"A self-sufficient China in the long run will play a big part in KGB's prospects"

Share price performance

	1M	3M	12M
Absolute (%)	15.9	6.6	-11.0
Rel KLCI (%)	17.9	-5.8	-8.2

	BUY	HOLD	SELL
Consensus	-	2	-

Source: Bloomberg

Stock Data

Sector	Oil & Gas
Issued shares (m)	321.2
Mkt cap (RMm)/(US$m)	362.9/86.5
Avg daily vol - 6mth (m)	1.6
52-wk range (RM)	0.59-1.43
Est free float	50.4%
Stock Beta	1.13
Net cash/(debt)	50.12
ROE (CY20E)	4.2%
Derivatives	Yes
Shariah Compliant	Yes

Key Shareholders

Palace Star	21.0%
KWAP	7.3%
Sun Lead International	6.2%

Source: Affin Hwang, Bloomberg

Tan Jianyuan, ACCA
T (603) 2146 7538
E jianyuan.tan@affinhwang.com

Kelington (KGRB MK)

HOLD (maintain)
Up/Downside: +8.0%

Price Target: RM1.22
Previous Target (Rating): RM1.00 (HOLD)

Looking past weak 2020; prospects remain bright

- **The pace of China moving towards becoming a self-sufficient chip manufacturer will determine KGB's long-term growth in the coming years. In recent months, we have witnessed SMIC benefiting from order diversion due to the US sanction on Huawei**
- **Near-term drag on earnings as project progress slows. Singapore is still suffering from low workforce efficiency with the number of new cases remaining high. Slashing FY20 earnings forecast by 54%.**
- **We raise our 12-month target price to RM1.22 based on higher 21x PER on FY21 EPS. Maintain HOLD.**

Singapore and Malaysia operations will drag down 2Q results

Singapore and Malaysia were the two most impacted regions in 2Q due to the lockdown measures. Despite China reopening its cities in 2Q, we believe this would not be sufficient to offset the negative impact. Besides, the liquid carbon dioxide (LCO2) plant utilisation would likely to have fallen drastically from an average 50% in 1Q20 due to lower cylinder refilling demand as activities come to a standstill. KGB's 2Q20 could fall into the red, in our view.

More diversion of orders could benefit KGB in the long term

In May 2020, Taiwan Semiconductor Manufacturing Co (TSMC) announced that it will stop supplying chips to Huawei, following the sanction by US. Following this, Huawei *reported* that it will now take orders from SMIC and Shanghai Microelectronics. As SMIC is an existing client of KGB, there could be more potential UHP contracts to be awarded out.

Cutting our FY20 profit

We slash our FY20 earnings by 54% (from RM14.6m to RM6.6m) mainly to factor in the delays in Singapore work recognition on current labour constraint. In addition, we lower our segmental gross profit margins across by 0.5–1% on possible higher short term cost. Nevertheless, we maintain our FY21 due to the expected job spill overs. We have factored in 30%/50%/70% LCO2 plant utilisation across FY20-22E.

Maintain Hold, China prospects remain promising

We raised our target price to RM1.22 based on higher 21x target PE to reflect the stronger expected earnings growth. China structural change in the next 5 years may help drive KGB's earnings higher as the country aim to be more self-sustaining, also motivated by the ongoing dispute with US. Maintain Hold.

Earnings & Valuation Summary

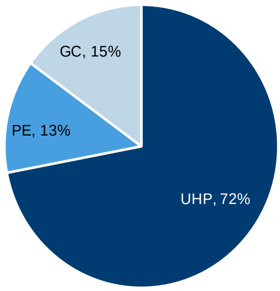
	2018	2019	2020E	2021E	2022E
Revenue (RMm)	350.0	379.8	311.8	400.3	415.4
EBITDA (RMm)	29.3	35.4	17.3	31.6	35.1
Pretax profit (RMm)	25.0	31.6	8.2	23.2	27.0
Net profit (RMm)	18.6	24.4	6.6	17.9	20.7
EPS (sen)	6.1	7.9	2.2	5.8	6.7
PER (x)	18.5	14.1	51.9	19.3	16.6
Core net profit (RMm)	20.6	25.8	6.6	17.9	20.7
Core EPS (sen)	6.7	8.4	2.2	5.8	6.7
Core EPS growth (%)	19.5	25.2	(74.2)	169.1	15.8
Core PER (x)	16.7	13.4	51.9	19.3	16.6
Net DPS (sen)	1.2	2.6	0.7	2.0	2.0
Dividend Yield (%)	1.1	2.4	0.6	1.8	1.8
EV/EBITDA (x)	10.1	8.4	16.9	8.5	7.5
Chg in EPS (%)			-54.4%	0.0%	-4.4%
Affin/Consensus (x)			0.5	1.0	1.0

