

Kian Ann Engineering Ltd

Another Solid Quarter

Kian Ann Engineering Ltd (KA) posted another sturdy quarter, with 3Q FY11 revenue and net profit rising 19% and 65% YoY to S\$40.4m and S\$4.75m respectively. 9M FY11 revenue and net profit formed 75.7% and 82.3% of our FY11F respectively. In view of the robust performance, we are increasing our FY11F net profit from S\$15.7m to S\$17.1m. Maintain **Invest** with an intrinsic value of S\$0.275 per share (S\$0.260 previously).

Key Developments:

- Results Summary:** The Malaysia market continued to support KA's revenue growth as the region's 3Q revenue rose 33% YoY to S\$12.9m. For 9M FY11, Malaysia sales grew 24.4% YoY to S\$38.5m, accounting for 32.4% of total sales. 9M revenue growth from Singapore and Indonesia were also healthy, rising 5.4% and 11.9% YoY respectively.
- Heavy machinery component shortages persisted in 3Q FY11, leading to gross profit margin of 28.6%. 9M gross profit margin stood at 28.5%, higher than the past four years average of 26.1%. Operating expenses inched up 8.2% YoY to S\$6.1m, largely due to higher provision for performance incentives. The S\$13m convertible loan to USCO Int generated an interest income of approximately S\$130,000 (for two months period). Consequently, net profit soared 65% YoY to S\$4.75m.
- Due to the convertible loan, total loans rose S\$3.2m QoQ to S\$19.6m while cash balances dipped S\$2.5m QoQ to S\$9.8m. 3Q FY11 gross debt/equity level remains at a comfortable level of 14%.
- In preparation for the peak 4Q season, the company also purchased more inventories - up S\$3.3m QoQ and S\$6.2m YoY to S\$80.0m.

Invest

- Intrinsic Value S\$0.275
- Prev Closing S\$0.200

Main Activities

Kian Ann Engineering (KA) is an independent distributor of heavy machinery parts and diesel engine components for various industries including infrastructure development, construction, forestry, agriculture, and mining industries.

Financial Highlights

(Y/E Jun) S\$m	FY09	FY10	FY11F
Revenue	135	149	157
Operating Profit	13.8	17.3	21.6
Net Profit	11.6	13.6	17.1
EPS (S cts)	2.6	3.0	3.8

Source: SIAS Research Estimate

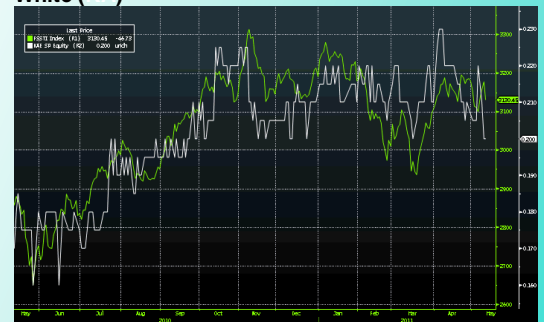
Key ratios (FY11F)

PER	6.61
P/BV	0.68
ROE	11.6%
Debt/Equity	13%
Current ratio	3.56

Source: SIAS Research Estimate

Indexed Price Chart

Green (FSSTI)
White (KIA)



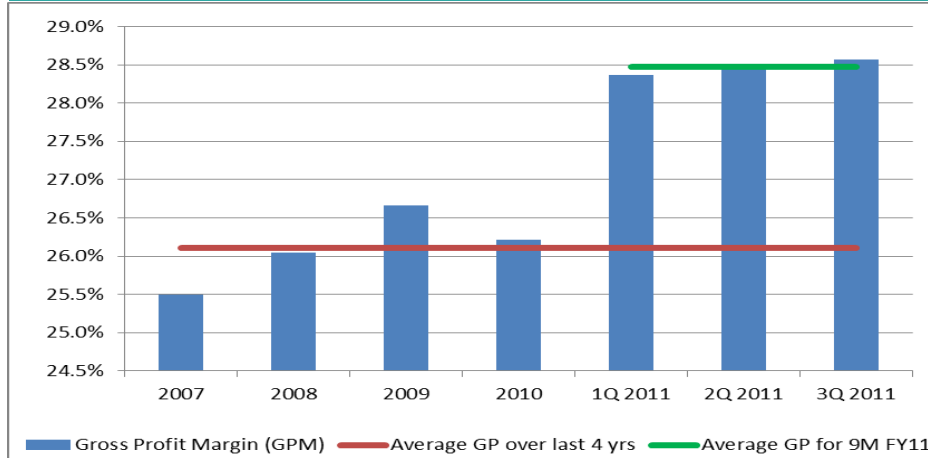
Source: Bloomberg

52wks High-Low 24.5 cents/16.0 cents
 Number of Shares 438 m
 Market Capitalization S\$87.6 m

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Figure 1: KA's Gross Profit Margin



Source: Company, SIAS Research

Industry Outlook Remains Positive: Caterpillar upgraded its 2011 outlook recently and expected the company to generate revenue of US\$52-54bn compared to US\$50bn previously. The company further commented that the forecast would have been higher if not for Japan's natural disasters.

