PP10551/10/2010(025682)
27 August 2010

OSK

MALAYSIA EQUITY
Investment Research
Daily News

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Trading Idea

Kelington Group Bhd

A Worthy ACE Company

Kelington Group Berhad (KG), a leading provider of ultra high purity gas and chemical delivery systems, was the first company to list on the ACE market, which last year underwent a name change from Mesdaq Market. KG has expanded to China, Taiwan and Singapore, backed by its track record in the provision of one-stop ultra high purity (UHP) delivery solutions. We value KG based on our small cap average PER of 8x over FY11EPS, and arrive at a TP of RM1.02. Having met our IPO forecasts and given the still positive outlook, we believe KG has the makings of a good Trading Idea.

NOT RATED

Target	**RM1.02**
Previous	**-**
Price	**RM0.76**

MANUFACTURING

Kelington Group is a leading ultra high purity gas and chemical delivery solutions provider. It is the first company listed on the renamed ACE market.

Stock Statistics

Bloomberg Ticker	KGRB MK
Share Capital (m)	74.7
Market Cap (RMm)	56.8
52 week H│L Price (RM)	0.99│ 0.53
3mth Avg Vol ('000)	18.2
YTD Returns	20.6
Beta (x)	N/A

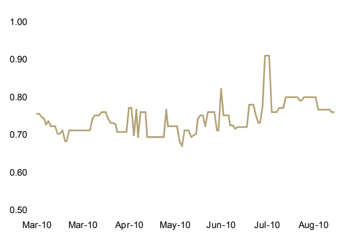
Major Shareholders (%)

Palace Star	53.2
Allied Moral	7.9
Sky Walker	12.9

Share Performance (%)

Month	Absolute	Relative
1m	-1.3	-5.2
3m	11.6	-3.0
6m	0.9	-12.6
12m	N/A	N/A

6-month Share Price Performance



Regional total engineering solutions player in UHP systems. Kelington Group (KG), which has been in the ultra-high purity gas and chemical delivery solution industry for more than 10 years, has a presence in Malaysia, China, Taiwan and Singapore. KG is a provider of total ultra-high purity gas/chemical delivery system solutions involving UHP system design, fabrication and installation, gas and chemical delivery equipment, QA and QC services, control and instrumentation, and maintenance and servicing.

Key beneficiary of a favorable sector outlook. The worldwide sales of semiconductor products are projected to grow at more than 8% per annum in the next two years, while solar cell demand is expected to surge by almost 60% per annum over the next few years. As the group has diversified to cover the semiconductor, solar cell, LCD panel and LED industries, its earnings will continue to grow even if one or the other sector slows down in the next few years given the overall continued growth of consumer electronics and green technology.

Climbing growth, solid financial position. KG has been registering revenue growth over the last four years, at a CAGR of 16% per annum. Despite the global economic downturn in 2009, the group still managed to register top and bottom-line growth of 6% and 23% respectively. Due to the nature of its business, KG's balance sheet is solid as it had minimal borrowings of RM1.3m and a strong cash balance of RM16m as at December 2009, with its cash increasing to RM26.8m as of June 2010. The group has been maintaining a net cash position over the last 4 years.

