



Lim Mei Ching
+60 (3) 9207 7622
Lim.meiching@osk.com.my

IPO Note

Kelington

Getting Recognition via ACE

Kelington, a leading Ultra High Purity (UHP) gas and chemical delivery solutions provider, will be the first company to list on the ACE Market since it underwent a name change from MESDAQ Market on 3 Aug this year. Given its strong orderbook, net cash and partnerships with industry leaders, the company should be able to achieve our small cap coverage PER of 8x. Applying this average PE of 8x over FY10 EPS, we derive a fair value of RM0.85. With an upside potential of 60.4% from its issue price of RM0.53, we recommend that investors **SUBSCRIBE** for Kelington.

A leading UHP provider. Formed in 2000, Kelington is a leading provider of Ultra High Purity (UHP) gas and chemical delivery solutions in the region. The company provides a comprehensive range of services in the value chain of UHP gas and chemical delivery systems encompasses design, installation, equipment, quality assurance and maintenance.

Raising profile through ACE. Through a listing in the ACE market, management believes it would be able to raise its profile as one of the leading UHP gas and chemical delivery solutions provider, and thus stand a higher chance of bidding for projects with established players in China and Taiwan.

Solid growth. From FY06 to FY08, Kelington had been registering an impressive top and bottom line growth of 40.9% and 54.1% respectively. With its strong orderbook of RM74.98m, revenue is expected to grow organically by 5.4% and 2.7% for FY09 and FY10 respectively.

Expanding its regional presence. In strengthening its position, Kelington plans to improve its capabilities, expand its UHP gas and delivery systems, develop its overseas markets and continue to undertake various research and development activities.

Undemanding valuation. Given its strong orderbook, net cash and partnerships with industry leaders, we believe the company should be able to attain our small cap coverage PER of 8x. Applying a small cap average PE of 8x over FY10 EPS, we derive a fair value of RM0.85. With an upside potential of 60.4% from its issue price of RM0.53, we recommend that investors **SUBSCRIBE** for Kelington.

SUBSCRIBE

Target **RM0.85**
IPO Price **RM0.53**

Enlarged Share Capital / Par Value

74.71m shares/RM0.10

Indicative Listing Date

25 November 2009

Listing Sought

ACE Market

Major Shareholders (% post- IPO)

Palace Star	53.2
Allied Moral	7.9
Sky Walker	12.9

IPO Details

Shares (m)

Public Issue

Malaysian Public	0.960
Eligible employees and business associates	2.809
Private placement	5.941

Existing Shares

65.000

Total

74.710

Utilisation of Proceeds

RMm

Working capital	2.6
Estimated listing expenses	1.8
Capital expenditure	0.5
R&D expenses	0.2
Total	5.1

FYE Dec (RMm)	FY06	FY07	FY08	FY09f	FY10f
Revenue	30.3	57.2	60.1	63.3	71.2
Net Profit	2.8	4.1	6.6	7.0	8.0
% chg y-o-y		47.0	61.6	6.5	13.1
EPS (sen)	3.7	5.5	8.8	9.4	10.6
DPS (sen)	0.0	0.0	0.0	0.0	0.0
Dividend yield (%)	0.0	0.0	0.0	0.0	0.0
ROE (%)	27.1	28.4	30.6	22.0	19.9
ROA (%)	14.8	10.0	14.6	12.7	12.4
PER (x)	14.2	9.7	6.0	5.6	5.0
BV/share (RM)	0.14	0.19	0.29	0.43	0.53
P/BV (x)	3.9	2.7	1.8	1.2	1.0

KEY HIGHLIGHTS

IPO DETAILS

Kelington is seeking a listing with a paid-up share capital of 74.71m shares of RM0.10 each on the ACE Market of Bursa Malaysia.

The Public Offering comprises 9.71m new shares (13.0% of 74.71m), of which:

- 2.809m are made available to employees and business associates (3.8%),
- 5.941m made available by way of private placement to selected investors (8.0%), and
- 0.96m shares available for subscription by the Malaysian public (1.3%).

