

27 May 2024

Construction & Engineering | Industrial

Kelington Group (KGRB MK)

Buy (Maintained)

New Markets And Sector Tailwinds; Keep BUY

- **BUY, new MYR3.85 TP from MYR3.35, 27% upside with c.2% yield.** Key 1Q24 results call takeaways: i) Tender activities to pick up in 2H24 on positive sector tailwinds; and ii) there is strong upside from the industrial gas (IG) segment. We remain upbeat on Kelington Group's earnings growth prospects, with margin accretion from its favourable orderbook mix and expansion into new markets. Our new TP is pegged to a higher target P/E of 23x on FY25F full diluted EPS (-0.5SD from KLTEC Index's 5-year mean). It also includes a 6% ESG premium, to reflect ESG initiatives made.
- **Favourable orderbook mix; MYR1.6bn tenderbook.** Kelington Group's outstanding orderbook of MYR1.3bn (end-Mar) indicates that there could be another record year in the making. Ultra-high purity (UHP) projects made up the largest portion at 78%, followed by general contracting (16%) and process engineering (6%) jobs. Management expects tender activities to ramp up in 2H24. 60% of the tenderbook is made-up of projects in China/Hong Kong, followed by Singapore (30%) and Malaysia (10%). KGB has also been invited to tender for a maiden project in Europe. Assuming a 50% success rate, total orderbook replenishment for FY24F could surpass our assumption and FY23's MYR1.1bn. Of the MYR375m orders secured to date (as of end-May), the bulk is from China - mainly from the largest chip foundry.
- **IG business scaling up nicely.** IG revenue grew 49% YoY in 1Q24 (FY23: +81%) with robust off-takes and optimal plant utilisation. The second liquid carbon dioxide (LCO2) plant (P2, annual capacity of 70,000 tonnes) commenced operations in late March with the overall utilisation rate at 58% (200 tonnes/day). In addition to the Oceania markets, KGB has started supplying LCO2 to South Africa and India. It is also in discussions to acquire an existing LCO2 business in Indonesia with a similar capacity to its P2 plant. We view the potential acquisition positively, due to the strong underlying domestic LCO2 demand in Indonesia (larger than Malaysia) which is only partially met by KGB's existing supply contracts. With additional capacity taken up by existing markets or customers, the new on-site gas supply contract in Kedah (worth MYR180m over 10 years), and potential new markets, IG revenue is set to climb. KGB also plans to start a LCO2 business in the Philippines, and enter the gas trading business in India.
- **Forecasts upgraded; higher target P/E to reflect positive tech sector dynamics.** We lift FY24-26F earnings by 6-9% after incorporating stronger margin and ASP assumptions for the LCO2 business. Our new TP of MYR3.85 is pegged to a higher target P/E of 23x on FY25F fully diluted EPS (from 21x previously), at +1 SD from its historical 5-year mean, to reflect the tailwinds in the semiconductor sector, strong earnings delivery and the IG business gaining traction. Downside risks are weaker-than-expected earnings and orderbook replenishment.

Target Price (Return): MYR3.85 (+27%)
 Price (Market Cap): MYR3.02 (USD428m)
 ESG score: 3.3 (out of 4)
 Avg Daily Turnover (MYR/USD) 5.24m/1.11m

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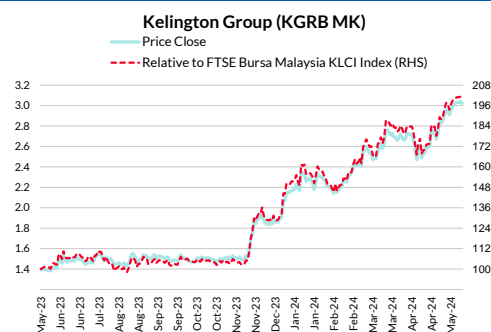


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Share Performance (%)

	YTD	1m	3m	6m	12m
Absolute	39.2	16.6	25.3	77.6	122.1
Relative	27.9	13.6	20.8	66.2	107.2
52-wk Price low/high (MYR)				1.38	-3.04



Source: Bloomberg

Overall ESG Score: 3.3 (out of 4)

E: EXCELLENT

KGB is committed to preserving the environment via practices like reducing electricity, water and CO2 consumption. The group designed and built the Stripper Reclaim System (SRS), and allowed the manufacturer to recycle the materials. It is also committed to designing exhaust systems that reduce noise pollution with emissions reduction technology.