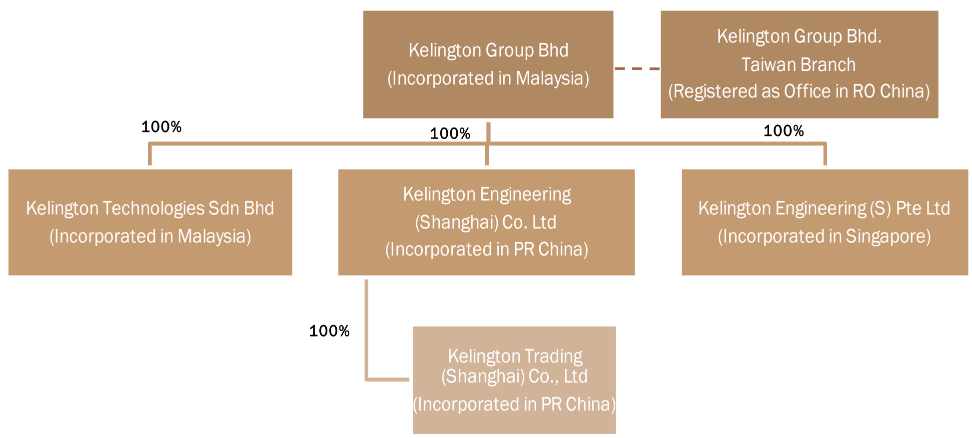
34% upside. After its IPO in November last year, the stock has risen some 45% from its IPO price of RM0.53. We had then ascribed Kelington's IPO shares a fair value of RM0.85 and given it a rare "Subscribe'' call. Given the continued positive outlook for the company and its strong balance sheet, we believe KG is a good trading idea. An indicative target price would be RM1.02, based on 8x FY11EPS, which offers a potential upside of 34%.

FYE Dec (RMm)	FY07	FY08	FY09	FY10f	FY11f
Revenue	57.2	60.1	63.8	80.0	89.6
Net Profit	4.1	6.6	8.1	8.4	9.5
% chg y-o-y	-	61.6	22.2	3.9	13.8
Consensus	-	-	-	-	-
EPS (sen)	5.5	8.8	10.8	11.2	12.8
DPS (sen)	-	-	3.0	3.1	3.5
Dividend Yield (%)	-	-	4.8	4.1	4.6
ROE (%)	28.4	30.6	23.5	20.7	20.2
ROA (%)	10.0	14.6	14.2	12.5	12.4
PER (x)	14.0	8.7	7.1	6.8	6.0
BV/share (RM)	0.19	0.29	0.46	0.54	0.63
P/BV (x)	4.0	2.6	1.7	1.4	1.2
EV/EBITDA (x)	8.2	6.3	4.4	3.8	2.8

KEY HIGHLIGHTS

Company background. Kelington Group has built its standing in the ultra-high purity gas and chemical delivery solution industry over 10 years. The group's business can be traced back to the commencement of its operation in 2000 when the group secured its maiden key project in Malaysia for SilTerra Malaysia's foundry at Kulim. Its first project in Taiwan started two years after its incorporation, following the implementation of first major project for wafer fabrication in China in 2004. In 2008, the group expanded to Singapore via its first renewable energy project and obtained pioneer status. In 2009, it demonstrated through the implementation of turnkey Bulk Chemical Delivery System for Seagate Skudai its ability to undertake a large-scale ultra-high purity project. The group has to date earned international prestige for its extensive experience and constant pursuit of excellence. Currently, it comprises three wholly-owned subsidiaries – Kelington Technologies Sdn Bhd, Kelington Engineering (Shanghai) Co., Ltd and Kelington Engineering (S) Pte Ltd. Kelington Engineering (Shanghai) Co. Ltd wholly owns Kelington Trading (Shanghai) Co. Ltd. The group has also a registered branch in Taiwan, where it does not have any associate companies.

