

25 May 2022

Construction & Engineering | Industrial

Kelington Group (KGRB MK)

Buy (Maintained)

1Q22: A Decent Start; Maintain BUY

Target Price (Return): MYR1.50 (32.7%)
 Price (Market Cap): MYR1.13 (USD165m)
 ESG score: 3.00 (out of 4)
 Avg Daily Turnover (MYR/USD) 2.11m/0.50m

- **BUY, new MYR1.50 TP from MYR1.70, 33% upside with c.1% yield.** Kelington Group's 1Q22 earnings were in line. We expect billing momentum to pick up, with manageable impact seen from the China lockdown. FY22F is set to be another record year for the group, backed by an outstanding orderbook of >MYR1.2bn. Key risks: Weaker-than-expected earnings, delays in project execution, and lower-than-expected orderbook replenishment. Our TP builds in a parity ESG score, in line with the country median.
- **Broadly in line.** 1Q22 core earnings came in at MYR8.3m (+46% YoY, -23% QoQ) against a 65% YoY jump in revenue (-4% QoQ). At 19-20% of our and consensus' estimates, core earnings exude the typical seasonality associated with 1Q. Our forecasts are maintained.
- **Strong growth across all markets.** Revenue from the ultra-high purity (UHP) segment (65% of group revenue) surged 62% YoY from the increase in investment activities by semiconductor outfits. General contracting revenue jumped 136% YoY on stronger progress billings from the MYR420m project secured in Sarawak in 3Q21. Geography-wise, contribution from Malaysia rose 77% YoY, while revenue from China and Singapore jumped 42% and 61% YoY. Despite the Shanghai lockdown, management said the impact on project execution has been minimal, with workers working on site, and sufficient materials and stocks in place.
- **Industrial gas business gaining traction.** Revenue grew 12% YoY (-7% QoQ) in tandem with higher utilisation of the LCO₂ plant, from the re-opening of economic sectors. We believe the plant is on track to achieve the 80% utilisation target by year-end. We note additional upside for the industrial gas segment from a new 10-year on-site gas supply job secured with an opto-electronics customer (valued at MYR180m) which should commence in 1Q23.
- **Outstanding orderbook of MYR1.24bn** should keep the group busy over the next 12-18 months. KGB has secured MYR427m new orders YTD with the most recent win being the hook up job for China's largest foundry, valued at MYR80m. Of the outstanding orderbook, the higher margin UHP projects account for 64%, followed by general contracting (32%), and process engineering (4%).
- **TP lowered.** We roll over our valuation to FY23F and ascribe a lower target P/E of 28x (from 32x) to reflect the tech sector's more cautious sentiment. We deem the valuation as fair, at +1SD of its historical P/E mean, considering the still-commendable industry prospects. Our FY22-24F core earnings are adjusted by -0.1% to 6.3%, mainly to account for some revenue recognition delays.

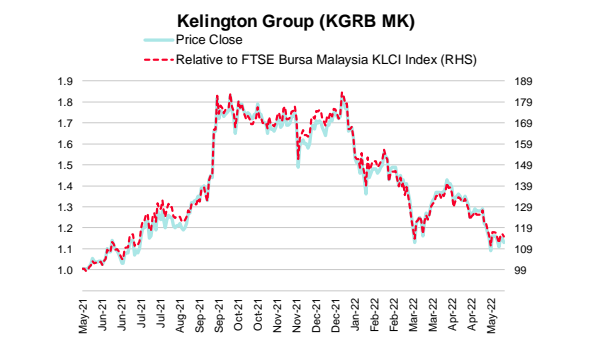
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Share Performance (%)

	YTD	1m	3m	6m	12m
Absolute	(34.3)	(13.8)	(19.3)	(35.4)	13.0
Relative	(32.0)	(9.4)	(16.6)	(36.0)	15.6
52-wk Price low/high (MYR)	1.01 – 1.83				



Source: Bloomberg

Forecasts and Valuation	Dec-20	Dec-21	Dec-22F	Dec-23F	Dec-24F
Total turnover (MYRm)	395	515	788	788	754
Recurring net profit (MYRm)	15	29	44	46	46
Recurring net profit growth (%)	(34.3)	89.7	52.6	3.3	(0.6)
Recurring P/E (x)	63.20	33.32	21.83	21.13	21.25
P/B (x)	5.8	5.1	4.4	3.8	3.3
P/CF (x)	21.23	na	19.41	19.29	19.51
Dividend Yield (%)	1.3	0.7	1.1	1.2	1.2
EV/EBITDA (x)	26.69	19.08	14.03	13.38	13.13
Return on average equity (%)	10.8	16.1	21.5	19.1	16.5
Net debt to equity (%)	net cash	net cash	net cash	net cash	net cash

