

22 May 2023

Construction & Engineering | Industrial

# Kelington Group (KGRB MK)

**Neutral** (Maintained)

## Another Strong Start

Target Price (Return): MYR1.41 (+6%)  
 Price (Market Cap): MYR1.34 (USD190m)  
 ESG score: 3.00 (out of 4)  
 Avg Daily Turnover (MYR/USD) 1.47m/0.33m

- Stay NEUTRAL, new MYR1.41 TP from MYR1.59, 6% upside with c.2% FY23F yield.** Kelington's 1Q23 revenue and earnings are ahead of expectations, mainly due to higher-than-expected revenue recognition. We lower our target P/E from 21x to 18x – at +0.5SD from its historical mean – to factor in the more cautious sentiment in the tech sector and the normalisation in industry prospects. Key upside/downside risks: Stronger/weaker-than-expected orderbook replenishment and a re-rating/de-rating of the tech sector.
- Earnings beat.** KGB's 1Q23 core earnings of MYR16.3m (+95.4% YoY, -9.9% QoQ) are ahead of expectations, at 26% and 28% of our and Street full-year estimates. While revenue dipped sequentially on seasonal factors, the higher revenue contribution from the process engineering (PE) and industrial gases (IG) segments boosted the group's GPM to 12.3% (4Q22: 10.4%). As financing costs rose to MYR3.3m (4Q22: MYR1.7m), core earnings contracted 10% QoQ.
- Positive growth across all segments.** The 1Q23 revenue from the ultra-high purity (UHP) segment surged 63% YoY from higher revenue recognition across all markets, and remains the largest contributor to group revenue (accounting for 60%). The PE unit's turnover of MYR35.7m (12% of total revenue) jumped 199% YoY, primarily from the tank pit expansion project secured in 4Q22, while the revenue from IG business shot up by 145% YoY. The utilisation rate of KGB's liquid carbon dioxide plant is at 91%, boosted by its penetration into Oceania countries.
- Outlook.** With MYR568m in new contracts secured as at end-April, and supported by a MYR2.27bn outstanding orderbook, KGB should be able to weather through the broader slowdown in semiconductor sales. According to [Gartner](#), global semiconductor revenue is projected to decline by 11.2% YoY in 2023 before rebounding by 18.5% YoY in 2024.
- Forecasts.** We raise FY23-25F earnings by 4-5% after increasing our orderbook replenishment assumptions. We also ascribe a lower target P/E of 18x (from 21x) to reflect a more conservative view on the tech sector's outlook, the macroeconomic headwinds in China, and sluggish consumer demand. Our valuation is fair, at +0.5SD from the historical P/E mean – considering its still-solid orderbook. Our TP incorporates a 0% ESG premium/discount as KGB's ESG score is on par with the country median.
- ESG framework update.** As there is now a greater focus on the E pillar due to critical climate change issues, we have tweaked our ESG weightage. Henceforth, we assign a weightage of 50% to the E pillar, followed by 25% each to the S and G pillars. Further details are in our 2 May thematic research note titled [Envisioning a Better Future](#).

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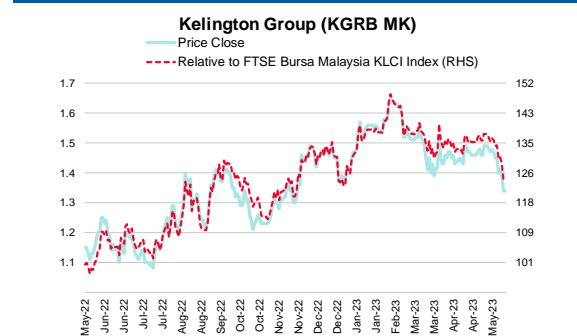


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### Share Performance (%)

	YTD	1m	3m	6m	12m
Absolute	(2.2)	(8.9)	(17.3)	3.1	20.7
Relative	2.3	(9.1)	(14.0)	4.5	28.5
52-wk Price low/high (MYR)					1.08 – 1.65



Source: Bloomberg

Forecasts and Valuation	Dec-21	Dec-22	Dec-23F	Dec-24F	Dec-25F
Total turnover (MYRm)	515	1,279	1,292	1,320	1,402
Recurring net profit (MYRm)	29	56	66	68	73
Recurring net profit growth (%)	89.7	92.1	17.8	2.4	8.1
Recurring P/E (x)	39.51	20.57	17.46	17.05	15.78
P/B (x)	6.0	4.8	4.4	3.8	3.3
P/CF (x)	na	33.62	4.06	15.42	14.49
Dividend Yield (%)	1.1	1.9	2.3	2.3	2.5
EV/EBITDA (x)	22.83	12.32	8.47	7.98	7.09
Return on average equity (%)	16.1	25.9	26.2	23.8	22.4
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, there is active community engagement and efforts to uplift employee relations. KGB is focused on attracting and retaining talent, and helping employees develop their skills.