Source: Company, Affin Hwang estimates

UHP and China remain KGB's key focus

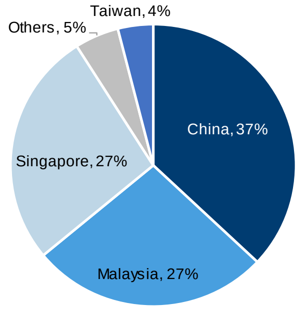
As of March 2020, KGB's outstanding order book stood at RM322m, of which China made up the substantial portion at 37%, with 27% each from Singapore and Malaysia, 4% from Taiwan and 5% from other countries. The UHP (Ultra High Purity) business continued to remain the bulk of the order book at 72% with general contracting and process engineering making up 15% and 13%, respectively.

Fig 1: Order book by segment



Source: Company

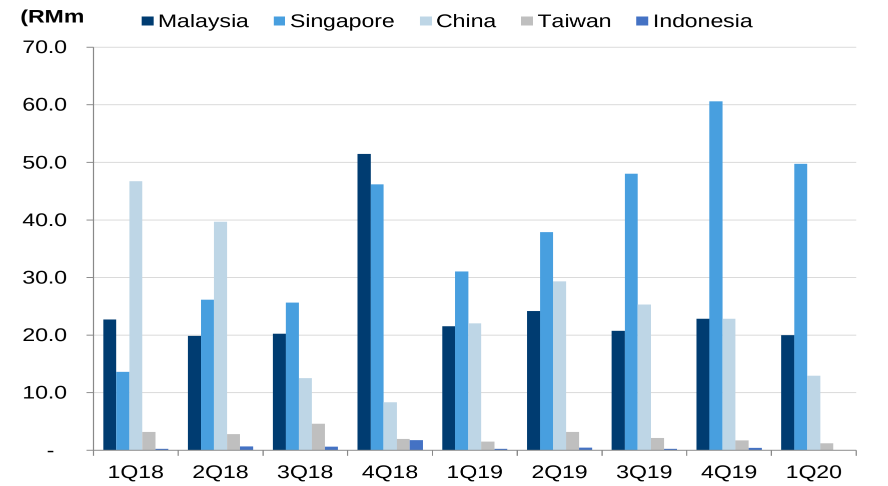
Fig 2: Order book by geographical



Source: Company

China reopened in 2Q, but with Singapore and Malaysia locked down, this would have dragged on earnings

Fig 3: Geographical quarterly revenue



Source: Company

China back to full swing post lock down since January 2020

China operation was largely affected in 1Q20 with revenue declining by 43% sequentially as cities were locked down since end-January 2020. With travel bans lifted since end-March 2020, business activities have returned to pre-COVID19 levels.

Singapore: Impacted by CB

Singapore operation will have been badly impacted in 2Q20 due to the circuit breaker (CB) which started in April 2020. Although it ended in May 2020, with the reopening of the city in June, operational efficiency is still being affected until today. Singapore's new COVID cases are predominantly among foreign workers living in dormitories. Hence, the government is still imposing strict restrictions, by not allowing foreign workers from different dormitories to operate in the same site. We estimate that efficiency could still be well below the 50% level, and clients would have extended the time needed to complete projects in hand.

Malaysia: Impacted by MCO

Malaysia was also affected by nearly 2 months of lockdown (mid-March until May) in 2Q20. Since then, operating efficiency has returned to the pre-COVID level. As such, 2Q20 will have been dragged down by Malaysia as well as Singapore.

