

29 February 2024

Construction & Engineering | Industrial

Kelington Group (KGRB MK)

Buy (Maintained)

A Stellar Close; Keep BUY

Target Price (Return): MYR3.03 (25.8%)
 Price (Market Cap): MYR2.41 (USD329m)
 ESG score: 3.1 (out of 4)
 Avg Daily Turnover (MYR/USD) 5.32m/1.14m

- **Maintain BUY, new MYR3.03 TP (from MYR2.64), 26% upside.** Kelington Group posted record FY23 earnings, thanks to stronger-than-expected revenue recognition across all segments and margin expansion. We lift our forecasts after factoring in higher progress billings and margin. We believe valuation is fair at 21x FY24F EPS (+0.5SD of historical mean) with the improved earnings delivery and robust demand from the industrial gas (IG) segment.
- **Stellar quarter and FY.** FY23 core earnings of MYR116m surged 88% YoY, surpassing ours and consensus estimates by 20% and 30%, with 4QFY23 alone making up 42% of the full-year earnings. FY23 revenue grew 26% YoY from higher contributions across all segments, specifically process engineering (PE) (+143% YoY). EBIT margin expanded c.3ppts (FY22: 6.2%) – thanks to the shift in revenue mix towards higher yielding services and lower administrative expenses. A DPS of 2.5 sen was declared, bringing full year DPS to 4 sen (FY22: 2.5 sen), a 25% payout.
- **Positive contribution from all segments.** The ultra high purity (UHP) segment remains the group's main contributor (63% of revenue) with 25% YoY growth. This is mainly driven by stronger project billings across all key operating markets. The PE segment ballooned 143% YoY, mainly attributed to the tank pit expansion project secured in 4Q22. Similarly, the IG segment did not disappoint, rising 81% YoY growth in tandem with the heightened demand for liquid carbon dioxide (LCO2).
- **Outstanding orderbook of MYR1.3bn** as at end-FY23 (vs MYR1.7bn a year ago) will keep the group busy for the next 12 months. FY23's new job wins were at MYR1.1bn, including a mix of UHP projects in China and Singapore. The group will focus on executing these projects while seeking new jobs with c.MYR2bn tenderbook. Looking ahead, we expect KGB to clinch more UHP projects, buoyed by the US-China tiff and the gradual rebound in the semiconductor space. Earnings prospect remains promising with the rise in higher-margin projects and the expansion of the LCO2 plant. The latter is underpinned by strong demand from Oceania markets, with margins more superior to the group's conventional business.
- **Forecast.** We bump up our FY24-25 forecasts by 11-15%, after factoring in higher revenue and margin assumptions. FY26F is introduced with earnings projected at MYR130m. Our TP rises to MYR3.03, still pegged to an unchanged P/E of 21x with a 2% ESG premium added on. The target P/E is at -0.5SD of KLTEC's 5-year mean, which we believe is fair given the current dynamics within the tech sector.
- **Key risks** are delays in LCO2 expansion, weaker-than-expected earnings, and lower-than-expected orderbook replenishment.

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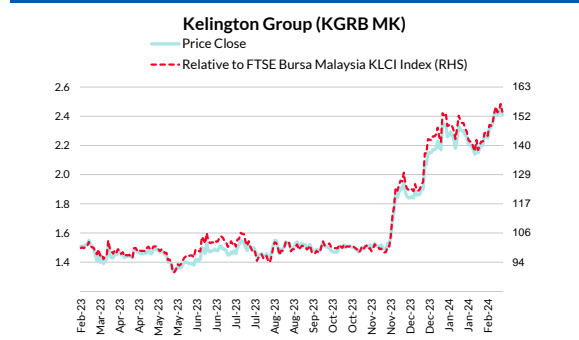


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Share Performance (%)

	YTD	1m	3m	6m	12m
Absolute	11.1	6.2	29.6	57.5	59.6
Relative	4.8	3.6	22.9	50.5	53.3
52-wk Price low/high (MYR)				1.34	-2.47



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

Forecasts and Valuation	Dec-22	Dec-23	Dec-24F	Dec-25F	Dec-26F
Total turnover (MYRm)	1,279	1,614	1,625	1,633	1,644
Recurring net profit (MYRm)	62	116	122	128	130
Recurring net profit growth (%)	81.6	88.1	4.9	4.9	1.4
Recurring P/E (x)	33.58	17.86	17.02	16.22	15.99
P/B (x)	8.7	6.2	5.4	4.5	3.9
P/CF (x)	60.47	12.30	6.11	14.67	14.23
Dividend Yield (%)	0.8	1.2	2.3	2.5	2.5
EV/EBITDA (x)	23.61	12.79	9.56	8.77	8.27
Return on average equity (%)	25.9	35.9	34.1	30.4	26.1
Net debt to equity (%)	net cash	net cash	net cash	net cash	net cash