Figure 1: Proposed utilisation of proceeds

Details of utilisation	RM('000)	Expected utilisation period after listing
Working capital	2641.3	1 year
Estimated listing expenses	1755.0	1 month
Capital expenditure	500.0	1 year
R&D expenses	250.0	1year
	<u>5146.3</u>	

Source: Prospectus

Figure 2: Important dates

Events	Tentative Dates
Issuance of prospectus/Opening date for IPO	30-Oct-09
Closing date for IPO	13-Nov-09
Balloting of applications	17-Nov-09
Allotment to successful applicants	24-Nov-09
Listing Date	25-Nov-09

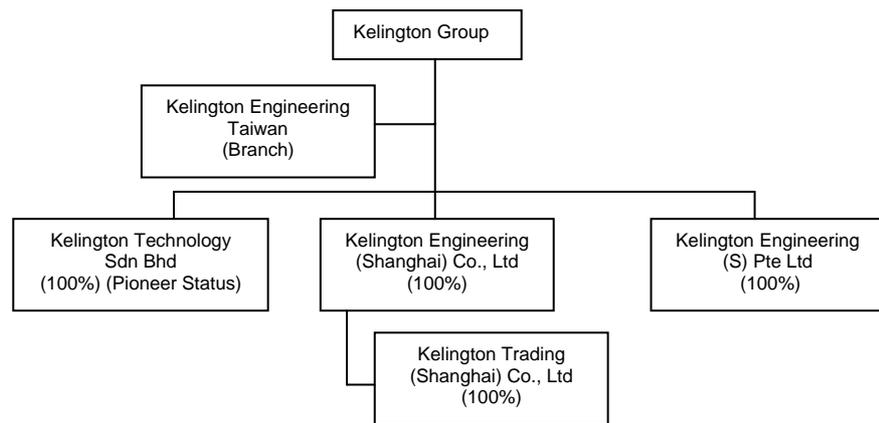
Source: Prospectus

BRIEF BACKGROUND

Engineer solutions. Formed in 2000, Kelington is one of the leading provider of Ultra High Purity (UHP) gas and chemical delivery solutions in the region. Kelington provides a comprehensive range of services in the value chain of UHP gas and chemical delivery systems, which encompasses design, installation, equipment, quality assurance and maintenance. Headquartered at Bukit Jelutong Industrial Park, Shah Alam, the Kelington has also established presence in China, Taiwan and Indonesia. Its UPH gas and chemical solutions are used in the following high-technology industries:

- Wafer fabrication
- Flat Panel Display (FPD) manufacturing
- Solar energy
- Pharmaceuticals
- Light Emitting Diode (LED)
- Storage media

Figure 3: Group Structure



Source: Prospectus, Company

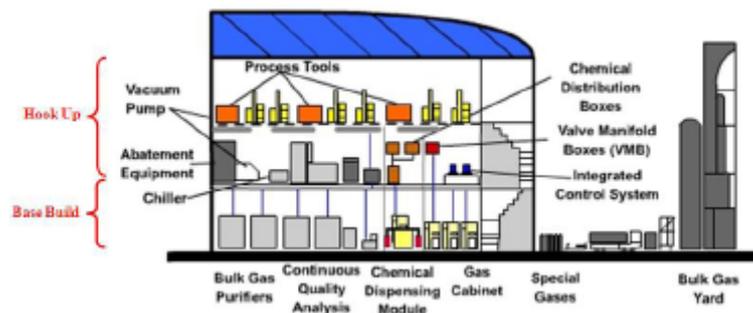
Comprehensive range. Offering a comprehensive range of products and services, Kelington provides end-to-end services ranging from designing, fabrication, installation, quality assurance, quality control and maintenance to servicing. The revenue is divided into the following 3 segments:

Base build: The “Backbone “ of UHP delivery system;

Hook-up: Last-mile delivery system from base build to primary and process tools;

Maintenance: Technical support.

Figure 4: A typical foundry



Source: Company

INVESTMENT MERITS

One-stop UHP centre. Kelington stands out among its peers by being a one-stop UHP delivery solutions provider. While most gas/chemical companies have strong competencies in gas/chemical system and UHP solutions are on standalone basis, general engineering companies usually have strong construction management but lack expertise on the gas/chemical side. However, Kelington is able to converge both gas/chemical and high-level engineering technical knowledge in its UPH delivery system solutions. Kelington covers the entire value chain of a UHP delivery system involving the designing, construction/fabrication, installation and commissioning of a UPH gas or chemical delivery system.

