Stock close-up

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Right on track

With an effective global strategy in place, KNM Group is expected to record significant earnings growth

KNM Group Bhd has all the right ingredients for a fundamentally sound company. It has growing global operations, strategic partnerships as well as strong financial results. Which explains why its stock price has outperformed the Composite Index by 71% on a year-to-date basis.

Order book-wise, KNM is steady, with a size of RM1.05bil as at May 2006. Management plans to increase this to an estimated RM1.3bil by end 2006.

For its first quarter ended March 2006, KNM once again displayed sterling performance when it announced its annualised first quarter results that were above consensus estimates. Turnover increased 144.2% to RM174.34mil while net profit surged 2.34 times to RM20.78mil.

Based on these results, the stock has an earnings per share of 13.21 sen. On an annualised basis, this would mean that the stock is trading at a price earnings ratio (PER) of 10.8 times (x), at its current price of RM5.70. This is not demanding, considering the stock has very clear earnings visibility.

AmResearch says that KNM is trading at a steep 32% discount to the 19.3x average PER of its listed international peers. It opines that KNM should trade closer to its competitors as its historical operating performance beats its peers despite it being a smaller establishment.

"We believe KNM would be able to improve its future earnings stream in the next three quarters given the growing order book and capacity. Additional capacity came from the facilities in Australia, Italy and Indonesia as well as expansions of the China plant," says Avenue Research.

AmResearch has upgraded KNM's earnings estimates by 10% to RM70.6mil and earnings per share (EPS) of 44.2 sen for financial year 2006 (FY06) and 10.4% to RM99.3mil for FY07.

This is on the back of stronger-than-expected performance from Hudson Products Pacific Pty Ltd (HPP), expected cost savings from synergistic benefits with new acquisitions, increased chances of securing new contracts with enlarged plant network and bigger order book.

KNM completed the acquisition of a 51% plus one share stake in Australia-based process and heat exchange systems maker HPP for RM11.3mil in January this year. This purchase is expected to boost capacity by 8,000 tonnes.

KNM has also managed to bag new jobs from existing customers for projects in Brazil. This is on top of the earlier reported potential contract that KNM is waiting to secure.

That contract is in relation to PetroBras, a government-owned Brazilian oil company, which plans to invest US$72bil for 5 years to 2010.

With regard to potential spin-off contracts from PetroBras in Brazil, KNM is still awaiting for an award from its customer. The latter has direct contact with PetroBras and is expected to sub-contract some work to KNM upon receiving jobs from PetroBras. AmResearch foresees new contracts coming in the 4th quarter of 2006 or the first half of 2007.

For KNM's maiden contracts in the Brazilian market, fabrication will be carried out in its Malaysian plants in the second quarter of 2006 and China plant in the third quarter of 2006.

Apart from that, KNM is looking to set up its own facility in Brazil, a change from its initial plan to acquire an existing plant in the country. This is because candidates identified have no intention to dispose of their assets given the robust outlook ahead.

KNM's process equipment is must-have in the oil and gas, petrochemical and minerals processing industries. The products are used in both the upstream and downstream segments of the oil and gas industry.

KNM operates in 8 regions in the world including oil and gas hotspots such as China, the Middle East and North America, via its strategic partnership and alliances with various world-renowned process equipment manufacturers.

This partnership strategy not only gives KNM the technology transfer but also offers an instant access to other corners of the world as well as global names in the oil and gas, petrochemical and minerals industries.

It is estimated that in FY05, exports accounted for over 90% of total turnover. This is expected to increase to 94% for FY06.

According to AmResearch, another factor that could propel KNM's earnings further is its latest joint venture to manufacture "Macchi" boilers. It recently signed an agreement with Softinter, an Italian company, to form joint ventures in the boiler business. The co-operation gives KNM access to renowned "Macchi" technology for the manufacturing of industrial boilers, utility boilers, waste heat boilers, heat recovery steam generators and marine propulsion boilers.

Meanwhile, management has guided that a private placement is to be completed in June 2006, followed by a bonus issue in August 2006. In deriving our fully-diluted EPS, we have assumed a private placement of 15.7 million shares, estimated to enlarge share capital to 159.9 million shares in FY06.