

21 August 2023

Construction & Engineering | Industrial

Kelington Group (KGRB MK)

Neutral (Maintained)

Another Record Breaking Quarter

Target Price (Return): MYR1.59 (8.9%)
 Price (Market Cap): MYR1.46 (USD203m)
 ESG score: 3.1 (out of 4)
 Avg Daily Turnover (MYR/USD) 0.96m/0.21m

- **Stay NEUTRAL, new MYR1.59 TP from MYR1.51, 9% upside with c.2% FY23F yield.** Kelington Group (KGB)'s 1H23 revenue and earnings were at record levels, thanks to higher-than-expected revenue recognition. Outstanding order book remains solid at MYR1.77bn – translating to 1.4x FY22 revenue. At a target P/E of 18x (+0.5SD from historical mean), the valuation is fair in our view, reflecting the cautious sentiment in the tech sector, with the strong earnings likely priced-in.

- **Earnings trumped expectations.** 2Q23 core earnings of MYR19.3m (+42.1% YoY, +18.7% QoQ) brought 1H23 earnings to MYR35.6m (+62.4% YoY). This formed 54% and 52% of ours and consensus' full-year estimates. 1H23 revenue jumped 51.1% YoY from the larger contribution across all segments and the higher billing momentum from ongoing projects. GPM narrowed to 10.8% in 2Q23 (1Q23: 12.3%) – mainly attributed to increased revenue recognition of projects in China (+51.3% YoY, +71.5% QoQ), which contributed lower margin due to tight competition. A DPS of 1.5 sen was declared for 1H23.

- **Robust billing performance.** The ultra-high purity segment remains the group's main revenue contributor at 69%, with 53% YoY and 59% QoQ growth. The growth is propelled by increased project recognitions across all markets, particularly Singapore (+56.6% YoY, +57.5% QoQ). As expected, the general contracting segment's contribution dropped to 18% (2Q22: 31%), with the major Sarawak turnkey job at completion stage. The industrial gas (IG) unit's topline of MYR28.7m surged 146% YoY and 19% QoQ – backed by increased sales and distribution of liquid carbon dioxide (LCO2) and other speciality gases. We remain positive on IG's growth outlook as the second LCO2 plant will commence production in 4Q23 – doubling the production capacity.

- **Headwinds persist.** According to [SEMI](#), the semiconductor manufacturing sector would continue to face challenges in 2H23, with dampened fab utilisation, before seeing a rebound in 2024. Nevertheless, we believe KGB is able to navigate the prevailing downturn in the semiconductor sector, supported by MYR744m new contract secured (end-June) and MYR1.77bn in outstanding order book. We raise FY23-25F earnings by 1.7-6.4% after tweaking our order book replenishment assumptions. Our new TP of MYR1.59 is still premised on 18x FY24F P/E and incorporates a 2% ESG premium, based on our in-house ESG scoring methodology.

- **Key risks** are weaker-than-expected earnings and order book replenishment, and an extended de-rating in the tech sector. The converse represents the upside risks.

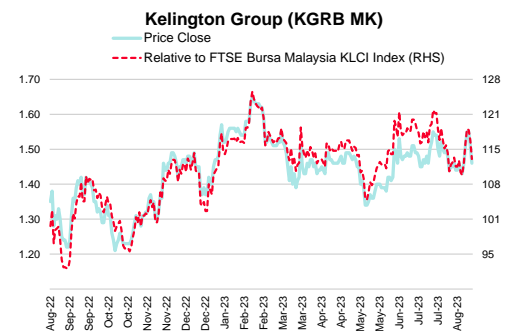
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Share Performance (%)

	YTD	1m	3m	6m	12m
Absolute	6.6	(5.2)	9.0	(9.9)	8.1
Relative	9.9	(8.3)	7.7	(7.8)	12.8
52-wk Price low/high (MYR)					1.21 – 1.65



Source: Bloomberg

Overall ESG Score: 3.1 (out of 4)

E: GOOD

KGB is committed to preserving the environment through various practices such as reducing electricity, water and CO2 consumption. It is also managing the usage of materials to reduce waste and taken steps to manage disposal of scheduled waste in a responsible manner.

S: GOOD

KGB has maintained zero fatalities in relation to work-related injuries. It has put in place Occupational Health & Safety Management System, which is 95% certified for ISO 45001:2018. Apart from 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: EXCELLENT

KGB has applied and adopted company codes and policies encompassing Board policy, corporate code and policies, and sustainability policies to ensure best practices of good corporate governance. Directors are skilled and from diverse backgrounds.