Figure 1: Group structure



Source: OSK, Company Data

Figure 2: Kelington's milestones

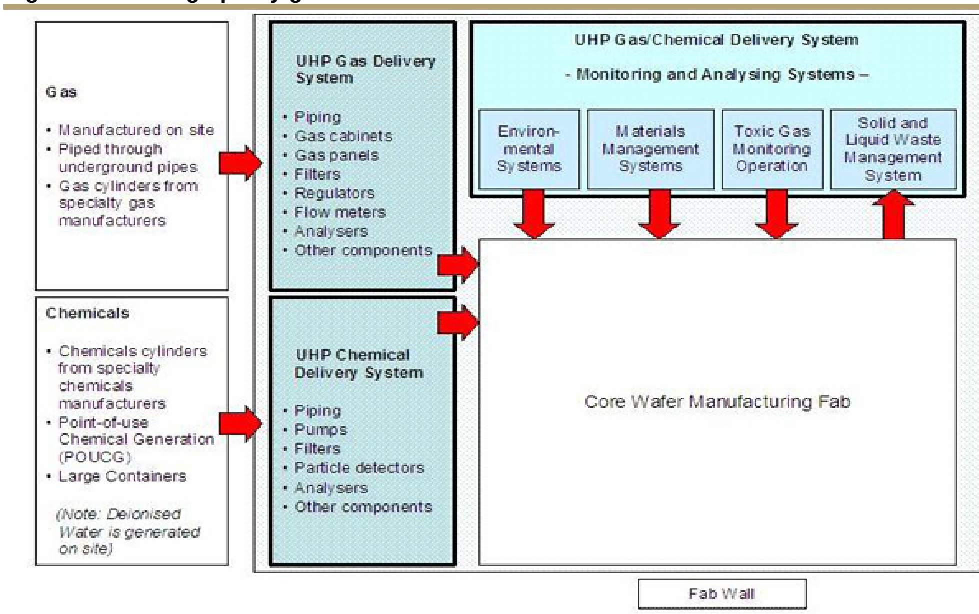
Year	Milestones
2000	Commenced operations
	Secured maiden key project in Malaysia for SilTerra Malaysia's foundry at Kulim
2003	Implemented first project in Taiwan for HannStar Display (TFT-LCD)
2004	Implemented first major project in PRC for Taiwan Semiconductor Manufacturing Corporation (Wafer fabrication)
	Manufactured first equipment (Valve Manifold Box & Valve Manifold Panel) as OEM for Taiwan
2005	SkyWalker Group Ltd (linked to The Linde Group) became a major shareholder of the Group
2007	Implemented first solar cell project for Suntech Power Holdings in PRC
2008	Implemented first renewable energy project in Singapore for Renewable Energy Corporation
	Attained Pioneer Status (with reproctive effect from May 2007)
2009	Implemented turnkey Bulk Chemical Delivery System for Seagate Skudai, cementing our ability to undertake large-scale chemical delivery systemes

Source: OSK, Company Data

Management background. The group is led by two key persons – Raymond Gan Hung Keng, who is currently the Chairman, and Steven Ong Weng Leong, who is Group Executive Director. Raymong Gan, with over 20 years of experience in various engineering aspects, is responsible for the Group's strategic direction. He graduated with a Bachelor of Chemical and Process Engineering from Universiti Kebangsaan Malaysia and is a Professional Engineer on the Malaysian Board of Engineers. Another key person, Steven Ong with more than 17 years' experience in the industry, is responsible for the Group's day-to-day functions in Taiwan and China. He also holds a Bachelor of Chemical Engineering, plus MBA from University of Bath in UK. The two key persons are also shareholders of Palace Star, which is the biggest substantial shareholder of Kelington Group with a 53.2% stake.

A niche in the ultra-high purity space. The group provides total ultra-high purity gas/chemical delivery system solutions involving UHP system design, fabrication and installation, gas and chemical delivery equipment, QA and QC services, control and instrumentation, and maintenance and servicing. Kelington stands out among its peers as a one-stop UHP delivery solutions provider. While most gas/chemical companies' competencies in gas/chemical systems and UHP solutions are on standalone basis, general engineering companies usually have strong construction managements but lack expertise on the gas/chemical side. However, Kelington has been able to converge both gas/chemical and high-level engineering technical knowledge for UPH delivery system solutions.

Figure 3: Ultra-high purity gas/chemical network



Source: Company Data

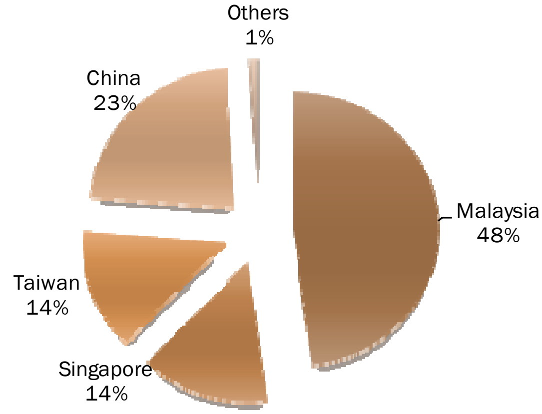
Figure 4: Three categories in the ultra high purity gas/chemical delivery system industry

