

Market Review and outlook – Oct 2005

1) Market Movements

| Index | MTD (%) | 3 MTHS (%) | YTD (%) |
|-------|---------|------------|---------|
| SET | -5.6 | 1.0 | 2.2 |

| Sector Performances | MTD (%) | YTD (%) |
|-----------------------------|---------|---------|
| SET Index | -5.6 | 2.2 |
| SET 50 Index | -6.7 | 1.9 |
| SET Banking Index | -5.6 | 2.5 |
| SET Building Material Index | -5.7 | -16.4 |
| SET Communication Index | -6.6 | -8.4 |
| SET Energy Index | -8.7 | 23.9 |
| SET Entertainment Index | -1.5 | -7.8 |
| SET Property Index | -4.2 | -8.6 |

As of Oct 31, 2005

The Thai market consolidated in Oct 05 upon the series of negative factors throughout the month. (1) Inflation in Sep 05 rose to 6%, higher than the market expectation, which leads to a 50bps rise in bench mark rate by the Monetary Policy Committee to 3.75%. Commercial banks are raising their deposit and saving rates in an effort to keep core and long-term deposits with them. (2) The Thai authorities have tried to minimise the increase in electricity price by demanding PTT to lower its gas prices selling to EGAT, the largest power producer that is seeking listing status in Nov 05. This move raises concern on the government intervention into the regulated industry. (3) Bird flu outbreak becomes a concern when a man died from bird flu after a pause during the last 12 months. Banks results were generally better than the market expectation but fail to lift the share prices. Investors have begun to concern on the weakening asset quality after the lending rates are rising. Key factors influenced the market were as followed

➤ In September 2005, economic indicators decelerated from the previous month. On the demand side, the Private Investment Index (PII) decelerated in line with slowing import growth. Meanwhile, exports continued to expand satisfactorily as in the previous month.

➤ On the supply side, agricultural output of major crops expanded continuously from the previous month following the alleviated drought problem. At the same time, crop prices also accelerated in line with the world agricultural prices resulting in farm income from major crops rising steadily from last month. Meanwhile, manufacturing production growth decelerated from the previous month in contrast to its high acceleration in the previous month owing to the low-base effect present in certain industries. As for the services sector, the number of foreign tourists increased slightly from the same period last year.

➤ Overall economic stability. The current account continued to register a surplus this month as in the previous month from the improvement in the trade balance. International reserves remained at a satisfactory level. Nevertheless, pressure on headline inflation increased mostly due to the rising prices of oil as well as fruits and vegetables.

Details of the economic conditions in September 2005 and the third quarter of 2005 are as follows:

➤ **Manufacturing Production.** In September 2005, the Manufacturing Production Index (MPI with 76 product categories) grew by 4.9%, decelerating from the previous month in contrast to its acceleration in the previous month partly owing to the low-base effect in August developing into a high-base effect in September. Products that continued to expand well include electronics, rubber and rubber products which expanded well due to external demand, petrochemicals which

accelerated from both domestic and external demand especially with respect to downstream petrochemical products, and vehicles and parts due to continued domestic and external demand for commercial vehicles. Nevertheless, some products showed negative growth. These include steel and steel products due to the prior accumulation of inventory coupled with decreased demand in the face of price uncertainty. Beverages production declined compared to the same period last year following the upward adjustment in the liquor tax as well as after a period of inventory accumulation. Also, during the same period last year, there was accelerated production of beer in anticipation of the upward adjustment in the excise tax. As for leather products which also decreased due to both a shortage in and the rising prices of high-quality raw materials, and tobacco due to the closure of certain factories for maintenance. The capacity utilization rate (with 69 product categories) of the manufacturing sector averaged at 72.8%, rising from 70.2% in the previous month.

➤ As for the third quarter, MPI grew at 6.7%y-o-y, moderating from the previous quarter. Most products exhibited satisfactory growth but production of certain products declined. Products that declined include beverages, leather products, and steel and steel products. In the third quarter, the capacity utilization rate of the manufacturing sector averaged at 71.1%, rising from 70.0% in the previous quarter.