#### G: GOOD

KGB's Chairman is also the 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 capitalization of less than USD0.5bn.

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## Financial Exhibits

Asia	Financial summary (MYR)	Dec-21	Dec-22	Dec-23F	Dec-24F	Dec-25F
Malaysia	Recurring EPS	0.03	0.07	0.08	0.08	0.08
Construction & Engineering	DPS	0.02	0.03	0.03	0.03	0.03
<b>Kelington Group</b>	BVPS	0.22	0.28	0.31	0.35	0.40
KGRB MK	Return on average equity (%)	16.1	25.9	26.2	23.8	22.4
Neutral						
	<b>Valuation metrics</b>	<b>Dec-21</b>	<b>Dec-22</b>	<b>Dec-23F</b>	<b>Dec-24F</b>	<b>Dec-25F</b>
<b>Valuation basis</b>	Recurring P/E (x)	39.51	20.57	17.46	17.05	15.78
19x FY24F P/E	P/B (x)	6.0	4.8	4.4	3.8	3.3
	FCF Yield (%)	(1.2)	(0.8)	24.2	6.1	6.5
<b>Key drivers</b>	Dividend Yield (%)	1.1	1.9	2.3	2.3	2.5
i. Tight inventory situation in the semiconductor industry;	EV/EBITDA (x)	22.83	12.32	8.47	7.98	7.09
ii. New contract wins;	EV/EBIT (x)	25.89	13.52	9.00	8.47	7.50
iii. Stronger contributions from the industrial gas (LCO2) business.						
	<b>Income statement (MYRm)</b>	<b>Dec-21</b>	<b>Dec-22</b>	<b>Dec-23F</b>	<b>Dec-24F</b>	<b>Dec-25F</b>
<b>Key risks</b>	Total turnover	515	1,279	1,292	1,320	1,402
Key risks include:	Gross profit	85	148	163	175	198
i. Weaker-than-expected earnings;	EBITDA	48	92	103	105	111
ii. Delays in project execution;	Depreciation and amortisation	(6)	(8)	(6)	(6)	(6)
iii. Faster-than-expected normalisation of the demand-supply imbalance in the tech sector;	Operating profit	42	84	97	99	105
iv. Lower-than-expected orderbook replenishment.	Net interest	(3)	(5)	(11)	(11)	(11)
	Pre-tax profit	36	74	86	88	95
<b>Company Profile</b>	Taxation	(6)	(16)	(17)	(18)	(19)
Kelington is involved in ultra-high purity or UHP delivery systems, process engineering and general contracting. The company commenced maiden production of liquid carbon dioxide in 4Q19.	Reported net profit	29	56	66	68	73
	Recurring net profit	29	56	66	68	73
	<b>Cash flow (MYRm)</b>	<b>Dec-21</b>	<b>Dec-22</b>	<b>Dec-23F</b>	<b>Dec-24F</b>	<b>Dec-25F</b>
	Change in working capital	(45)	(51)	209	(2)	(2)
	Cash flow from operations	(4)	34	284	75	79
	Capex	(10)	(43)	(5)	(5)	(5)
	Cash flow from investing activities	(9)	(43)	35	(5)	(5)
	Dividends paid	(6)	(13)	(3)	(26)	(27)
	Cash flow from financing activities	(60)	157	(28)	(26)	(27)
	Cash at beginning of period	132	106	260	496	540
	Net change in cash	(74)	148	291	43	47
	Ending balance cash	60	252	551	540	587
	<b>Balance sheet (MYRm)</b>	<b>Dec-21</b>	<b>Dec-22</b>	<b>Dec-23F</b>	<b>Dec-24F</b>	<b>Dec-25F</b>
	Total cash and equivalents	106	260	496	540	587
	Tangible fixed assets	64	107	106	105	104
	Total assets	404	1,056	1,127	1,174	1,236
	Short-term debt	29	206	206	206	206
	Total long-term debt	23	32	7	7	7
	Total liabilities	211	813	857	861	876
	Total equity	193	243	270	313	360
	Total liabilities & equity	404	1,056	1,127	1,174	1,236
	<b>Key metrics</b>	<b>Dec-21</b>	<b>Dec-22</b>	<b>Dec-23F</b>	<b>Dec-24F</b>	<b>Dec-25F</b>
	Revenue growth (%)	30.4	148.5	1.0	2.1	6.2
	Gross margin (%)	16.6	11.6	12.6	13.3	14.1
	Operating EBITDA margin (%)	9.4	7.2	8.0	7.9	7.9
	Net profit margin (%)	5.6	4.4	5.1	5.1	5.2
	Dividend payout ratio (%)	44.5	38.5	40.0	40.0	40.0
	Capex/sales (%)	1.9	3.4	0.4	0.4	0.4
	Interest cover (x)	16.1	15.5	8.6	9.2	9.9

