

25 November 2020

Construction & Engineering | Industrial

Kelington Group (KGRB MK)

Neutral (Maintained)

A Strong Comeback

Target Price (Return): MYR1.62 (-4.7%)
 Price: MYR1.70
 Market Cap: USD134m
 Avg Daily Turnover (MYR/USD): 3.54m/0.86m

- **Stay NEUTRAL with higher DCF-derived MYR1.62 TP from MYR1.55, 5% downside and c.1% yield.** Kelington Group's 9MFY20 earnings surprised on the upside, on better-than-expected margins. While we remain positive on earnings prospects going into FY21, the sharp 41% rally in its share price over the past month has possibly priced-in the earnings surprise and positive news flow. Our latest TP implies 21x FY21F P/E (+1.55 SD from its 5-year mean).
- **Strong 3Q rebound as expected.** 3Q20 core earnings leapt more than 10-folds QoQ to MYR7m (+65% YoY), against a +27% QoQ (+1% YoY) surge in revenue. This was off the June quarter's low base, which saw projects halted due to movement restrictions in Singapore and Malaysia. 9M20 core earnings were ahead of expectations, at 88% and 158% of our and market estimates. We excluded the MYR2.4m impairment of trade receivables in deriving our core NPAT for the quarter (9MFY20: MYR11.5m).
- **3Q adjusted EBITDA margin widened 5.1ppts YoY to 11.5%.** We understand the margin expansion came from improved billings for several on-going projects, which are at the tail-end, coupled with some variation orders. It is also supported by the turnaround of its Taiwan operations and scale benefits from on-going projects in China.
- **MYR142m new orders in 3Q20.** In addition to the MYR62m contract from Semiconductor Manufacturing International Corp in August, KGB secured an additional MYR80m of projects in 3Q, which consists of an even split of smallish contracts from Singapore and Malaysia. YTD new orders totalled MYR372m with c.42% from China, 32% from Malaysia and 20% from Singapore, based on our count. Of the outstanding orderbook of MYR370m, 71% are Ultra High Purity (UHP) related jobs.
- **Industrial gas business scaling up rapidly.** Its revenue more than doubled sequentially to a quarterly record, on stronger utilisation of its liquid carbon dioxide (LCO₂) plant, following the resumption of economic activities. We expect the segment to remain a key growth driver, with potential new contracts clinched within the food and beverage sector.
- **FY20F-FY22F earnings lifted 31%/6%/6%.** We tweak our FY20F new order wins assumption slightly, imputed higher project margins, and lower administrative costs based on the latest numbers. Key risks: Weaker-than-expected orders/earnings/margins, resumption of movement restrictions, and management execution. Upside risks: Stronger contract replenishment, faster-than-expected LCO₂ demand recovery, and subsiding COVID-19 risks.

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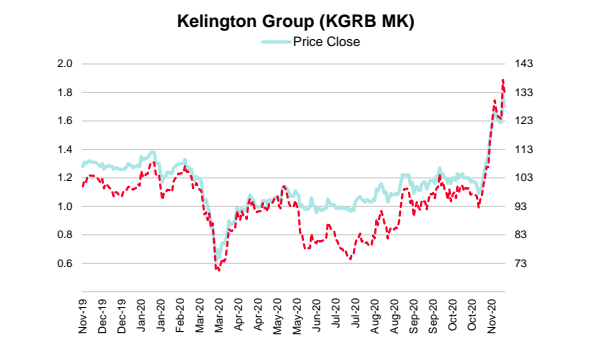


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Share Performance (%)

	YTD	1m	3m	6m	12m
Absolute	34.9	41.7	57.4	58.9	28.8
Relative	35.6	36.1	56.8	49.0	30.0
52-wk Price low/high (MYR)				0.62	1.77



Source: Bloomberg

Forecasts and Valuation	Dec-18	Dec-19	Dec-20F	Dec-21F	Dec-22F
Total turnover (MYRm)	350	380	390	455	474
Recurring net profit (MYRm)	19	24	17	24	26
Recurring net profit growth (%)	34.1	21.2	(28.2)	39.7	11.5
Recurring P/E (x)	27.12	22.38	31.16	22.31	20.02
P/B (x)	4.5	3.4	3.1	2.8	2.6
P/CF (x)	62.97	26.76	14.63	25.99	19.15
Dividend Yield (%)	0.6	1.1	0.8	1.1	1.2
EV/EBITDA (x)	16.69	13.07	16.71	12.28	10.76
Return on average equity (%)	19.2	18.0	10.5	13.4	13.5
Net debt to equity (%)	net cash	net cash	net cash	net cash	net cash