Lower demand for LCO2 plant during lock down

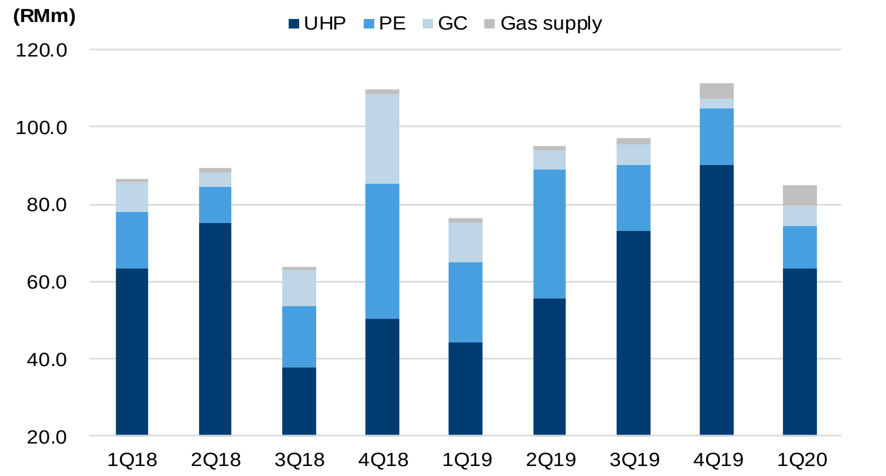
KGB's LCO2 plant was operating at 50% utilisation prior to the lockdowns in Malaysia and Singapore. However, with activities halted during the lockdown, plant utilisation fell to as low as 6% in 2Q20, below the breakeven level of 30%. Prior to this, KGB was supplying to cylinder refillers, which in turn supplied mainly to the construction sector. With Singapore demand still disrupted, we believe the plant utilisation would likely still be lower than the pre-COVID level, but supported by the resumption of domestic construction activities. Meanwhile, the work to commence the skid tank installation in Singapore is pending site owner approval.

Taiwan breakeven target remains on track

KGB targets its Taiwan operation to break even this year, based on the contracts in hand from Micron and Apple. This region has been largely unaffected by the COVID lockdown measures.

2Q20 results preview

Fig 4: Segmental quarterly revenue



Source: Company

2Q20 results will be affected

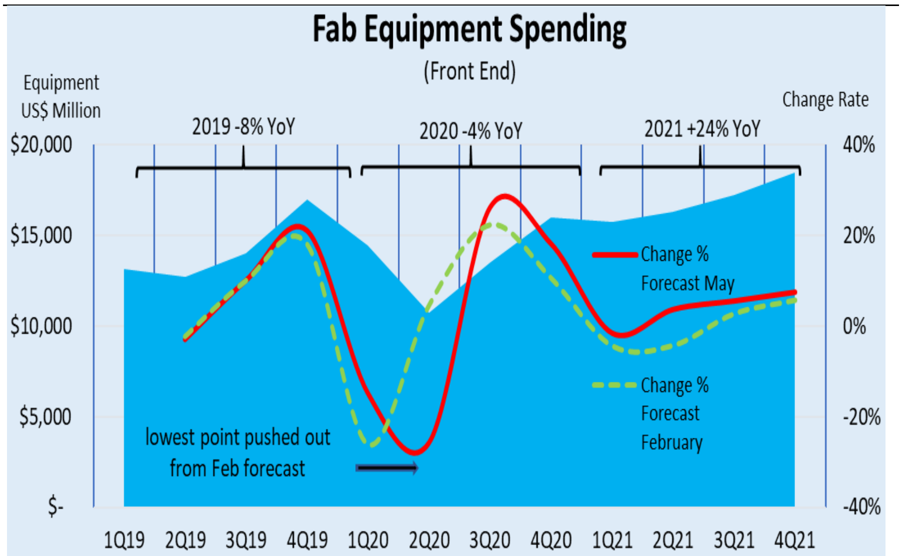
The negative impact of the lockdowns in Singapore and Malaysia in 2Q20 is unlikely to have been offset by the reopening of China's economy in the quarter. In addition, the LCO2 plant utilisation would have fallen drastically in 2Q20, from the 50% average in 1Q20. This was due to the export restriction to Singapore and the halt of construction activities during the MCO period in Malaysia. Overall, we believe KGB could have fallen into the red in 2Q20 (previous quarterly loss was in 4Q15). KGB is due to release its results on 25 August.