Source: Company data, RHB

## Results At a Glance

Figure 1: KGB's 1Q22 results

FYE Dec (MYRm)	1Q22	4Q22	1Q23	QoQ (%)	YoY (%)	Comments
<b>Revenue</b>	173.3	417.4	308.9	-26%	78%	Higher contribution across all divisions
<b>EBIT</b>	11.7	27.9	24.3	-13%	108%	
<i>EBIT margin (%)</i>	6.8%	6.7%	7.9%			
Other income	0.7	2.5	1.5	-39%	133%	
Finance Costs	(0.6)	(1.7)	(3.3)	-88%	-454%	
<b>Pretax profit</b>	11.1	26.2	21.0	-20%	89%	
<i>Pretax margin (%)</i>	6%	6%	7%			
Tax	(2.6)	(6.8)	(4.4)	35%	-69%	
Effective tax rate (%)	23%	26%	21%			
Minority interest	0.2	1.5	0.4	-72%	102%	
<b>Net Profit</b>	8.3	17.8	16.2	-9%	95%	
<b>Core Profit</b>	8.3	18.0	16.3	-10%	95%	Ahead of Expectation
<i>Core net margin (%)</i>	5%	4%	5%			

Source: Company data, RHB

Figure 2: Segmental revenue

FYE Dec (MYRm)	1Q22	4Q22	1Q23	QoQ (%)	YoY (%)
Ultra High Purity	112.9	295.8	184.2	-38%	63%
Process Engineering	12.0	13.4	35.7	166%	199%
General Contracting	38.7	87.8	64.9	-26%	68%
Industrial Gases	9.9	20.3	24.1	19%	145%
<b>Total Revenue</b>	<b>173.3</b>	<b>417.4</b>	<b>308.9</b>	<b>-26%</b>	<b>78%</b>

Source: Company data

## Recommendation Chart

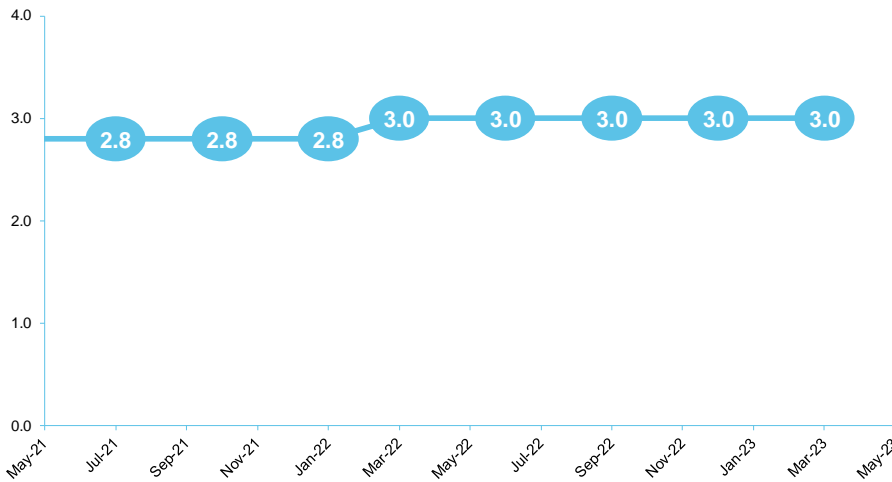


Source: RHB, Bloomberg

Date	Recommendation	Target Price	Price
2023-03-08	Neutral	1.59	1.52
2023-02-28	Neutral	1.59	1.51
2022-12-22	Neutral	1.53	1.45
2022-11-21	Buy	1.53	1.32
2022-09-08	Buy	1.71	1.35
2022-07-28	Buy	1.69	1.22
2022-06-03	Buy	1.60	1.25
2022-05-25	Buy	1.50	1.11
2022-03-09	Buy	1.70	1.22
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

Source: RHB, Bloomberg

## ESG Rating History



Source: RHB

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