Sound track record. Since UHP delivery systems mainly involve hazardous gases and chemicals which are either flammable, toxic, corrosive or asphyxia, customers usually demand that system providers like Kelington have sound track records to execute, fabricate and install UHP systems. As such, Kelington has developed stringent in-house standard operating procedures in executing projects to meet the high quality control standards in testing and certification. In fact, the company has a proven track record not only in Malaysia but also in China and Taiwan.

Figure 5: Commendable standing in the industry

2000	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 & Vale 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 China.
2008	Implemented first renewable energy project in Singapore for Renewable Energy Corporation. Attained Pioneer Status (with retrospective effect from May 2007).
2009	Implemented turnkey Bulk Chemical Delivery System for Seagate Skudai, cementing its ability to undertake large-scale chemical delivery systems.

Source: Company

Strong partnership with reputable gas providers. In strengthening its position as a leading UHP delivery solutions provider, Kelington is partnering major gas and chemical manufacturers to undertake UHP projects, namely The Linde Group, Air Liquide and Air Products (three of the four world's largest gas providers).

Reputable global clientele. Its reputable global clientele comprising industry leaders reflect the customers' confidence in Kelington. Among others, the company has been providing UHP delivery system solutions to internationally recognised Wafer Fabrication and FPD Fabrication players such as Infineon, TSMC, HannStar Display Corporation, Winbond Electronics Corporation and ProMOS Technologies.

Figure 6: Reputable global customers



Source: Company

Complementing gas/chemical companies. Compared to normal engineering companies, Kelington's products and services complement gas/chemical companies rather than compete with them as they prefer to focus on their core business of supplying gas/chemicals while outsourcing their UHP delivery systems. Such complementary relationships serve to assist Kelington in developing close relationships with gas /chemical companies.

Well-documented process. According to management, Kelington is able to compete its competitors in China and Taiwan as its UHP delivery system is well documented. Such competency actually sets Kelington apart whenever bidding for projects from reputable companies. Through a well-documented process, Kelington is also able to identify and rectify any problems in the UHP gas/chemical delivery system more efficiently.

RISKS

Lack of long term contracts. It is a norm in the UHP delivery systems industry that the users of gas and chemical delivery equipment do not enter into long-term contracts with suppliers. Hence, there is no assurance of business continuity even with existing customers.

Dependence on major customers. At least 34.4% of the Group's total revenue in FY08 came from the BOCLH group of companies ("BOCLH Group"). BOLCH is a joint venture between Lien Hwa Industrial Corporation of Taiwan and BOC Group Plc of the United Kingdom. BOLCH is also a related company of Kelington by virtue of their indirect shareholding interest in Kelington through Sky Walker, a substantial shareholder. Nevertheless, the management expects to maintain this close relationship, established since March 2003.

Dealing with hazardous gases and chemicals. As UHP delivery systems contain hazardous gases/chemicals which could be flammable, combustible, corrosive and toxic, any major leakages due to design flaws, improper use of materials and installation methods could potentially result in major disasters and serious injury to personnel, or even cause fatalities. Although Kelington's impeccable safety record to date is testament of its commitment to safety, there is no assurance that accidents would not happen in future that may affect its ability to tender for future projects.

Fluctuating raw material prices. Kelington is also affected by the fluctuation in raw material prices as cost of steel piping and fittings account for about 25% of a typical project cost. Besides, there is no assurance that the Group would be able to pass on the rise in cost of raw materials to its customers without affecting its competitiveness.

SHAREHOLDINGS

Majority owned by directors of the company. The company's substantial shareholders are Palace Star (53.19%), Allied Moral (7.88%) and Sky Walker (12.88%). The current directors of Palace Star are Gan Hung Keng (27.0%), Ong Weng Leong (27.0%) and Lim Hock San (46.0%). While Lim Hock San is not directly involved in the management of the Group, Gan Hung Keng is the Chairman while Ong Weng Leong is Group Executive Director. Gan Hung Keng, with over 20 years of experience, is responsible for the Group's strategic direction. On the other hand, Ong Weng Leong, with 17 years' experience in the industry, is responsible for the Group's day-to-day functions in Taiwan and China. As for Allied Moral, its shareholders are individual financial investors who are not involved in the company's management. Sky Walker, incorporated in British Virgin Islands, is principally involved in overseas investment.