Category	Design	Building & Construction	Procurement	Installation	QA	Maintenance	Supply of Gas/Chemical
Multinational specialty gas/chemical companies (in-house engineering divisions)	√	√	√	√	√	√	√
UHP gas/chemical engineering companies	√	√	√	√	√	√	
UHP gas/chemical installation companies		√	√	√		√	

Source: OSK, Frost & Sullivan

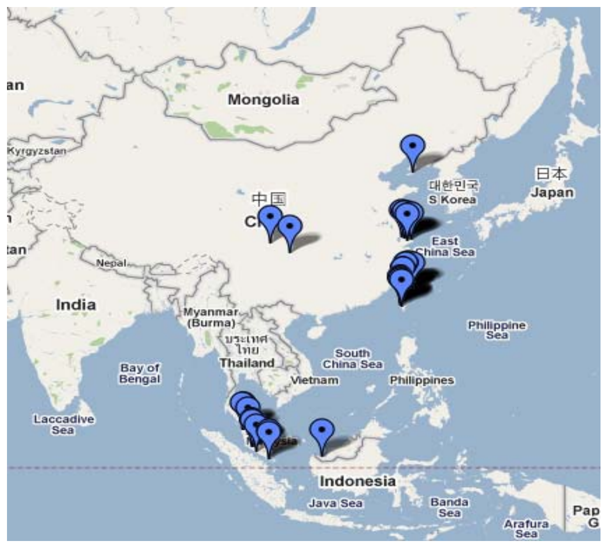
Strong regional presence. Kelington is headquartered in Bukit Jelutong Industrial Park in Shah Alam. It has also established a presence in China, Taiwan and Singapore. Its presence in these countries, which have registered the highest growth in capital expenditure and are also leaders in wafer/flat panel display fabrication and the emerging sectors, is key to the group's future growth. In 2009, nearly half of its total revenue, or about 48%, was from the Malaysian market, while the other half was from the overseas markets, including 23% from China, and 14% each from Taiwan and Singapore.

Figure 5: Revenue contribution by geographical segment in 2009



Source: OSK, Company Data

Figure 6: Location of Kelington's projects on map



Source: OSK, Company Data

Reputable global clientele. Kelington provides ultra-high purity gas and chemical solutions to high-technology industries such as wafer fabrication, flat panel display manufacturing (TFT-LCDs), solar energy, pharmaceuticals, and electronics/packaging industrial plants. It has been serving internationally recognized wafer fabrication and TFT-LCDs players such as Intel Corporation, TSMC, Infineon, ProMOS Technologies, and HannStar Display Corporations. Its reputable global clientele reflects customers'' confidence in Kelington.

Figure 7: Kelington's customers

Source: OSK, Company Data

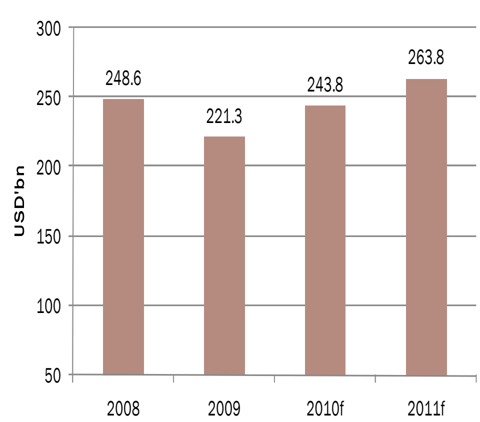
Established relationship with reputable gas and chemical manufacturers. In order to undertake UHP projects, Kelington has built strong relationships with major gas and chemical manufacturers, namely The Linde Group, Air Liquide and Air Products, which are three of the four world's largest gas providers. These partnerships strengthen its position as a leading UHP delivery solutions provider.