S: EXCELLENT

KGB has maintained zero fatalities related to work-related injuries and put in place an occupational health & safety management system. It is focused on attracting and retaining talent, and helping employees develop their skills to drive success further. We also see efforts to uplift employee relations, while KGB is actively involved in community engagements, such as supporting Core Liver Baby Programme and Project Sambung Sekolah.

G: EXCELLENT

Company policies encompass its Board policy, corporate code of conduct and policies, and sustainability policies to ensure best practices of good corporate governance. Directors are skilled and from diverse backgrounds. Management has been transparent and open in communication.

Note:

Small cap stocks are defined as companies with a market capitalization 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	1,629	1,642	1,671
Recurring net profit (MYRm)	62	118	130	136	142
Recurring net profit growth (%)	81.6	90.5	10.3	4.7	4.8
Recurring P/E (x)	42.08	22.09	20.03	19.14	18.27
P/B (x)	10.8	7.8	6.6	5.4	4.5
P/CF (x)	89.96	14.87	7.91	17.47	16.58
Dividend Yield (%)	0.6	1.0	1.7	1.8	1.9
EV/EBITDA (x)	29.80	16.34	11.96	11.05	10.17
Return on average equity (%)	25.7	35.6	35.7	30.9	26.9
Net debt to equity (%)	net cash	net cash	net cash	net cash	net cash

Source: Company data, RHB

See important disclosures at the end of this report

Market Dateline / PP 19489/05/2019 (035080)

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Financial Exhibits

Asia	Financial summary (MYR)	Dec-22	Dec-23	Dec-24F	Dec-25F	Dec-26F
Malaysia	Recurring EPS	0.07	0.14	0.15	0.16	0.17
Construction & Engineering	DPS	0.02	0.03	0.05	0.06	0.06
Kelington Group	BVPS	0.28	0.39	0.46	0.56	0.67
KGRB MK	Return on average equity (%)	25.7	35.6	35.7	30.9	26.9
Buy						
	Valuation metrics	Dec-22	Dec-23	Dec-24F	Dec-25F	Dec-26F
Valuation basis	Recurring P/E (x)	42.08	22.09	20.03	19.14	18.27
23x FY25F P/E	P/B (x)	10.8	7.8	6.6	5.4	4.5
	FCF Yield (%)	(0.4)	4.1	11.9	5.0	5.3
Key drivers	Dividend Yield (%)	0.6	1.0	1.7	1.8	1.9
i. The recovery in the semiconductor sector;	EV/EBITDA (x)	29.80	16.34	11.96	11.05	10.17
ii. New contract wins;	EV/EBIT (x)	32.49	17.61	12.86	11.87	10.92
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	1,629	1,642	1,671
Key risks include weaker-than-expected earnings, delays in project execution, slower-than-expected recovery in the technology sector, and a pick-up in orderbook replenishment.	Gross profit	148	230	246	259	269
	EBITDA	87	153	186	194	202
	Depreciation and amortisation	(7)	(11)	(13)	(13)	(14)
	Operating profit	79	142	173	180	188
	Net interest	(5)	(11)	(9)	(8)	(8)
	Pre-tax profit	74	131	164	172	180
	Taxation	(16)	(28)	(33)	(34)	(36)
	Reported net profit	55	102	130	136	142
	Recurring net profit	62	118	130	136	142
	Cash flow (MYRm)	Dec-22	Dec-23	Dec-24F	Dec-25F	Dec-26F
	Change in working capital	(56)	30	184	(2)	(1)
	Cash flow from operations	29	175	328	149	157
	Capex	(38)	(69)	(20)	(20)	(20)
	Cash flow from investing activities	(38)	(68)	27	(20)	(20)
	Dividends paid	(13)	(19)	(0)	(45)	(47)
	Cash flow from financing activities	157	(117)	(5)	(50)	(52)
	Cash at beginning of period	106	260	269	551	629
	Net change in cash	148	(11)	350	78	84
	Ending balance cash	251	255	619	629	713
	Balance sheet (MYRm)	Dec-22	Dec-23	Dec-24F	Dec-25F	Dec-26F
	Total cash and equivalents	260	269	551	629	713
	Tangible fixed assets	107	169	176	182	188
	Total assets	1,056	1,071	1,254	1,341	1,437
	Short-term debt	206	119	104	89	74
	Total long-term debt	32	56	66	76	86
	Total liabilities	813	733	852	849	850
	Total equity	243	338	402	492	586
	Total liabilities & equity	1,056	1,071	1,254	1,341	1,437
	Key metrics	Dec-22	Dec-23	Dec-24F	Dec-25F	Dec-26F
	Revenue growth (%)	148.5	26.2	0.9	0.8	1.8
	Recurrent EPS growth (%)	81.6	90.5	10.3	4.7	4.8
	Gross margin (%)	11.6	14.2	15.1	15.8	16.1
	Operating EBITDA margin (%)	6.8	9.5	11.4	11.8	12.1
	Net profit margin (%)	4.3	6.3	8.0	8.3	8.5
	Dividend payout ratio (%)	29.1	25.4	35.0	35.0	35.0
	Capex/sales (%)	3.0	4.3	1.2	1.2	1.2
	Interest cover (x)	14.6	13.0	20.3	21.3	23.2