LOOKING FORWARD

Improve capability in Base Build and Hook Up systems. As Base Build and Hook Up systems are major revenue generators, Kelington plans to ramp up its UHP capability from existing traces of impurities in parts per billion (ppb) to parts per trillion (ppt). Through research and development, Kelington also hopes to enhance its products and services to meet the latest technology requirements in the areas of Wafer Fabrication, FPD and miniaturisation via nanotechnology.

Expanding UHP gas and chemical delivery systems. In Malaysia, Kelington has an 18% market share but less than 2% in China and Taiwan. Having said that, the China and Taiwan business accounted for 61.4% of its revenue in 2008. The fact that China and Taiwan offer tremendous growth potential is prompting management to grow its market share there. As such, the management believes it needs to secure bigger contracts to be seen as a serious player in this niche industry.

Developing e-QAM. Within 12 months of its listing, Kelington expects the first phase of its Electronics-based Quality Assurance Management (e-QAM) to be developed for testing. e-QAM is a concept developed and pioneered by Kelington to improve the efficiency and traceability of the quality assurance process during the installation of an UHP delivery system. Aimed at achieving consistent quality for its deliverables, e-QAM is pioneered and developed by Kelington mainly for its own internal quality assurance.

Include K-Flow vision for UHP chemicals. So far, Kelington has jointly developed the K-Flow Vision modeling and simulation software for the design phase of Base Build and Hook Up for UHP gas delivery systems. Using this software, Kelington is able to efficiently complete its design and marketability, which has led to a shorter lead-time from design to fabrication and installation. Due to the success of the software, the management plans to extend it to UHP chemicals by the first quarter of 2010.

Gas sub-assembly in process tools. Kelington is currently involved in the delivery of gases up to the process tools that involve UHP gas delivery within the gas-sub assembly. Going forward, Kelington intends to build its capability in the gas sub-assembly for such primary and process tools. The company, which is still in the midst of prototyping its design for gas sub-assembly, expects to provide the full range of gas sub-assembly by the second quarter of 2011.

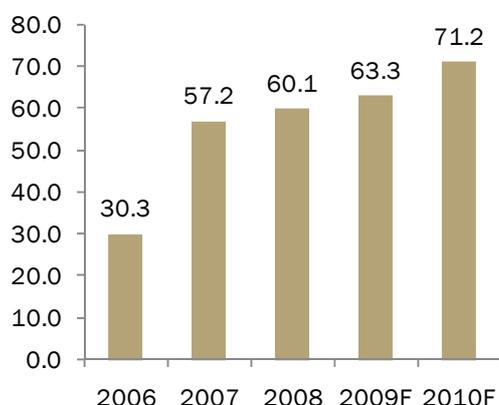
R&D on its equipment. The company is carrying out R&D on its equipment, including gas cabinets, chemical dispensing units, chemical manifold boxes, precision parts and valve manifold box/valve manifold panel/gas panels. By improving the quality, efficiency and cost of its current products, it will strengthen its position as a total solutions provider with in-house manufacturing capability for UHP delivery systems.

FINANCIALS

Solid growth. From FY06 to FY08, Kelington registered an impressive top and bottom line growth of 40.9% and 54.1% respectively. In 2007, revenue surged 89.2% y-o-y, largely due to a Base Build project for an electronic hard disk manufacturing plant in Malaysia amounting to around RM18.7m, of which 67.0% was realised in 2007, coupled with an equipment and material procurement order from China amounting to RM8.1m. Towards 2008, revenue continued to improve by 4.9%, mainly due to a RM14.1m contract secured from the electronic hard disk manufacturing plant project in Malaysia. In addition, Kelington secured the Base Build for a wafer fabrication in China valued at RM11.6m. Except for Malaysia, which showed a slight decline in revenue contribution of 3.2% y-o-y in FY08, revenue contribution from China and Taiwan grew 15.0% and 19.5% y-o-y respectively.