Cutting our FY20 profit ahead of results

We slash our FY20 earnings by 54% (from RM14.6m to RM6.6m), assuming delays in the Singapore work recognition due to the current labour constraint. In addition, we lower our segmental gross profit margins across the board by 0.5–1% due to the lack of economies of scale. Nevertheless, we maintain our FY21E EPS due to the expected job spill overs, but cut the FY22E EPS slightly by 4%.

Long-term outlook still positive

Fig 5: Global fabrication equipment spending



Source: SEMI.org

Robust global fab equipment spending

Full-year spending is expected to fall by another 4% yoy in 2020, given the weak 1H20, after an 8% drop in 2019. Nevertheless, SEMI is now forecasting overall global fab equipment spending to grow at 24% yoy to US$68bn in 2021, representing a 10% growth vs its initial forecast, Memory fab, logic and foundry, memory are all projected to grow in 2021. The ongoing COVID pandemic will change consumer behaviour, as more emphasis is put on improving one's online life, translating to higher demand for electronics products.

KGB's biggest client raising capex is a positive

Semiconductor Manufacturing International (SMIC) has raised its 2020 capex target twice this year, from US$3.2bn to US$4.3bn (+34%) in May 2020, and by another 59% to US$6.7bn more recently. As SMIC is KGB's largest client, we believe this 109% increase in capex spending for 2020 alone is a long-term positive for KGB in terms of securing more new contracts to replenish its order book.

Fig 6: Order book detailed breakdown

NO	CLIENT	COUNTRY	SEGMENT	OUTSTANDING O'BOOK (RM'MIL)
1	SMNC/SMSC	China	UHP	91
2	M+W Singapore (Micron)	Singapore	UHP	67
3	MNC Gas company	Singapore	UHP	12
4	Yi Xing ZhongHuan	China	UHP	10
5	Chengdu Construction	China	UHP	7
6	Infineon	Malaysia	UHP	6
7	Micron	Taiwan	UHP	5
8	NUS WSB Project	Singapore	UHP	4
9	Hewlett-Packard	Malaysia	UHP	3
10	Xu Zhou SDS	China	UHP	3
11	Micron	Malaysia	UHP	3
12	Ji Nan Quan Xin	China	UHP	3
13	Others - UHP		UHP	18
14	Stolthaven	Malaysia	Process	18
15	Dyson	Malaysia	Process	5
16	GPS	Malaysia	Process	5
17	Others - Process		Process	12
18	Global MNC	Malaysia	GC	34
19	Solar jobs (Apple)	Taiwan	GC	4
20	Onsemi	Malaysia	GC	4
21	Others - Gen Con		GC	7
22	Industrial Gases	Malaysia	IG	1
			TOTAL	322

UHP RM232m (72%)

PE RM40m (13%)

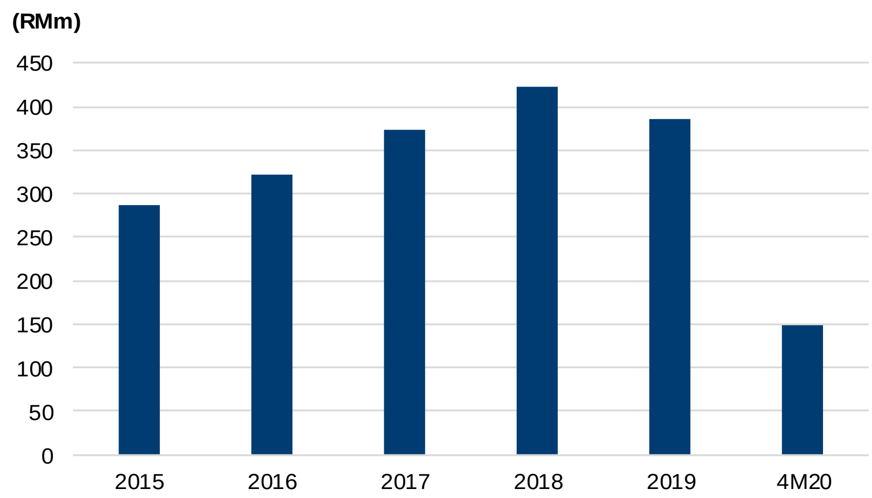
GC RM49m (15%)