➤ **Domestic Spending.** The Private Consumption Index (PCI) increased by 0.8% comparable to the previous month. This increase was accompanied by an expansion in motorcycles sales, accelerated electricity consumption, but a slowdown in the (real term) revenue of value-added tax, imported consumable goods, and passenger car sales as compared to the same period last year. Nevertheless, the Private Investment Index (PII) grew by 5.6%y-o-y, decelerating from the previous month due to the slowdown in equipment investment in tandem with the deceleration in the import value of capital goods at constant prices. Construction investment also slowed in tandem with the downward trend in urban area permitted for construction as well as the decline in cement sales following the periods of frequent and heavy rain.

➤ As for the third quarter, PCI decelerated from the previous quarter despite the significant expansion of farm income and the upward adjustment of the minimum wage. Consumer confidence continued to decline mostly from the higher oil prices and their negative impact on consumers' purchasing power. PII decelerated from the previous quarter with most indicators slowing except for commercial car sales which continued to expand. In addition, the Business Sentiments Index also adjusted downward due to entrepreneur's chief concern over some risks and uncertainties going forward, especially with regards to production cost and rising oil prices.

➤ **Fiscal Position.** In September 2005, government revenue collection attained Bt118.7bn, rising by 32.2%y-o-y, with tax revenue increasing by 22.8%. Non-tax revenue rose by 208.3% mostly from the significantly increased remittance of revenue from large state enterprises. Value-added tax collection grew by 60.6%, attributable mainly to special tax items in the sales of electricity within the electricity sector in the amount of Bt14.1bn. Specifically, there were both collected value-added tax and its subsequent refund of the same amount in the month of September. Once the abovementioned special tax item is deducted, value-added tax and government revenue expanded by 11.9% and 16.5%, respectively.

➤ For the Fiscal Year 2005 (Oct04-Sep05), government revenue collection attained Bt1,474.3bn increasing from the previous year by 14.3%. Once the tax refunded is deducted, government revenue collection attained Bt1,255.9bn, increasing from the previous year by 13.3% and exceeding forecasted revenue collection as reported in the Budget Document (Bt1,200bn) by Bt55.9bn or 4.7%.

➤ **External Sector.** The trade balance registered a surplus for the first time this year, attaining USD818m from export value which grew considerably by 23.8%y-o-y or USD10,329m. Export categories that contributed to the expansion include computers, automobiles and parts, rubber, and plastic products. Meanwhile, import value growth moderated to 19.9% or USD9,510m. The slowdown was reflected in almost all import categories. Import categories that registered significant deceleration included raw materials such as steel and steel products and automobiles and parts. The services and transfers account recorded a surplus of USD58m, decreasing from the previous month's surplus of USD384m, from the scheduled remittance of dividends to foreign investors. Consequently, the current account recorded a surplus of USD877m, rising from a surplus of USD106m in the previous month. The balance of payments was in surplus by USD1,115m as compared to a surplus of USD382m in the previous month. International reserves at end-September was at USD49.8bn, with a net forward position of USD2.3bn.

➤ In the third quarter, the trade balance registered a surplus of USD203m mostly due to the surplus in September. Export value attained USD29,794m, growing by 22.7%. Import value attained USD29,590m, also increasing by 22.7%. The services and transfers account recorded a surplus of USD949m, rising from the previous quarter in line with decreased remittance of profits and dividends. Once accounting for the trade surplus, the current account recorded a surplus of USD1,153m after two consecutive quarters of deficit. The balance of payments was in surplus by USD1,765m.

➤ **Prices.** In the month of September, the Consumer Price Index (CPI) rose by 6%y-o-y, accelerating from the previous month by 0.7%. The increase was due to the rise in the prices of raw food, energy, and other products. Raw food prices rose due to shortage of supply in meeting demand, especially during the Vegetarian Food Festival. Energy prices remained high in line with global oil prices. Core CPI grew by 2.3%y-o-y as in the previous month due to the rise in the prices of transportation, consumable foods within and outside the household, cleaning products and alcoholic drinks following the upward adjustment in the excise tax.

