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China plant gives KNM an edge

BY JOSE BARROCK

KNM Group Bhd's strongest attraction is probably the tremendous potential the Chinese market provides this manufacturer of process equipment for the oil and gas sector.

Against much optimism in the sector locally and abroad, this company will soon be listed on the KLSE's second board.

And its products are essentials. KNM Group managing director Lee Swee Eng says: "Our products are such that you need them wherever you find oil, vessels, heat exchangers or process equipment in general which are required before you can get oil."

Most research houses are quite upbeat about this company. Am Research fair values the stock at RM2.59, about 75 per cent higher than the initial public offering price of RM1.48.

Maybank Securities fair values the stock at RM3. The "premium rating", it says, is justified given KNM's niche operations, wide range of products, market dominance, ability to improve product designs and manufacturing and opportunities to enhance earnings from China operations.

KNM is already an international player with strong inroads in the Chinese market and about 83 customers worldwide.

To make the company more competitive on an international level, a plant in Changsu, China was set up by KNM at a cost of some RM25 million, to compete with players from Japan, South Korea and the likes.

Lee foresees a bright future for the group

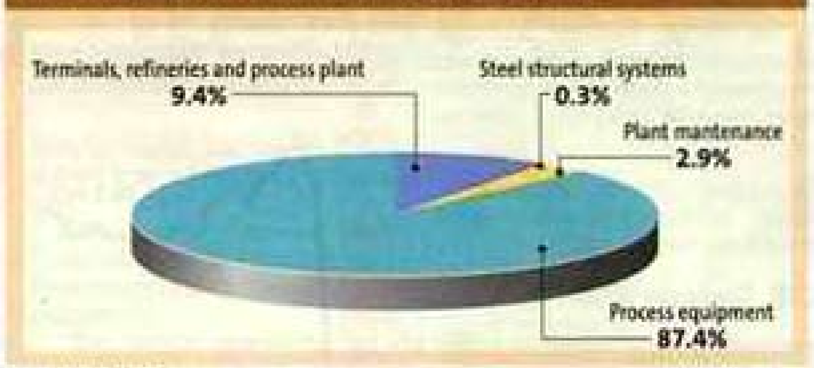
Lee notes: "For the moment the immediate plans for the China plant is to cater to the Chinese market, but in the long term we expect to get accreditation for the plant ... within a year or so and hope to do international markets after that".

Maybank Securities says the company is poised to benefit from discoveries of oil and gas reserves in China while the expansion of current exploration fields will spur demand from the Changsu plant. "Once the China plant is accredited, logistics-wise we will be able to match all our rivals. Currently the cost of manufacturing in Malaysia is not cheap, neither is the logistics costs," Lee adds.

The plant in China is also strategically located by a riverside making transportation to nearby ports easy.

"Hence the very bright outlook for KNM. We even see ourselves as one of the major players for process equipment (for the oil and gas sector) in the world in the near future," Lee says optimistically.

KNM Group: 2002 turnover breakdown



Source: KNM Group

Am Research adds to the optimistic outlook for the company based on the China plant. "Transportation is always a major price factor due to the large size and weight of the equipment which may weigh over several hundred tonnes.

"The China plant, being the largest of its four plants is nearer to the other major markets such as Japan, Korea, Russia, the West Coast of North and South America, which is not competitive for KNM's Malaysian operations due to the high delivery cost," the research report says.

The plant in China set up in 2002 has a maximum capacity of some 11,500 tonnes, which Lee says will be fully utilised by next year.

"Then we will look into possibly expanding that capacity as well," Lee says.

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From the company's RM21.06 million expected from the initial public offering, Lee says some of it will be invested into the China plant. The proceeds from the initial public offering will be utilised to repay term loans, capital expenditure, working capital and listing expenditures.

One of the main concerns of the group currently is finding new markets, Lee says. "We are looking into more areas within the South American region ... Mexico, Argentina, Venezuela and even Oceania, Southeast Asian areas and even Russia have good potential ... generally areas where we have not penetrated very well".

Exports for KNM accounted for some 45 per cent of business last year. Lee says that exports in the current year should contribute to more than 50 per cent of the group's revenue.

"The major contributor in the long run will be exports with the domestic market scaling down, but with a consistent volume," he adds.

Lee notes that there is a lot of potential in the Middle East with regards to setting up plants similar to China, and he does not discount the possibility of KNM initiating plant development there.

"If the Middle East market grows there could be potential there. We will not hesitate to consider opening up new plants in the Middle East," he says.

On the local front with an increased demand for crude oil and natural gas, driven by an increase in transportation and energy requirements, coupled with increased activities in the manufacturing sector driven by the strong growth in the usage of petrochemical products should see improvements in KNM's performance.

KNM is forecasting a 2.4 per cent increase in net profit to RM8.47 million for the year ending December 2003. It is projecting a 2.5 per cent increase in sales to RM110 million.

KNM's initial public offering involves the issuing of 6.68 million shares of RM1 each at an issue price of RM1.48 per share with the balloting date set on August 7. KNM Group is looking to list on the Second Board of the Kuala Lumpur Stock Exchange on August 13.