Source: Company data, RHB

Overall ESG Score: 3.00 (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 the usage of materials to reduce waste. There is however a lack of environmental statistics on 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: GOOD

KGB's Chairman is also Group CEO. The board does not utilise independent sources to identify the appointment of directors, which could limit operational checks and balances. A third party investor relations unit facilitates the communication with the investment community with periodic meetings convened

Note:

Small cap stocks are defined as companies with a market capitalisation of less than USD0.5bn.

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Financial Exhibits

Asia	Financial summary (MYR)	Dec-20	Dec-21	Dec-22F	Dec-23F	Dec-24F
Malaysia	Recurring EPS	0.02	0.03	0.05	0.05	0.05
Construction & Engineering	DPS	0.02	0.01	0.01	0.01	0.01
Kelington Group	BVPS	0.20	0.22	0.26	0.30	0.34
KGRB MK	Return on average equity (%)	10.8	16.1	21.5	19.1	16.5
Buy						
	Valuation metrics	Dec-20	Dec-21	Dec-22F	Dec-23F	Dec-24F
Valuation basis	Recurring P/E (x)	63.20	33.32	21.83	21.13	21.25
28x PE on FY23F	P/B (x)	5.8	5.1	4.4	3.8	3.3
	FCF Yield (%)	3.6	(1.4)	4.6	4.7	4.6
	Dividend Yield (%)	1.3	0.7	1.1	1.2	1.2
	EV/EBITDA (x)	26.69	19.08	14.03	13.38	13.13
	EV/EBIT (x)	31.52	21.64	14.93	14.24	14.02
Key drivers						
i. Tight inventory situation in the semiconductor industry;						
ii. New contract wins;						
iii. Stronger contributions from the industrial gas business.						
Key risks						
i. Sector valuation de-rating;						
ii. Weaker-than-expected earnings/margins;						
iii. Slower than expected orderbook replenishment.						
Company Profile						
Kelington is involved in ultra-high purity (UHP) delivery systems, process engineering and general contracting. The company commenced maiden production of Liquid Carbon Dioxide (LCO2) in 4Q19						
	Income statement (MYRm)	Dec-20	Dec-21	Dec-22F	Dec-23F	Dec-24F
	Total turnover	395	515	788	788	754
	Gross profit	59	85	128	129	124
	EBITDA	34	48	62	63	62
	Depreciation and amortisation	(5)	(6)	(4)	(4)	(4)
	Operating profit	28	42	59	59	58
	Net interest	(2)	(3)	(2)	(1)	(0)
	Pre-tax profit	21	36	57	58	58
	Taxation	(3)	(6)	(11)	(12)	(12)
	Reported net profit	17	29	44	46	45
	Recurring net profit	15	29	44	46	46
	Cash flow (MYRm)	Dec-20	Dec-21	Dec-22F	Dec-23F	Dec-24F
	Change in working capital	18	(45)	1	(0)	(0)
	Cash flow from operations	46	(4)	50	50	50
	Capex	(11)	(10)	(5)	(5)	(5)
	Cash flow from investing activities	(10)	(17)	(5)	(5)	(5)
	Dividends paid	(5)	(6)	0	(11)	(11)
	Cash flow from financing activities	12	(10)	(25)	(36)	(11)
	Cash at beginning of period	85	132	106	125	134
	Net change in cash	47	(30)	20	9	33
	Ending balance cash	133	104	127	134	167
	Balance sheet (MYRm)	Dec-20	Dec-21	Dec-22F	Dec-23F	Dec-24F
	Total cash and equivalents	132	106	125	134	168
	Tangible fixed assets	60	64	66	67	68
	Total assets	350	404	473	483	512
	Short-term debt	28	29	4	4	4
	Total long-term debt	27	23	23	(2)	(2)
	Total liabilities	182	211	248	223	217
	Total equity	168	193	225	260	295
	Total liabilities & equity	350	404	473	483	512
	Key metrics	Dec-20	Dec-21	Dec-22F	Dec-23F	Dec-24F
	Revenue growth (%)	3.9	30.4	53.2	(0.0)	(4.3)
	Recurrent EPS growth (%)	(34.3)	89.7	52.6	3.3	(0.6)
	Gross margin (%)	14.9	16.6	16.2	16.3	16.5
	Operating EBITDA margin (%)	8.5	9.4	7.9	8.0	8.2
	Net profit margin (%)	4.4	5.6	5.6	5.8	6.0
	Dividend payout ratio (%)	73.7	25.0	25.0	25.0	25.3
	Capex/sales (%)	2.8	1.9	0.6	0.6	0.7
	Interest cover (x)	11.5	16.1	28.1	80.5	527.6