Source: Company data, RHB

Financial Exhibits

Asia	Financial summary (MYR)	Dec-22	Dec-23	Dec-24F	Dec-25F	Dec-26F
Malaysia	Recurring EPS	0.07	0.13	0.14	0.15	0.15
Construction & Engineering	DPS	0.02	0.03	0.06	0.06	0.06
Kelington Group	BVPS	0.28	0.39	0.44	0.53	0.62
KGRB MK	Return on average equity (%)	25.9	35.9	34.1	30.4	26.1
Buy						
	Valuation metrics	Dec-22	Dec-23	Dec-24F	Dec-25F	Dec-26F
Valuation basis	Recurring P/E (x)	33.58	17.86	17.02	16.22	15.99
21x PE on FY24F	P/B (x)	8.7	6.2	5.4	4.5	3.9
	FCF Yield (%)	(0.4)	4.9	15.4	5.9	6.1
Key drivers	Dividend Yield (%)	0.8	1.2	2.3	2.5	2.5
i. Tight inventory situation in the semiconductor industry;	EV/EBITDA (x)	23.61	12.79	9.56	8.77	8.27
ii. New contract wins;	EV/EBIT (x)	25.73	13.77	10.32	9.46	8.94
iii. Stronger contributions from the industrial gas (LCO2) business.						
	Income statement (MYRm)	Dec-22	Dec-23	Dec-24F	Dec-25F	Dec-26F
Key risks	Total turnover	1,279	1,614	1,625	1,633	1,644
Key risks include:	Gross profit	148	229	236	249	252
i. Weaker-than-expected earnings;	EBITDA	87	155	177	185	187
ii. Delays in project execution;	Depreciation and amortisation	(7)	(11)	(13)	(13)	(14)
iii. Faster-than-expected normalisation of demand-supply imbalance in the tech sector; and	Operating profit	80	144	164	171	173
iv. Lower-than-expected orderbook replenishment.	Net interest	(5)	(11)	(9)	(8)	(8)
	Pre-tax profit	74	133	155	163	165
	Taxation	(16)	(28)	(31)	(33)	(33)
	Reported net profit	56	103	122	128	130
	Recurring net profit	62	116	122	128	130
Company Profile						
Kelington is involved in ultra-high purity or UHP delivery systems, process engineering, and general contracting. The group commenced maiden production of liquid carbon dioxide or LCO2 in 4Q19.	Cash flow (MYRm)	Dec-22	Dec-23	Dec-24F	Dec-25F	Dec-26F
	Change in working capital	(51)	15	202	(2)	(0)
	Cash flow from operations	34	168	339	141	146
	Capex	(43)	(66)	(20)	(20)	(20)
	Cash flow from investing activities	(43)	(65)	23	(20)	(20)
	Dividends paid	(13)	(19)	(0)	(49)	(51)
	Cash flow from financing activities	157	(109)	(5)	(54)	(56)
	Cash at beginning of period	106	260	269	561	628
	Net change in cash	148	(5)	356	68	69
	Ending balance cash	252	259	625	628	698
	Balance sheet (MYRm)	Dec-22	Dec-23	Dec-24F	Dec-25F	Dec-26F
	Total cash and equivalents	260	269	561	628	698
	Tangible fixed assets	107	169	176	182	189
	Total assets	1,056	1,073	1,257	1,332	1,410
	Short-term debt	206	116	101	86	71
	Total long-term debt	32	59	69	79	89
	Total liabilities	813	735	866	863	860
	Total equity	243	339	390	470	550
	Total liabilities & equity	1,056	1,073	1,257	1,332	1,410
	Key metrics	Dec-22	Dec-23	Dec-24F	Dec-25F	Dec-26F
	Revenue growth (%)	148.5	26.2	0.7	0.5	0.7
	Recurrent EPS growth (%)	81.6	88.1	4.9	4.9	1.4
	Gross margin (%)	11.6	14.2	14.5	15.2	15.3
	Operating EBITDA margin (%)	6.8	9.6	10.9	11.3	11.4
	Net profit margin (%)	4.4	6.4	7.5	7.8	7.9
	Dividend payout ratio (%)	28.9	25.2	40.0	40.0	40.0
	Capex/sales (%)	3.4	4.1	1.2	1.2	1.2
	Interest cover (x)	14.7	13.0	19.3	20.3	21.4