Source: Company

China ending its foreign reliance is likely to benefit KGB in the long term

In May 2020, TSMC announced that it would stop supplying chips to Huawei, following the US sanction to restrict the sale of technology to the Chinese telco company. Following this, Huawei reported that it will now obtain chips from SMIC and Shanghai Microelectronics. With the supply chain disruption intensifying as a result of the dispute between the US and China, this will make the 'Made in China 2025" policy even more important as China aims to end its reliance on foreign technology. Given KGB's high exposure in China and SMIC being its largest client, we believe this development will continue to benefit KGB in the long term. To date, KGB has secured a combined RM149m worth of contracts up to April 2020, close to 40% of its 2019 full-year replenishment.

Fig 7: Yearly contract replenishment



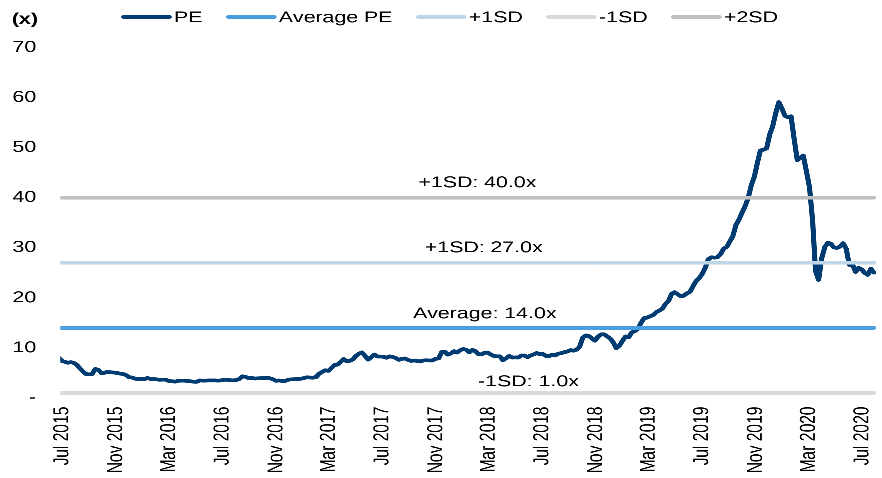
Source: Affin Hwang

Valuation and recommendation

Maintain HOLD

We are positive on KGB's earnings prospects for the next 5 years, which we believe will be largely driven by structural change in China. With the ongoing dispute with the US, China is likely to be motivated to achieve its target to be more self-reliant by 2025. We raise our target price to RM1.22 (from RM1.00) based on a higher target of 21x (+0.5SD mean; previously 16x) on the FY21E EPS. The higher PER multiple also represents a 20% discount to its global industrial gas peers (see Fig. 9). We maintain our Hold rating.

