

KNM Group
(RM1.61 KNMG MK)

Buy
Target Price: RM1.81

2QFY08 : Borsig trickles in

OIL & GAS

• **Within Expectations**

With the consolidation of Borsig from 6th June, 2Q08 earnings got a boost from the <1month contributions from KNM's latest acquisition. 1H08 net profit now makes up 36.8% of our full year net profit projections and similarly for street estimates.

• **Margins on the rise**

Margins for 1H08 have improved to 16.2% from 14.4% in the previous corresponding quarter and this is much within expectations. As mentioned before, KNM has been actively doing away with manufacture of low end process equipment and increased its profile in the high end and mid end segment through several key acquisitions as well as internal changes in capabilities.

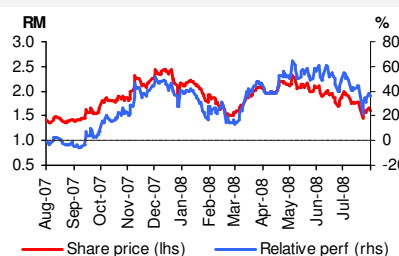
• **Other points to highlight – est. RM4.4bn orderbook**

KNM's orderbook continues to be strong and the group recently added another RM463m to its orderbook over June. To note, of total orderbook, Borsig accounts for about RM1.5bn. Also to note, average selling price per tonne should see a trading up, nearing RM18,000 per mt by year end from <RM15,000 per mt seen over 2007. Towards 2009 however, this should increase to >RM22,000 per mt. Current manufacturing capacity of the Group stands at 160,300 mt while utilisation is at an estimated 88%. This is because newer capacity takes some time to come on-stream. Looking into 2009, we expect capacity to grow by at least 15% from organic growth in their plants and utilisation is expected to be optimum at 90%.

• **Maintain BUY. TP RM1.81**

We see it hard to fault KNM at this juncture as with earnings from Borsig coming through, even a high interest rate paid on the RM600m term loan would damage bottom-line only minimally. The Group still is on a steep growth path and despite that some smaller acquisitions do not go as smoothly as expected (like HZM in Brazil); organic growth by itself can pull them through double digit growth. Process equipment has vast applications, not just for the oil & gas industry, but in the food, chemical and even biodiesel/ethanol industries hence there is a lot of long term potential seen in their business. The group will hold a briefing on the 28th of August.

Share Price Chart



Source: Bloomberg

Price Performance

| | |
|-------------------------|-------------|
| Price (RM) | 1.61 |
| 52-week Range (RM) | 2.44 – 1.35 |
| Avg Daily Volume ('000) | 13513 |

| | | | |
|--------------|-------|-------|-------|
| | 1M | 3M | 6M |
| Absolute (%) | -14.4 | -25.1 | -16.8 |
| Relative (%) | -8.7 | -11.7 | 7.1 |

Key Data

| | |
|-------------------|------|
| Market Cap (RM m) | 6527 |
| Issued Shares (m) | 3956 |
| Free Float | 70.7 |

Major Shareholders

| | |
|----------------------|------|
| | % |
| Inter Merger Sdn Bhd | 24.5 |
| EPF | 3.5 |
| Small Cap World Fund | 3.0 |

Balance Sheet Highlights (RM m)

(@ 31.12.2008) (performance indicator's annualised)

| | |
|-----------------------|--------|
| Total Assets | 1249.7 |
| Total Liabilities | 263.4 |
| Total Debt (Gross) | 1245.9 |
| Shareholders' Equity | 576.6 |
| Return on Assets (%) | 18.2 |
| Return on Equity (%) | 72.1 |
| Net Cash / Share (RM) | 9.7 |
| Debt/Equity (x) | 2.2 |
| Interest Cover (x) | 8.6 |