Note:

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

Forecasts and Valuation	Dec-21	Dec-22	Dec-23F	Dec-24F	Dec-25F
Total turnover (MYRm)	515	1,279	1,398	1,399	1,440
Recurring net profit (MYRm)	29	56	73	74	77
Recurring net profit growth (%)	89.7	92.1	30.2	2.2	3.4
Recurring P/E (x)	43.05	22.41	17.22	16.85	16.30
P/B (x)	6.5	5.2	4.7	4.0	3.5
P/CF (x)	na	36.63	4.32	15.43	15.03
Dividend Yield (%)	1.0	1.7	2.3	2.4	2.5
EV/EBITDA (x)	24.98	13.44	8.68	8.19	7.57
Return on average equity (%)	16.1	25.9	28.8	25.7	22.9
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-21	Dec-22	Dec-23F	Dec-24F	Dec-25F
Malaysia	Recurring EPS	0.03	0.07	0.08	0.09	0.09
Construction & Engineering	DPS	0.02	0.03	0.03	0.03	0.04
Kelington Group	BVPS	0.22	0.28	0.31	0.36	0.42
KGRB MK	Return on average equity (%)	16.1	25.9	28.8	25.7	22.9
Neutral						
	Valuation metrics	Dec-21	Dec-22	Dec-23F	Dec-24F	Dec-25F
Valuation basis	Recurring P/E (x)	43.05	22.41	17.22	16.85	16.30
18x PE on FY24F	P/B (x)	6.5	5.2	4.7	4.0	3.5
	FCF Yield (%)	(1.1)	(0.7)	22.8	6.1	6.3
Key drivers	Dividend Yield (%)	1.0	1.7	2.3	2.4	2.5
i. Tight inventory situation in the semiconductor industry	EV/EBITDA (x)	24.98	13.44	8.68	8.19	7.57
ii. New contract wins	EV/EBIT (x)	28.33	14.75	9.18	8.65	7.99
iii. Stronger contributions from the industrial gas (LCO2) business						
	Income statement (MYRm)	Dec-21	Dec-22	Dec-23F	Dec-24F	Dec-25F
Key risks	Total turnover	515	1,279	1,398	1,399	1,440
Key risks include weaker-than-expected earnings, delays in project execution, faster-than-expected normalisation of the demand-supply imbalance in the tech sector, and lower-than-expected orderbook replenishment.	Gross profit	85	148	179	189	205
	EBITDA	48	92	112	113	116
	Depreciation and amortisation	(6)	(8)	(6)	(6)	(6)
	Operating profit	42	84	106	107	110
	Net interest	(3)	(5)	(11)	(11)	(11)
	Pre-tax profit	36	74	95	97	100
	Taxation	(6)	(16)	(19)	(19)	(20)
	Reported net profit	29	56	73	74	77
	Recurring net profit	29	56	73	74	77
Company Profile						
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 or LCO2 in 4Q19.	Cash flow (MYRm)	Dec-21	Dec-22	Dec-23F	Dec-24F	Dec-25F
	Change in working capital	(45)	(51)	209	(2)	(2)
	Cash flow from operations	(4)	34	291	81	84
	Capex	(10)	(43)	(5)	(5)	(5)
	Cash flow from investing activities	(9)	(43)	35	(5)	(5)
	Dividends paid	(6)	(13)	(3)	(29)	(30)
	Cash flow from financing activities	(60)	157	(28)	(29)	(30)
	Cash at beginning of period	132	106	260	503	550
	Net change in cash	(74)	148	298	47	49
	Ending balance cash	60	252	558	550	599
	Balance sheet (MYRm)	Dec-21	Dec-22	Dec-23F	Dec-24F	Dec-25F
	Total cash and equivalents	106	260	503	550	599
	Tangible fixed assets	64	107	106	105	104
	Total assets	404	1,056	1,153	1,200	1,255
	Short-term debt	29	206	206	206	206
	Total long-term debt	23	32	7	7	7
	Total liabilities	211	813	879	878	884
	Total equity	193	243	274	322	371
	Total liabilities & equity	404	1,056	1,153	1,200	1,255
	Key metrics	Dec-21	Dec-22	Dec-23F	Dec-24F	Dec-25F
	Revenue growth (%)	30.4	148.5	9.3	0.1	2.9
	Recurrent EPS growth (%)	89.7	92.1	30.2	2.2	3.4
	Gross margin (%)	16.6	11.6	12.8	13.5	14.3
	Operating EBITDA margin (%)	9.4	7.2	8.0	8.1	8.1
	Net profit margin (%)	5.6	4.4	5.2	5.3	5.3
	Dividend payout ratio (%)	44.5	38.5	40.0	40.0	40.0
	Capex/sales (%)	1.9	3.4	0.4	0.4	0.3
	Interest cover (x)	16.1	15.5	9.4	10.1	10.4