Source: Company data, RHB

Note:

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

Financial Exhibits

Asia	Financial summary (MYR)	Dec-18	Dec-19	Dec-20F	Dec-21F	Dec-22F
Malaysia	Recurring EPS	0.06	0.08	0.05	0.08	0.08
Construction & Engineering	DPS	0.01	0.02	0.01	0.02	0.02
Kelington Group	BV/PS	0.37	0.50	0.54	0.60	0.66
KGRB MK	Return on average equity (%)	19.2	18.0	10.5	13.4	13.5
Neutral						
	Valuation metrics	Dec-18	Dec-19	Dec-20F	Dec-21F	Dec-22F
	Recurring P/E (x)	27.12	22.38	31.16	22.31	20.02
	P/B (x)	4.5	3.4	3.1	2.8	2.6
	FCF Yield (%)	(0.4)	(2.6)	5.9	2.0	3.3
	Dividend Yield (%)	0.6	1.1	0.8	1.1	1.2
	EV/EBITDA (x)	16.69	13.07	16.71	12.28	10.76
	EV/EBIT (x)	18.01	14.09	19.00	13.61	11.92
	Income statement (MYRm)	Dec-18	Dec-19	Dec-20F	Dec-21F	Dec-22F
	Total turnover	350	380	390	455	474
	Gross profit	59	64	58	70	76
	EBITDA	29	37	27	36	40
	Depreciation and amortisation	(2)	(3)	(3)	(3)	(4)
	Operating profit	27	34	23	32	36
	Net interest	(1)	(1)	(2)	(2)	(2)
	Pre-tax profit	25	32	22	30	34
	Taxation	(7)	(8)	(5)	(7)	(8)
	Reported net profit	19	24	17	24	26
	Recurring net profit	19	24	17	24	26
	Cash flow (MYRm)	Dec-18	Dec-19	Dec-20F	Dec-21F	Dec-22F
	Change in working capital	(16.7)	(8.5)	16.4	(6.3)	(2.2)
	Cash flow from operations	8.4	19.7	36.1	20.3	27.5
	Capex	(10.6)	(33.5)	(5.0)	(10.0)	(10.0)
	Cash flow from investing activities	(12.1)	(35.2)	(5.6)	(10.0)	(10.0)
	Dividends paid	(3.7)	(8.1)	0.0	(4.2)	(5.9)
	Cash flow from financing activities	8.5	34.5	0.0	(4.2)	(5.9)
	Cash at beginning of period	62.2	67.1	85.1	116.1	122.2
	Net change in cash	4.8	18.9	30.5	6.1	11.6
	Ending balance cash	67.1	85.3	115.5	122.2	133.8
	Balance sheet (MYRm)	Dec-18	Dec-19	Dec-20F	Dec-21F	Dec-22F
	Total cash and equivalents	67	85	116	122	134
	Tangible fixed assets	25	53	55	61	67
	Total assets	243	303	338	367	389
	Short-term debt	16	12	12	12	12
	Total long-term debt	2	23	23	23	23
	Total liabilities	127	148	171	182	185
	Total equity	116	156	168	185	204
	Total liabilities & equity	243	303	338	367	389
	Key metrics	Dec-18	Dec-19	Dec-20F	Dec-21F	Dec-22F
	Revenue growth (%)	11.7	8.5	2.6	16.7	4.3
	Recurrent EPS growth (%)	34.1	21.2	(28.2)	39.7	11.5
	Gross margin (%)	16.7	16.7	14.8	15.5	15.9
	Operating EBITDA margin (%)	8.2	9.6	6.9	7.9	8.4
	Net profit margin (%)	5.3	6.4	4.3	5.2	5.6
	Dividend payout ratio (%)	14.2	22.9	25.0	25.0	25.0
	Capex/sales (%)	3.0	8.8	1.3	2.2	2.1
	Interest cover (x)	29.0	25.9	12.5	17.2	19.1

