

Trading Idea

20 April 2012

# Kelington Group Berhad

**Non-Rated**

*An undiscovered gem*

<b>Share Price</b>	<b>RM0.88</b>
<b>Target Price</b>	<b>RM1.18</b>

## Investment Highlights

### Company Description

The Group designs, fabricates and installs ultra-high purity gas and chemicals delivery systems.

### Stock Data

Bursa / Bloomberg code	0151/ KGRB MK
Board / Sector	Main / Industrial
Syariah Compliant status	Yes
Issued shares (m)	79.11
Par Value (RM)	0.10
Market cap. (RM m)	69.62
52-week price Range	RM0.77 – 1.10
Beta (against KLCI)	0.37
3-m Average Daily Volume	0.06m
3-m Average Daily Value <sup>A</sup>	RM0.06m

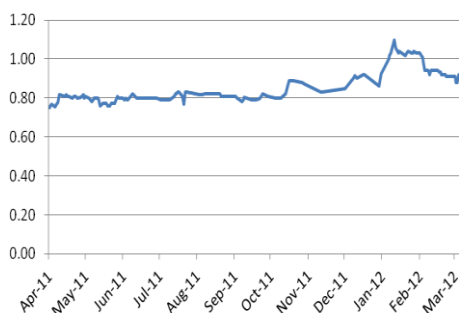
### Share Performance

	1m	3m	12m
Absolute (%)	-3.30	3.53	13.55
Relative (%-pts)	-4.69	-9.62	8.21

### Major Shareholders

	%
Palace Star Sdn Bhd	48.3
Sky Walker Group	12.2
LTAT	12.6

### Historical Chart



Source: Bloomberg

### Team Coverage

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- **An undiscovered gem with growth potential.** We like Kelington because it is a leading provider of Ultra High Purity (UPH) gas and chemical delivery solutions in the region with its niche business model that is not well represented in any of the companies listed in Bursa Malaysia. Its impressive future earnings growth and aggressive overseas expansion also deserve investors' attention.
- **UHP industry benefiting from shorter tech life cycles,** which necessitate reinvestments in key sectors like wafer fabrication (planting circuit) and FPD fabrication (glass substrates). Rapid changes in manufacturing technologies and unabated demand for innovative consumer electronics, i.e. widespread use and continuous innovation of wireless and portable communication devices, and increased demand in LCD TV continue to render more projects for the Group.
- **Commendable earnings growth.** Kelington has successfully achieved revenue and net earnings CAGR of 40.4% and 31.7% respectively over the past 7 years. Moving forward, we forecast the Group will chalk up RM11.1m net profit in 2012 (up 28% yoy) on the back of RM170m revenue (consisting of outstanding orderbook of RM54m, contributions from newly acquired Singaporean company named Puritec and new job secure worth RM100m p.a.) and continue its strong earnings momentum with net profit of RM13.3m (up 19% yoy) in 2013 on the back of RM195m revenue. The company is currently tendering for contracts worth RM400m including Infineon's second fabrication facility in Kulim and a solar project in China. Historically, Kelington has a success rate of 25%.
- **Margin expected to stabilised.** The Group's historical gross margin shown a downtrend from the peak of 25% in 2009 to 14.9% in 2011 as a result of stiff competition in China and Taiwan whereby margin sacrificed to capture the market share. However, the Group believes that gross margin is able to sustain at current level of 15% in 2012-13.
- **Established firm foothold in Singapore.** Kelington started a small office two years ago in Singapore to penetrate a range of clientele from high-tech industries such as solar cell to the wafer fabrication. Last year, the Group successfully secured a RM23m project in bioscience segment to install a process mechanical system for International Flavours & Fragrances (IFF), a leading creator and manufacturer of flavours and fragrance. Going forward, we believe that Singapore market could land the Group for

more projects as Singapore is currently having 16 wafer fabrication plants as compared to only 4 wafer fabrication plants in Malaysia.

- **Expansion into other scope of services in existing and new countries.** The Group intends to broaden scope beyond UHP gas and chemical into other utilities such as water, exhaust and vacuum. Furthermore, it plans to penetrate deeper into new and existing sectors in Taiwan, China (particularly in northern and southern areas) as there is huge potential in emerging markets in areas such as solar energy, LED and bioscience. On new markets, the company has started its first project in Vietnam and is eyeing opportunities in India, Indonesia, the Philippines and Middle East
- **More M&A in the pipeline.** We understand that the Group is also exploring M&A for synergistic opportunities to expand range of services and client base. To recap, the Group successfully acquired a Singaporean company named Puritec last year which started to contribute to its earnings this year.
- **Bonus issue to enhance stock's liquidity?** Kelington is a small cap stock that having RM73m market cap with relatively low public float of 27%. The management has hinted a possible bonus issue to improve the market liquidity in future with its healthy reserves position of RM42.5m as of Dec 2011.
- **Strategic shareholders.** Among Kelington's major shareholders are Lembaga Tabung Angkatan Tentera (LTAT) with 12.6% and Sky Walker Group Ltd (12.2%), which is a consortium of key global semiconductor players.
- **Dividend policy.** The Group introduced a dividend policy of 25% payout or 2.75 sen in 2011, which is equivalent to dividend yield of 3%, to attract more institutional investors' interests in future. We estimate that the Group will propose a decent dividend yield of 4-5% for 2012-13.