➤ The Producer Price Index (PPI) increased by 9.6%y-o-y due to increases in (1) the price of agricultural products due to abundant rains resulting in diminished products reaching markets, (2) the price of mining products which rose in line with the rise in the price of crude oil and natural gas and (3) the price of manufactured products which rose following the rise in the prices of raw materials, production costs and especially petroleum products.

➤ In the third quarter, CPI, core CPI, and PPI increased from the same period last year by 5.6, 2.2, and 9.4%, respectively.

➤ **Monetary Conditions.** In September, commercial bank deposits expanded by 6.4%y-o-y from the inclusion of deposits of the finance companies that were merged and upgraded into commercial banks. Excluding the changes in deposits due to the said mergers, commercial bank deposits in September would rise by 4.8%y-o-y, accelerating slightly from 4.4% in the previous month, in line with increased household deposits. Commercial bank credits to the private sector (including holding of private securities) rose by 4.1%y-o-y partly due to the inclusion of the credits of the newly merged financial institutions. If the rise in credits due solely to the said mergers were subtracted, commercial bank credits in September would rise by 2.2%y-o-y, decelerating from the previous month's growth of 4.1%. The deceleration in the expansion of credit was due to the high-base effect in September 2004 from the merger of Industrial Finance Corporation of Thailand, Thai Military Bank and DBS Thai Danu Bank.

➤ In September, broad money M2, M2a and M3 grew by 6.6, 5.2 and 4.8%, respectively, with M2 and M2a accelerating from the previous month partly due to the increase in deposits. Broad money M3 grew at a rate comparable to that of the previous month.

- Money market interest rates. In September, the 1-day repurchase rate and the overnight interbank rate both averaged at 3.10% per annum, respectively, rising from the previous month in line with the upwards adjustment of the Bank of Thailand's policy rate by half a percentage point.
- In the third quarter, the 1-day repurchase rate and the overnight interbank rate rose from the previous quarter to both average at 2.79% per annum in line with the upward adjustment in the policy rate. This development resulted in the gradual increase of financial institutions' deposit and lending rates over the period.
- **Exchange Rate.** In September, the baht averaged at Bt41.05 per US dollar, appreciating slightly from the previous month's rate of Bt41.19 per US dollar partly due to the National Economic and Social Development Board's release of better-than-expected economic statistics for the second quarter and the improvement in the current account balance. During the period of 1-25 October 2005, the baht averaged at Bt40.94 US dollar, fluctuating within a narrow range but nevertheless exhibiting a slight appreciation trend.
- In the third quarter of 2005, the baht weakened to average at Bt41.31 per US dollar from Bt40.16 per US dollar in the previous quarter with an appreciation trend toward the close of the third quarter partly due to the current account surplus, increased foreign investment in the stock exchange, and the continued upward trend in interest rates.

2) Valuation

| | Year 2003 | Year 2004 | 2005 Fwd | 2006 Fwd |
|-----------------|-----------|-----------|----------|----------|
| EPS growth (%)* | 57.7 | 55.9 | 4.2 | -2.9 |
| P/E (x) | 14.0 | 9.8 | 9.0 | 9.2 |
| P/BV (x)** | 2.7 | 2.3 | 2.0 | 1.8 |
| Yield (%) | 2.8 | 3.9 | 4.5 | 4.7 |
| EV/EBITDA | 10.3 | 8.0 | 6.7 | 6.1 |

* 70% of the total market capitalisation

** data from SET, all stocks

3) Sector Strategy

| | Recommendation (o/w, n, u/w) |
|-------------------|------------------------------|
| Banking | O/W |
| Building material | N |
| Communication | O/W |
| Commerce | U/W |
| Electronics | N |
| Energy | O/W |
| Entertainment | U/W |
| Property | U/W |
| Vehicle | O/W |

4) Market Outlook & Strategy

➤ Going forward, the market is likely to focus on the upcoming results season. The market should become sluggish in early Nov 05 but the situation should improve thereafter. Sectors that should outperform the market are banking, energy, construction contractors, communication, and automobile. Upon the listing of EGAT in Nov 05, the market should become more active, particularly the energy stocks. Strategy is accumulation big cap stocks in key sector to capture a medium-term gain as the Thai market should have already reached the bottom at around 680.

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