Orderbook and tenders. According to management, from January to July 2010 Kelington had an outstanding orderbook of around RM84m, which is estimated to be broken down by 53% from Malaysia, 13% from Singapore and 17% each from Taiwan and China. A part from other book, to date 28% of group's tender is from Taiwan, 62% from China, 8% from Malaysia, and 2% from Singapore. The group's success rate for tenders is around 30%.

Expansion plan. We understand from management that the group is looking to expand to India, Philippines and Vietnam. Also, it will start looking at mergers and acquisitions with potential companies which would bring synergy and benefits to the group. It also plans to extend its UHP gas and chemical solutions to utilities such as water and vacuum.

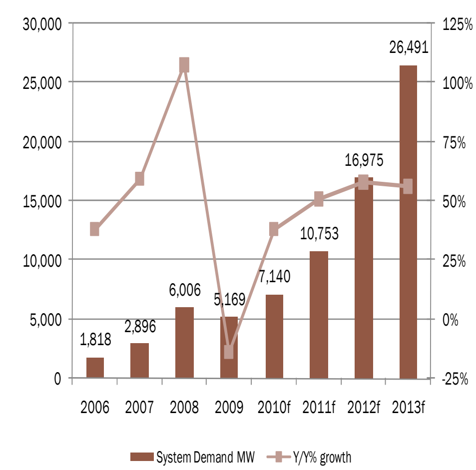
Rosier demand outlook. The Semiconductor Industry Association (SIA) projects that worldwide sales would increase from USD221.3bn for FY09 to USD243.8bn and USD263.8bn for FY10 and FY11 respectively, which is an increase of 10.2% in FY10 and 8.2% in FY11. Apart from that, DisplaySearch expects solar cell demand to jump from 7,140MW in FY10 to 26,491MW in FY13. As the group has diversified to cover the semiconductor, solar cell, LCD panel and LED industries, its earnings will continue to grow even if one or the other sector slows down in the next few years given the overall continued growth of consumer electronics and green technology.

Figure 8: Semiconductor industry



Source: OSK, Company Data

Figure 9: Solar cell end market demand

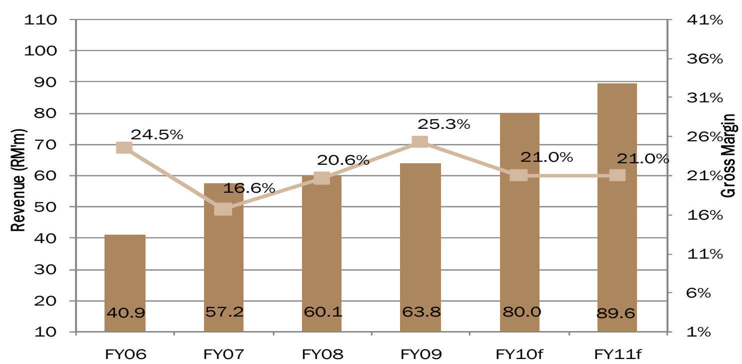


Source: OSK, Company Data

FINANCIAL HIGHLIGHTS

Climbing growth. The group's revenue has been climbing over the last four years at a CAGR of 16% per annum, from RM40.9m in FY06 to RM63.8m in FY09. Also, despite the global economic downturn in 2009, the group still managed to chalk up positive financial performance, with a revenue growth that is 6% higher than that in FY08. Hence, we believe the group should comfortably register revenue of RM80m and RM89.6m for FY10 and FY11 respectively, which implies an annual growth rate of 25% for FY10 and 12% for FY11. In line with the revenue growth, gross profit margin has been recording consistent growth of about 20% since 2007. However, due to the higher cost of sales as brought up by management, we are projecting a lower gross profit margin of 21% for FY10 and FY11.

