07-12-2007: KNM eyes high-end process equipment firms

by Joseph Chin

Email us your feedback at fd@bizedge.com

KUALA LUMPUR: KNM Group Bhd is eyeing a high-end process equipment company which could boost its bottomline by RM200 million and its revenue by RM1 billion, according to OSK Investment Research.

The research house said the target company should be able to manufacture process equipment used in gold extraction as well as sulphur extraction from sour crude oil.

"It has a potential profit figure of RM200 million. It also has a higher gross margin than KNM. For high-end process equipment, the gross margin can rise to 30% to 35% compared to KNM's 25%," it said.

OSK Research said the average selling price for such equipment was high because of the corrosive process and the requirement for materials like titanium.

At an analysts' briefing on Wednesday, KNM indicated the acquisition target was one of the few global players that could work with exotic materials like titanium to fabricate high-end process equipment. The proposed acquisition could be announced by January next year and completed by June.

OSK Research said the target company also had a fabrication yard with 22,500 million tonnes per annum (mtpa) capacity and the cost could be RM2 billion. The acquisition would come at a cost of eight times to 10 times price-to-earnings ratio (PER).

KNM Group

FYE Dec (RM m)	FY07F	FY08F	FY09F
Turnover	1,349.3	2,730.3	3,754.7
Net profit	184.0	420.6	618.3
EPS (sen)	17.6	40.2	59.1
ROE	41.4%	64.4%	59.4%
PER (x)	42.6	18.7	12.7
P/BV (x)	7.9	-9.7	57.6
EV/EBITDA (x)	34.5	14.5	11.0

Share Base of 1036.7m in FY07 to FY09 post 1-for-1 bonus issue and 1-into-2 share split
Source: OSK Research

Based on the assumption the acquisition could be completed by June next year, OSK Research said this would boost its profit forecast by 24% in the financial year ending 2008 and 50% in 2009.

"Valuation for the company will be at 10 times price-to-earnings ratio (PER) and 2.5 time price/book value. Intangibles will rise by RM1.2 billion due to the goodwill involved," it said.

However, the research house said as the acquisition had yet to be announced, there were still many uncertainties, including whether the purchase would take place. Another uncertainty was the funding mechanism for the possible acquisition. It said KNM had indicated it would cap its gearing at 80%.

"With their current shareholder's funds at RM522.09 million and net gearing at 22.8%, financing the acquisition (RM2 billion) using debt alone will be too much for KNM's balance sheet to take. We believe pure debt financing will raise net gearing to 249% and push net tangible asset into negative territory," it said.

OSK Research said there would likely be a cash call from KNM although it was uncertain as to how the rights issue will be structured. For now, it had only incorporated 100% debt financing into its forecast while awaiting details of the potential acquisition.

On KNM's order book, it said it had increased from RM2.1 billion in September to RM2.5 billion currently while the tenderbook was RM11 billion.

KNM's "as-is" business was still growing strongly, with the order book now at RM2.5 billion, up from RM2.1 billion in September while the tenderbook was RM11 billion.

Of the RM2.5 billion order book, oil and gas accounted for 47%, petrochemicals (18%), minerals (17%) and other 8%. As for KNM's tender book, it had increased by 10% to RM11 billion with most of the tenders still in O&G at 45%.

OSK Research said there was more upside for KNM Group Bhd, despite that its share price had run up more than 25% since end-November on good results, new contracts, excellent outlook, MSCI inclusion and the potential for new acquisitions in the high-end range of the process equipment industry.