Kelington Group Bhd

Hit by Project Delay

By the Kenanga Research Team I *research@kenanga.com.my*

	Rating	Fair Value
Last Price	-	RM0.255
Kenanga	Trading Sell	RM0.280
Consensus	NA	-

INVESTMENT MERIT

- **Share price has fallen by 33%** since our very first Trading Buy call on 13th June 2013 (Report titled: More contracts in the pipeline) at the price of RM0.383 (ex-bonus) before it reached the peak of RM0.475 in 6th August 2014 (our TP back then was at RM0.51). YTD, its share price has declined by 25%, -14ppts, more than FBM Small Cap Index's 11% decline. We believe the underperformance could be owing to: (i) delay in contracts completion, particularly from China operations, and (ii) weaker sentiment, particularly in the small cap stocks.
- **1H15 results below expectation.** The group reported a 2Q15 NP of RM1.5m (-28% QoQ; -24% YoY), bringing 1H15 NP of RM3.6m (-11%) which only made up 39% of our FY15E NP of RM9.1m. The main negative deviation was the slower than expected project completion with weakness seen from China side. On a QoQ basis, while 2Q15 revenue inched up to register at RM40.6m (+5%), EBIT dropped by 26% with margin shrinking to 4% (-1.7ppts) dragged by higher-than-expected cost from provisions of bonus, audit and tax fees.
- **Earnings disappointment likely in 2H15 due to longer-than-expected contracts completion date.** The group's single largest contract, which was awarded by International Healthway Corp (IHC) on building a full-fledged medical centre in China (previously only catered for maternity centre) is unlikely to see full recognition in the near-term vis-à-vis previous guided completion in FY15. Recall that the RM132m worth project was awarded in 4Q13 and has an outstanding orderbook of RM99m thus far. From our last meeting with management, we gather that IHC has yet to come back to Kelington on the progress of the medical licenses application, where these licenses are needed before any new upgrades and changes in design and layout can be carried out from Kelington side. Recall that the construction works have started in 4Q13 (originally for maternity centre) and put on hold since 2Q14 while waiting for the medical license approval from the related authorities. *To be on the safe side, we have excluded this project's outstanding orderbook of RM99m from our earnings projection for FY15.*
- **Outstanding orderbook stands at RM235m (current orderbook at RM314m) as of June 2015,** (vis-à-vis last year's RM191m as of June 2014 and RM200m as of Dec 2014, respectively). Apart from the above-mentioned IHC project, this amount consists of other projects' outstanding orderbook such as: (i) total facility management contract for an established semiconductor manufacturer worth RM18m, (ii) mechanical piping work for B.Braun worth RM20m, (iii) provision of wastewater treatment services (hospital project) for Fusionopolis worth c.RM13m, and (iv) mechanical and electrical installation work for military airport worth c.RM14m, and remaining contracts value of c.RM71m from other semiconductors, O&G, and plantation players. Moving into 2H15, the group needs another RM76m orderbook replenishment to match last year's orderbook amount of RM390m which we believe is possible given the group's track record. *However, our concern is on the margins side going forward as we understand that the group might take on lower-margins jobs for different sectors exposure in the short-term. Furthermore, as Kelington is undertaking projects with larger values of which the job scope includes supply of equipment, this will bring down the overall margin as margins from supply of equipment is lower as compared to the provision of engineering services alone.*
- **Fairly valued.** We introduced our FY16E earnings projections with key assumptions being: (i) recognition of the remaining outstanding orderbook, (ii) 30% success rate of tenderbook assumption of RM400m, (ii) EBIT margin of 4.0%. Note that we have also reduced our FY15E earnings projection by 29% to account mainly for the lower revenue by excluding the IHC project recognitions (but partly made up by other projects) and lower EBIT margin assumption of 4.2% (-1ppts). Hence, to also align with the overall broad market de-rating, we have trimmed our TP to RM0.28 (from RM0.52) based on a lower targeted PER of 8.5x (from 13.0x), a valuation which is in line with FBMSC's forward PER. We may revisit the stock again should the group manages to secure good earnings-lucrative projects in the future.