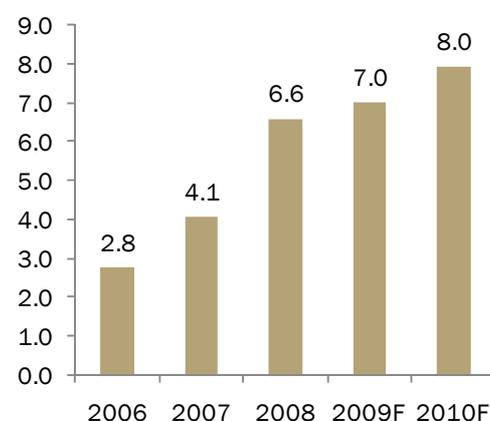
More encouraging semiconductor outlook. The Semiconductor Industry Association (SIA) is projecting worldwide sales of USD195.6bn for 2009, down 21% from USD248.6bn in 2008 but sees sales beginning to rebound in 2010, with a projected y-o-y 6.5% growth to USD208.3bn, followed by 6.5% growth in 2011 to USD221.9bn. As 74.8% of Kelington's FY08 revenue is derived from wafer fabrication and storage media, we are assuming organic revenue growth of 5.4% and 2.7% for FY09 and FY10 respectively.

Figure 7: Revenue (RMm)



Source : Company, OSK

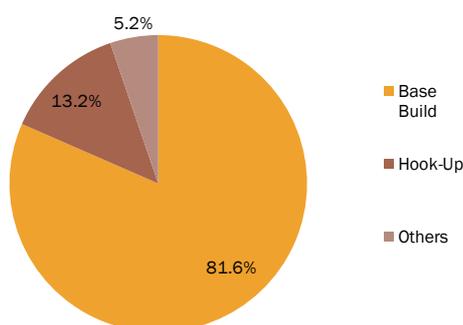
Figure 8: Net profit (RMm)



Source : Company, OSK

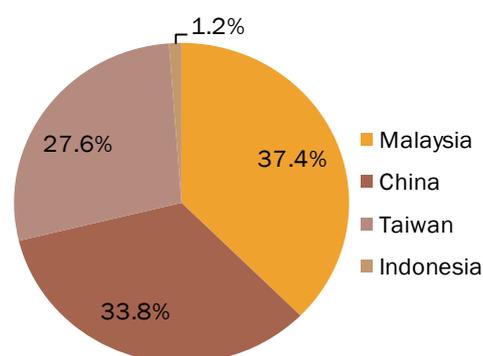
Gross margins improve in FY08. Kelington posted a relatively lower gross margin of 16.6% in FY07 vs 22.1% in FY06 on the back of lower gross profit margins undertaken in China and Taiwan. Nonetheless, gross margins inched up slightly to 20.6%, mainly due to several large projects secured in Malaysia.

Figure 9: Revenue by segment (FY08)



Source : Company

Figure 10: Revenue by location (FY08)



Source : Company

VALUATION & RECOMMENDATION

First to be listed on ACE. Kelington is set to be the first company to be listed on the ACE Market. According to management, the listing is not about raising funds but rather to raise its profile as a leading UHP gas and chemical delivery solutions provider, which will enhance its chances of bidding for projects from established players in China and Taiwan market. In fact, 34.1% of the IPO proceeds would be spent on listing expenses. This being the first IPO on ACE, we note that there may be some concerns over the quality of the company as IPOs on the ACE market do not need approval from the SC but will instead be sponsor-driven. IPOs on the ACE market also do not need to meet any minimum profit track record or market capitalization to list. However, in terms of disposal of shares by vendors, the requirements of the ACE market are actually tighter than those of the Mesdaq, with a 100% moratorium on disposal of vendor shares in the first 6 months, as opposed to only a 45% moratorium in the first year for Mesdaq. While we understand these concerns, the fact that Kelington has been profitable over the last 3 years and boasts a cumulative profit track record of RM13.5m and is listing to gain a higher profile among its current and potential clients, should assuage investors' concerns.

