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K-Tech Construction (KTECH)

New : LONG-TERM BUY
Previous : TAKE PROFIT

Construction

Price **Bt5.90**
Target **Bt6.90**

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Brighter outlook from improving margins

KTECH's earnings prospects appear stronger in 2H04 from growing order book and improving margins. KTECH was able to reduce its raw material costs around 3% after establishing a centralised purchasing system in September 2004. Also, the company has a stronger position to negotiate with sufficient cash on hand for bank guarantees. As a result, its gross margins widened by around 1-2% and we believe margins will further widen from 4Q04 onwards. However, we are conservatively maintaining our full-year gross margins projection at 6.8% due to its lower-than-expected gross margins of only 6.2% in 1H04.

As of September 2004, KTECH's remaining backlog orders has risen to Bt4.92bn, after deducting revenue recognised during 1Q04-3Q04. The current remaining backlog accounts for 92% of our 2005 sales projection of Bt5.36bn. We expect KTECH to secure construction contracts of Crowne Plaza Sukhumvit project phase 2 worth Bt1.0bn and Golden Nakara project phase 2 worth Bt500mn in the near-term since the company has almost completed the first phase work on these projects. KTECH also submitted construction bids for almost 20 potential projects with a total value of around Bt18.5bn.

The recent sell-off has depressed KTECH's share price to Bt5.9/share, 17% lower than our fair value estimate of Bt6.9/share. We are basing our fair value estimate on a 2004 PER of 15x. With brighter outlook of the company's earnings potential, we recommend investors to begin accumulating the stock for long-term investment.

Table 1 : KTECH Earnings Summary

Year to Dec	**2002**	**2003**	**2004F**	**2005F**	**2006F**
Sales (Btmn)	1,628	2,618	4,492	5,355	5,192
Net profit (Bt)	24	40	108	178	195
EPS (Bt)	16.12	21.37	0.46	0.76	0.83
Growth (%)	583%	33%	(98%)	64%	9%
CF/share(Bt)	16.1	39.2	0.6	1.0	1.1
PER (X)	0.4	0.3	12.8	7.8	7.1
BVPS (Bt)	90.6	197.1	3.5	4.3	5.1
EV/EBITDA (x)	42.4	14.9	7.5	4.6	4.0
Dividend Yield (%)	0%	0%	0%	0%	0%

Source: Company reports and KeLive estimates.

Remaining backlog increased to Bt4.92bn as of September 2004

KTECH has increased its remaining backlog from Bt3.51bn at the end of 2003 to Bt4.92bn as of September 2004, after deducting revenue recognised during 1Q04-3Q04. The current remaining backlog accounts for 92% of our 2005 sales projection of Bt5.36bn. We expect KTECH to recognise sales of Bt1.21bn in 3Q04. Part of this is due to be awarded additional works on some existing projects, such as Central World Tower, Golden Nakara and Graceland Hotel & Spa Phuket.

Table 2 : Composition of existing backlog

Project Name	Construction period	Project value (Bt mn)	Remaining value (Bt mn)
Current projects as of September 2004			
1. Centerpoint Sukhumvit	Aug 03 – Aug 05	635	298
2. Central World Tower phase 1	Aug 03 – Sep 04	617	92
3. Baan Ananda phase 1	Oct 03 – Oct 04	360	108
4. Golden Nakara phase 1	Dec 02 – Dec 04	1,000	270
5. Raja Oversea Trading	Oct 03 – May 05	346	232
6. Amburaya Resort and Spa	May 03 – Aug 04	374	175
7. The Trees Sathorn	Dec 03 – Oct 04	290	226
8. Graceland Hotel and Spa Phuket	Dec 03 – Dec 04	287	152
9. Majestic Grande hotel	Dec 02 – Oct 04	266	24
10. Royal Phuket Marina phase 1	Feb 04 – Dec 05	500	425
11. Royal Phuket Marina phase 2	Feb 04 – Dec 05	1,500	1,500
12. Baan Nanthawan Ramkamhaeng	Feb 04 – Apr 05	360	288
13. Carrefour Haadyai	Feb 04 – May 05	355	36
14. Crowne Plaza Sukhumvit	Mar 04 – Sep 04	99	25
15. Windmill Sports Life	May 04 – May 05	370	26
16. Pattaya Northshore residential condominium	Aug 04 – Dec 05	350	340
17. Central World Zen	Jun 04 – Jun 07	680	666
18. Evason Phuket	Jun 04 – Jan 05	60	39
Total		**8,449**	**4,922**

Source: KTECH

KTECH still has a good chance to win the construction contracts of Crowne Plaza Sukhumvit project phase 2 worth Bt500mn since the company is currently working on the substructure of phase 1 of this project. Moreover, the company is likely to continue its works on Golden Nakara project in the second phase worth Bt1.0bn since the first phase will be completed at the end of this year. KTECH also submitted construction bids for almost 20 potential projects with a total value of around Bt18.5bn. KTEC has good prospects to win a large number of additional works due to its proven track record as well as number of repeat clients who tend to create additional construction projects.