### Recommendation

- **Attractive valuation with 34% potential upside.** Kelington (Not Rated) is currently trades at 6.3x 2012F PER and 5.2x 2013F PER, which is based on our 2012 EPS of 14.0. sen/share and 2013 EPS of 16.8 sen/share. Our target price for the stock is at RM1.18, pegged at 7x 2013F PE, in line with small cap valuation.

## Background

Founded in 2000, Kelington is a leading provider of UHP gas and chemical delivery solutions in the region. The Group provides a comprehensive range of services in the value chain of UHP delivery systems, encompassing designs, installation, equipment, quality assurance, and maintenance.

Kelington's UHP gas and chemical solutions are deployed in high-tech industries such as:

- Wafer fabrication
- Flat panel fabrication (FPD) manufacturing
- Solar energy
- Pharmaceutical
- Light Emitting Diode (LED)
- Storage media

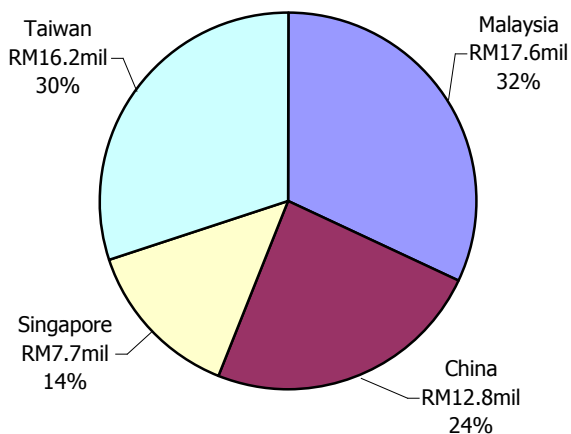
Kelington plays a complementary role to gas and chemical suppliers and has built strong relationships with 3 of the 4 largest gas companies (The Linde Group, Air Liquide, and Air Products). Kelington has direct presence in Malaysia, China, Taiwan and Singapore.

**Figure 1: Financial Summary**

Year to 31 Dec (RMm)	2009	2010	2011	2012F	2013F
Revenue	63.8	84.5	139.7	170.0	195.0
EBITDA	9.1	9.4	10.7	13.6	15.6
Net profit	8.1	8.5	8.7	11.1	13.3
EPS (sen)	12.0	11.0	11.0	14.0	16.8
P/E (x)	7.3	8.0	8.0	6.3	5.2
P/B (x)	1.9	1.6	1.4	-	-
EV/EBITDA (x)	7.6	7.4	6.5	5.1	4.5
Dividend yield (%)	-	-	3.1	4.0	4.8
Gross margin (%)	25.3	18.4	14.9	15.0	15.0
Net Gearing (%)	Net Cash	Net Cash	Net Cash	-	-
ROE (%)	23.5	21.1	17.3	-	-

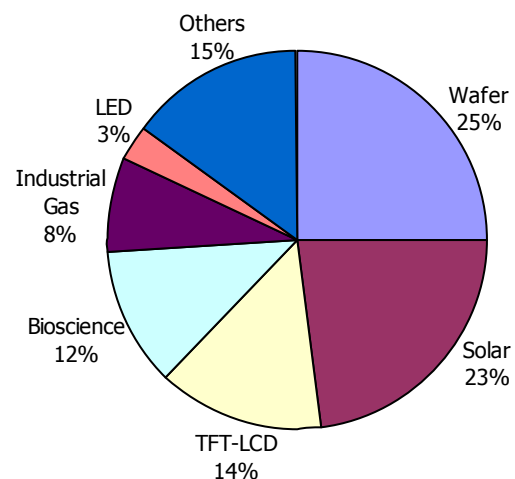
Source: Company, JF Apex

**Figure 2: Current orderbook by geographical location**



Source: Company

**Figure 3: Current orderbook by industries**



Source: Company

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**JF APEX SECURITIES - RESEARCH RECOMMENDATION FRAMEWORK**
**STOCK RECOMMENDATIONS**

- BUY** : The stock's total returns\* are expected to exceed 10% within the next 12 months.
- HOLD** : The stock's total returns\* are expected to be within +10% to – 10% within the next 12 months.
- SELL** : The stock's total returns\* are expected to be below -10% within the next 12 months.
- TRADING BUY** : The stock's total returns\* are expected to exceed 10% within the next 3 months.
- TRADING SELL** : The stock's total returns\* are expected to be below -10% within the next 3 months.

**SECTOR RECOMMENDATIONS**

- OVERWEIGHT** : The industry as defined by the analyst is expected to exceed 10% within the next 12 months.
- MARKETWEIGHT** : The industry as defined by the analyst is expected to be within +10% to – 10% within the next 12 months.
- UNDERWEIGHT** : The industry as defined by the analyst, is expected to be below -10% within the next 12 months.

\*capital gain + dividend yield

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