Fig 8: KGB's 5-year forward PE



Source: Bloomberg, Affin Hwang estimates

Fig 9: Peer Comparison Table

Company	Bloomberg code	Rating	Share Price (LC)	Core PE (x)		EPS growth (%)		EV/ EBITDA	P/BV (x)	Div Yield
				CY20E	CY21E	CY20E	CY21E	CY20E	CY20E	CY20E
Kelington	KGRB MK	HOLD	1.13	51.9	19.3	(74.2)	>100	16.9	2.2	0.6
Linde	LIN GR	N/R	207	32.2	28.4	0.5	13.5	18.5	2.7	1.5
Air Liquide	AIQUY US	N/R	33	27.3	24.7	n.m	10.5	13.4	3.5	2.0
Air Products	APD US	N/R	281	32.4	28.1	2.1	17.1	17.8	5.1	1.9
Taiyo Nippon Sanso	4091 JP	N/R	1,895	16.2	13.9	n.m	16.9	10.2	1.7	1.6
Pnc Process System	603690 CH	N/R	43	67.1	45.2	49.5	47.7	44.3	6.4	0.2
Simple Average ex- PNC				**32.0**	**22.9**	**(23.9)**	**14.5**	**15.4**	**3.1**	**1.5**
Weighted Average ex- PNC				**30.3**	**26.8**	**0.7**	**13.5**	**16.6**	**3.4**	**1.7**

Source: Bloomberg, Affin Hwang estimates
Note: Share prices as of close on 11 August 2020 for Asia-listed stocks (10 August for others)

Key risks

Upside risks to our call include a faster recovery in Singapore labour efficiency, a quicker recovery in LCO2 plant utilisation and higher contract wins. Downside risks include further lockdowns affecting work progress, slower-than-expected economic recovery leading to weaker consumption spending, and client deferring their expansion plans.

Financial Summary – Kelington

Profit & Loss Statement

FYE 31 Dec (RM m)	2018A	2019A	2020E	2021E	2022E
Revenue	**350.0**	**379.8**	**311.8**	**400.3**	**415.4**
Operating expenses	(320.7)	(344.4)	(294.5)	(368.7)	(380.2)
EBITDA	**29.3**	**35.4**	**17.3**	**31.6**	**35.1**
Depreciation	(2.1)	(1.1)	(7.5)	(7.5)	(7.5)
EBIT	**27.2**	**34.3**	**9.7**	**24.0**	**27.6**
Net interest expense	(0.9)	(1.3)	(1.5)	(1.5)	(1.5)
Associates' contribution	0.0	0.0	0.0	0.0	0.0
Exceptional gain/(loss)	(2.0)	(1.4)	0.0	0.0	0.0
Pretax profit	**25.0**	**31.6**	**8.2**	**23.2**	**27.0**
Tax	(6.7)	(7.7)	(2.1)	(5.8)	(6.7)
Minority interest	0.3	0.5	0.5	0.5	0.5
Net profit	**18.6**	**24.4**	**6.6**	**17.9**	**20.7**
Core Net Profit	**20.6**	**25.8**	**6.6**	**17.9**	**20.7**

Balance Sheet Statement

FYE 31 Dec (RM m)	2018A	2019A	2020E	2021E	2022E
Fixed assets	24.7	57.3	58.2	65.7	73.1
Other long term assets	6.3	6.4	6.4	6.4	6.4
Total non-current assets	**31.0**	**63.6**	**64.6**	**72.0**	**79.5**
Cash and equivalents	42.9	85.1	90.8	114.3	120.1
Stocks	0.2	0.6	0.9	1.1	1.1
Debtors	81.4	90.9	81.1	93.2	96.7
Other current assets	88.0	62.9	62.9	62.9	62.9
Total current assets	**212.5**	**239.4**	**235.7**	**271.5**	**280.8**
Creditors	60.3	40.3	33.1	64.6	66.8
Short term borrowings	15.6	12.1	12.1	12.1	12.1
Other current liabilities	49.7	69.1	69.1	69.1	69.1
Total current liabilities	**125.7**	**121.6**	**114.3**	**145.8**	**148.0**
Long term borrowings	1.5	25.9	25.9	25.9	25.9
Other long term liabilities	0.1	0.1	0.1	0.1	0.1
Total long term liabilities	**1.6**	**26.0**	**26.0**	**26.0**	**26.0**
Shareholders' Funds	**116.1**	**155.3**	**159.8**	**171.5**	**186.1**
Minority interests	**0.1**	**0.3**	**0.3**	**0.3**	**0.3**

