

Kingsmen Creatives

PRICE S\$ 0.24
Buy
Key Stock Statistics

NRA EPS Est. 2004	3.1
P/E on NRA Est. 2004	7.8
NRA EPS Est. 2005	4.2
P/E on NRA Est. 2005	5.8
Dividend/Share	0.75
Dividend yield (%)	3.1
Shs. Outstg. (m)	100
Market capitalisation \$m	24
Avg. daily vol (m)	0.01
Book Value/Share	0.12
Shareholders:	
Benedict Soh	25.3%
Simon Ong	25.3%

Per share data

Year:	2001	2002	2003	2004F	2005F
Book Value (\$)	na	0.08	0.12	0.15	0.2
Cash Flow (cts)	na	3.6	2.0	3.7	4.9
Earnings (cts)	na	4.1	1.8	3.1	4.2
Dividend (cts)	na	na	0.75	1.0	1.0
Payout Ratio	na	na	38.3%	25.9%	19.2%
PER (x)	na	5.8	13.5	7.8	5.8
P/CF (x)	na	6.6	12.2	6.5	4.9
P/BV (x)	na	3.2	2.0	1.6	1.2
Dividend yield %	na	na	3.1%	4.2%	4.2%
ROE (%)	na	55.0%	12.5%	20.1%	21.3%

P&L analysis (\$m)

	2001	2002	2003	2004F	2005F
Revenue	45.26	60.84	53.48	66.30	76.99
Operating Profit	1.93	4.42	2.54	4.99	6.71
Depreciation	0.17	0.33	0.44	0.60	0.70
Interest Expense	0.08	0.06	0.08	0.20	0.30
Pretax Profit	1.99	4.25	2.13	4.33	5.87
Effective tax rate	26.9%	18.9%	25.7%	24.0%	23.0%
Net Profit	1.45	3.30	1.53	3.09	4.16

Margins

Gross	28.9%	26.6%	27.8%	28.1%	28.2%
Operating	4.3%	7.3%	4.7%	7.5%	8.7%
Pre tax	4.4%	7.0%	4.0%	6.5%	7.6%
Net	3.2%	5.4%	2.9%	4.7%	5.4%

Investment highlights:

- The group delivers “one-stop-shop” solution in three-dimensional communications design and production through a vertical and horizontal integration of its services.
- It has established long standing relationships with internationally known clients in the mid to up-market retail sector. The interiors division is able to handle "roll-out management" services for clients who have retail outlets in the Asia Pacific region.
- Earnings results in FY03 show strong rebound in the 2H as 1H was adversely affected by terrorism threats and SARS. Going forward, the group will benefit from the trend of increasing museums and visitor centre projects arising from Malaysia and Singapore as well as the continuing expansion and upgrading of airports in the Asia Pacific and Middle East regions.
- Another avenue of earnings expansion is through exercising the options to acquire the equity interests in the Kingsmen Affiliates held by its controlling shareholders directly or through Kingsmen International when they become sufficiently profitable. Its affiliates in Greater China, Japan, Korea and Vietnam are possibilities for acquisition within the next two years.
- The group has a dynamic management and good track record which allows the group to strive in a highly competitive industry. Its three divisions - Design, Exhibition and Interior - have been profitable throughout its 28-year history in Singapore.
- We are initiating coverage of the stock with a buy rating. Fair value of \$0.31 is based on a PER of 10 times on FY 2004 earnings.

Background

Kingsmen Creatives was set up in 1976 by Benedict Soh and Simon Ong with an initial staff strength of seven to provide high quality design and production services to clients in the exhibition, retail and office interior sectors. Today the group has more than 300 employees and delivers a "one-stop-shop" solution in three-dimensional communication design and production through a vertical and horizontal integration of its services. Currently, its principal markets are Singapore and Malaysia. It also has a network of offices in 15 major cities across the Asia Pacific and Middle East regions through its business arrangements with the Kingsmen Affiliates.

It has established a good working relationships with its clients for the past 28 years. In FY 2002, about 55% of its business came from repeat customers. Clients of more than 10 years include DFS, Robinson Group, Asian Aerospace, Singapore Science Centre, Reed Exhibitions, Tax Free World Association, the Dickson Group, The Hour Glass, FJ Benjamin, Jay Gee Enterprises and Burberry Asia. UOB accounted for 20% and 16% of its total revenue in FY02 and FY03 respectively.

Major Customers

	Percentage of Total Revenue			
	FY00	FY01	FY02	FY03
	%	%	%	%
UOB	-	-	20.4	16.0%
Robinson & Co (S) Pte Ltd	8.4	10.3	1.8	1.9%
DFS	0.3	4.1	7.7	8.0%

The stock was listed on the SGX Sesdaq in September 2003. Its public offer comprised 20m new shares at \$0.30 a share.