Stock Information

Stock Name	KELINGTON GROUP BHD
CAT Code	0151
Industry	Engineering&Construction
Industry Sub-sector	Engineering/R&D Services
YTD stock price chg	-25.00%
Market Cap (RM m)	55.81
Issued shares (m)	218.86
52-week range (Hi)	0.49
52-week range (Low)	0.25
3-mth avg daily vol:	59948.48
Free Float	24%
Beta	1.02
Altman's Z-score	2.79

Major Shareholders

PALACE STAR	45.83%
LEMBAGA TABUNG ANGKA	12.18%
SUN LEAD INTERNATIONAL	9.05%

Financials

FYE Dec (RM'm)	2014A	2015E	2016E
Revenue	189.1	175.0	194.0
EBITDA	6.7	8.1	8.8
PBT	5.2	6.7	7.6
Net Profit (NP)	5.2	6.4	7.3
EPS (sen)	2.4	2.9	3.3
BV/Share (RM)	0.27	0.29	0.31
PER	10.6	8.7	7.6
Price/BV (x)	0.9	0.9	0.8
Net Gearing (x)	0.2	0.1	0.1
NDPS (sen)	1.0	1.2	1.4
Dividend Yield (%)	3.9	4.8	5.4

Quarterly Financial Data (RMm)	4Q14	1Q15	2Q15
Revenue	43.7	38.5	40.6
Revenue Growth (QoQ)	-10.7%	-11.9%	5.3%
EBIT	-0.6	2.2	1.6
OP Margin	-1.4%	5.7%	4.0%
Net Profit (NP)	-1.0	2.1	1.5
EPS (sen)	-0.5	0.9	68.0%
EPS Growth (QoQ)	<-100%	>100%	-27.7%

Peers Comparisons	PER (fwd)	Div. Yld (%)	Mkt Cap (RM'm)
Average	NA	NA	NA
FBMSC	8.5	5.1	86.99B

* Index Level

Daily Charting – Kelington Group Berhad

Comment: KGB has undergone a drastic sell-down over the past one-month, as it sees its share price plunging to a 52-week low level of RM0.255 yesterday. The share price is poised for a sustained bearish outlook ahead, underpinned by (i) lackluster trading volume, (ii) continued divergence of the Bollinger band and MACD, as well as (iii) negative trend of both Stochastic and RSI. Weighed down by the uninspiring economic outlook and tepid investor's sentiment, we reckon that the share price could look to trend towards its immediate support of RM0.24 (S1) and possibly RM0.22 (S2) next, in the near-term.

About the stock:

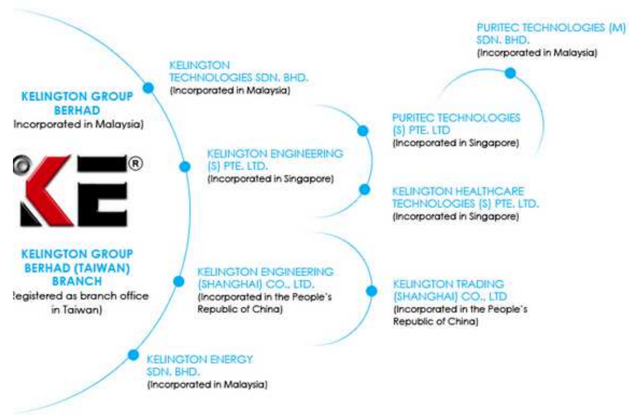
Name	:	KELINGTON GROUP BERHAD
Bursa Code	:	KGB
CAT Code	:	0151

Key Support & Resistance level

Resistance	:	RM0.27 (R1)	RM0.31 (R2)	RM0.35 (R3)
Support	:	RM0.24 (S1)	RM0.20 (S2)	RM0.17 (S3)
Outlook	:	Bearish		

Source: Kenanga Research

CORPORATE STRUCTURE



BUSINESS OVERVIEW

Kelington is a leading ultra-high purity (UHP) gas and chemical delivery solutions provider with operations in Malaysia, China, Taiwan and Singapore. Throughout the years, it has also diversified into other areas of system design and modeling, fabrication and installation, quality testing and certification, control and instrumentation and maintenance for various foundries (semiconductor/flat panel display). In 2012, the acquisition of Singapore-based Puritec Technologies (S) Pte. Ltd further strengthened its capability in becoming a one-stop facility solution provider encompassing the delivery of gas, chemical and exhaust.

BUSINESS SEGMENTS

The group offers a comprehensive range of services as below:

- UHP system design: Includes procedures such as ground and site analysis, feasibility studies, delivery system conceptualisation and so on.
- Fabrication and installation: Involves the physical construction and fabrication of the UHP delivery system.
- Gas and chemical delivery equipment: It is either manufactured in-house or sourced externally according to design specifications.
- QA and QC services: Generally encompass tests done on the air quality and the particle size and quantity observed at the end point of use.
- Control and instrumentation: It is responsible for the contant monitoring any Wafer Fabrication or FPD Fabrication Plant.
- Maintenance and servicing: Mainly for equipment such as Gas Cabinet, VMB/VMP, and Abatement Sytem.

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