

Kian Ann Engineering Ltd

Deserves an Upgrade

Kian Ann Engineering Ltd (KA) posted a record FY11 results with revenue and PAT rising 8.7% and 29.3% YoY to S\$162.3m and S\$17.6m respectively – both figures exceeded our full year forecasts by ~3%.

Going forward, we expect KA to generate growth from 1) new regions such as Africa and South America where its existing clients are venturing into, 2) cross selling products between the East and the West and 3) resource and infrastructure needs in developing nations like China. The company is current trading at a dividend yield of 5.5% and FY12F P/E of 5.5X, which we reckon is a bargain given its defensive nature. Maintain **Invest** with an upgraded valuation of S\$0.295.

Key Developments:

Results Summary: The healthy growth in revenue was largely due to strong demand for parts in Malaysia and Indonesia which grew 22.4% and 17.2% YoY respectively. Gross profit grew 21.6% YoY to S\$46.1m owing to shortage of certain parts in the region. However, we understand that the deficiency issue is gradually receding and hence, FY12F and FY13F gross margin may inch down slightly – we had previously incorporated that into our model by projecting gross margin of 27% in FY12F vs 28.4% in FY11.

Distribution costs climbed merely 4.7% YoY to S\$13.7m due to lower impairment allowances and competitive shipping fees. However, administrative expenses rose 13.4% YoY to S\$10.0m due to wage pressure. We reckon that the cost control is still well managed given that the increment is only slightly more than revenue. The company also enjoyed S\$194,000 interest from its long term convertible bond to USCO Int in 4Q FY11. KA's performance would be even more spectacular if not for the FOREX loss of S\$2.01m owing to unfavorable RM\$ and US\$ movement against S\$.

Balance sheet remained healthy with a net cash position. KA also strived to increase its inventory (rose 19.5% YoY to S\$83.4m) back to historical level so that it will be capable of fulfilling the clients' orders.

Invest

- Intrinsic Value S\$0.295
- 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	FY10	FY11	FY12F
Revenue	149	162	170
Operating Profit	17.3	21.4	20.6
Net Profit	13.6	17.6	16.3
EPS (S cts)	3.0	3.8	3.6

Source: SIAS Research Estimate

Key ratios (FY12F)

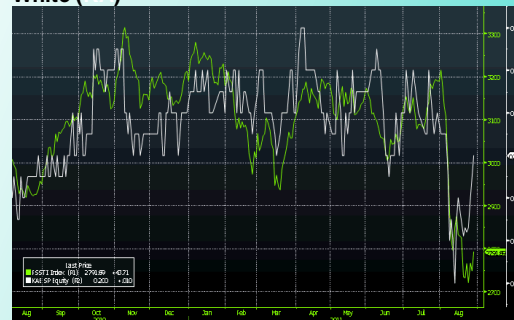
PER	5.5
P/BV	0.62
ROE	10.2%
Debt/Equity	16%
Current ratio	3.82

Source: SIAS Research Estimate

Indexed Price Chart

Green (FSSTI)

White (KIA)



Source: Bloomberg

52wks High-Low	24.5 cents/17.0 cents
Number of Shares	438 m
Market Capitalization	S\$87.6 m

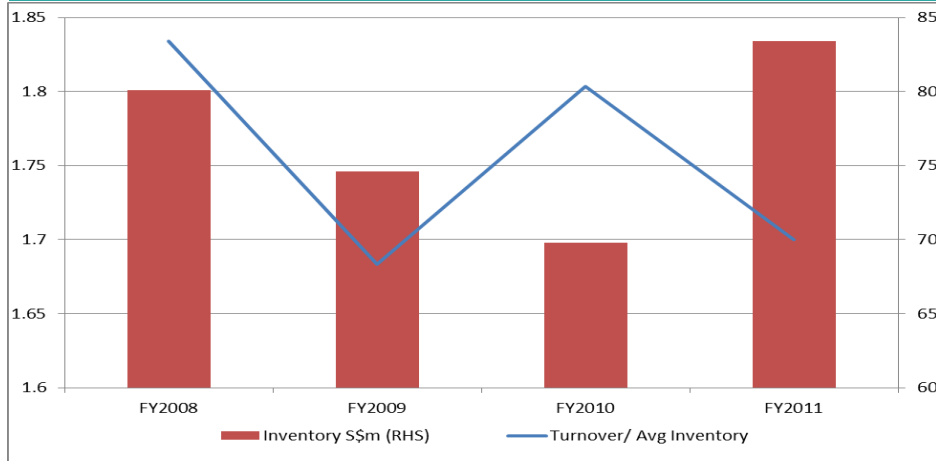
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Figure 1: KA Restocking Its Inventory Back to Historical Level