Source: Company data, RHB

Results At a Glance

Figure 1: KGB's FY23 results

FYE Dec (MYRm)	4Q22	3Q23	4Q23	QoQ (%)	YoY (%)	FY22	FY23	YoY (%)	Comments
Revenue	426.7	401.8	478.3	19%	12%	1,278.8	1,613.9	26%	Higher contribution across all divisions
Gross profit	51.2	59.3	86.0	45%	68%	148.1	229.3	55%	
<i>Gross profit margin (%)</i>	12.0%	14.8%	18.0%			11.6%	14.2%		Higher GPM due to higher contribution from higher-margin projects
Other income	3.3	1.8	3.7	103%	11%	5.0	10.4	107%	
Finance costs	(2.6)	(2.8)	(3.0)	-8%	-16%	(5.4)	(11.1)	-104%	
Pretax profit	26.9	39.1	46.9	20%	74%	74.4	133.0	79%	
<i>Pretax margin (%)</i>	6.3%	9.7%	9.8%			6%	8%		
Tax	(7.2)	(7.1)	(10.7)	-50%	-49%	(15.9)	(27.9)	-75%	
Effective tax rate (%)	27%	18%	23%			21%	21%		
Minority interest	1.5	0.3	0.5	39%	-69%	2.8	2.5		
Net profit	18.2	31.7	35.7	13%	96%	55.8	102.7	84%	
Core profit	21.2	31.8	48.7	53%	129%	61.7	116.0	88%	Results exceeded both ours/consensus expectations
<i>Core net margin (%)</i>	5.0%	7.9%	10.2%			4.8%	7.2%		

Source: Company data, RHB

Emissions And ESG

Trend analysis

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

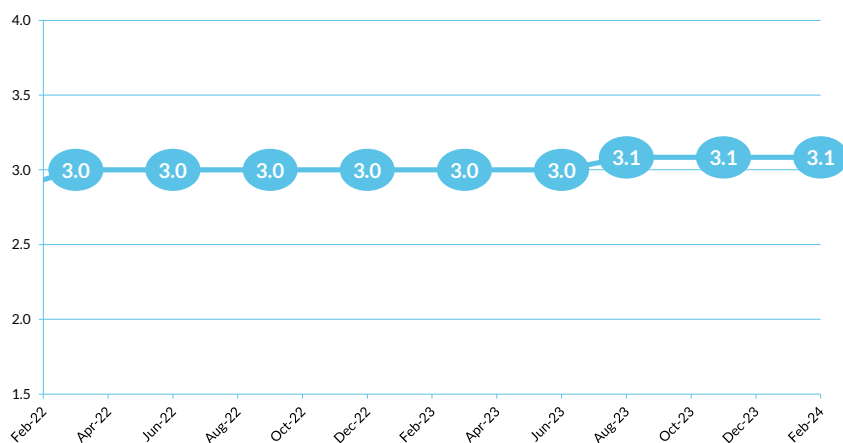
Emissions (tCO2e)	Dec-21	Dec-22	Dec-23
Scope 1	10,688	11,173	na
Scope 2	2,270	3,004	na
Scope 3	5,470	33,605	na
Total emissions	18,428	47,782	na

Source: Company data, RHB

Latest ESG-Related Developments

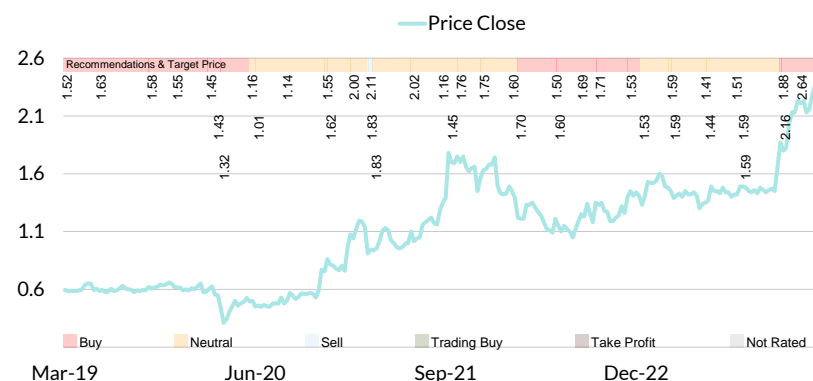
- KGB has pledged to reduce Scope 1, 2 and 3 emissions and achieve net zero greenhouse gas emissions by FY50.
- The commencement of the second LCO2 plant in Kerteh may increase Scope 2 emissions as it requires more heat and electricity.
- The group targets to reduce CO2 emission intensity by 20% in FY24 vs FY20. However, it 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
2024-01-10	Buy	2.64	2.34
2023-11-30	Buy	2.16	1.88
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

Source: RHB, Bloomberg

RHB Guide to Investment Ratings

Buy:	Share price may exceed 10% over the next 12 months
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
Take Profit:	Target price has been attained. Look to accumulate at lower levels
Sell:	Share price may fall by more than 10% over the next 12 months
Not Rated:	Stock is not within regular research coverage

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