Figure 11: Peers description

Company	Description
Marketech (Taiwan)	Acts as an agent to distribute semiconductor as well as optical equipment and raw materials. It also provides services for designing and building of clean rooms, gas and chemical distribution systems, optoelectronics equipment, as well as waste treatment and hazard gas monitoring systems.
Hanyang Engineering (Korea)	The company provides industrial plant construction services which include semiconductor manufacturing plants, electronics manufacturing plants and other technology related plants. It also produces central chemical supply systems.
Wholtech System Hitech (Taiwan)	Designs, installs, repairs semi-conductor equipments, chemical equipments, automatic controlling system.

Source: Bloomberg

Figure 12: Peers (FY08)

Company	Mkt Cap (RMm)	FY08					
		Revenue (RMm)	Net profit (RMm)	Gross margin (%)	ROE (%)	PER	P/B
Kelington (Malaysia)	39.6	60.1	6.6	20.6	30.6	6.0	1.8
Marketech (Taiwan)	239.9	1053.3	22.2	12.2	5.6	10.9	0.6
Hanyang Engineering (Korea)	259.4	603.6	16.7	6.1	8.4	16.3	1.3
Wholtech System Hitech (Taiwan)	115.5	213.4	0.3	12.6	0.5	337.1	1.7

*As at 9 Nov 2009

Source: Bloomberg

Undemanding valuation. Given its strong orderbook, net cash position and partnerships with industry leaders, we believe the company should be able to achieve our small cap coverage PER of 8x. Applying a small cap average PE of 8x over FY10 EPS, we arrive at a fair value of RM0.85. With an upside potential of 60.4% from the issue price of RM0.53, we recommend investors to SUBSCRIBE for Kelington.

EARNINGS FORECAST

FYE Dec (RMm)	FY06	FY07	FY08	FY09f	FY10f
Turnover	30.3	57.2	60.1	63.3	71.2
EBIT	3.4	5.6	7.1	7.6	8.6
PBT	3.4	5.5	7.1	7.5	8.5
Net Profit	2.8	4.1	6.6	7.0	8.0
EPS (sen)	3.7	5.5	8.8	9.4	10.6
DPS (sen)	0.0	0.0	0.0	0.0	0.0
Margin					
EBIT (%)	11.3	9.8	11.9	12.0	12.0
PBT (%)	11.1	9.6	11.8	11.9	11.9
Net Profit (%)	9.2	7.1	11.0	11.1	11.2
ROE (%)	27.1	28.4	30.6	22.0	19.9
ROA (%)	14.8	10.0	14.6	12.7	12.4
Balance Sheet					
Fixed Assets	4.7	5.1	5.5	5.5	5.9
Current Assets	14.1	35.7	39.7	50.0	58.2
Total Assets	18.8	40.8	45.2	55.5	64.1
Current Liabilities	7.3	25.0	21.9	22.1	22.7
Net Current Assets	6.8	10.7	17.8	27.9	35.5
LT Liabilities	1.2	1.4	1.7	1.4	1.4
Shareholders Funds	10.3	14.4	21.6	32.0	39.9
Net Gearing (%)	Net Cash	Net Cash	Net Cash	Net Cash	Net Cash

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Chris Eng

Kuala Lumpur	Hong Kong	Singapore	Jakarta	Shanghai
Malaysia Research Office OSK Research Sdn. Bhd. 6 th Floor, Plaza OSK Jalan Ampang 50450 Kuala Lumpur Malaysia Tel : +(60) 3 9207 7688 Fax : +(60) 3 2175 3202	Hong Kong Office OSK Securities Hong Kong Ltd. 12 th Floor, World-Wide House 19 Des Voeux Road Central, Hong Kong Tel : + (852) 2525 1118 Fax : + (852) 2537 1332	Singapore Office DMG & Partners Securities Pte. Ltd. #22-01 Ocean Towers 20 Raffles Place Singapore 048620 Tel : +(65) 6438 8810 Fax : +(65) 6535 4809	Jakarta Office PT OSK Nusadana Securities Indonesia Plaza Lippo, 14 th Floor, Jl. Jend. Sudirman Kav. 25. Jakarta 12920 Indonesia Tel : + (6221) 520 4599 Fax : + (6221) 520 4505	Shanghai Office OSK (China) Investment Advisory Co. Ltd. Room 6506, Plaza 66 No. 1266 West Nanjing Road 200040, Shanghai China Tel : +(8621) 6288 9611 Fax : + (8621) 6288 9633