

23 August 2019

Construction & Engineering | Industrial

## Kelington Group (KGRB MK)

**Buy** (Maintained)

### Steady As She Goes

Target Price (Return)	MYR1.63 (+28%)
Price:	MYR1.27
Market Cap:	USD94m
Avg Daily Turnover (MYR/USD)	0.6m/0.1m

- Stay BUY, MYR1.63 DCF TP** (WACC: 9.6%), 28% upside, with 1.5% yield. 1H19 core earnings broadly met our and consensus estimates. New contracts secured (YTD: MYR227m) remain strong. KGB also declared a first interim dividend of 1 sen/share for FY19. New industrial gas business (IGB) is set to drive a new leg up in earnings from 1Q20, which should lift margins further in FY20F-21F.
- Broadly in line.** 2Q19 core profit came in at MYR4.6m (-8% QoQ, -7% YoY), after excluding the write-back impairment charges totalling MYR0.524m. This brought 1H19 earnings to MYR9.6m (+5% YoY), making up 39% and 38% of our and Street estimates. The latter is consistent with stronger 2H seasonality, with 1H earnings having made up some 42% of full year earnings over the past three FYs.
- 2Q19 revenue a commendable MYR95.1m** (+24% QoQ, +7% YoY). Contribution from process engineering (PE) more than tripled to MYR33.3m YoY in 2Q19 (+60% QoQ, +250% YoY) upon higher project completion in Singapore. The ultra high purity (UHP) segment contributed MYR55.6m to revenue (+26% QoQ, -26% YoY) – the dip was mainly due to lower progress billings recognised from the near-completion of a large UHP project in China. Nevertheless, both segments command similar margins, hence 1H19 PBT margin remained strong at 8%, a notable improvement (FY18: 7.2%).
- Outstanding orderbook of MYR312m.** KGB won MYR81m worth of project orders in 2Q19, bringing YTD new contract wins to MYR227m (1H18: MYR236m) – comprising mainly of UHP and PE projects. Singapore remains a strong feeder for UHP and PE related projects (approx. 60% of outstanding orders), while the remaining projects are split evenly between Malaysia and China. Tender book currently stands at approximately MYR1.2bn.
- Forecasts unchanged.** Our estimates remains intact. We expect a stronger 2H19, premised on seasonality and stronger billings of higher-yielding UHP projects. Our DCF derived TP of MYR1.63 implies a 17x P/E on FY20F EPS. The stock is currently trading at 13.3x FY20F valuation, which in our view remains undemanding, considering the fairly attractive 2-year EPS CAGR of 21% coupled with the strong balance sheet and net cash position of MYR0.23 per share.
- Key risks include** a prolonged US-China trade war, weaker orderbook replenishment, lower margins, and management execution.

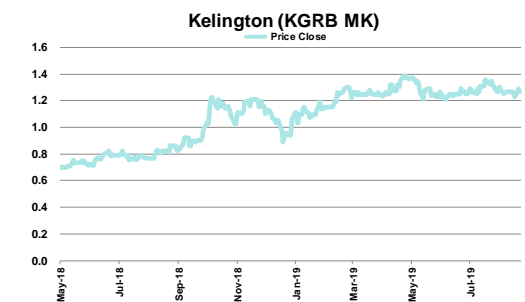
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#### Share Performance (%)

	YTD	1m	3m	6m	12m
Absolute	13.4	(3.8)	2.4	(3.1)	53.9
Relative	18.6	(0.6)	2.5	3.9	64.8
52-wk Price low/high (MYR)	0.83 - 1.41				