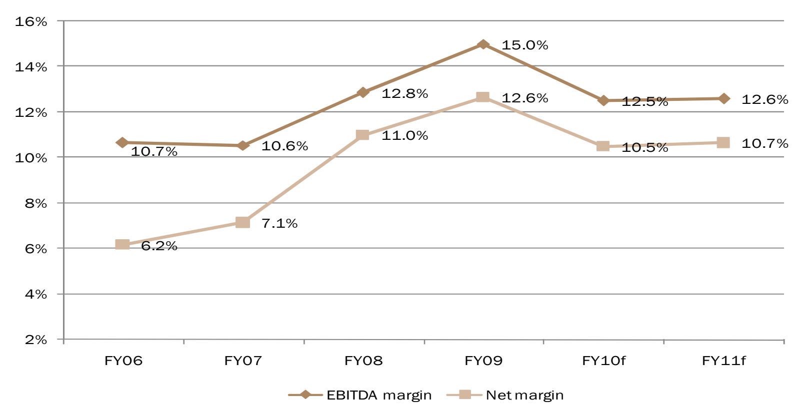
Figure 10: Group revenue and gross margin



Source: OSK, Company Data

Slight dip in projected EBITDA and net margin seen. In line with the revenue growth, the group has been recording an average earnings growth of 49% per annum for the last four years. Margins too have been rather lucrative, with an average EBITDA margin and net margin of about 12% and 10% respectively over the last 4 years. Also, we note that the higher margin in 2009 was due to an exceptional project that garnered good margins during that particular year. However, we gather that such margin is unlikely to be emulated in the following years. Going forward, margins will be minimally lower than in 2009. Hence, we expect EBITDA margin to fall from 15% for FY09 to 12.5% and 12.6% for FY10 and FY11 respectively. As such, the group's net profit is expected to come in at RM8.4m and RM9.5m for FY10 and FY11, with average net margin of about 10.6% against 12.6% in FY09.

Figure 11: EBITDA margin and net margin



Source: OSK, Company Data

Strong balance sheet. Due to the nature of its business, Kelington's balance sheet has been healthy, with minimal borrowing and a strong cash position. As at 30 June 2010, total borrowings and cash balances stood at RM1.2m and RM26.8m respectively, which leaves the group with net cash of RM25.5m and net cash per share of RM0.34. The group has been maintaining a net cash position over the last 4 years. It has a strong cash flow generating ability, with an average net increase in cash and cash equivalents of about RM6m per year. Hence, despite its aggressive expansion plan, we believe the group will still be in a net cash position.

RISKS TO OUR VIEW

Lack of long-term contracts. It is normal for users of gas and chemical delivery equipment to not enter into long-term contracts with suppliers. The lack of such contracts, however, does not ensure business continuity with its existing customers. Hence, we believe that any rise or fall in the foundries' capex spending will affect the group's financial performance.

Threat of competition. Although Kelington is competing directly with only a few established engineering companies, namely Marketech International Corp, Wholetech System Hitech Limited and Kinetics Process Systems, it would still be under threat from multinational specialty gas and chemical providers such as Air Liquide and Linde Gas, whose total UHP gas/chemical delivery system services are offered through their gas/chemical system engineering divisions. It also has to be cognizant of the reality that UHP installation companies could potentially move up the value chain by acquiring technology and become one-stop UHP delivery system providers.

Figure 12: Leading players in Malaysia, China and Taiwan

Category	Company		
	China	Taiwan	Malaysia
Multinational specialty gas/chemical companies (in-house engineering divisions)	Air Liquide Air Products BOC China (Holdings) Co Ltd Linde Bectronics & Specialty Gas Messer Group Praxair	Air Liquide Air Products BOC Lienhwa Super Clean Technology Co Ltd	Air Products STB Sdn Bhd MOX-LINDE Gases Sdn Bhd
UHP gas/chemical engineering companies	Kelington Group Bhd Marketech International Corp Wholetech System Hitech Ltd Kinetics Process Systems Ltd	Kelington Group Bhd Marketech International Corp Wholetech System Hitech Ltd	Kelington Group Bhd Kinetics Process Systems Sdn Bhd
UHP gas/chemical installation companies	50-60 companies (companies that act as installers of UHP systems)	60-70 companies (companies that act as installers of UHP systems)	2-4 companies (companies that act as installers of UHP systems)

Source: OSK, Frost & Sullivan

Foreign exchange fluctuation. The group procures its supply of raw materials and labour services not only from Malaysia, but also China, Taiwan and Singapore. Its costs are therefore subject to fluctuations in exchange rates. Furthermore, as almost a half of the group's revenue in 2009 was generated from the overseas markets (i.e. China, Taiwan, and Singapore), this significant portion of revenue was dominated in foreign currencies. Hence, any fluctuation in exchange rate may affect the group's financial performance.