Team Coverage

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| FYE 31 Dec | 2Q08 | 1Q08 | 2Q07 | % YoY chg | % QoQ chg | 6M08 | 6M07 | % YoY chg |
|------------|-------|-------|-------|-----------|-----------|-------|-------|-----------|
| Revenue | 599.4 | 331.2 | 262.8 | 128.1 | 81.0 | 930.6 | 525.0 | 77.3 |
| EBITDA | 122.5 | 66.8 | 38.6 | 217.6 | 83.3 | 189.4 | 86.1 | 119.8 |
| PBT | 109.5 | 61.4 | 33.6 | 226.0 | 78.2 | 171.0 | 78.5 | 117.9 |
| Net Profit | 96.3 | 54.1 | 37.1 | 159.7 | 77.9 | 150.4 | 75.4 | 99.5 |
| Margin (%) | | | | | | | | |
| EBITDA | 20.4% | 20.2% | 14.7% | | | 20.4% | 16.4% | |
| Net Profit | 16.1% | 16.3% | 14.1% | | | 16.2% | 14.4% | |
| EPS (sen) | 2.43 | 1.37 | 0.94 | | | 3.80 | 1.91 | |
| DPS (sen) | - | - | - | | | - | - | |
| NTA (RM) | | | | | | 1.09 | 1.05 | |