Source: Bloomberg

Forecasts and Valuation	Dec-17	Dec-18	Dec-19F	Dec-20F	Dec-21F
Total turnover (MYRm)	313	350	458	540	627
Net profit (MYRm)	15	19	25	29	34
Net profit growth (%)	(26.6)	34.1	26.4	19.3	16.5
Recurring EPS (MYR)	0.05	0.06	0.08	0.10	0.11
Recurring P/E (x)	27.0	20.1	15.9	13.3	11.4
P/B (x)	5.0	3.4	2.5	2.2	1.9
P/CF (x)	16.9	46.7	12.8	12.9	10.9
Dividend Yield (%)	1.3	0.8	1.5	1.9	1.7
EV/EBITDA (x)	18.1	12.0	8.9	7.0	5.8
ROAE (%)	20.0	20.0	18.1	17.7	17.9
Inrrest cover (x)	24.9	29.0	22.1	18.7	21.7

Source: Company data, RHB

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## Financial Exhibits

Asia	Financial summary	Dec-17	Dec-18	Dec-19F	Dec-20F	Dec-21F
Malaysia	Recurring EPS (MYR)	0.05	0.06	0.08	0.10	0.11
Industrial	DPS (MYR)	0.02	0.01	0.02	0.02	0.02
<b>Kelington Group</b>	BVPS (MYR)	0.25	0.38	0.50	0.57	0.66
KGRB MK	ROE (%)	20.03	20.01	18.12	17.66	17.90

Valuation basis	Valuation metrics	Dec-17	Dec-18	Dec-19F	Dec-20F	Dec-21F
We use DCF to value Kelington	Recurring P/E (x)	27.0	20.1	15.9	13.3	11.4
<b>Key drivers</b>	P/B (x)	5.0	3.4	2.5	2.2	1.9
i. Stellar growth of semiconductor industry in China;	FCF Yield (%)	3.8	(0.6)	(2.4)	3.9	5.3
ii. Growing outstanding orderbook.	Dividend yield (%)	1.3	0.8	1.5	1.9	1.7
<b>Key risks</b>	EV/EBITDA (x)	18.1	12.0	8.9	7.0	5.8
i. Potential delay in commencement of LCO2 plant;	EV/EBIT (x)	19.0	12.9	9.6	7.7	6.4
ii. Stronger-than-expected slowdown in semiconductor industry in China.						

Company Profile	Income statement (MYRm)	Dec-17	Dec-18	Dec-19F	Dec-20F	Dec-21F
Kelington is primarily engaged in UHP delivery systems, process engineering and general contracting.	Total turnover	313	350	458	540	627
	Gross profit	50	59	73	87	102
	EBITDA (adj.)	20	28	38	46	54
	Depreciation & amortisation	(1)	(2)	(3)	(5)	(5)
	Operating profit	19	27	35	42	48
	Net interest	(0)	(1)	(1)	(2)	(2)
	Pre-tax profit	17	25	33	40	46
	Taxation	(6)	(7)	(9)	(11)	(12)
	Net profit	12	18	24	29	34
	Recurring net profit	15	19	25	29	34

	Cash flow (MYRm)	Dec-17	Dec-18	Dec-19F	Dec-20F	Dec-21F
	Change in working capital	(2)	(17)	3	(3)	(3)
	Cash flow from operations	23	8	31	30	36
	Capex	(8)	(11)	(40)	(15)	(15)
	Cash flow from investing activities	(13)	(12)	(40)	(15)	(15)
	Dividends paid	(2)	(4)	(3)	(6)	(7)
	Cash flow from financing activities	5	7	43	(6)	(7)
	Cash at beginning of period	34	49	52	85	95
	Net change in cash	15	3	33	9	13
	Ending balance cash	49	52	85	95	108

	Balance sheet (MYRm)	Dec-17	Dec-18	Dec-19F	Dec-20F	Dec-21F
	Total cash and equivalents	62	67	100	110	123
	Tangible fixed assets	16	25	62	72	82
	Total investments	-	-	-	-	-
	Total assets	230	243	333	371	413
	Short-term debt	28	16	16	16	16
	Total long-term debt	2	2	27	27	27
	Total liabilities	151	127	178	195	210
	Total equity	78	116	155	176	204
	Total liabilities & equity	230	243	333	371	413

