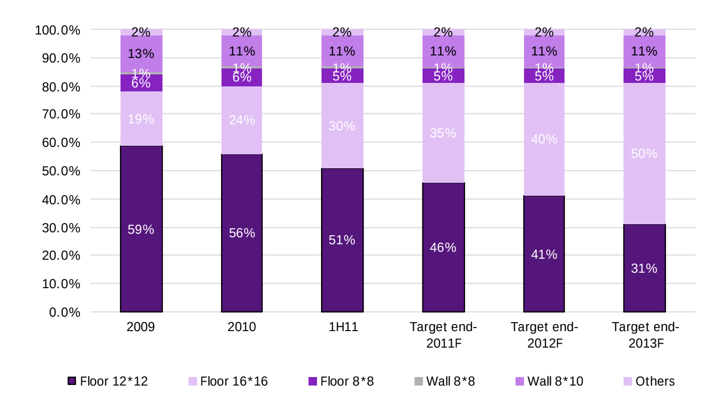
Margin expansion story not yet ended. We also like DCC's margin expansion story. Over the past ten years, its gross margin doubled to 44% in 2010 from 24% in 2001, backed by its ability to raise selling price and control production costs. Looking ahead, margin expansion is poised to continue and we estimate gross margin expansion to go up to 45.4% in 2012 and 46.8% in 2013F from 44% in 2011F. Pivotal to this is a change in product mix to a heavier proportion of items with a better margin plus cost reduction.

Change in product mix. To get in on the rising trend for larger ceramic floor tiles, DCC plans to continue to raise the sales portion of 16x16" ceramic floor tiles by reducing the portion of 12x12" tiles over the next few years. This should repeat the success seen when it raised the proportion of 12x12" tiles and reduced 8x8". Of DCC's sales, 51% comes from 12x12" ceramic floor tiles, 30% from 16x16" ceramic floor tiles, 11% from 8x10" ceramic wall tiles, 8% from 8x8" ceramic floor tiles, and the rest from other products. DCC plans to raise the proportion of 16x16" ceramic floor tiles from 30% in 1H11 to 35% at the end of 2011, 40% in 2012F, and 50% in 2013F. The price of the 16x16" ceramic floor tiles is more than 10% above the 12x12", and gross margin of the

16x16" ceramic floor tiles is 6-8% above 12x12". The change of product mix, thus, should be positive to product selling price and margin.

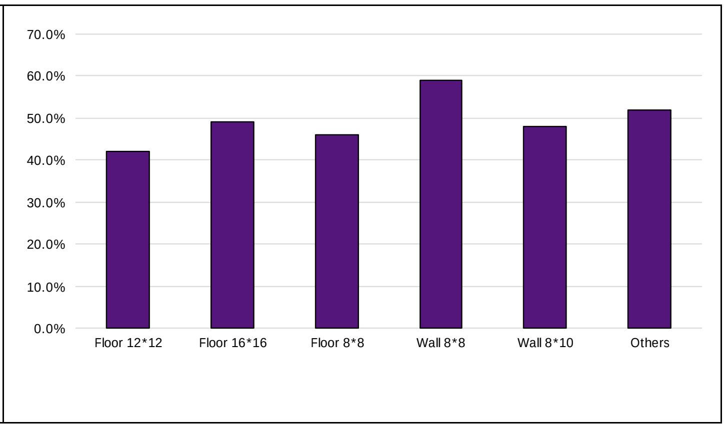
Cost reduction. DCC's cost per unit is expected to drop further from: 1) economies of scale from higher sales volume; 2) cost control measures including 10% glazing and pigment cost savings from new technology (since 2Q11) and 6% gas cost savings from a new body formula (as of 3Q11); 3) a reduction in depreciation expenses of Bt140mn/year (4% of production cost) on a change in accounting treatment to a separate determination for each portion of the assets from straight-line basis (since 2Q11).

Chart 8: DCC plans to change product mix by replacing 12x12" with 16x16" ceramic floor tiles



Source: Company data and SCBS Investment Research

Chart 9: Margin for 16x16" ceramic floor tiles ~6-8% above 12x12" ceramic floor tiles

