

16 June 2021

Construction & Engineering | Industrial

# Kelington Group (KGRB MK)

**Neutral** (Maintained)

## Chugging Along

Target Price (Return): MYR2.02 (-8.2%)  
 Price: MYR2.20  
 Market Cap: USD172m  
 Avg Daily Turnover (MYR/USD) 2.62m/0.64m

- Maintain NEUTRAL, with a higher DCF-derived MYR2.02 TP (ex-price: MYR1.01), from MYR1.83, 8.2% downside and 1% FY22F yield.** Kelington Group's decent order wins to date should support the double-digit growth in core earnings for FY21F. While the full MCO (FMCO) could impact the industrial gas business (IGB) and existing job orders in Malaysia in the near-term, this should be buffered by stronger contributions from China and Singapore, in our view. The stock's risk-reward profile is balanced. We raise our TP slightly (21x implied FY22F P/E), which is still at a discount to the tech sector mean P/E of 27x, given the contractual nature of its business.
- FMCO headwinds in Malaysia.** We expect stronger 2Q21 (1Q21: -19% QoQ), driven by improved billings from China (48% of outstanding orderbook of MYR364m in 1Q21) as production normalises post the winter season and seasonality. This could be partially offset by delays in domestic billings arising from slower work progress during the FMCO. We gather from management that nine out of 15 project sites are operational during the latest phase of the lockdown while the utilisation of its LCO<sub>2</sub> plant has moderated, from 60% in April to 50% in early June (1Q21: 60%).
- Singapore to see stronger order wins in 2H21.** KGB clinched MYR105m of new orders in 1Q21 (outstanding orderbook of MYR364m), or some 24% of our orderbook replenishment assumption for FY21F. Of the group's existing MYR1.0bn tender book, Singapore makes up the largest proportion. Management is hopeful of matching the record order wins of MYR490m in FY20 this year, given several notable fab expansion projects coming on stream in Singapore (Micron, Global Foundries and Siltronic) and new jobs from China (including from Semiconductor Manufacturing International Corp (SMIC) where it lost the hook-up contract earlier this year).
- Halal certification.** Management said the crucial audit process by JAKIM has been completed with the award of the halal certification underway. With customer qualifications taking up to six months, we think contribution from new F&B customers (major consumers of liquid carbon dioxide or LCO<sub>2</sub>) would only materialise in 1Q22, at the earliest. KGB previously said it is looking to supply about 15-20m tonnes of the c.50m tonnes of LCO<sub>2</sub> consumed daily by the F&B industry. We expect the stronger off-take to boost the utilization of the LCO<sub>2</sub> plant, which currently contributes about two-thirds of IGB. IGB revenue surged 73% YoY in 1Q21, driven by the recovery in economic activities. The trading of specialty gases should also drive the IGB growth in the medium to longer-term.
- Forecast and risks.** We raise FY21-23F core earnings 8-13% after factoring in a higher margin assumption for the LCO<sub>2</sub> business and a lower effective tax rate. Weaker-than-expected orders/earnings/margins, population movement restrictions are key risks. Upside risks: Stronger contract replenishment, faster-than-expected LCO<sub>2</sub> demand recovery and receding COVID-19 risks.

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### Share Performance (%)

	YTD	1m	3m	6m	12m
Absolute	30.2	9.5	14.6	37.5	130.4
Relative	33.0	9.5	17.0	43.0	124.8
52-wk Price low/high (MYR)					0.97 – 2.63

Kelington Group (KGRB MK)



Source: Bloomberg

### Overall ESG Score: 2.8 (out of 4)

#### E: Good

KGB is committed to preserving the environment through various practices such as reducing electricity and water consumption. It is also managing its usage of materials to reduce waste. However, KGB lacks environmental statistics for pollution and waste management

#### S: Good

Apart from up-to-standard health & safety policies, we see active community engagements, and efforts to uplift employee relations. KGB is focused on attracting and retaining talent, and helping employees develop their skills to drive further success.

#### G: Moderate

Ir Raymond Gan is the Chairman and also Group CEO. The board does not utilise independent sources to identify the appointment of directors, which could limit operational checks and balances. KGB engages a third party investor relations outfit to facilitate communication with the investment community, with periodic meetings held.

#### Note:

Small cap stocks are defined as companies with a market capitalization of less than USD1bn.

