

27 May 2021

Construction & Engineering | Industrial

## Kelington Group (KGRB MK)

**Neutral** (Maintained)

### Recovery On Track, Malaysia Contribution Doubled

- Maintain NEUTRAL and MYR1.83 TP, 9% downside with 1% yield.** 1Q21 core earnings were broadly in line with expectations. Outstanding orders amount is higher at MYR364m with MYR105m clinched in the quarter. We retain our recommendation at this juncture, as we consider FY21F earnings growth of 18% is largely priced in following the 19% share price re-rating YTD. The next round of bidding for Semiconductor International Corp's hook-up jobs could present an upside risk.
- Broadly in line.** Kelington Group's 1Q21 revenue improved 24% YoY (-19% QoQ), with core earnings of MYR5.7m (+51% YoY, -44% QoQ). This is at 22.4% and 20.5% of our and Street's estimates, which we deem broadly in line with expectations, as 1Q is seasonally weaker due to shorter working days. In deriving our core earnings, we excluded the loss on disposal of equipment of MYR0.2m.
- Results review.** YoY increase in revenue was largely supported by higher billings of general contracting jobs, as well as elevated industrial gases contribution. Its largest revenue contributor was still ultra-high purity projects (UHP), which now contribute 66% (1Q20: 75%) to revenue, albeit a 9% YoY growth. Geographical wise, contributions from Malaysia increased more than twofold in 1Q21. EBITDA margin for the quarter improved to 8.2% by 0.8ppts (flat QoQ).
- KGB secured MYR105m new orders in the quarter,** or at 24% of our FY21 replenishment assumption, which boosted outstanding orders to MYR364m. Aside from the MYR59m clinched in March, we believe the additional contracts secured are from Singapore and Malaysia. Its outstanding order book comprises mainly of UHP projects (79%), which we believe are mostly from China. Tenderbook is at c.MYR900m, which we believe is an even split between China, Malaysia, and Singapore. Historically, it has a 30-40% success rate.
- We make no changes to our forecasts.** Our TP implies 21x FY21F P/E, or +1.3SD from its 5-year mean – a discount to the current technology sector's (KLTEC) P/E of 31x – given the contractual nature of its business. We see near-term earnings being supported by the global chip shortages, which has accelerated capacity expansion activities for semiconductor foundries, ie KGB's principal source of UHP customers.
- Risks.** Weaker-than-expected orders/earnings/margins, resumption of movement restrictions, and management execution. Upside risks: Stronger contract replenishment, faster-than-expected liquid carbon dioxide (LCO2) demand recovery, and subsiding COVID-19 risks.

Target Price (Return):	MYR1.83 (-9.0%)
Price:	MYR2.01
Market Cap:	USD156m
Avg Daily Turnover (MYR/USD)	4.71m/1.15m

#### Analysts

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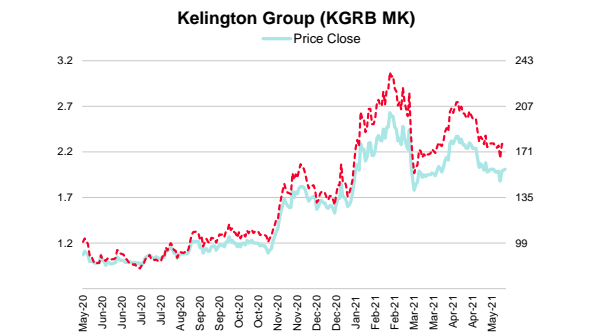


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#### Share Performance (%)

	YTD	1m	3m	6m	12m
Absolute	18.9	(12.6)	(19.0)	14.2	87.9
Relative	21.9	(10.7)	(18.8)	15.4	78.1
52-wk Price low/high (MYR)	0.96 – 2.63				



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 capitalisation of less than USD1bn.