Cash Flow Statement

FYE 31 Dec (RM m)	2018A	2019A	2020E	2021E	2022E
Pretax Profit	25.0	31.6	8.2	23.2	27.0
Depreciation & amortisatior	2.1	1.1	7.5	7.5	7.5
Working capital changes	9.8	14.2	2.2	19.2	(1.3)
Cash tax paid	(5.9)	(7.9)	(2.1)	(5.8)	(6.7)
Others	(23.5)	(17.2)	0.0	0.0	0.0
Cashflow from operation	**7.5**	**21.7**	**15.9**	**44.2**	**26.4**
Capex	(11.5)	(33.5)	(5.0)	(15.0)	(15.0)
Others	(1.9)	(1.7)	0.0	0.0	0.0
Cash flow from investing	**(13.4)**	**(35.2)**	**(5.0)**	**(15.0)**	**(15.0)**
Debt raised/(repaid)	(12.0)	19.6	0.0	0.0	0.0
Dividends paid	(3.7)	(8.1)	(2.2)	(6.2)	(6.2)
Others	22.8	20.2	0.0	0.0	0.0
C/F from financing	**7.1**	**31.7**	**(2.2)**	**(6.2)**	**(6.2)**
Net change in cash flow	**1.2**	**18.2**	**8.7**	**23.0**	**5.3**
Free Cash Flow	**(4.0)**	**(11.8)**	**10.9**	**29.2**	**11.4**

Source: Company, Affin Hwang estimates

Key Financial Ratios and Margins

FYE 31 Dec (RM m)	2018A	2019A	2020E	2021E	2022E
Growth					
Revenue (%)	11.7	8.5	(17.9)	28.4	3.8
EBITDA (%)	18.0	20.8	(51.2)	83.0	11.2
Core net profit (%)	19.5	25.2	(74.2)	169.1	15.8
Profitability					
EBITDA margin (%)	8.4	9.3	5.5	7.9	8.5
PBT margin (%)	7.1	8.3	2.6	5.8	6.5
Net profit margin (%)	5.3	6.4	2.1	4.5	5.0
Effective tax rate (%)	26.8	24.3	25.0	25.0	25.0
ROA (%)	7.9	8.9	2.2	5.6	5.9
Core ROE (%)	21.2	19.0	4.2	10.8	11.6
ROCE (%)	22.5	21.0	5.0	11.8	12.7
Dividend payout ratio (%)	19.7	33.2	32.4	34.4	29.7
Liquidity					
Current ratio (x)	1.7	2.0	2.1	1.9	1.9
Op. cash flow (RMm)	7.5	21.7	15.9	44.2	26.4
Free cashflow (RMm)	(4.0)	(11.8)	10.9	29.2	11.4
FCF/share (sen)	(0.0)	(0.0)	0.0	0.1	0.0
Asset management					
Debtors turnover (days)	84.9	87.4	95.0	85.0	85.0
Stock turnover (days)	0.2	0.6	1.1	1.1	1.1
Creditors turnover (days)	68.6	42.8	41.0	63.9	64.1
Capital structure					
Net gearing (%)	-22%	-30%	-33%	-45%	-44%
Interest cover (x)	32.1	26.9	11.4	20.8	23.1

Quarterly Profit & Loss

FYE 31 Dec (RM m)	1Q19	2Q19	3Q19	4Q19	1Q20
Revenue	76.4	95.1	97.0	111.3	84.7
Operating expenses	(68.8)	(88.4)	(91.1)	(99.2)	(80.7)
EBITDA	**7.6**	**6.6**	**5.9**	**12.1**	**4.0**
Depreciation	(0.6)	(0.6)	(0.6)	(1.3)	(1.2)
EBIT	**7.1**	**6.1**	**5.3**	**10.9**	**2.8**
Net int income/(expense)	(0.3)	(0.3)	(0.4)	(0.5)	(0.7)
Associates	0.0	0.0	0.0	0.0	0.0
Forex gains	3.0	3.0	3.0	3.0	3.0
Exceptional gain/(loss)	(0.8)	0.8	2.0	(1.4)	1.6
Pretax profit	**6.5**	**7.2**	**7.5**	**10.2**	**4.9**
Tax	(1.7)	(2.1)	(1.3)	(2.6)	(0.9)
Minority interest	0.1	0.1	0.0	0.2	(0.0)
Net profit	**4.8**	**5.1**	**6.3**	**7.8**	**4.0**
Core net profit	**5.6**	**4.3**	**4.3**	**9.2**	**2.4**
Margins (%)					
EBIT	10.0	7.0	6.1	10.9	4.8
PBT	8.5	7.5	7.8	9.1	5.8
Net profit	6.3	5.4	6.5	7.0	4.7

