

30 November 2023

Construction & Engineering | Industrial

Kelington Group (KGRB MK)

Buy (Maintained)

Expanding Its Footprint; Still BUY

Target Price (Return): MYR2.16 (17.4%)
 Price (Market Cap): MYR1.84 (USD254m)
 ESG score: 3.1 (out of 4)
 Avg Daily Turnover (MYR/USD) 2.37m/0.49m

- **Still BUY, new MYR2.16 TP from MYR1.88, 17% upside with c.2% FY23F yield.** We lift our earnings forecasts on Kelington Group following the upbeat 3Q23 results call with management. The global fab equipment (300mm) spending is likely to see a turnaround after two years of declines with the expansion into new markets fuelling longer-term earnings prospects. Our TP is now pegged to a higher target P/E of 18x FY24F EPS, reflecting the stronger fab prospects and earnings tailwinds.
- **We remain sanguine on KGB's earnings prospects** post the quarterly results call. Key takeaways were the focus on profitable growth and expansion into new markets, notwithstanding concerns over a slowdown in the semiconductor sector. Growth is backed by the: i) Sizable outstanding orderbook of >MYR1.5bn, ii) fast-growing liquid CO2 (LCO2) business, and iii) potential ultra high purity or UHP pipelines. Clients are still spending too.
- **A fab-ulous rebound underway.** The stage is set for a strong recovery in 300mm fab equipment spending in 2024 (mostly by KGB's clients) with a projected 12% growth with another +24% in 2025 according to a [SEMI report](#). KGB is well positioned to capitalise on the upturn, in our view. YTD new wins have crossed the MYR1bn mark (up to end Nov 2023) with another MYR145m in hook-up jobs forthcoming from China's largest fab – taking overall order wins to c.MYR1.2bn (the majority from UHP jobs).
- **Phase 2 LCO2 plant to start soon.** With additional 70k tpa capacity, KGB's installed LCO2 capacity will more than double, making it the largest domestic LCO2 producer. The robust demand from Oceania and secured off-takes should see the second plant breaking even at 20-25% utilisation and potentially hitting 30% by 2Q24. KGB is exploring the setting up of LCO2 facilities in New Zealand and Indonesia given the shortage of CO2 in those markets and tight ESG regulations enforced there. For engineering jobs, management outlined plans to penetrate the Hong Kong and Germany markets in the near future, with the latter providing an entry point into the EU. We view the prospective expansion positively given KGB's strong track record with European fabs that have operations locally and in Singapore.
- **Forecasts tweaked.** We up our FY24F-25F core earnings (c.2-8%) after updating our assumptions for the industrial gases (IG) segment. Our TP of MYR2.16 is now pegged to a higher target P/E of 18x on FY24F EPS (previously 16x) at a narrower discount (-1SD) to KLTEC Index's 5-year mean P/E on account of the tailwinds in the wafer fab industry, KGB's healthy tenderbook, and IG business gaining traction. The TP incorporates a 2% ESG premium based on our in-house methodology.
- **Downside risks:** Weaker-than-expected earnings and orderbook replenishments.

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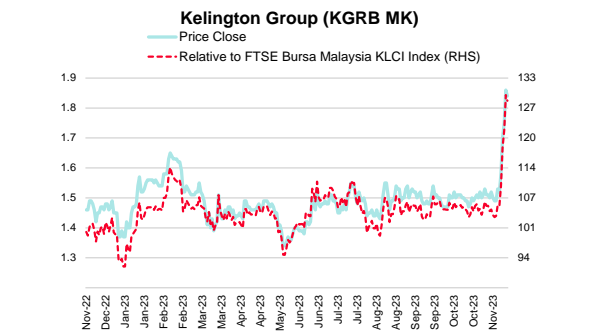


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Share Performance (%)

	YTD	1m	3m	6m	12m
Absolute	34.3	24.3	23.5	31.4	26.0
Relative	37.6	24.0	24.1	28.5	28.1
52-wk Price low/high (MYR)	1.34 – 1.86				



Source: Bloomberg

Forecasts and Valuation	Dec-21	Dec-22	Dec-23F	Dec-24F	Dec-25F
Total turnover (MYRm)	515	1,279	1,483	1,502	1,509
Recurring net profit (MYRm)	33	60	91	101	112
Recurring net profit growth (%)	63.4	80.6	51.5	11.2	11.2
Recurring P/E (x)	47.57	26.34	17.39	15.64	14.06
P/B (x)	8.3	6.6	5.6	4.6	3.8
P/CF (x)	na	52.34	5.11	13.98	12.65
Dividend Yield (%)	0.8	1.0	2.3	2.6	2.8
EV/EBITDA (x)	34.72	17.98	9.61	8.36	7.25
Return on average equity (%)	13.8	24.0	34.8	32.2	29.7
Net debt to equity (%)	net cash	net cash	net cash	net cash	net cash

Source: Company data, RHB

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 related to work-related injuries. It has in-placed Occupational Health & Safety Management System which is 95% certified to ISO 45001:2018 standards. 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: 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:

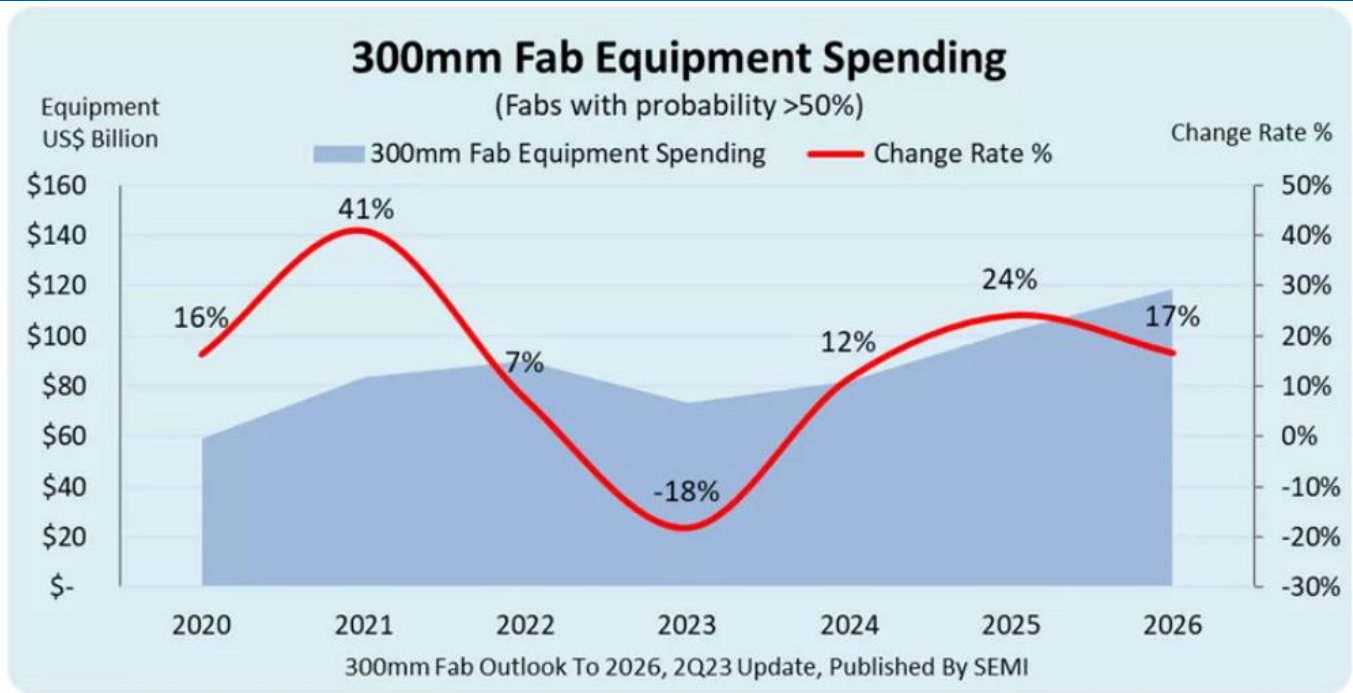
Small cap stocks are defined as companies with a market capitalisation of less than USD0.5bn.

Financial Exhibits

Asia	Financial summary (MYR)	Dec-21	Dec-22	Dec-23F	Dec-24F	Dec-25F
Malaysia	Recurring EPS	0.04	0.07	0.11	0.12	0.13
Construction & Engineering	DPS	0.02	0.02	0.04	0.05	0.05
Kelington Group	BVPS	0.22	0.28	0.33	0.40	0.48
KGRB MK	Return on average equity (%)	13.8	24.0	34.8	32.2	29.7
Buy						
	Valuation metrics	Dec-21	Dec-22	Dec-23F	Dec-24F	Dec-25F
Valuation basis	Recurring P/E (x)	47.57	26.34	17.39	15.64	14.06
18x PE on FY25F	P/B (x)	8.3	6.6	5.6	4.6	3.8
	FCF Yield (%)	(1.1)	(0.8)	15.8	5.9	6.6
Key drivers	Dividend Yield (%)	0.8	1.0	2.3	2.6	2.8
i. Tight inventory situation in the semiconductor industry;	EV/EBITDA (x)	34.72	17.98	9.61	8.36	7.25
ii. New contract wins;	EV/EBIT (x)	39.88	19.59	10.35	9.07	7.84
iii. Stronger contributions from the industrial gas (LCO2) business.						
Key risks	Income statement (MYRm)	Dec-21	Dec-22	Dec-23F	Dec-24F	Dec-25F
Downside risks: Weaker-than-expected earnings and orderbook replenishments.	Total turnover	515	1,279	1,483	1,502	1,509
	Gross profit	85	148	204	220	234
Company Profile	EBITDA	44	87	138	153	167
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.	Depreciation and amortisation	(6)	(7)	(10)	(12)	(13)
	Operating profit	38	80	128	141	155
	Net interest	(3)	(5)	(11)	(11)	(11)
	Pre-tax profit	32	70	117	130	144
	Taxation	(6)	(16)	(23)	(26)	(29)
	Reported net profit	25	52	91	101	112
	Recurring net profit	33	60	91	101	112
	Cash flow (MYRm)	Dec-21	Dec-22	Dec-23F	Dec-24F	Dec-25F
	Change in working capital	(45)	(51)	206	(3)	(3)
	Cash flow from operations	(8)	30	310	113	125
	Capex	(10)	(43)	(60)	(20)	(20)
	Cash flow from investing activities	(9)	(43)	(14)	(20)	(20)
	Dividends paid	(6)	(13)	(3)	(36)	(40)
	Cash flow from financing activities	(60)	157	(23)	(41)	(45)
	Cash at beginning of period	132	106	260	478	529
	Net change in cash	(78)	144	272	52	60
	Ending balance cash	56	248	532	529	589
	Balance sheet (MYRm)	Dec-21	Dec-22	Dec-23F	Dec-24F	Dec-25F
	Total cash and equivalents	106	260	478	529	589
	Tangible fixed assets	64	107	157	165	172
	Total assets	404	1,056	1,195	1,258	1,326
	Short-term debt	29	206	196	181	166
	Total long-term debt	23	32	22	32	42
	Total liabilities	211	813	905	904	902
	Total equity	193	243	290	354	424
	Total liabilities & equity	404	1,056	1,195	1,258	1,326
	Key metrics	Dec-21	Dec-22	Dec-23F	Dec-24F	Dec-25F
	Revenue growth (%)	30.4	148.5	16.0	1.3	0.5
	Recurrent EPS growth (%)	63.4	80.6	51.5	11.2	11.2
	Gross margin (%)	16.6	11.6	13.7	14.6	15.5
	Operating EBITDA margin (%)	8.6	6.8	9.3	10.2	11.1
	Net profit margin (%)	4.8	4.0	6.1	6.7	7.5
	Dividend payout ratio (%)	51.9	31.1	40.0	40.0	40.0
	Capex/sales (%)	1.9	3.4	4.0	1.3	1.3
	Interest cover (x)	14.5	14.7	11.4	13.2	14.5