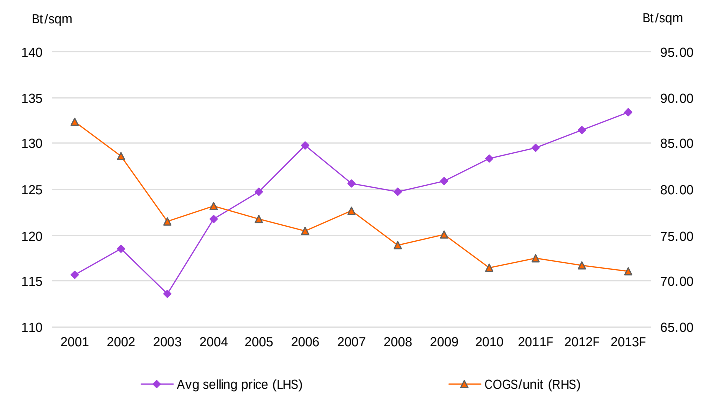


Source: Company data and SCBS Investment Research

Chart 10: Examples of DCC's products

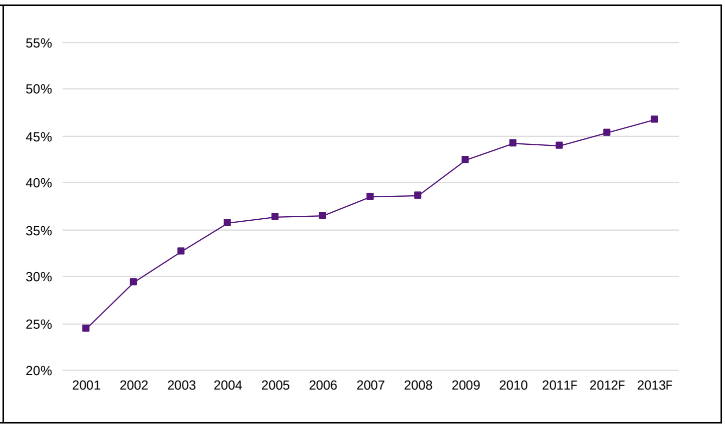
Source: Company data and SCBS Investment Research

Chart 11: Selling price to rise from more favorable product mix; Costs down from better cost controls



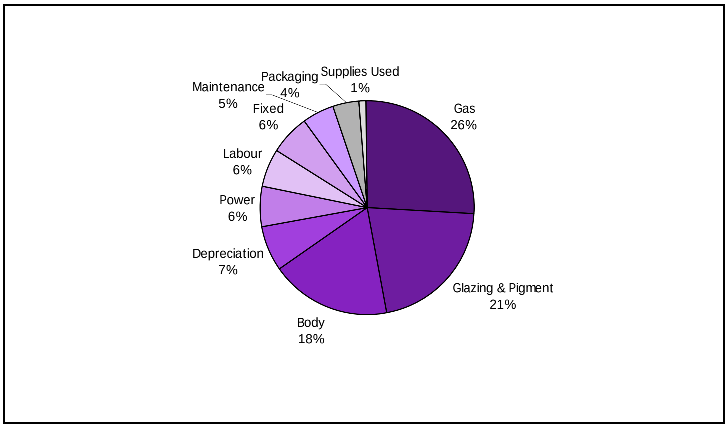
Source: Company data and SCBS Investment Research

Chart 12: Margin expansion coming



Source: Company data and SCBS Investment Research

Chart 13: DCC's cost breakdown



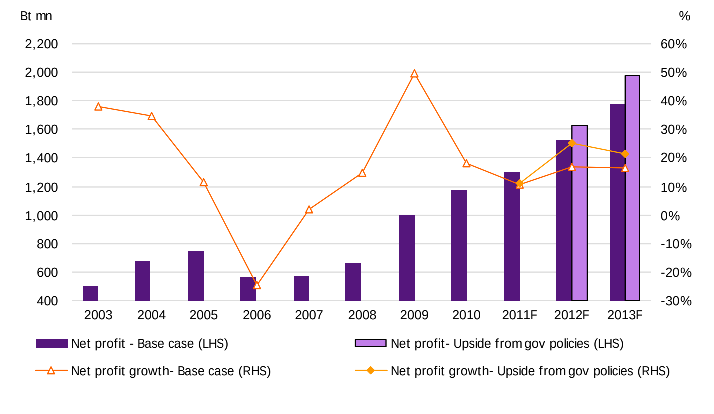
Source: Company data and SCBS Investment Research

To deliver growth with high yield

17% earnings CAGR in 2011-13; Dividend yield of 7.5%. Backed by an increase in sales volume plus margin expansion, DCC has a solid earnings profile with 17% CAGR in 2011-13. With net cash on hand and no plans for sizable investment, DCC aims to continue on with its 100% dividend payout ratio. This implies a compelling dividend yield of 6.4% for 2011 and 7.5% for 2012, above the average of 6.3% in 2002-10.