At the same time, we expect logging activities in Malaysia to remain buoyant due to strong demand in European and China markets. KA is likely to benefit from these industry factors.

Increasing FY11F and Intrinsic Value: KA had reported better than expected figures for the past three quarters and 9M net profit stood at 82.3% of our full year forecast. Fourth quarter is traditionally the strongest quarter and hence, we are upgrading our FY11 net profit from S\$15.7m to S\$17.1m. For conservative reasons, we are retaining our FY12F. Accordingly, our intrinsic value rose to S\$0.275 (from S\$0.260 previously). Maintain **Invest**.

Figure 2: Economic Profit Model

S\$ 'm	FY10	FY11F	FY12F	FY13F
Revenue	149.4	156.8	161.5	166.4
EBIT	17.3	21.6	19.7	19.7
Tax on EBIT	1.9	2.4	2.2	2.2
NOPLAT (Company)	15.4	19.2	17.5	17.6
Invested Capital	147.1	145.3	159.2	166.3
% of Debt	12.8%	11.9%	8.1%	8.0%
% of Equity	87.2%	88.1%	91.9%	92.0%
WACC	10.47%	10.51%	10.71%	10.72%
Capital Charge	15.4	15.3	17.1	17.8
Economic Profit		3.9	0.4	(0.2)
Terminal				-2.7
Discount Rate		0.94	0.85	0.76
Present Value		3.7	0.4	(0.2)
Book Value	119.2	Risk Free	2.5%	
Explicit Value	3.8	Beta	1.2	
Terminal Value	(2.7)	Market RP	7.5%	
Value of Firm	120.3	Cost of Equity	11.1%	
Number of Shares (m)	438.1	Cost of Debt	6.0%	
Value per share (S\$)	0.275	LT Growth	1.5%	

Source: SIAS Research Estimates

Figure 3: Financial Forecast and Estimate

S\$'m	FY2008	FY2009	FY2010	FY2011F	FY2012F	FY2013F
Revenue	150	135	149	157	162	166
Operating Profit	15.6	13.8	17.3	21.6	19.7	19.7
Net Income After Tax	11.2	11.6	13.6	17.1	15.5	15.4
Total Current Assets	154	142	146	148	156	168
Total Non-Current Assets	30.1	29.9	29.1	45.4	46.1	48.1
Total Current Liabilities	69.8	40.9	35.2	41.6	38.6	39.7
Total Non-Current Liabilities	2.5	10.2	8.6	7.2	7.2	8.2
Total Equity	111	121	130	144	156	168
Net Income Before Tax	13.8	12.3	16.6	20.9	18.9	18.8
Cash from Operating Activities	10.7	2.9	16.7	11.7	12.5	12.2
Cash from Investing Activities	-0.8	-1.1	-0.6	-17.4	-1.8	-1.8
Cash from Financing Activities	-5.2	-0.2	-8.8	-2.8	-8.1	-2.4
Net Change in Cash	4.7	1.5	7.3	-8.5	2.6	8.0
ROE	10.0%	9.5%	10.2%	11.6%	9.7%	9.0%
ROA	6.1%	6.7%	7.8%	8.8%	7.7%	7.1%
Debt/Equity	48%	34%	23%	13%	12%	8%
Current Ratio	2.20	3.47	4.13	3.56	4.05	4.24
P/E	6.02	7.28	7.62	6.61	5.25	5.79
P/B	0.72	0.73	0.74	0.68	0.62	0.57

Source: SIAS Research Estimates

Rating Definition:

Increase Exposure – The current price of the stock is significantly lower than the underlying fundamental value. Readers can consider increasing their exposure in their portfolio to a higher level.

Invest – The current price of the stock is sufficiently lower than the underlying fundamental value of the firm. Readers can consider adding this stock to their portfolio.

Fairly Valued – The current price of the stock is reflective of the underlying fundamental value of the firm. Readers may not need to take actions at current price.

Take Profit – The current price of the stock is sufficiently higher than the underlying fundamental value of the firm. Readers can consider rebalancing their portfolio to take advantage of the profits.

Reduce Exposure - The current price of the stock is significantly higher than the underlying fundamental value of the firm. Readers can consider reducing their holdings in their portfolio.

IMPORTANT DISCLOSURE:

SIAS Research Pte Ltd received compensation for conducting this valuation research. The estimated fair value of the stock is statement of opinion, and not statement of fact or recommendation on the stock.

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