Source: Company data, RHB

Figure 1: KGB's 9M20 results

FYE Dec (MYRm)	3Q19	2Q20	3Q20	QoQ (%)	YoY (%)	9M19	9M20	YoY (%)	Comments
Revenue	97.0	77.3	98.3	27%	1%	268.5	260.3	-3%	Gradual reopening of the economy
Adj. EBITDA	6.2	3.0	11.3	275%	82%	21.1	20.6	-2%	
Adj. EBITDA margin (%)	6.4%	4%	11.5%			7.9%	7.9%		Supported by recognition of profits upon finalisation of accounts and VOs.
Other income	3.2	3.2	1.8	-45%	-44%	4.6	5.5	19%	
Finance costs	(0.4)	(0.6)	(0.7)	-25%	-89%	(1.0)	(2.0)	-103%	
Pretax profit	7.5	1.2	7.2	498%	-5%	21.2	13.3	-37%	
Pretax margin (%)	7.8%	1.5%	7.3%			8%	5%		
Tax	(1.3)	(0.6)	(2.2)	-292%	-65%	(5.2)	(3.6)	30%	
Effective tax rate (%)	18%	47%	31%			25%	27%		
Minority interest	(0.0)	0.0	0.1	318%	248%	(0.2)	0.1		
Net profit	6.3	0.6	4.9	687%	-22%	16.2	9.6	-41%	
Core profit	4.3	0.6	7.0	1007%	65%	13.8	11.5	-17%	Beat expectations
Core net margin (%)	4%	1%	7%			5%	4%		

Source: RHB

Figure 2: Revenue by geography

FYE Dec (MYRm)	3Q19	2Q20	3Q20	QoQ (%)	YoY (%)	9M19	9M20	YoY (%)
Malaysia	20.7	18.7	31.5	69%	52%	66.4	70.2	6%
China	25.3	32.1	35.0	9%	38%	76.7	80.0	4%
Taiwan	2.1	4.5	5.4	19%	153%	6.8	11.1	63%
Singapore	48.0	21.1	24.1	14%	-50%	117.0	94.9	-19%
Indonesia	0.3	0.3	0.1	-82%	-79%	1.0	0.4	-61%
Total Revenue	97.0	77.3	98.3	27%	1%	268.5	260.3	-3%

Source: RHB

Figure 3: Segmental revenue

FYE Dec (MYRm)	3Q19	2Q20	3Q20	QoQ (%)	YoY (%)	9M19	9M20	YoY (%)
Ultra High Purity Process	73.1	62.7	70.1	12%	-4%	172.7	196.3	14%
General Contracting	17.0	6.2	9.3	51%	-45%	75.7	26.6	-65%
Industrial Gases	5.5	5.3	11.6	119%	110%	16.2	22.1	36%
Industrial Gases	1.4	3.1	7.2	134%	432%	3.9	15.3	294%
Total Revenue	97.0	77.3	98.3	27%	1%	268.5	260.3	-3%

Source: RHB

Figure 4: Kelington's corroborative DCF valuation

FYE Dec (MYRm)	FY21F	FY22F	FY23F	FY24F	FY25F	FY26F	FY27F	FY28F	FY29F	FY30F
EBIT	32.3	35.9	37.9	39.5	41.4	42.3	43.3	43.8	44.8	45.9
EBIT*(1-tax rate)	24.6	27.3	28.8	30.0	31.5	32.2	32.9	33.3	34.1	34.9
Add: D&A	3.5	3.9	4.2	4.6	4.9	5.2	5.5	5.7	6.0	6.1
Less: WC investments (WC Inv)	-6.3	-2.2	-1.7	-1.6	-1.3	-1.3	-1.3	-1.1	-1.4	-1.5
Less: Fixed investments (FC Inv)	-10	-10	-10	-10	-10	-10	-10	-10	-10	-6.1
FCFF	11.72	18.96	21.26	22.97	25.09	26.05	27.01	27.88	28.62	33.41
Disc. FCFF	10.69	15.77	16.12	15.88	15.82	14.98	14.16	13.33	12.48	13.28
Terminal value at T=10	563									
PV of terminal value	272									
NPV	143									
Enterprise Value of Firm	415									
Add Net Cash	87									
Equity Value of Firm	502									
Equity Value per share (MYR)	1.62			TG	5.5%	6.5%	7.5%	8.5%	9.5%	
Implied CY21F P/E (x)	21			0.5%	2.00	1.69	1.48	1.33	1.22	
				1.0%	2.14	1.79	1.55	1.38	1.25	
Rf	2.9%			1.5%	2.33	1.90	1.62	1.43	1.29	
Beta (x)	1.2			2.0%	2.56	2.03	1.70	1.48	1.33	
Risk premium	5.51%			2.5%	2.87	2.20	1.80	1.55	1.37	
Rm	8.4%									
TG (%)	1.5%									
CoE	9.4%									
CoD	2.4%									
Tax rate	24.0%									
WACC	7.5%									

Source: Company data, RHB

Recommendation Chart



Source: RHB, Bloomberg

Date	Recommendation	Target Price	Price
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
2019-05-21	Buy	1.63	1.24
2019-02-27	Buy	1.52	1.24
2018-11-23	Buy	1.41	1.17

Source: RHB, Bloomberg

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Analyst	Company
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