Source: Company data, RHB

Results At a Glance

Figure 1: KGB's 1H23 results

FYE Dec (MYRm)	2Q22	1Q23	2Q23	QoQ (%)	YoY (%)	1H22	1H23	YoY (%)	Comments
Revenue	312.4	308.9	424.9	38%	36%	485.7	733.8	51%	Higher contribution across all divisions
Gross profit	32.5	37.9	46.0	21%	41%	56.3	83.9	49%	
<i>Gross profit margin (%)</i>	10.4%	12.3%	10.8%			11.6%	11.4%		Lower GPM due to higher contribution from China market
Other income	0.8	1.5	3.3	116%	323%	1.4	4.9	236%	
Finance costs	(1.0)	(3.3)	(1.9)	42%	-90%	(1.6)	(5.2)	-225%	
Pretax profit	17.5	21.0	25.9	23%	48%	28.6	47.0	64%	
<i>Pretax margin (%)</i>	5.6%	6.8%	6.1%			6%	6%		
Tax	(3.6)	(4.4)	(5.6)	-28%	-58%	(6.2)	(10.0)	-63%	
<i>Effective tax rate (%)</i>	20%	21%	22%			22%	21%		
Minority interest	0.4	0.4	1.2	190%	233%	0.6	1.7		
Net profit	13.6	16.2	19.1	18%	41%	21.9	35.3	61%	
Core profit	13.6	16.3	19.3	19%	42%	21.9	35.6	62%	Results exceeded both ours and consensus' expectations
<i>Core net margin (%)</i>	4.3%	5.3%	4.5%			4.5%	4.8%		

Source: Company data, RHB

Figure 2: Segmental revenue

FYE Dec (MYRm)	2Q22	1Q23	2Q23	QoQ (%)	YoY (%)	1H22	1H23	YoY (%)
Ultra high purity	191.8	184.2	292.5	59%	53%	304.6	476.7	56%
Process engineering	11.5	35.7	25.6	-28%	122%	23.5	61.3	161%
General contracting	97.4	64.9	78.1	20%	-20%	136.1	143.0	5%
Industrial gases	11.7	24.1	28.7	19%	146%	21.5	52.9	146%
Total Revenue	312.4	308.9	424.9	38%	36%	485.7	733.8	51%

Source: Company data, RHB

Recommendation Chart

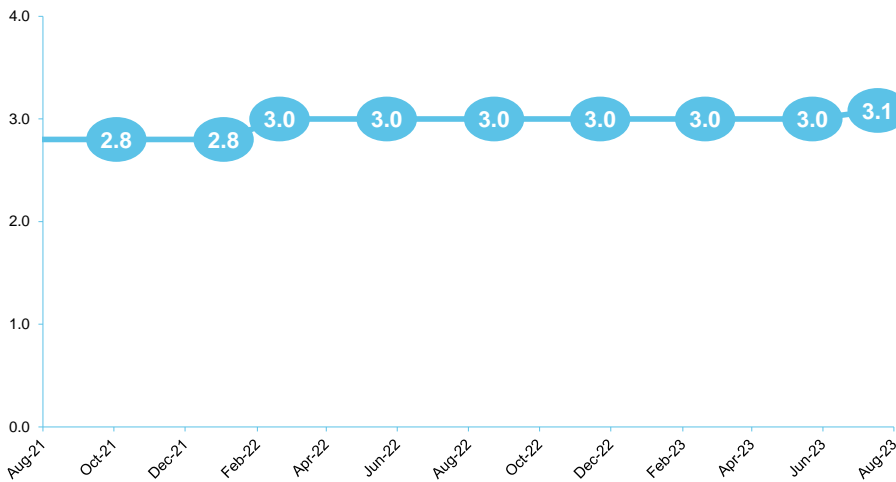


Source: RHB, Bloomberg

Date	Recommendation	Target Price	Price
2023-08-04	Neutral	1.51	1.44
2023-06-01	Neutral	1.44	1.39
2023-05-21	Neutral	1.41	1.34
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

Source: RHB, Bloomberg

ESG Rating History



Source: RHB

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