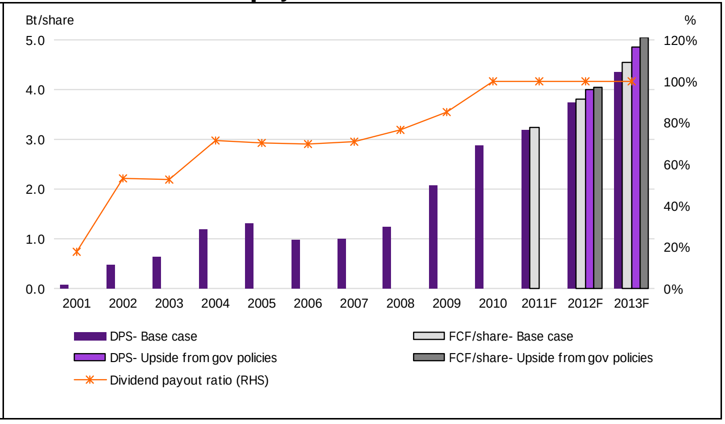
Earnings upside of 7-11% in 2012-13 from populist policies. DCC could have some earnings upside arising out of new policies, as by our calculations, the cut in corporate income tax from 30% in 2011 to 23% in 2012 and 20% in 2013 will outweigh the government's planned increase in wages. Factoring in the net impact of these two policies, 2012 earnings could go up by 7% and 2013 by 11%. Off the low 2011 base, its earnings growth profile would be even more attractive with 24% CAGR in 2011-13, and its dividend yield would rise to 8% in 2012. Other populist policies, such as rice pledging scheme, could enhance LT demand.

Chart 14: Net profit poised to head up



Source: Company data and SCBS Investment Research

Chart 15: Dividend payment is also set to rise



Source: Company data and SCBS Investment Research

Valuation and recommendation

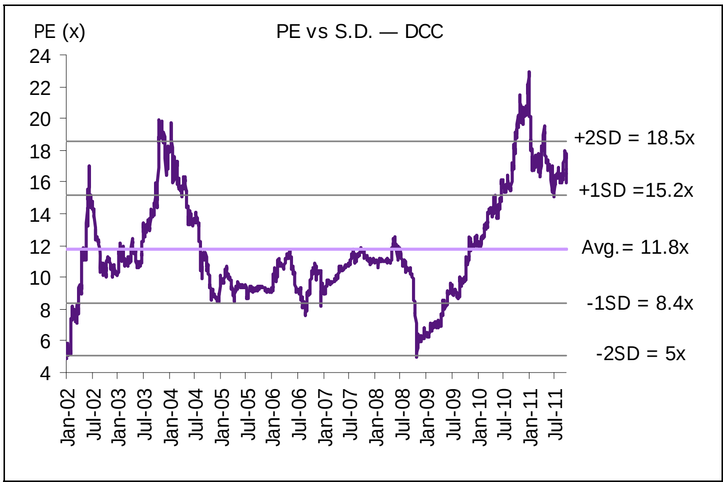
Initiate coverage with a Buy rating. We initiate DCC with a BUY. Our 12-month PT is Bt60, based on 17x theoretical PE (62% L-T ROE, 9.1% cost of equity and 3.5% growth). The stock is now trading at 13.3x 12PE and 7.2x 12PBV against a record high ROE of 54%, above historical average at 12x PE and 4x PBV in 2002-10, when ROE was 36%.

Table 1: Valuation components

Gordon Growth Model	
Risk-free rate (%)	4.5
Market premium (%)	6.5
Beta (10-year average)	0.7
Cost of equity (Ke) (%)	9.1
Long-term ROE (%)	62.0
Long-term growth rate (%)	3.5
PE (1-g/ROE)/(Ke-g) (x)	17.0