Table 3 : High potential projects

Project Name	Project value (Bt mn)
1. Crowne Plaza Sukhumvit phase 2	1,000
2. Golden Nakara phase 2	500
3. Ratchadapisek Complex	4,500
4. Department store at Ratchada	1,000
5. Resort and hotel in Phuket	2,000

Source: KTECH

KTECH also plans to expand to the government sector and expects to add public projects in its backlog orders within the next year. However, the percentage of public works next year is projected at only 10-20% of total backlog orders as the company just begins work in this sector.

Improving gross margins from centralised purchasing system

KTECH successfully established a centralised purchasing system in September 2004, which helps to increase the company's bargaining power with suppliers. The company's previous system let each project buy raw materials individually, leading to low bargaining power and low discount from suppliers.

Moreover, after the IPO, KTECH has enough cash to provide bank guarantee and will be able to buy materials with big suppliers directly at lower price. Without the bank guarantee, KTECH has to buy material via agents, who will provide credit but also charge higher prices. As a result, KTECH has successfully reduced its raw material costs by around 3%. For these reasons, we expect KTECH's gross margins to improve from 4Q04 onward.

Expect 3Q04 earnings growth of 231% qoq

Given improving gross margins from centralised purchasing system, KTECH's 3Q04 earnings are projected to rise 231% qoq to Bt32mn. The company's sales are expected to surge 12% qoq to Bt1.21bn while gross margins are forecast to widen to 7.1%. We expect SG&A to fall 23% qoq to the normal level at Bt37mn as the company booked the consulting fee in 2Q04. As a result of better gross margins and lower SG&A, operating margins should widen substantially from 1.7% last quarter to 4.0%.

Table 4 : KTECH 3Q04 earnings estimates

	3Q04	2Q04	% Chg	2004F	2003	% Chg
Sales	1,209	1,079	12.0%	4,493	2,618	71.6%
COGS	1,123	1,012	10.9%	4,183	2,440	71.4%
Gross profit	**86**	**67**	**28.4%**	**310**	**177**	**74.8%**
SG& A	37	49	(23.0%)	164	111	48.1%
Operating profit	**48**	**18**	**165.5%**	**145**	**66**	**119.6%**
Interest expenses	3	3	(10.0%)	11	11	3.5%
Non-operating income	1	1	20.8%	7	6	21.2%
Pre-tax income	46	16	195.1%	141	61	131.2%
Normalised profit	32	10	231.1%	108	40	173.6%
Net profit	**32**	**10**	**231.1%**	**108**	**40**	**173.6%**
EPS	**0.88**	**0.26**	**231.1%**	0.29	0.21	37.0%
Gross margin (%)	7.1	6.2		6.9	6.8	
Operating margin (%)	4.0	1.7		3.2	2.5	

Source: KTECH and KELIVE estimates

Income statement

(Btmn)	2002	2003	2004	2005F	2006F
Sales	1,628	2,618	4,492	5,355	5,192
COGS	1,476	2,440	4,187	4,942	4,753
Gross margin	**152**	**177**	**305**	**413**	**439**
SG&A	119	111	148	161	156
Operating margin	**33**	**66**	**157**	**253**	**283**
Interest expenses	7	11	14	19	23
Other income	14	6	12	12	12
Pretax profits	41	61	154	245	272
Income taxes	17	21	46	73	82
Extraordinary items	(0)	(0)	(0)	(0)	(0)
Net income	**24**	**40**	**108**	**171**	**190**

Balance sheet

	2002	2003	2004	2005F	2006F
Cash equivalents	23	75	114	39	169
Receivables	160	252	394	470	455
Inventories	136	439	746	1,016	951
Fixed assets	111	223	296	309	292
Total assets	**630**	**1,337**	**2,111**	**2,495**	**2,509**
Credits	316	702	986	1,164	990
ST-debts	11	80	121	137	137
LT-debts	40	88	119	135	134
Other liability	**127**	**103**	**111**	**115**	**114**
Equities	**136**	**365**	**772**	**944**	**1,134**

Cash flow statement

(Btmn)	2002	2003	2004	2005F	2006F
Net profit	24	40	108	171	190
Depre. / Amort.	-	33	39	51	59
Net working cap.	(51)	(8)	(164)	(168)	(96)
Cash flow from operations	**(10)**	**(73)**	**(224)**	**(41)**	**172**
CAPEX	(30)	(145)	(112)	(64)	(42)
Investment	-	-	-	-	-
Cash flow from investing	**(36)**	**(154)**	**(112)**	**(64)**	**(42)**
Debt movement	38	117	72	31	(1)
Capital call	12	67	300	-	-
Dividend paid	-	-	-	-	-
Cash flow from financing	**54**	**279**	**372**	**31**	**(1)**
Free cash flow	**(41)**	**(218)**	**(336)**	**(105)**	**130**

Financial ratios

	2002	2003	2004	2005F	2006F
Gross margin	9.3%	6.8%	6.8%	7.7%	8.5%
Operating margins	2.1%	2.5%	3.5%	4.7%	5.5%
Net gearing (X)	0.21	0.26	0.16	0.25	0.09
Interest coverage (X)	6.9	6.6	11.8	13.8	12.8
Inventory days	34	66	65	75	73
Collection days	36	35	32	32	32
Payment days	78	105	86	86	76

Source: Company reports and KeLive estimates

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