Source: Company data, RHB

Emissions And ESG

Trend analysis

Total emissions fell by 15% in FY23, mainly driven by the reduction in Scope 3 emissions. This follows decreases of 42% and 38% in total waste generated and materials purchased. Conversely, the hike in its Scope 1 and 2 emissions was due to the company undertaking more jobs.

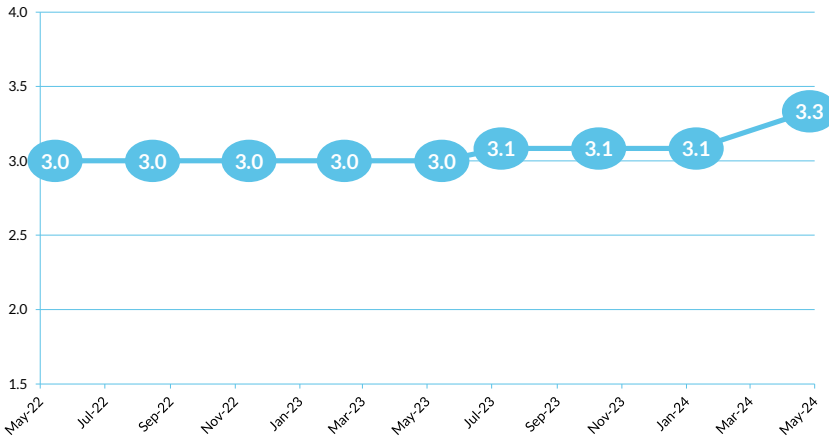
Emissions (tCO2e)	Dec-21	Dec-22	Dec-23
Scope 1	10,688	11,173	12,495
Scope 2	2,270	3,004	3,807
Scope 3	5,470	33,605	24,137
Total emissions	18,428	47,782	40,439

Source: Company data, RHB

Latest ESG-Related Developments

- The group has successfully achieved its target to reduce CO2 emission intensity by 20% in 2024. The focus will be on cutting Scope 1, 2 and 3 emissions to achieve net-zero emissions by 2050.
- Although the commencement of the second LCO2 plant will increase Scope 2 emissions, the group will continue to improve productivity and efficiency to reduce overall emissions.

ESG Rating History



Source: RHB

Recommendation Chart



Source: RHB, Bloomberg

Date	Recommendation	Target Price	Price
2024-05-21	Buy	3.35	3.03
2024-02-29	Buy	3.03	2.55
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

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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