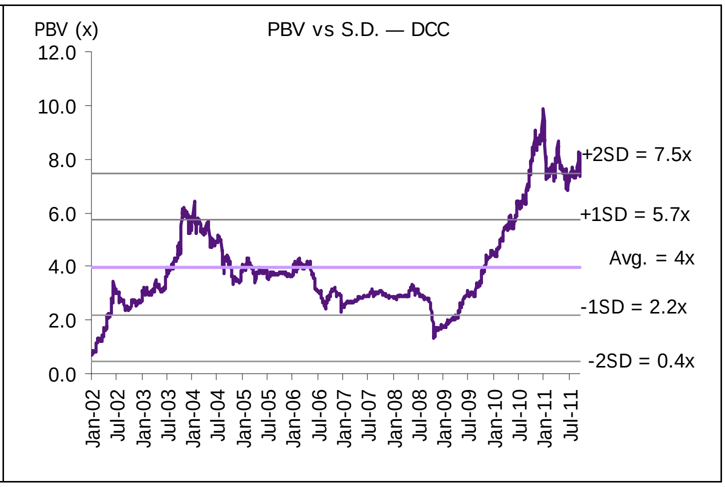
Source: SCBS Investment Research

Chart 16: DCC's historical PE



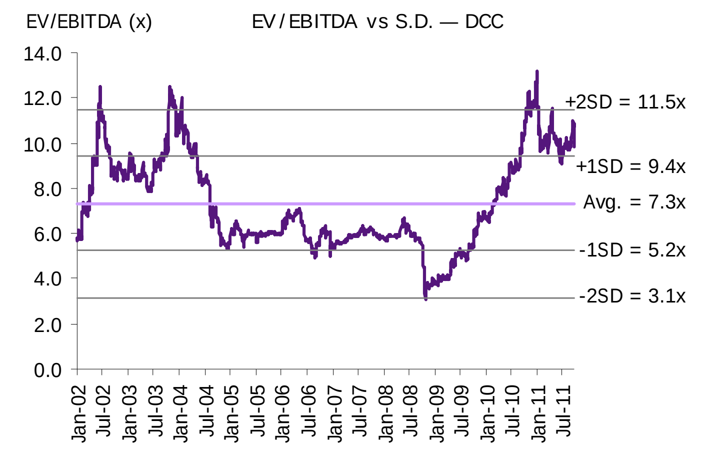
Source: SCBS Investment Research

Chart 17: DCC's historical PBV



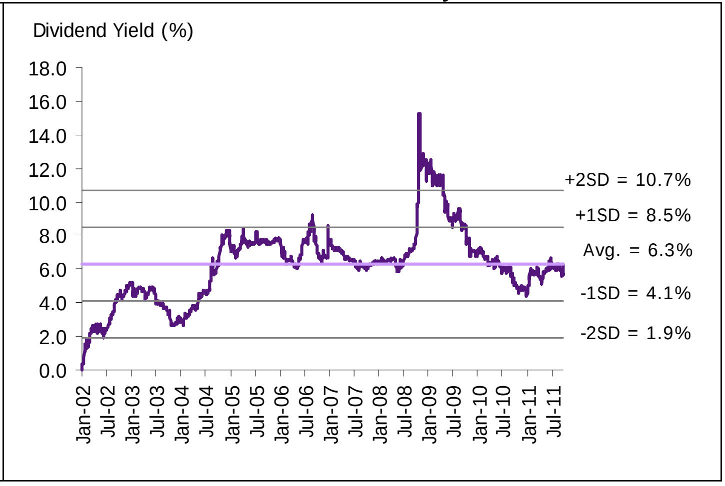
Source: SCBS Investment Research

Chart 18: DCC's historical EV/EBITDA



Source: SCBS Investment Research

Chart 19: DCC's historical dividend yield



Source: SCBS Investment Research

Dynasty Ceramic PLC

Company description

DCC was established on 1 August 1989 and listed on the SET on 3 January 1992. It is a manufacturer and distributor of ceramic floor and wall tiles under the Dynasty, Tile Top, Tomahawk, Jaguar, Anna, Value, and Mustang brands. Capacity expansion throughout the years will bring annual capacity to 61mn sqm at the end of 2011. DCC's market share was 32% (domestic and export markets) and 40% (only domestic market) in 2010. Of total sales, 98% comes from the domestic market; a small amount is exported to South Africa, Brunei, the Maldives, Indochina, Sri Lanka, Myanmar, Australia, New Zealand, Korea, Japan, Canada, Fiji, Laos and Cambodia. Of total domestic sales, 95% comes from rural areas, most of which are through its outlets (84%), and the rest from agents and franchisees.

Investment thesis

DCC will gain from improved market demand created by the upward trend in farm income in the LT, and in the immediate term, from the high season for construction (usually in 4Q11) and which this year will be boosted for the need for renovation after the end of flooding. Specifically, we also like DCC for: 1) its outperforming sales growth versus the market thanks to its strong distribution channel; 2) its margin expansion through raising the proportion of products that attract a higher margin, plus economies of scale brought by higher sales volume, cost control measures and lower depreciation from a change in accounting treatment. DCC is set to deliver a strong earnings profile with 17.0% CAGR in FY2011-13. With its 100% dividend payout ratio, its dividend yield will be compelling at 6.4% in 2011 and 7.5% in 2012.

Valuation

Our 12-month PT is Bt60, based on based on 17.0x theoretical PE (62% L-T ROE, 9.1% cost of equity and 3.5% growth).

Risks

Risks include 1) disasters (i.e. flooding); 2) an economic slowdown, leading to a slowing in demand; 3) price competition; 4) higher prices for natural gas (production cost) and diesel (transportation cost).