| KNM Group | | Financial Summary | | | | | Share Price: RM 1.61 | | | | |
|-----------------------------------|----------------|-------------------|----------------|----------------|----------------|---------------------------|----------------------|--------------|--------------|--------------|--------------|
| Balance Sheet | 2006 | 2007 | 2008E | 2009E | 2010E | Income Statement | 2006 | 2007 | 2008E | 2009E | 2010E |
| FY 31 Dec (RM'mil) | | | | | | FY 31 Dec (RM'mil) | | | | | |
| Fixed Assets | 457.0 | 524.9 | 1234.5 | 1320.9 | 1406.2 | Revenue | 909.0 | 1,230.1 | 2,634.4 | 3,698.2 | 4,319.4 |
| Intangible Assets | 4.2 | 6.7 | 6.7 | 6.7 | 6.7 | EBITDA | 131.5 | 228.6 | 545.7 | 799.6 | 866.0 |
| Inventories | 24.8 | 62.2 | 51.7 | 72.5 | 86.4 | Dep/Amortisation | 2.5 | 5.6 | 9.6 | 13.6 | 14.6 |
| Receivables | 438.5 | 547.9 | 1082.6 | 1519.8 | 1775.1 | EBIT | 129.0 | 223.0 | 536.1 | 786.0 | 851.4 |
| Other Asset | 0.0 | 2.7 | 2.7 | 2.7 | 2.7 | Other Operating Income | 16.4 | - | - | - | - |
| Cash and ST Funds | 91.2 | 105.3 | 861.8 | 606.9 | 653.3 | Financing Cost | (8.9) | (7.5) | (62.3) | (87.8) | (57.3) |
| Total Assets | 1015.7 | 1249.7 | 3240.0 | 3529.3 | 3930.3 | Exceptional Item | - | - | - | - | - |
| Payables | 295.6 | 310.4 | 465.7 | 652.3 | 734.3 | Pretax Profit | 147.5 | 215.6 | 473.8 | 698.2 | 794.1 |
| ST Borrowings | 156.6 | 220.9 | 1,021.6 | 980.6 | 939.6 | Taxation | (9.4) | (28.9) | (64.0) | (97.7) | (111.2) |
| Other ST Liability | 27.9 | 27.7 | 859.1 | 806.2 | 885.4 | Minority Interest | (5.7) | 1.7 | (1.7) | (1.7) | (1.7) |
| LT Borrowings | 42.9 | 45.0 | 224.3 | 215.3 | 206.3 | Net Profit | 132.5 | 188.3 | 408.2 | 598.8 | 681.2 |
| Other LT Liability | 87.6 | 90.0 | 92.7 | 95.2 | 97.7 | FY 31 Dec (RM'mil) | | | | | |
| Liabilities | 610.7 | 694.0 | 2,663.4 | 2,749.6 | 2,863.3 | Growth | | | | | |
| MI | 14.7 | 0.2 | 0.2 | 0.2 | 0.2 | Turnover | 164 | 35 | 114 | 40 | 17 |
| Share Capital | 128.9 | 261.6 | 262.4 | 262.4 | 262.4 | EBITDA | 137 | 74 | 139 | 47 | 8 |
| Reserves | 261.4 | 293.8 | 314.0 | 517.1 | 804.4 | Pretax Profit | 178 | 46 | 120 | 47 | 14 |
| Shareholders' Fund | 405.0 | 555.7 | 576.6 | 779.7 | 1,067.0 | Net Profit | 222 | 42 | 117 | 47 | 14 |
| Liabilities & Equities | 1,015.7 | 1,249.7 | 3,240.0 | 3,529.3 | 3,930.3 | EPS | 97 | -67 | -43 | 47 | 14 |
| Cashflow Statement | 2006 | 2007E | 2008E | 2009E | 2010E | Efficiency | | | | | |
| FY 31 Dec (RM'mil) | | | | | | Inv. Processing (days) | 8 | 16 | 10 | 10 | 10 |
| Profit Before Tax | 147.5 | 170.3 | 473.8 | 698.2 | 794.1 | Rec. Collection (days) | 115 | 146 | 150 | 150 | 150 |
| Dep/Amortisation | 8.2 | 5.6 | 9.6 | 13.6 | 14.6 | Pay. Payment (days) | 94 | 113 | 90 | 90 | 85 |
| Financing Cost | 2.7 | 34.4 | 34.4 | 35.2 | 36.1 | Cash Conversion (days) | 28 | 49 | 70 | 70 | 75 |
| Change in WC | - | (57.3) | (286.3) | (333.3) | (159.4) | Profitability | | | | | |
| Other Non-cash Items | (26.4) | (62.0) | (98.4) | (161.0) | (147.2) | EBITDA Margin | 14.5% | 18.6% | 20.7% | 21.6% | 20.0% |
| Tax Paid | (138.2) | 28.9 | 64.0 | 97.7 | 111.2 | Pretax Profit Margin | 16.2% | 17.5% | 18.0% | 18.9% | 18.4% |
| Operating Cashflow | (28.1) | 120.0 | 197.1 | 350.5 | 649.3 | Net Profit Margin | 14.6% | 15.3% | 15.5% | 16.2% | 15.8% |
| Capex | | (101.0) | (700.0) | (100.0) | (100.0) | Return on Asset | 19.3% | 16.6% | 18.2% | 17.7% | 18.3% |
| Disposal | (23.5) | - | - | - | - | Return on Equity | 47.1% | 39.2% | 72.1% | 88.3% | 74.0% |
| Others | 4.5 | - | - | - | - | Leverage | | | | | |
| Investing Cashflow | (18.9) | (101.0) | (700.0) | (100.0) | (100.0) | Total debt/Total Asset(x) | 0.2 | 0.2 | 0.4 | 0.3 | 0.3 |
| Equity Raised | 22.4 | 10.3 | 11.3 | - | - | Total debt/Equity (x) | 0.5 | 0.5 | 2.2 | 1.5 | 1.1 |
| Borrowings | (5.5) | 2,000.0 | - | - | - | Net Gearing Ratio (%) | 26.7% | 28.9% | 66.6% | 75.5% | -168.6% |
| Repayment | 108.4 | - | (20.0) | (50.0) | (50.0) | Valuations | | | | | |
| Dividends Paid | (29.6) | (284.8) | (395.6) | (395.6) | (395.6) | EPS (sen) | 54.1 | 18.0 | 10.3 | 15.1 | 17.3 |
| Others | 95.7 | 38.0 | (62.3) | (59.8) | (57.3) | PER (x) | 3.0 | 8.9 | 15.6 | 10.6 | 9.3 |
| Financing Cashflow | | 1,763.4 | (466.6) | (505.4) | (502.9) | DPS (sen) | 6.9 | 10.0 | 10.0 | 10.0 | 10.0 |
| Net Cashflow | 15.6 | 2.1 | (969.5) | (254.9) | 46.4 | Dividend Yield (%) | 4.3% | 6.2% | 6.2% | 6.2% | 6.2% |
| Changes in Forex | 58.0 | - | - | - | - | NTA/Share | 1.55 | 1.05 | 1.09 | 1.48 | 2.03 |
| Beginning Cash | | 48.9 | 1,831.3 | 861.8 | 606.9 | P/NTA (x) | 1.0 | 1.5 | 1.5 | 1.1 | 0.8 |
| Ending Cash | (57.8) | 51.0 | 861.8 | 606.9 | 653.3 | | | | | | |

Key to investment rankings: Buy = Expected share price to appreciate by >10%; Hold = Expected share price to move by less than 10%; Sell = Expected share price to decline by >10%.

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