

Kian Ann Engineering Ltd

Another Record Year in the Making

Kian Ann Engineering Ltd (KA) posted an impressive 1Q FY12 results with revenue and PATMI rising 17.1% and 39.7% YoY to S\$44.2m and S\$5.3m respectively. We had previously expected the gross margin to taper off in FY2012 but it seems that demand for spare parts continues to be firm with no sign of weakness.

KA's buoyant sales is also shared by industry bellwether Caterpillar, which recorded over 40% YoY increment in sales and profit after tax in the recent 3Q results. The latter also expected 20% sales growth in FY2012. On the back of robust 1Q results and optimistic outlook from Caterpillar, we are revising our FY2012F revenue and profit after tax to S\$180m and S\$19.1m respectively. Maintain **Invest** with a valuation of S\$0.300.

Key Developments:

Results Summary: Revenue growth was mainly attributable to 57.6% increment in sales to non-Asian countries such as Russia, Australia and New Zealand. Revenue from this segment formed 22.5% of 1Q total revenue. Contribution from other key regions such as Malaysia, Singapore and Indonesia continued to be firm, increasing about S\$1.5m YoY to S\$27.4m. Gross margin remained robust at 28.4% similar to 1Q FY2011. Distribution expenses grew slightly faster than revenue, at 32.9% YoY to S\$3.4m, owing to higher wages, more allowance for inventories obsolescence and lower reversal of impairment loss. Other expenses dipped S\$0.8m largely due to lower forex losses. Their long term convertible loan continued to generate S\$0.197m interest income for the company. Consequently, profit after tax soared 39.5% YoY to S\$5.4m.

There was a slight increase in inventories and trade receivables as the company stock up more goods for customers. Cash flow from operations remained stable at S\$6.8m as trade payables and bills payables rose about the same level as inventories and receivables.

Invest

- Intrinsic Value S\$0.300
- Prev Closing S\$0.215

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	180
Operating Profit	17.3	21.4	24.0
Net Profit	13.6	17.6	19.1
EPS (S cts)	3.0	3.8	4.3

Source: SIAS Research Estimate

Key ratios (FY12F)

PER	5.05
P/BV	0.67
ROE	11.8%
Debt/Equity	14%
Current ratio	3.74

Source: SIAS Research Estimate

Indexed Price Chart

Green (FSSTI)
White (◀)



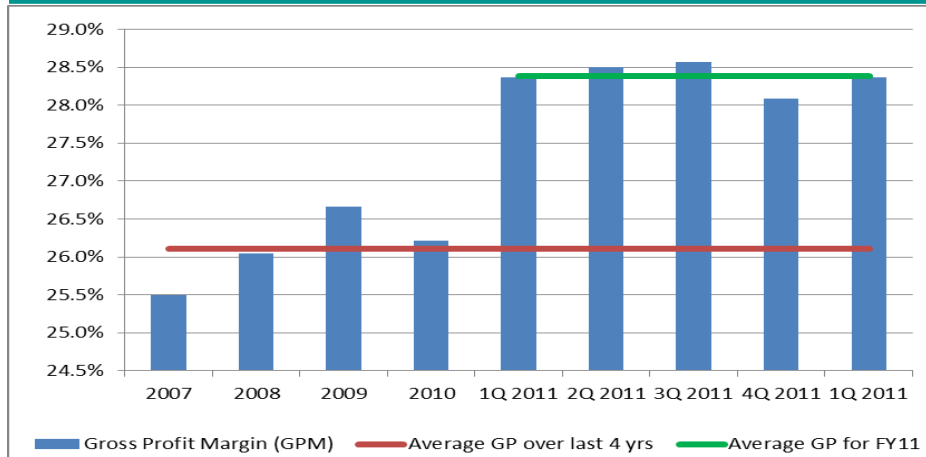
Source: Bloomberg

52wks High-Low 23.0 cents/17.0 cents
 Number of Shares 438 m
 Market Capitalization S\$94.2 m

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Figure 1: KA's Gross Profit Margin



Source: Company, SIAS Research

Company Development: KA is making progression in entering new markets with its existing clients and we reckon growth will come in gradually – we have already noted some growth in sales to non-Asian countries. Management intends to increase contribution outside Singapore, Malaysia and Indonesia to create a diversified revenue base which can help to buffer the company from any non-systematic risk. The company is also operating close to its warehouse capacity limit and is probably close to concluding plans to solve the bottleneck issue. We will adjust our numbers after we have attained more news from the company. Upside for the company will probably flow in after FY2012.

Ready for Another Record Year: Though management is cautious about the recent global uncertainties, they commented that demand for their parts continued to be firm and thus, we anticipate the current gross margin to sustain for the subsequent quarters. KA is not an outlier – market leader Caterpillar posted an incredible 3Q results with sales and net income rising more than 40% YoY. The bellwether also projected a bullish FY2012 with 20% sales growth! If the projection were to come true, Kian Ann is on track to post another record year.

Adjusting our Forecast: On the back of better than expected 1Q FY2012 results and optimistic outlook from industry bellwether, we are revising our FY12F revenue and profit after tax to S\$180m and S\$19.1m respectively. Maintain **Invest** with a valuation of S\$0.300.

Figure 2: Economic Profit Model

S\$ 'm	FY11	FY12F	FY13F
Revenue	162.3	180.2	185.6
EBIT	21.4	24.0	21.9
Tax on EBIT	2.4	2.6	2.4
NOPLAT (Company)	19.1	21.3	19.5
Invested Capital	145.3	163.1	168.8
% of Debt	13.9%	7.8%	7.9%
% of Equity	86.1%	92.2%	92.1%
WACC	11.18%	11.55%	11.54%
Capital Charge	16.3	18.8	19.5
Economic Profit	2.8	2.5	0.0
Terminal			0.0
Discount Rate		0.93	0.83
Present Value		2.3	0.0
Book Value	128.9	Risk Free	2.5%
Explicit Value	2.3	Beta	1.3
Terminal Value	0.0	Market RP	7.5%
Value of Firm	131.2	Cost of Equity	12.0%
Number of Shares (m)	438.1	Cost of Debt	6.0%
Value per share (S\$)	0.300	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	180	186
Operating Profit	15.6	13.8	17.3	21.4	24.0	21.9
Net Income After Tax	11.2	11.6	13.6	17.6	19.1	17.2
Total Current Assets	154	142	146	160	159	173
Total Non-Current Assets	30.1	29.9	29.1	41.7	49.8	51.8
Total Current Liabilities	69.8	40.9	35.2	52.1	42.5	44.2
Total Non-Current Liabilities	2.5	10.2	8.6	6.0	7.3	8.3
Total Equity	112	121	131	143	159	172
Net Income Before Tax	13.8	12.3	16.6	20.8	23.2	21.0
Cash from Operating Activities	10.7	2.9	16.7	17.3	9.4	12.8
Cash from Investing Activities	-0.8	-1.1	-0.6	-13.6	-9.1	-1.9
Cash from Financing Activities	-5.2	-0.2	-8.8	-7.9	-13.0	-2.4
Net Change in Cash	4.7	1.5	7.3	-4.2	-12.6	8.5
ROE	9.9%	9.5%	10.1%	11.7%	11.8%	9.8%
ROA	6.1%	6.7%	7.8%	8.7%	9.1%	7.7%
Debt/Equity	33%	25%	19%	11%	14%	8%
Current Ratio	2.20	3.47	4.13	3.07	3.74	3.92
P/E	7.83	8.19	7.11	5.62	5.05	5.60
P/B	0.77	0.79	0.79	0.73	0.67	0.61

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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