VALUATIONS

34% upside. After its IPO in November last year, the stock has risen by some 45% from its IPO price of RM0.53. We had then priced its IPO shares at a fair value of RM0.85 each and given it a rare "Subscribe'' call. Given the continued positive outlook for the company and its strong balance sheet, we believe Kelington has the makings of a good trading idea. An indicative target price would be RM1.02 based on 8x FY11EPS, giving it a potential upside of 34%. While its peers were hit by the economic slowdown, Kelington managed to perform quite well, registering a net profit of RM8.1m in FY09. We like Kelington's resilience. Given its strong orderbook, net cash position and partnership with industry leaders, we believe the company would continue to thrive and stand out among its peers.

Figure 13: Peers comparison

Company	Mkt Cap (RM'm)	FY09					
		Revenue (RM'm)	Net profit (RM'm)	Gross margin (%)	ROE (%)	PER	P/B
Marketech (Taiwan)	261.3	445.1	-16.6	13.1	-4.2	n/a	0.8
Hanyang Engineering (Korea)	237.3	335.6	-41.9	-8.5	-25.4	n/a	2.1
Wholetech System Hitech (Taiwan)	191.7	81.1	3.4	22.3	4.8	45.7	2.2
Kelington (Malaysia)	39.6	63.8	8.1	25.3	23.5	7.1	1.7

As at 26 August 2010
Source: OSK, Bloomberg

EARNINGS FORECAST

FYE Dec (RMm)	FY07	FY08	FY09	FY10f	FY11f
Turnover	57.2	60.1	63.8	80.0	89.6
EBITDA	6.0	7.7	9.6	10.0	11.3
PBT	5.5	7.1	8.6	9.0	10.2
Net Profit	4.1	6.6	8.1	8.4	9.5
EPS (sen)	5.5	8.8	10.8	11.2	12.8
DPS (sen)	-	-	3.0	3.1	3.5
Margin					
EBITDA (%)	10.6	12.8	15.0	12.5	12.6
PBT (%)	9.6	11.8	13.5	11.2	11.4
Net Profit (%)	7.1	11.0	12.6	10.5	10.7
ROE (%)	28.4	30.6	23.5	20.7	20.2
ROA (%)	10.0	14.6	14.2	12.5	12.4
Balance Sheet					
Fixed Assets	5.1	5.5	6.5	6.8	7.1
Current Assets	35.7	39.7	50.1	60.5	70.1
Total Assets	40.8	45.2	56.7	67.3	77.2
Current Liabilities	25.0	21.9	20.8	25.2	28.2
Net Current Assets	15.8	23.3	35.9	42.1	49.0
LT Liabilities	1.4	1.7	1.5	1.6	1.7
Shareholders Funds	14.4	21.6	34.4	40.5	47.4
Net Gearing (%)	Net Cash.	Net Cash.	Net Cash.	Net Cash.	Net Cash.

OSK Research Guide to Investment Ratings

Buy: Share price may exceed 10% over the next 12 months

Trading Buy: Share price may exceed 15% over the next 3 months, however longer-term outlook remains uncertain

Neutral: Share price may fall within the range of +/- 10% over the next 12 months

Take Profit: Target price has been attained. Look to accumulate at lower levels

Sell: Share price may fall by more than 10% over the next 12 months

Not Rated (NR): Stock is not within regular research coverage

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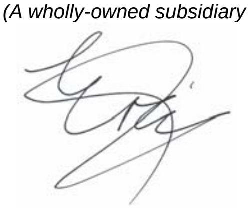

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