Forecasts and Valuation	Dec-19	Dec-20	Dec-21F	Dec-22F	Dec-23F
Total turnover (MYRm)	380	395	490	490	501
Recurring net profit (MYRm)	23	22	28	30	33
Recurring net profit growth (%)	20.3	(5.8)	25.4	10.2	8.4
Recurring P/E (x)	30.34	32.20	25.67	23.29	21.49
P/B (x)	4.6	4.2	3.8	3.4	3.0
P/CF (x)	33.62	15.52	33.30	21.06	19.55
Dividend Yield (%)	0.8	0.7	1.0	1.1	1.2
EV/EBITDA (x)	17.85	18.89	14.93	13.28	12.06
Return on average equity (%)	18.0	10.8	15.6	15.4	14.9
Net debt to equity (%)	net cash	net cash	net cash	net cash	net cash

Source: Company data, RHB

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## Financial Exhibits

Asia	Financial summary (MYR)	Dec-19	Dec-20	Dec-21F	Dec-22F	Dec-23F
Malaysia	Recurring EPS	0.07	0.07	0.09	0.09	0.10
Construction & Engineering	DPS	0.02	0.02	0.02	0.02	0.03
<b>Kelington Group</b>	BVPS	0.48	0.52	0.58	0.65	0.73
KGRB MK	Return on average equity (%)	18.0	10.8	15.6	15.4	14.9
Neutral						
	<b>Valuation metrics</b>	<b>Dec-19</b>	<b>Dec-20</b>	<b>Dec-21F</b>	<b>Dec-22F</b>	<b>Dec-23F</b>
	Recurring P/E (x)	30.34	32.20	25.67	23.29	21.49
	P/B (x)	4.6	4.2	3.8	3.4	3.0
	FCF Yield (%)	(1.7)	4.9	2.3	4.0	4.4
	Dividend Yield (%)	0.8	0.7	1.0	1.1	1.2
	EV/EBITDA (x)	17.85	18.89	14.93	13.28	12.06
	EV/EBIT (x)	19.46	22.31	16.41	14.51	13.13
	<b>Income statement (MYRm)</b>	<b>Dec-19</b>	<b>Dec-20</b>	<b>Dec-21F</b>	<b>Dec-22F</b>	<b>Dec-23F</b>
	Total turnover	380	395	490	490	501
	Gross profit	64	59	77	81	85
	EBITDA	37	34	41	45	48
	Depreciation and amortisation	(3)	(5)	(4)	(4)	(4)
	Operating profit	34	28	38	41	44
	Net interest	(1)	(2)	(3)	(3)	(2)
	Pre-tax profit	32	21	35	38	41
	Taxation	(8)	(3)	(7)	(8)	(8)
	Reported net profit	24	17	28	30	33
	Recurring net profit	23	22	28	30	33
	<b>Cash flow (MYRm)</b>	<b>Dec-19</b>	<b>Dec-20</b>	<b>Dec-21F</b>	<b>Dec-22F</b>	<b>Dec-23F</b>
	Change in working capital	(8.5)	18.3	(10.2)	(0.7)	(0.7)
	Cash flow from operations	21.1	45.7	21.3	33.7	36.3
	Capex	(33.5)	(11.2)	(5.0)	(5.0)	(5.0)
	Cash flow from investing activities	(35.2)	(12.0)	(6.0)	(5.0)	(5.0)
	Dividends paid	(8.1)	(4.8)	0.0	(6.9)	(7.6)
	Cash flow from financing activities	32.8	11.7	0.0	(6.9)	(32.6)
	Cash at beginning of period	67.1	85.2	132.0	146.6	168.4
	Net change in cash	18.7	45.4	15.3	21.8	(1.3)
	Ending balance cash	85.1	131.4	147.3	168.4	167.1
	<b>Balance sheet (MYRm)</b>	<b>Dec-19</b>	<b>Dec-20</b>	<b>Dec-21F</b>	<b>Dec-22F</b>	<b>Dec-23F</b>
	Total cash and equivalents	85	132	147	168	167
	Tangible fixed assets	53	60	61	62	63
	Total assets	305	350	384	407	409
	Short-term debt	12	28	28	28	28
	Total long-term debt	23	27	27	27	2
	Total liabilities	149	182	197	197	174
	Total equity	156	168	187	210	235
	Total liabilities & equity	305	350	384	407	409
	<b>Key metrics</b>	<b>Dec-19</b>	<b>Dec-20</b>	<b>Dec-21F</b>	<b>Dec-22F</b>	<b>Dec-23F</b>
	Revenue growth (%)	8.5	3.9	24.2	0.0	2.2
	Recurrent EPS growth (%)	20.3	(5.8)	25.4	10.2	8.4
	Gross margin (%)	16.7	14.9	15.7	16.5	16.9
	Operating EBITDA margin (%)	9.7	8.5	8.5	9.2	9.5
	Net profit margin (%)	6.4	4.4	5.6	6.2	6.6
	Dividend payout ratio (%)	23.0	27.7	25.0	25.0	25.0
	Capex/sales (%)	8.8	2.8	1.0	1.0	1.0
	Interest cover (x)	25.9	11.5	12.5	14.0	19.2