Source: Company, SIAS Research

Following Its Clients: We understand that many of the logging estates in Malaysia are well developed and several clients of KA expressed their interest to venture into new areas in Africa and South America. We believe the company is likely to follow its clients into these new markets. KA is also attempting to cross sell products between the East and the West, particularly bring quality and inexpensive Asian products to the Europe regions. We believe both developments will help to drive revenue going forward and hence, are upgrading our FY12F and FY13F revenue growth projection from 3% to 5%.

Growth from China: Demand for resources and infrastructure construction in developing nations like China and India are fast growing and the phenomenon is likely to persist even if a slowdown is to occur. This explains Caterpillar’s aggressive expansion plans in China and its intention to invest US\$3bn CAPEX this year. KA has a subsidiary in China to tap on the giant’s growth and the subsidiary also attended convention and exhibition to showcase its products and broaden its network. We expect KA to benefit the most when operators choose to adopt original equipment manufacturer parts for their machines.

Deserves a Higher Intrinsic Value: KA’s FY11 results were better than expected and its growth is likely to remain healthy going forward. The company also rewarded its shareholders with a full year dividend of 1.1 S cents – a dividend yield of 5.5%. Given its defensive nature and low forward P/E of 5.5X, we argue that KA deserves a better valuation. Maintain **Invest** with an upgraded valuation of S\$0.295.

Figure 2: Economic Profit Model

S\$ 'm	FY10	FY11	FY12F	FY13F
Revenue	149.4	162.3	170.4	178.9
EBIT	17.3	21.4	20.6	21.1
Tax on EBIT	1.9	2.4	2.3	2.3
NOPLAT (Company)	15.4	19.1	18.4	18.8
Invested Capital	147.1	145.3	163.1	165.7
% of Debt	12.8%	16.1%	8.4%	8.0%
% of Equity	87.2%	83.9%	91.6%	92.0%
WACC	11.04%	10.85%	11.29%	11.32%
Capital Charge	16.2	15.8	18.4	18.7
Economic Profit		3.3	(0.1)	0.0
Terminal				0.5
Discount Rate		0.93	0.84	0.76
Present Value			(0.1)	0.0
Book Value	128.9	Risk Free	2.5%	
Explicit Value	(0.0)	Beta	1.2	
Terminal Value	0.5	Market RP	7.5%	
Value of Firm	129.4	Cost of Equity	11.8%	
Number of Shares (m)	438.1	Cost of Debt	6.0%	
Value per share (S\$)	0.295	LT Growth	1.5%	

Source: SIAS Research Estimates

Figure 3: Financial Forecast and Estimate

S\$'m	FY2008	FY2009	FY2010	FY2011	FY2012F	FY2013F
Revenue	150	135	149	162	170	179
Operating Profit	15.6	13.8	17.3	21.4	20.6	21.1
Net Income After Tax	11.2	11.6	13.6	17.6	16.3	16.6
Total Current Assets	154	142	146	160	156	170
Total Non-Current Assets	30.1	29.9	29.1	41.7	47.9	50.6
Total Current Liabilities	69.8	40.9	35.2	52.1	40.9	42.8
Total Non-Current Liabilities	2.5	10.2	8.6	6.0	7.3	8.3
Total Equity	112	121	131	143	156	169
Net Income Before Tax	13.8	12.3	16.6	20.8	19.9	20.2
Cash from Operating Activities	10.7	2.9	16.7	17.3	12.0	11.0
Cash from Investing Activities	-0.8	-1.1	-0.6	-13.6	-7.2	-2.5
Cash from Financing Activities	-5.2	-0.2	-8.8	-7.9	-13.4	-2.2
Net Change in Cash	4.7	1.5	7.3	-4.2	-8.5	6.2
ROE	9.9%	9.5%	10.1%	11.7%	10.2%	9.6%
ROA	6.1%	6.7%	7.8%	8.7%	8.0%	7.5%
Debt/Equity	48%	34%	23%	13%	16%	8%
Current Ratio	2.20	3.47	4.13	3.07	3.82	3.96
P/E	6.02	7.28	7.62	6.61	5.22	5.50
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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