Source: Company data, RHB

Figure 1: 300mm fab outlook



Source: SEMI

Emissions And ESG

Trend analysis

Although total emissions increased 159% in FY22 or up to 47782 tCO2e, the CO2e intensity ratio fell by 39%. The higher emissions were due to more jobs undertaken while the lower intensity ratio implies higher energy efficiency and productivity.

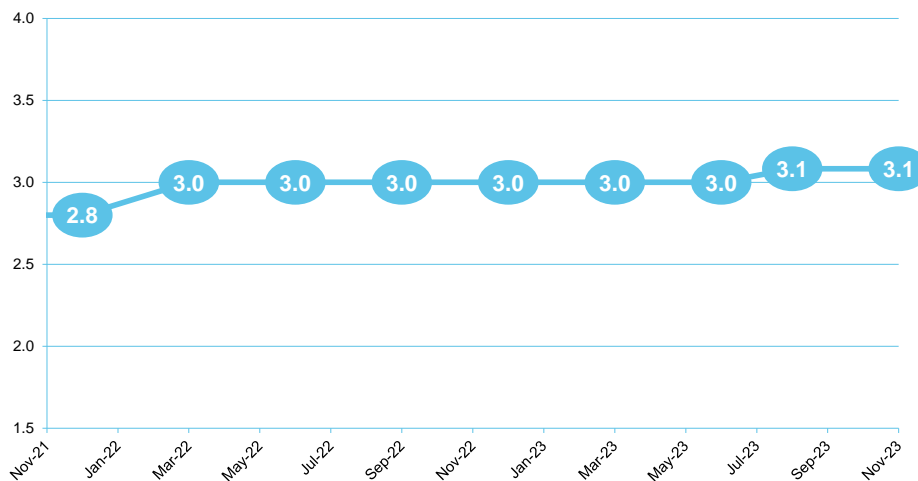
Emissions (tCO2e)	Dec-20	Dec-21	Dec-22
Scope 1	9,349	10,688	11,173
Scope 2	2,281	2,270	3,004
Scope 3	5,583	5,470	33,605
Total emissions	17,213	18,428	47,782

Source: Company data, RHB

Latest ESG-Related Developments

- The company has pledged to reduce Scope 1-3 emissions and achieve net zero greenhouse gas emissions by FY50.
- The commencement of the second LCO2 plant in Kerteh may increase Scope 2 emissions as it requires more heat and electricity.
- KGB targets to reduce CO2 emissions intensity by 20% in FY24 vs FY20. However, the company has already outperformed by cutting the intensity ratio by 39% in FY22.

ESG Rating History



Source: RHB

Recommendation Chart



Source: RHB, Bloomberg

Date	Recommendation	Target Price	Price
2023-11-24	Buy	1.88	1.70
2023-11-09	Neutral	1.59	1.53
2023-08-25	Neutral	1.59	1.53
2023-08-21	Neutral	1.59	1.49
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

Source: RHB, Bloomberg

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Trading Buy:	Share price may exceed 15% over the next 3 months, however longer-term outlook remains uncertain
Neutral:	Share price may fall within the range of +/- 10% over the next 12 months
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