


DMG & Partners Research
CONSTRUCTION

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Construction

Kian Ann Engineering is one of the world's largest independent distributors of heavy machinery parts and diesel engine components. It has the capacity to carry >1.3m items covering >270 brands like Caterpillar, Volvo and Kobelco and distributes to >50 countries.

Stock Profile/Statistics

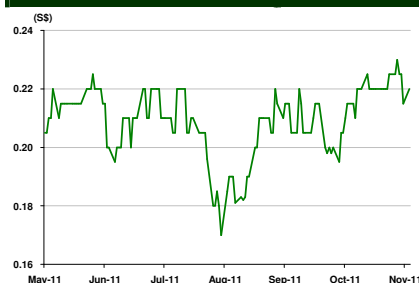
Bloomberg Ticker	KAE SP
STI	2,830.14
Issued Share Capital (m)	438.1
Market Capitalisation (\$m)	96.4
52 week H L Price (\$)	0.23 0.17
Average Volume ('000)	99.3
YTD Returns (%)	4.8
Net gearing (x)	Net cash
Altman Z-Score	3.12
ROCE/WACC	1.26
Beta (x)	0.98
Book Value/share (S¢)	33.39

Major Shareholders (%)

Lau Hung Swee & Sons	27.24%
Low Han Cheong	12.83%
Lau Hwee Beng	10.19%

Share Performance (%)

Month	Absolute	Relative
1m	2.33%	-0.81%
3m	18.92%	20.46%
6m	7.32%	17.08%
12m	4.76%	17.33%

6-month Share Price Performance

1QFY12 Results Review

Private Circulation Only

KIAN ANN ENGINEERING	BUY	↕
Price	S\$0.22	
Previous	S\$0.31	
Target	S\$0.31	

Margins holding up on strong demand

Kian Ann Engineering's (KA) 1QFY12 earnings were in line with our expectations. Earnings jumped 39.7% YoY, reaching S\$5.3m, on the back of a 17.1% YoY leap in revenue. On the back of strong demand for spare parts, we forecast gross margin to come in at 28% in FY12, above its historical average of 25%. Trading at 5.1x FY12 earnings, we believe the stock is undervalued when compared against its construction-related and heavy equipment peers at 6.9x blended CY11/CY12 earnings. Based on a target P/E of 7x FY12 earnings (5-year historical average), we value KA at a TP of S\$0.31, implying a 40.9% upside.

1QFY12 earnings within expectations. KA's 1QFY12 earnings leapt 39.7% YoY to S\$5.3m, attributable to a 17.1% YoY jump in revenue. 1QFY12 revenue grew on the back of higher sales from 1) Indonesia (+15% YoY), 2) Other Asian Countries (+30.3% YoY) predominantly due to an increase in demand of parts from China and 3) Non-Asian Countries (+57.6% YoY, largely on the back of growth from Russia and Oceania), hitting S\$44.2m due to strong demand from the forestry, mining and infrastructure sectors.

Strong demand holding up gross margin. Following the 2008 global financial crisis, KA has seen greater demand for parts and selling prices have been raised. Consequently, gross profit margin expanded and remains relatively stable and higher than its historical average of ~25%, coming in at 28.4% in 1QFY12 (1QFY11 and FY11: 28.4%). This marks the sixth consecutive quarter that KA has enjoyed gross margins above its historical average. We believe this is an indication of the pent-up demand for KA's parts and understand that margins are still holding up currently.

Focusing on emerging markets. As reflected from the geographical segmental growth in KA's sales, it is now reaping the fruits of its labour from its efforts in penetrating the emerging markets. KA would continue to focus on growing its sales in markets like Indonesia, China and Russia. We forecast FY12 and FY13 earnings to come in at S\$19.1m and S\$21.1m respectively, on the back of sustained gross margin of ~28% and a 10% YoY increase in sales.

FYE Jun (\$m)	FY09	FY10	FY11	FY12F	FY13F
Turnover	134.8	149.4	162.3	178.5	196.4
Net profit	11.5	13.2	16.8	19.1	21.1
% chg YoY	3.5%	15.2%	26.6%	13.8%	10.7%
Consensus net profit	-	-	-	17.4	18.9
EPS (S¢)	2.6	3.0	3.8	4.4	4.8
DPS (S¢)	0.7	1.0	1.1	1.1	1.1
Div Yield	3.2%	4.5%	5.0%	5.0%	5.0%
ROE (%)	10.0%	10.7%	12.4%	12.9%	13.0%
ROA (%)	6.5%	7.6%	8.9%	9.0%	9.1%
P/E (x)	8.4	7.3	5.7	5.1	4.6
P/B (x)	0.8	0.7	0.7	0.6	0.6

Source: Company data and DMG estimates

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Results Table (\$m)