Important Disclosures and Disclaimer

Equity Rating Structure and Definitions

BUY	Total return is expected to exceed +10% over a 12-month period
HOLD	Total return is expected to be between -5% and +10% over a 12-month period
SELL	Total return is expected to be below -5% over a 12-month period
NOT RATED	Affin Hwang Investment Bank Berhad does not provide research coverage or rating for this company. Report is intended as information only and not as a recommendation

The total expected return is defined as the percentage upside/downside to our target price plus the net dividend yield over the next 12 months.

OVERWEIGHT	Industry, as defined by the analyst's coverage universe, is expected to outperform the KLCI benchmark over the next 12 months
NEUTRAL	Industry, as defined by the analyst's coverage universe, is expected to perform inline with the KLCI benchmark over the next 12 months
UNDERWEIGHT	Industry, as defined by the analyst's coverage universe is expected to under-perform the KLCI benchmark over the next 12 months

This report is intended for information purposes only and has been prepared by Affin Hwang Investment Bank Berhad (14389-U) ("the Company") based on sources believed to be reliable and is not to be taken in substitution for the exercise of your judgment. You should obtain independent financial, legal, tax or such other professional advice, when making your independent appraisal, assessment, review and evaluation of the company/entity covered in this report, and the extent of the risk involved in doing so, before investing or participating in any of the securities or investment strategies or transactions discussed in this report. However, such sources have not been independently verified by the Company, and as such the Company does not give any guarantee, representation or warranty (expressed or implied) as to the adequacy, accuracy, reliability or completeness of the information and/or opinion provided or rendered in this report. Facts, information, estimates, views and/or opinion presented in this report have not been reviewed by, may not reflect information known to, and may present a differing view expressed by other business units within the Company, including investment banking personnel and the same are subject to change without notice. Reports issued by the Company, are prepared in accordance with the Company's policies for managing conflicts of interest. Under no circumstances shall the Company, be liable in any manner whatsoever for any consequences (including but are not limited to any direct, indirect or consequential losses, loss of profit and damages) arising from the use of or reliance on the information and/or opinion provided or rendered in this report. Under no circumstances shall this report be construed as an offer to sell or a solicitation of an offer to buy any securities. The Company its directors, its employees and their respective associates may have positions or financial interest in the securities mentioned therein. The Company, its directors, its employees and their respective associates may further act as market maker, may have assumed an underwriting commitment, deal with such securities, may also perform or seek to perform investment banking services, advisory and other services relating to the subject company/entity, and may also make investment decisions or take proprietary positions that are inconsistent with the recommendations or views in this report. The Company, its directors, its employees and their respective associates, may provide, or have provided in the past 12 months investment banking, corporate finance or other services and may receive, or may have received compensation for the services provided from the subject company/entity covered in this report. No part of the research analyst's compensation or benefit was, is or will be, directly or indirectly, related to the specific recommendations or views expressed in this report. Employees of the Company may serve as a board member of the subject company/entity covered in this report.

Third-party data providers make no warranties or representations of any kind relating to the accuracy, completeness, or timeliness of the data they provide and shall not have liability for any damages of any kind relating to such data.

This report, or any portion thereof may not be reprinted, sold or redistributed without the written consent of the Company.

This report is printed and published by:
Affin Hwang Investment Bank Berhad (14389-U)
A Participating Organisation of Bursa Malaysia Securities Berhad

22nd Floor, Menara Boustead,
69, Jalan Raja Chulan,
50200 Kuala Lumpur, Malaysia.

T : + 603 2142 3700
F : + 603 2146 7630
research@affinhwang.com

www.affinhwang.com