



14 March 2012

Kelington

Into the regional league

OUTPERFORM ↔Price: **RM0.91**Target Price: **RM1.10** ↔

We attended Kelington's analyst briefing yesterday. To recap, FY11 topline grew 65% YoY but saw gross margins compressions of 3.5% to 14.9% YoY. Management guided that FY12E topline is expected to grow 30% and the gross margin will be maintained at 15%. The lower margins contribution from China and Taiwan will be offset by the higher margins from Malaysia and Singapore. The trend is sustainable as the US manufacturers are moving their plants to Asia and management has seen Asia as a high-growth region in high-tech industry. However, to be conservative, we are expecting FY12E revenue growth rate of 19% due to the start-up of its new acquisition, Puritec. Positively, the group has secured new orderbook of RM54.3m from Jan to Feb 2012, which forms part of our FY12E orderbook replenishment assumptions of RM165m. Hence, we maintain our earnings forecasts of RM10.7m (+23%). Going forward, we expect future orderbooks to come mainly from overseas market, such as China, Taiwan and Singapore. We maintain our Target Price of RM1.10, based on 8.0X forward PER (+2 STD of its mean) pegged to our FY12E EPS of 13.5sen. We continue to reiterate an OUTPERFORM call on Kelington given Target Price upside of 21%.

Time for growth. Kelington has reported FY11 revenue growth of 65% from 2010's RM84.5m to a record RM139.7m (the seventh consecutive year of growth) due to increased overseas operations (from 52% to 71% in 2011). FY11 gross margin was 14.9%, down from FY10's 18.4%. This was driven by lower-margin projects undertaken in China and Taiwan. Going forward, management expects FY12E gross margins to be maintained at 15% given cross countries margins. Besides that, the group has a healthy balance sheet and they manage to maintain healthy cash flow in FY11, allowing them to make cash acquisitions, such as their recent purchase of Puritech (SGD2.1m). The group expects the return on investment is 2-3 years with SGD 600k-SGD700k PAT per year.

Expecting strong orderbook replenishments. The group has secured new orderbook of RM54.3m from Jan to Feb 2012, which forms part of our FY12E orderbook replenishment of RM165m. It comprises of order Malaysia (32%), Taiwan (30%) and China (24%), while Singapore only made up 14%. In the market, demand has been strong for engineering solution provider, which is mainly coming out of which Asia. Kelington's orderbook is expected to grow rapidly, being one of the few niche players. Their lead time has actually reduced to 3-6 months compared to last year's 9 months. It enables them to cope with the rising demand. Additionally, the group has recently expanded its product range via acquisition of Puritec (a Singapore based company providing the exhaust engineering services for factories), which will likely increase its Singapore orderbook by 15%-20% in FY12E; this has already been imputed in our estimates.

STOCK DATA

Bloomberg Ticker	KGRB MK EQUITY	YTD price chg	1.1%
Market Cap	72.0	YTD KLCI chg	2.2%
Issued shares	79.1	Beta	0.4
52-week range (H)	1.10	Major Shareholders	
52-week range (L)	0.62	PALACE STAR	48.3%
3-mth avg daily vol.	59,856	LTAT	12.6%
Free Float	26.9%	SKY WALKER	12.2%
Altman Z-score	3.6		

AT A GLANCE

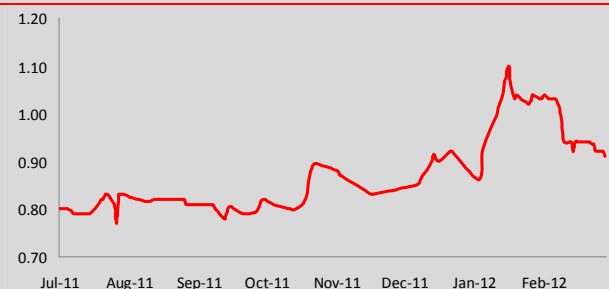
Target Price (RM):	1.10	Maintain
Valuation:	8.0x forward PER (+2 standard deviation) to FY12E EPS of 13.5sen	
Current Price (RM):	0.91	
Report Reason:	Key highlights from analyst's briefing	

Action:	Outperform	Maintain
Reason:	-	

Basis of call:	1) Gains in sales from new acquisition 2) Improving outlook for semiconductor
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Catalyst:	1) Earnings upgrade from acquisition 2) Strong and rising sales trend
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FYE31Dec(RMm)	2011A	2012E	2013E
Turnover	139.7	165.1	196.0
Net Profit (NP)	8.7	10.7	12.5
Consensus (NP)	N.A.	N.A.	N.A.
Earnings Revision:	N.A.	0.0%	0.0%
Earnings Revision Rationale:	No changes to our earnings estimate.		