Forecasts and Valuation	Dec-19	Dec-20	Dec-21F	Dec-22F	Dec-23F
Total turnover (MYRm)	380	390	490	490	501
Recurring net profit (MYRm)	23	22	26	27	29
Recurring net profit growth (%)	20.3	(7.3)	18.2	6.3	6.9
Recurring P/E (x)	26.66	28.77	24.34	22.88	21.40
P/B (x)	4.0	3.7	3.4	3.0	2.7
P/CF (x)	31.64	14.80	na	20.29	19.56
Dividend Yield (%)	0.9	0.7	1.0	1.1	1.2
EV/EBITDA (x)	15.52	19.66	13.81	12.67	11.68
Return on average equity (%)	18.0	10.6	14.5	14.0	13.5
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	0.08	0.07	0.08	0.09	0.09
Construction & Engineering	DPS	0.02	0.01	0.02	0.02	0.02
<b>Kelington Group</b>	BVPS	0.50	0.54	0.60	0.66	0.73
KGRB MK	Return on average equity (%)	18.0	10.6	14.5	14.0	13.5
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)	26.66	28.77	24.34	22.88	21.40
	P/B (x)	4.0	3.7	3.4	3.0	2.7
	DCF methodology (WACC: 7.5%, TG: 1.5%)	(2.2)	5.5	(1.6)	4.1	4.3
	FCF Yield (%)	0.9	0.7	1.0	1.1	1.2
	Dividend Yield (%)	15.52	19.66	13.81	12.67	11.68
	EV/EBITDA (x)	16.92	24.14	15.17	13.87	12.76
	EV/EBIT (x)					
	<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	390	490	490	501
	Gross profit	64	54	76	78	81
	EBITDA	37	28	40	43	45
	Depreciation and amortisation	(3)	(5)	(4)	(4)	(4)
	Operating profit	34	23	37	39	41
	Net interest	(1)	(3)	(3)	(3)	(2)
	Pre-tax profit	32	20	34	36	38
	Taxation	(8)	(3)	(8)	(9)	(9)
	Reported net profit	24	17	26	27	29
	Recurring net profit	23	22	26	27	29
	<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)	18.4	(34.3)	(0.3)	(1.1)
	Cash flow from operations	19.7	42.1	(5.0)	30.7	31.9
	Capex	(33.5)	(7.7)	(5.0)	(5.0)	(5.0)
	Cash flow from investing activities	(35.2)	(7.9)	(7.0)	(5.0)	(5.0)
	Dividends paid	(8.1)	(4.8)	0.0	(6.4)	(6.8)
	Cash flow from financing activities	33.9	13.2	0.0	(6.4)	(31.8)
	Cash at beginning of period	67.1	85.1	132.0	120.0	139.3
	Net change in cash	18.4	47.5	(12.0)	19.3	(4.9)
	Ending balance cash	84.8	132.0	120.0	139.3	134.4
	<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	120	139	134
	Tangible fixed assets	53	60	61	62	64
	Total assets	303	351	380	401	400
	Short-term debt	12	25	25	25	25
	Total long-term debt	23	30	30	30	5
	Total liabilities	148	183	195	195	172
	Total equity	156	168	185	206	228
	Total liabilities & equity	303	351	380	401	400
	<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	2.6	25.7	0.0	2.2
	Recurrent EPS growth (%)	20.3	(7.3)	18.2	6.3	6.9
	Gross margin (%)	16.7	13.9	15.5	15.9	16.1
	Operating EBITDA margin (%)	9.7	7.1	8.3	8.7	8.9
	Net profit margin (%)	6.4	4.4	5.2	5.6	5.8
	Dividend payout ratio (%)	22.9	25.0	25.0	25.0	25.0
	Capex/sales (%)	8.8	2.0	1.0	1.0	1.0
	Interest cover (x)	25.9	8.7	12.2	13.3	18.0

Source: Company data, RHB

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## Results At a Glance

Figure 1: KGB's FY20 results

FYE Dec (MYRm)	1Q20	4Q20	1Q21	QoQ (%)	YoY (%)	1Q20	1Q21	YoY (%)	Comments
<b>Revenue</b>	84.7	129.5	104.8	-19%	24%	84.7	104.8	24%	Higher billings of general contracting jobs and industrial gases contributions.
<b>Adj. EBITDA</b>	6.2	10.6	8.6	-19%	38%	6.2	8.6	38%	
<i>Adj. EBITDA margin (%)</i>	7.4%	8.2%	8.2%			7.4%	8.2%		
Other income	0.5	2.0	1.6	-16%	232%	0.5	1.6	232%	
Finance costs	(0.7)	(0.7)	(0.8)	-15%	-8%	(0.7)	(0.8)	-8%	
<b>Pre-tax profit</b>	4.9	6.8	6.7	-1%	37%	4.9	6.7	37%	
<i>Pre-tax margin (%)</i>	5.8%	5.2%	6.4%			6%	6%		
Tax	(0.9)	0.8	(1.0)	-232%	-17%	(0.9)	(1.0)	-17%	
Effective tax rate (%)	18%	-11%	15%			18%	15%		
Minority interest	(0.0)	0.1	0.2	217%	616%	(0.0)	0.2		
<b>Net profit</b>	4.1	7.5	5.5	-26%	37%	4.1	5.5	37%	
<b>Core profit</b>	3.8	10.2	5.7	-44%	51%	3.8	5.7	51%	Broadly in line with expectations.
<i>Core net margin (%)</i>	4%	8%	5%			4.5%	5.5%		