	Key metrics	Dec-17	Dec-18	Dec-19F	Dec-20F	Dec-21F
	Revenue growth (%)	(8.7)	11.7	30.7	18.0	16.2
	Recurrent EPS growth (%)	(26.6)	34.1	26.4	19.3	16.5
	Gross margin (%)	15.9	16.8	16.0	16.2	16.2
	Operating EBITDA margin (%)	6.3	8.1	8.2	8.6	8.6
	Net profit margin (%)	4.6	5.6	5.4	5.4	5.4
	Capex/sales (%)	2.7	3.0	8.7	2.8	2.4
	Interest cover (x)	24.9	29.0	22.1	18.7	21.7

Source: Company data, RHB

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## Results At a Glance

Figure 1: KGB's 1H19 results

FYE Dec (MYRm)	2Q18	1Q19	2Q19	QoQ (%)	YoY (%)	1H18	1H19	YoY (%)	Comments
<b>Revenue</b>	89.2	76.4	95.1	24%	7%	175.8	171.5	-2%	Stronger QoQ premised on larger contribution from process engineering business.
<b>EBIT</b>	5.5	6.8	7.4	8%	34%	12.3	14.3	16%	
<i>EBIT margin (%)</i>	6%	9%	8%			7%	8%		
Other income	0.2	0.5	0.9	83%	383%	0.8	1.5	81%	Improvements in margins due to favourable project billing mix.
Finance Costs	(0.3)	(0.3)	(0.3)	27%	12%	(0.6)	(0.6)	-1%	
<b>Pretax profit</b>	5.2	6.5	7.2	10%	37%	11.7	13.7	17%	
<i>Pretax margin (%)</i>	5.9%	8.5%	7.5%			7%	8%		
Tax	(0.9)	(1.7)	(2.1)	-24%	-140%	(3.1)	(3.9)	-24%	
Effective tax rate (%)	17%	27%	30%			27%	28%		
Minority interest	(0.1)	(0.1)	(0.1)	-31%	-37%	(0.1)	(0.2)		
<b>Net Profit</b>	4.4	4.8	5.1	5%	16%	8.6	9.9	15%	Broadly in line.
<b>Core Profit</b>	4.9	5.0	4.6	-8%	-7%	9.1	9.6	5%	
<i>Core net margin (%)</i>	6%	7%	5%			5%	6%		

Source: RHB

Figure 1: Revenue by geography

FYE Dec (MYRm)	2Q18	1Q19	2Q19	QoQ (%)	YoY (%)	1H18	1H19	YoY (%)
Malaysia	19.9	21.5	24.2	12%	22%	42.6	45.7	7%
China	39.7	22.1	29.4	33%	-26%	86.4	51.4	-41%
Taiwan	2.8	1.5	3.2	111%	13%	6.0	4.7	-22%
Singapore	26.2	31.1	37.9	22%	45%	39.8	68.9	73%
Indonesia	0.7	0.3	0.5	85%	-31%	0.9	0.7	-24%
<b>Total Revenue</b>	<b>89.2</b>	<b>76.4</b>	<b>95.1</b>	<b>24%</b>	<b>7%</b>	<b>175.8</b>	<b>171.5</b>	<b>-2%</b>

Source: RHB

Figure 3: Segmental revenue

FYE Dec (MYRm)	2Q18	1Q19	2Q19	QoQ (%)	YoY (%)	1H18	1H19	YoY (%)
Ultra High Purity	75.0	44.0	55.6	26%	-26%	138.4	99.6	-28%
Process Engineering	9.5	20.8	33.3	60%	250%	24.1	54.0	125%
General Contracting	3.7	10.3	5.0	-51%	36%	11.7	15.3	31%
Industrial Gases	1.0	1.3	1.2	-4%	27%	1.6	2.5	56%
<b>Total Revenue</b>	<b>89.2</b>	<b>76.4</b>	<b>95.1</b>	<b>24%</b>	<b>7%</b>	<b>175.8</b>	<b>171.5</b>	<b>-2%</b>

Source: RHB

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