Source: Company data, RHB

Results At a Glance

Figure 1: KGB's results summary

FYE Dec (MYRm)	1Q21	4Q21	1Q22	QoQ (%)	YoY (%)	Comments
Revenue	104.8	180.1	173.3	-4%	65%	Higher contribution across all divisions
EBIT	7.5	13.8	11.7	-15%	56%	
<i>EBIT margin (%)</i>	7.1%	7.7%	6.8%			
Other income	1.6	1.1	0.7	-38%	-60%	
Finance Costs	(0.8)	(0.6)	(0.6)	-2%	21%	
Pretax profit	6.7	13.3	11.1	-16%	65%	
<i>Pretax margin (%)</i>	6%	7%	6%			
Tax	(1.0)	(2.1)	(2.6)	-25%	-153%	
Effective tax rate (%)	15%	16%	23%			
Minority interest	0.2	0.2	0.2	1%	28%	
Net Profit	5.5	11.0	8.3	-24%	50%	
Core Profit	5.7	11.0	8.3	-23%	46%	Broadly in line with expectations
<i>Core net margin (%)</i>	5%	6%	5%			

Source: Company data, RHB

Figure 2: Segmental revenue

FYE Dec (MYRm)	1Q21	4Q21	1Q22	QoQ (%)	YoY (%)
Ultra High Purity	69.8	109.1	112.9	3%	62%
Process Engineering	9.6	22.8	12.0	-48%	24%
General Contracting	16.5	37.7	38.7	3%	134%
Industrial Gases	8.8	10.6	9.9	-7%	12%
Total Revenue	104.8	180.1	173.3	-4%	65%

Source: Company data

Recommendation Chart

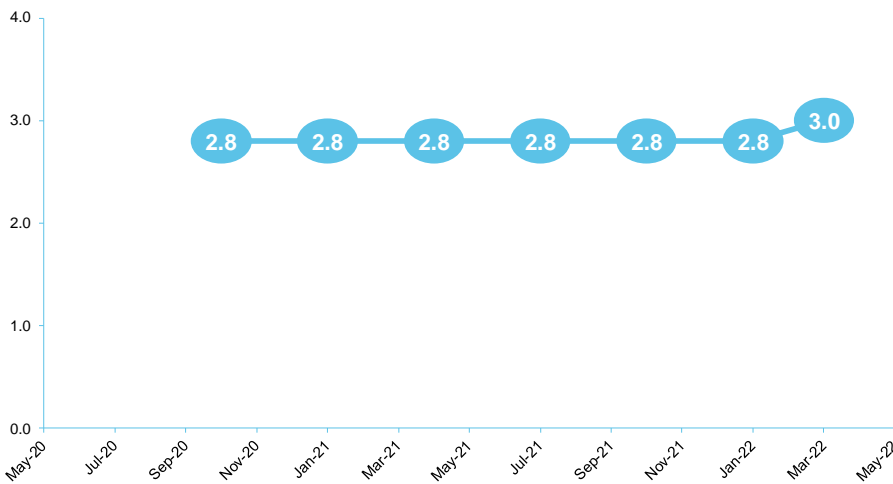


Source: RHB, Bloomberg

Date	Recommendation	Target Price	Price
2022-02-28	Buy	1.70	1.38
2022-02-09	Neutral	1.60	1.56
2021-12-01	Neutral	1.75	1.62
2021-10-07	Neutral	1.76	1.77
2021-09-15	Neutral	1.45	1.66
2021-08-25	Neutral	1.16	1.27
2021-06-15	Neutral	2.02	1.10
2021-03-16	Neutral	1.83	0.98
2021-03-05	Sell	1.83	0.95
2021-03-01	Sell	2.11	1.15
2021-01-20	Neutral	2.00	1.15
2020-11-25	Neutral	1.62	0.88
2020-11-17	Neutral	1.55	0.82
2020-08-13	Neutral	1.14	0.55

Source: RHB, Bloomberg

ESG Rating History



Source: RHB

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Trading Buy:	Share price may exceed 15% over the next 3 months, however longer-term outlook remains uncertain
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