Year Ended Jun	1QFY11	1QFY12	% Chge YoY	4QFY11	% Chge QoQ	Comments
Revenue	37.7	44.2	17.1%	43.6	1.4%	Up YoY driven by increase in sales from China, Russia, Oceania and Indonesia.
Cost of Sales	-27.0	-31.7	17.2%	-31.3	1.1%	
Gross Profit	10.7	12.5	16.8%	12.2	2.5%	
Rental Income	0.1	0.1	7.1%	0.1	5.8%	
Other income	0.1	0.2	363.5%	0.8	-69.9%	
Distribution costs	-2.6	-3.4	32.9%	-4.5	-24.5%	Up YoY due to higher employment cost, higher allowance of inventories obsolescence and lower reversals of impairment loss for trade related debts.
Administrative expenses	-2.3	-2.4	7.9%	-2.7	-8.5%	
Other operating expenses	-1.3	-0.5	-65.4%	-0.4	16.7%	Lower YoY largely due to lower FX losses reported this quarter.
Operating Profit	4.7	6.6	38.8%	5.6	18.2%	
Finance Costs	-0.1	-0.2	32.1%	-0.2	6.8%	
Share of profit/(loss) from joint venture companies/ associates	0.0	0.0	-	0.0	-	
Profit before Taxation	4.6	6.4	38.9%	5.4	18.5%	
Taxation	-0.7	-1.0	36.0%	-0.7	36.6%	
Minority Interests	0.1	0.2	32.2%	0.3	-54.0%	
Net profit attributable to shareholders	3.8	5.3	39.7%	4.3	21.3%	

Source: Company data

FINANCIALS

Year End Jun (\$m)					
Income Statement					
	FY09	FY10	FY11	FY12F	FY13F
Revenue	134.8	149.4	162.3	178.5	196.4
Cost of sales	(99.3)	(111.4)	(116.2)	(128.6)	(142.4)
Other income	0.6	1.7	1.4	1.7	1.7
Operating Expenses	(22.3)	(22.3)	(26.1)	(27.6)	(29.1)
Other credits / (charges)	0.0	0.0	0.0	0.0	0.0
Finance costs (net)	(1.4)	(0.7)	(0.6)	(0.7)	(0.7)
Profit before tax	12.3	16.6	20.8	23.5	26.0
Tax	(0.7)	(3.0)	(3.2)	(3.6)	(4.0)
Profit including minority interest	11.6	13.6	17.6	19.8	21.9
Minority interest	0.1	0.4	0.8	0.7	0.8
Profit attributable to equity holders	11.5	13.2	16.8	19.1	21.1

Balance Sheet					
	FY09	FY10	FY11	FY12F	FY13F
Cash	20.4	27.7	23.3	37.9	55.2
Other current assets	121.5	118.0	136.4	140.6	145.0
Fixed assets	24.1	23.8	23.7	23.6	23.5
Non-current assets	5.7	5.3	18.1	20.6	19.5
Total assets	171.8	174.7	201.5	222.7	243.2
Current liabilities (excl. debt)	22.1	26.2	34.2	38.4	40.1
Debt	27.9	16.4	22.6	23.5	24.5
Other long term liabilities	1.1	1.2	1.3	2.4	3.1
Total liabilities	51.0	43.9	58.1	64.3	67.7
Shareholders equity	119.2	128.9	140.5	154.8	171.1
Minority interest	1.6	1.9	2.8	3.6	4.4
Total equity	120.8	130.9	143.4	158.4	175.5
Total equity and liabilities	171.8	174.7	201.5	222.7	243.2

* includes bank overdrafts

Source: Company data and DMG estimates

Cash Flow					
	FY09	FY10	FY11	FY12F	FY13F
Operating cash flow before working capital changes	15.5	19.7	22.3	24.6	27.1
Working capital changes	(10.8)	(0.0)	(1.8)	(1.8)	(1.8)
Other operating cashflow	(1.8)	(2.9)	(3.2)	(3.5)	(4.0)
Net cash from operations	2.9	16.7	17.3	19.3	21.4
Net cash from investing activities	(1.1)	(0.6)	(13.6)	(0.2)	(0.2)
Net change in debt	2.6	(5.3)	(3.5)	0.9	1.0
Other financing cashflow	(2.8)	(3.6)	(4.4)	(4.8)	(4.8)
Net cash from financing activities	(0.2)	(8.8)	(7.9)	(3.9)	(3.8)
Net incr. in cash/cash equivalents	1.5	7.3	(4.2)	15.2	17.3
Cash at beginning of year	18.1	19.7	26.9	22.7	37.9
Cash at end of year*	19.7	26.9	22.7	37.9	55.2

Margins	FY09	FY10	FY11	FY12F	FY13F
Gross profit	26.3%	25.4%	28.4%	28.0%	27.5%
Pre-Tax	9.1%	11.1%	12.8%	13.1%	13.2%
Net Profit	8.5%	8.9%	10.3%	10.7%	10.8%

Growth	FY09	FY10	FY11	FY12F	FY13F
Revenue	-10.2%	10.8%	8.7%	10.0%	10.0%
Pre-Tax	-10.7%	34.5%	25.7%	12.5%	10.7%
Net Profit	3.5%	15.2%	26.6%	13.8%	10.7%
Tax rate	5.8%	17.9%	15.5%	15.5%	15.5%

DMG & Partners Research Guide to Investment Ratings

Buy: Share price may exceed 10% over the next 12 months

Trading Buy: Share price may exceed 15% over the next 3 months, however longer-term outlook remains uncertain

Neutral: Share price may fall within the range of +/- 10% over the next 12 months

Take Profit: Target price has been attained. Look to accumulate at lower levels

Sell: Share price may fall by more than 10% over the next 12 months

Not Rated: Stock is not within regular research coverage

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|---------|---------|
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