Source: Company data, RHB

Figure 1: Kelington's corroborative DCF valuation

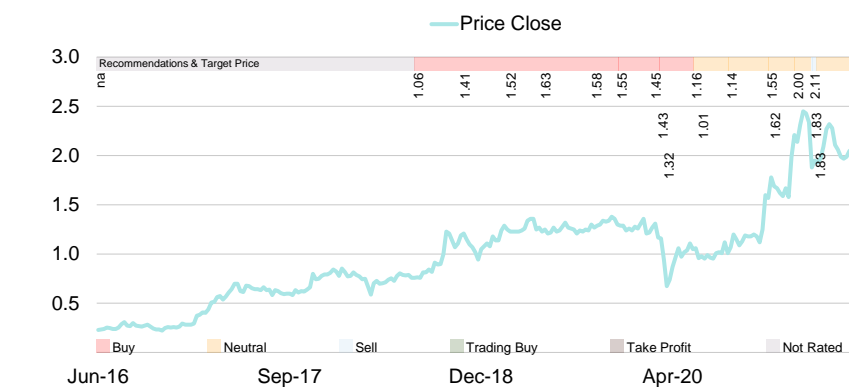
FYE Dec (MYRm)	FY22F	FY23F	FY24F	FY25F	FY26F	FY27F	FY28F	FY29F	FY30F	FY31F
EBIT	41.2	43.7	45.5	45.8	46.4	47.1	47.5	48.2	49.0	49.7
EBIT*(1-tax rate)	32.9	35.0	36.4	36.6	37.2	37.7	38.0	38.6	39.2	39.8
Add: D&A	3.8	3.9	4.0	4.0	4.1	4.1	4.2	4.2	4.3	4.3
Less: WC investments (WC Inv)	-0.7	-0.7	-0.7	-0.6	-0.5	-0.5	-0.4	-0.5	-0.5	-0.6
Less: Fixed investments (FC Inv)	-5	-5	-5	-5	-5	-5	-5	-5	-5.0	-4.3
<b>FCFF</b>	<b>31.06</b>	<b>33.12</b>	<b>34.71</b>	<b>35.05</b>	<b>35.78</b>	<b>36.37</b>	<b>36.77</b>	<b>37.28</b>	<b>37.92</b>	<b>39.24</b>
<b>Disc. FCFF</b>	<b>28.88</b>	<b>28.63</b>	<b>27.90</b>	<b>26.19</b>	<b>24.86</b>	<b>23.50</b>	<b>22.09</b>	<b>20.82</b>	<b>19.69</b>	<b>18.95</b>
Terminal value at T=10	658									
PV of terminal value	318									
NPV	242									
Enterprise Value of Firm	559									
Add Net Cash	91									
Equity Value of Firm	650									
<b>Equity Value per share (MYR)</b>	<b>2.02</b>									
Implied 2022F P/E (x)	21									
Rf	2.9%									
Beta (x)	1.2									
Risk premium	5.51%									
Rm	8.4%									
TG (%)	1.5%									
CoE	9.4%									
CoD	2.4%									
Tax rate	20.0%									
WACC	7.6%									

	WACC				
TG	5.5%	6.5%	7.5%	8.5%	9.5%
0.5%	2.52	2.14	1.87	1.67	1.51
1.0%	2.69	2.25	1.94	1.72	1.54
1.5%	2.89	2.37	2.02	1.77	1.58
2.0%	3.15	2.52	2.12	1.83	1.63
2.5%	3.50	2.71	2.23	1.91	1.68

Source: Company data, RHB

## Recommendation Chart



Source: RHB, Bloomberg

Date	Recommendation	Target Price	Price
2021-03-16	Neutral	1.83	1.95
2021-03-05	Sell	1.83	1.90
2021-03-01	Sell	2.11	2.29
2021-01-20	Neutral	2.00	2.29
2020-11-25	Neutral	1.62	1.76
2020-11-17	Neutral	1.55	1.64
2020-08-13	Neutral	1.14	1.10
2020-06-05	Neutral	1.01	0.98
2020-05-19	Neutral	1.16	1.14
2020-03-13	Buy	1.32	0.97
2020-02-27	Buy	1.43	1.26
2020-02-09	Buy	1.45	1.24
2019-11-20	Buy	1.55	1.35
2019-09-20	Buy	1.58	1.32
2019-08-23	Buy	1.63	1.26

Source: RHB, Bloomberg

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