Source: RHB

Figure 2: Revenue by geography

FYE Dec (MYRm)	1Q20	4Q20	1Q21	QoQ (%)	YoY (%)	1Q20	1Q21	YoY (%)
Malaysia	20.0	48.0	43.9	-9%	120%	20.0	43.9	120%
China	12.9	44.7	19.0	-57%	47%	12.9	19.0	47%
Taiwan	1.2	3.7	3.1	-16%	149%	1.2	3.1	149%
Singapore	49.8	32.5	38.7	19%	-22%	49.8	38.7	-22%
Indonesia	0.0	0.3	0.0	-100%	-100%	0.0	0.0	-100%
<b>Total Revenue</b>	<b>84.7</b>	<b>129.5</b>	<b>104.8</b>	<b>-19%</b>	<b>24%</b>	<b>84.7</b>	<b>104.8</b>	<b>24%</b>

Source: RHB

Figure 3: Segmental revenue

FYE Dec (MYRm)	1Q20	4Q20	1Q21	QoQ (%)	YoY (%)	1Q20	1Q21	YoY (%)
UHP	63.5	81.8	68.9	-16%	9%	63.5	68.9	9%
Process engineering	11.1	18.5	10.5	-43%	-5%	11.1	10.5	-5%
General contracting	5.2	22.3	16.5	-26%	216%	5.2	16.5	216%
Industrial gases	5.0	6.9	8.8	28%	77%	5.0	8.8	77%
<b>Total Revenue</b>	<b>84.7</b>	<b>129.5</b>	<b>104.8</b>	<b>-19%</b>	<b>24%</b>	<b>84.7</b>	<b>104.8</b>	<b>24%</b>

Figure 4: KGB's corroborative DCF valuation

FYE Dec (MYRm)	FY22F	FY23F	FY24F	FY25F	FY26F	FY27F	FY28F	FY29F	FY30F	FY31F
EBIT	38.9	40.7	42.5	42.1	43.3	44.5	45.3	46.5	47.9	49.3
EBIT*(1-tax rate)	29.6	31.0	32.3	32.0	32.9	33.8	34.4	35.4	36.4	37.4
Add: D&A	3.7	3.8	3.8	3.9	4.0	4.0	4.1	4.1	4.2	4.2
Less: WC investments (WC Inv)	-0.3	-1.1	-1.4	-1.2	-1.3	-1.3	-1.2	-1.4	-1.5	-1.5
Less: Fixed investments (FC Inv)	-5	-5	-5	-5	-5	-5	-5	-5	-5.0	-4.2
<b>FCFF</b>	<b>27.96</b>	<b>28.60</b>	<b>29.76</b>	<b>29.79</b>	<b>30.60</b>	<b>31.49</b>	<b>32.34</b>	<b>33.09</b>	<b>34.11</b>	<b>35.92</b>
<b>Disc. FCFF</b>	<b>25.50</b>	<b>23.78</b>	<b>22.57</b>	<b>20.60</b>	<b>19.29</b>	<b>18.11</b>	<b>16.96</b>	<b>15.82</b>	<b>14.87</b>	<b>14.28</b>
Terminal value at T=10	604									
PV of terminal value	292									
NPV	192									
Enterprise Value of Firm	484									
Add Net Cash	84									
Equity Value of Firm	568									
<b>Equity Value per share (MYR)</b>	<b>1.83</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	24.0%									
WACC	7.5%									

	WACC				
TG	5.5%	6.5%	7.5%	8.5%	9.5%
0.5%	2.24	1.91	1.69	1.53	1.41
1.0%	2.39	2.01	1.75	1.57	1.44
1.5%	2.59	2.13	1.83	1.62	1.48
2.0%	2.84	2.27	1.92	1.68	1.52
2.5%	3.17	2.45	2.03	1.76	1.57

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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