SHARE PRICE CHART

Thien Ting Ting

ting.ting.thien@kenanga.com.my

Tel: 603-2713 2292

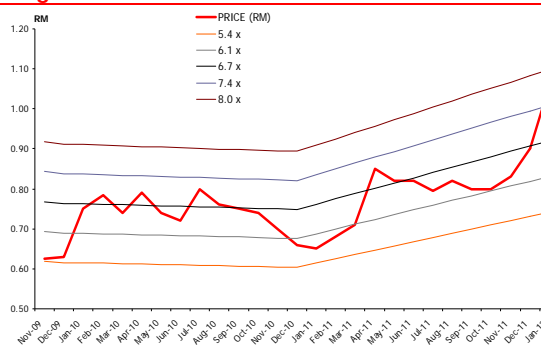
Earnings Estimates					
FYE 31 Dec (RMm)	2009A	2010A	2011A	2012E	2013E
Turnover	63.9	84.5	139.7	165.1	196.0
EBIT Profit	8.8	8.7	9.9	11.6	13.6
Pretax profit	8.7	8.6	9.8	11.5	13.5
Net Profit	8.1	8.5	8.7	10.7	12.5
EBIT Profit Margin	13.8%	10.3%	7.1%	7.1%	6.9%
Pretax margin	13.6%	10.2%	7.0%	7.0%	6.9%
Net profit margin	12.7%	10.1%	6.2%	6.5%	6.4%
Effective tax rate	6.9%	1.2%	10.7%	6.9%	6.9%
Growth ratios					
Turnover	6.3%	32.2%	65.3%	18.8%	18.7%
EBIT	23.9%	-1.1%	13.8%	24.3%	16.6%
Pretax profit	22.5%	-1.1%	13.5%	24.6%	16.8%
Net profit	22.7%	4.9%	2.5%	24.6%	16.8%
ROE	23.5%	21.1%	18.3%	18.9%	18.4%
ROA	14.3%	12.3%	9.5%	9.9%	9.8%
Net Gearing	-71.6%	-52.0%	-45.6%	-49.7%	-44.1%
Per share data					
EPS (sen)	10.2	10.7	11.0	13.6	15.9
EPS growth (%)	22.7%	4.9%	2.5%	24.6%	16.8%
PER (x)	9.6	9.1	8.9	7.2	6.2
Gross DPS (sen)	3.0	3.0	2.8	3.4	4.0
Div. Yield (%)	3.1%	2.6%	2.8%	3.5%	4.0%
Historical Price Ratio					
PER (x) – High	N.A.	N.A.	529.2	5.8	8.3
PER (x) – Last	N.A.	N.A.	525.0	825.0	8.0
PER (x) – Low	N.A.	N.A.	0.52	525.0	5.4
PBV (x) – High	N.A.	N.A.	1.4	2.2	1.8
PBV (x) – Last	N.A.	N.A.	1.4	1.2	N.A.
PBV (x) – Low	N.A.	N.A.	1.4	1.2	1.2

Source: Kenanga Research

Balance Sheet					
FYE 31 Dec (RMm)	2009A	2010A	2011A	2012E	2013E
Non Current Assets	6.5	7.8	8.2	10.5	18.2
Current Assets	50.1	61.5	90.5	97.8	110.2
Total Assets	56.7	69.2	98.7	108.3	128.4
Current Liabilities	20.7	27.6	46.6	48.6	57.1
Non Current Liabilities	1.5	1.4	1.7	2.8	3.1
Shareholders' Fund	34.4	40.2	50.4	56.8	68.2
Minority Interests	N.A.	N.A.	N.A.	N.A.	N.A.
Equity & Liabilities	56.7	69.3	98.7	108.3	128.4

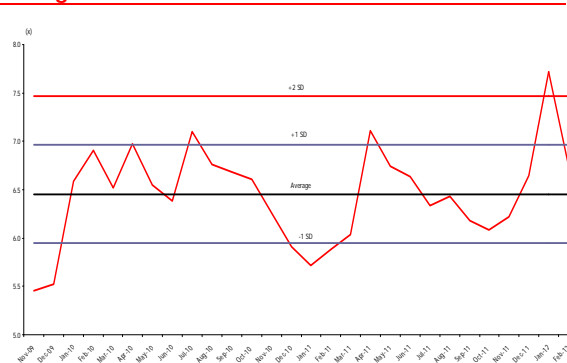
Source: Kenanga Research

Kelington - Fwd PER Band



Source: Kenanga Research

Kelington - Fwd PER Standard Deviation



Source: Kenanga Research

Stock Ratings are defined as follows:

Stock Recommendations

- OUTPERFORM : A particular stock's Expected Total Return is MORE than 10% (an approximation to the 5-year annualised Total Return of FBMKLCI of 10.2%).
- MARKET PERFORM: A particular stock's Expected Total Return is WITHIN the range of 3% to 10%.
- UNDERPERFORM : A particular stock's Expected Total Return is LESS than 3% (an approximation to the 12-month Fixed Deposit Rate of 3.15% as a proxy to Risk-Free Rate).

Sector Recommendations***

- OVERWEIGHT : A particular stock's Expected Total Return is MORE than 10% (an approximation to the 5-year annualised Total Return of FBMKLCI of 10.2%).
- NEUTRAL : A particular stock's Expected Total Return is WITHIN the range of 3% to 10%.
- UNDERWEIGHT : A particular stock's Expected Total Return is LESS than 3% (an approximation to the 12-month Fixed Deposit Rate of 3.15% as a proxy to Risk-Free Rate).

******Sector recommendations are defined based on market capitalisation weighted average expected total return for stocks under our coverage.***

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KENANGA INVESTMENT BANK BERHAD (15678-H)
8th Floor, Kenanga International, Jalan Sultan Ismail, 50250 Kuala Lumpur, Malaysia
Telephone: (603) 2166 6822 Facsimile: (603) 2166 6823 Website: www.kenangaresearch.com



Chan Ken Yew
Associate Director