Valuation

Comparative valuation

Stock	Share Price	Mkt Cap \$m	FY03 EPS cts	FY03 PER (x)	P/NTA	Yield
Pico Far East	HK\$0.55	65.5	2.34	23.5	0.7	3.6%
ISG Asia	S\$0.115	15.5	0.18	63.9	1.2	-
Design Studio	S\$0.10	21.0	0.40	25.0	1.1	-
Nobel Design	S\$0.13	14.3	(1.02)	(12.8)	1.2	-
Futuristic	S\$0.15	11.0	(4.65)	(3.2)	5.0	-
Kingsmen Creatives	S\$0.24	24.0	1.78	13.5	2.0	3.1%

No earnings forecasts are available for these companies but based on historical performance in FY03, Kingsmen Creatives stood out as the best among its listed peers. Its major competitor in the exhibition and museum division is HK-listed Pico Far East Holdings Ltd. In the interiors division, Kingsmen has been compared with ISG Asia through subsidiary CityAxis, Design Studio, Nobel Design and Futuristic. Bearing in mind its small size and low liquidity, we believe we are being conservative in applying a prospective PER of 10 times on FY 2004 earnings. This would give the stock a potential value of 31 cents and an upside of 29%. We are initiating coverage of the stock with a buy rating.

Business Model

The group has structured its operations into four main divisions.

Breakdown of FY03 Results by Activities (\$m)

	Revenue	Operating Profit
Exhibitions and Museums	21.43	1.33
Interiors	29.17	1.29
Research and Design	2.01	0.07
Integrated Marketing Communications	0.87	0.03
Total	53.48	2.72

Business Model (cont'd)

Exhibitions and Museums (E&M):

The division produces and implements the design works of its designers for trade shows, promotional events and festivities in the form of temporary installations and displays. It also produces interiors and displays for museums and visitor centres. Some of its notable projects include the Asian Aerospace in Singapore and air shows in Malaysia, Thailand, Indonesia, India and South Korea and Reed Exhibitions.

Its competitor, Pico, derives about half of its turnover and profits from Greater China and the remaining from other parts of Asia. As for Kingsmen, 72% of its revenue comes from Singapore. On comparison with Pico, Kingsmen has been able to generate a higher operating margin and also makes a higher ROE overall.

Comparative Data

	Operating Margins From E&M	ROE
Pico Far East	4.1%	3.0%
Kingsmen Creatives	6.2%	12.5%

The trend of increasing museums and visitor centre projects arising from Malaysia and Singapore is expected to provide strong opportunities of growth for the group.

Interiors:

The interiors division translates designs into interiors which reflect the corporate or brand image of its clients. It focuses on retail stores, eateries and restaurants, corporate offices and showrooms.

Competition in the interior industry in Singapore is intense as the industry is fragmented with a large number of small players. Nevertheless, over the years, Kingsmen has carved a niche in the middle and upper end of the retail sector. It has produced interior design and fit-out works for clients representing retail brands such as Gucci, Fendi, Polo Ralph Lauren, Burberry, The Hour Glass, Guess, The Body Shop, the Robinson group and DFS.

In recent years, it has also provided "roll-out management" services to its clients by producing a series of retail outlets in different Asian cities, with each having the similar "look" and projecting the same brand image and identity of its clients. The results were only possible because of the close inter-office relationships that have been developed within the Kingsmen group. Since FY 2002, it has carried out "roll-out management" services for some of its clients such as Burberry, The Body Shop and UOB. For example, it has successfully carried out roll-out management projects for UOB, where it managed, designed, produced and installed interiors for 34 branches across Singapore within nine months in 2002/3 and is currently rolling-out 13 more branches in the third phase. This strategic move has probably contributed to the improvement in its interior's gross margins from 17.4% to 19.6% in FY02.

Comparative Data

	Operating Margins From Interiors	ROE
ISG Asia	0.9%	1.3%
Design Studio	1.5%	4.9%
Nobel Design	-4.7%	-9.6%
Futuristic	-9.6%	-153.0%
Kingsmen Creatives	4.4%	12.5%

Although we have included only the revenue and earnings from interiors for comparison purpose, the focus among these companies are quite different from Kingsmen. For example, Nobel's focus is in commercial and residential projects. This demonstrates Kingsmen's ability to achieve better returns from its strategic focus on the mid to up-market retail sector complemented by large local companies and MNCs in the corporate office sector.

An emerging trend is for shorter renewal periods for retail interiors to two to three years from five to ten years in the past. Although retail sector has been in the doldrums for a long time in Singapore, recent experience by the management shows increasing competition has given rise to the need for retail players to upgrade or fit-out every two years instead of previously five years to coincide with lease expiry. This development has been beneficial to the group.

The group has the biggest slice of the pie of fitting out retail outlets at the Changi Airport Terminals. The contract size for a retail outlet is a minimum of \$150,000. With the continuing expansion and upgrading of airports in the Asia Pacific and Middle East regions, we can expect steady growth in the demand for its services in fitting-out of duty free retail outlets in the next few years.

Research and Design

It has a team of about 30 designers in the research and design centre in Singapore to provide support to the Exhibitions and Museums and Interiors divisions.

Integrated Marketing Communications

As part of its “one-stop-shop” concept, it provides services that aid marketing and promotion of its clients’ products and services such as traffic generation, visitor data collection, pre-show promotions and post-show analysis and reports, brand consultancy and event management.

Kingsmen Affiliates

As a result of the restructuring exercise in connection with the IPO last year, the Kingsmen Affiliates have been excluded and do not form part of the group. The Kingsmen Affiliates are located in territories including Greater China, Japan, South Korea, Vietnam, Indonesia, India and Middle East. However, the group has been granted call options to acquire shares of the Kingsmen Affiliates when any of them achieves a profit after tax of at least \$500,000 and positive NTA. Currently, Greater China, Japan, Korea and Vietnam met this criteria based on last year's results. The management intends to exercise the option to acquire two or three of these this year, possibly Korea, Japan or Vietnam. Based on last FY results, the Korea affiliate made a turnover of \$3m, Vietnam \$4m, Hong Kong \$10m, Taiwan \$4m and the PRC \$4.7m. The fast-growing Greater China affiliates, comprising Hong Kong, Taiwan and the PRC, would probably be included in FY05.

Name of Kingsmen Affiliate	Equity Interest by Kingsmen International*
Kingsmen Vietnam	80%
Kingsmen Hong Kong	50.50%
Kingsmen Beijing	50.50%
Kingsmen Taiwan	50.50%
Kingsmen Shanghai	50.50%
Kingsmen Nikko	30%
Kingsmen Korea	25%
Kingsmen Middle East	25%
Kingsmen India	19.50%
Kingsmen Indonesia	20%#

* the group's co-founders hold 50% each.

the group's co-founders hold 10% each.

Review of Financial Performance

Earnings Forecast (\$m)

Year ended 31 Dec	2001	2002	2003	2004F	2005F
Turnover	45.3	60.8	53.5	66.3	77.0
Cost of sales	(32.2)	(44.6)	(38.6)	(47.7)	(55.3)
Gross Profit	13.1	16.2	14.9	18.6	21.7
Other income	1.1	0.5	1.0	1.2	1.3
Operating expenses	(12.4)	(12.6)	(3.8)	(15.4)	(17.0)
Financial expenses	(0.1)	(0.1)	(0.1)	(0.2)	(0.3)
Financial income	0.3	0.2	0.1	0.1	0.2
Pretax profit	2.0	4.3	2.1	4.3	5.9
Taxation	(0.5)	(0.8)	(0.6)	(1.0)	(1.4)
Aftertax profit	1.5	3.5	1.6	3.3	4.5
Minority interest	-	(0.2)	(0.1)	(0.2)	(0.4)
Net profit	1.5	3.3	1.5	3.1	4.2

The threat of terrorism and the SARS epidemic in the 2Q of FY03 resulted in postponement or cancellation of some exhibitions and events and interior projects during the 1H of 2003. As a result, performance in the 1H was adversely affected. However, the group made a strong turnaround in the 2H with turnover doubling that of the 1H of FY03.

The group completed several major projects such as The Body World exhibition, Ford motorshows, the National Day Parade, Christmas lightup at Orchard Road, interior fit-outs for numerous DFS shops, branded retail outlets at Paragon Shopping Centre and fitting-out of UOB branch outlets which contributed a total of \$16.5m to group turnover during the 2H of FY03. The Ford motorshows, which include shows in Thailand, Taiwan, Japan, Sydney, Malaysia and Jakarta, contributed \$3m in FY03 and are expected to contribute another \$1m in FY04.

The group started FY04 with the bi-annual Asian Aerospace event which is expected to contribute about \$5m to group turnover. As to-date, the group has secured another 5 projects in the exhibition and museum division such as NTUC, Malay Heritage, Sentosa, Science Centre and a military museum in Malaysia, totaling \$4m. The Science Centre project valued at about \$1m is for an atrium display for the Lord of the Rings exhibition.

We are projecting a doubling in net profit for FY04, with FY03 being an exceptionally bad year, and a 35% y-o-y growth for FY05.

Investment Risk

There is no consistency in the number and value of projects secured each year.

External factors such as terrorist action or outbreak of epidemic such as SARS could lead to postponement or cancellation of exhibitions and events.

The group is very dependent on the key management personnel who have been responsible in maintaining good relationships with both clients and suppliers.

Its financial results are exposed to foreign exchange fluctuations. Its transactions are carried out mainly in S\$ and US\$. Between 6.5% to 15.9% of its revenue were denominated in US\$ and between 2% to 4% of its costs were denominated in US\$ over the last three years. In the event of a significant depreciation in the US\$ against the S\$, its operating results will be adversely affected.

Balance Sheet & Other Fin. Data (\$m)

December	2002	2003
Property, plant and equipment	2.1	2.3
Other investments	0.5	0.4
Current assets	28.3	30.4
Current liabilities	24	19.8
Non-current liabilities	0.4	0.4
Shareholders funds	6	12.3
Minority interests	0.4	0.5
Net debt	Net cash	Net cash
Gearing	9.9%	12.4%

The group has a healthy balance sheet. It has cash and deposits totaling \$5.5m as at Dec 03. Much of the IPO proceeds of \$4.7m has not been deployed but would be used for new acquisitions and regional expansion.

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