

23 August 2024

Construction & Engineering | Industrial

Kelington Group (KGRB MK)

Buy (Maintained)

Benefitting From China's "Big Fund"; Keep BUY

Target Price (Return): MYR3.90 (21%)
 Price (Market Cap): MYR3.22 (USD502m)
 ESG score: 3.3 (out of 4)
 Avg Daily Turnover (MYR/USD) 5.98m/1.28m

- Keep BUY and MYR3.90 TP, 21% upside and 2% yield.** Kelington Group offers a unique exposure to China's raucous appetite for chip supremacy. Earnings prospects are well supported by the torrid pace of fab expansion across the key markets of China and Singapore. The industrial gas (IG) wing should also drive a new earnings leg-up over the mid-term, lifting KGB's overall profitability. Stock valuation remains undemanding at 20x FY25F EPS (-1SD to KLTEC Index's 5-year mean) considering that earnings are set to hit another record in FY24.
- Optimistic views.** Management hosted a results call yesterday. Key takeaways: i) Demand for ultra-high purity (UHP) projects to remain strong (underpinned by a MYR1.6bn tender pipeline), ii) the strong outlook for the LCO2 business, and iii) unrelenting focus on bottomline (profitability). To recap, 1H24 core earnings grew 40% YoY on a better project mix and expanding contributions from the IG segment, with EBIT margin reaching a quarterly record of 10.7%.
- Healthy orderbook.** KGB's outstanding orderbook of MYR1.3bn as at end-June translates into a cover ratio of 0.8x. UHP projects formed the bulk of the orderbook at 77%, followed by general contracting (18%) and process engineering (5%). With Singapore tender awards likely to be backloaded into 2H24, we believe the group is on track to hit our FY24 orderbook replenishment assumption of MYR1bn (1H24: MYR564m). Singapore makes up the largest portion of the c.MYR1.66bn tenderbook at 33% (MYR556m).
- China market to account for new fab bulk.** According to SEMI, [global fab capacity](#) is expected to expand by 6% in 2024 and 7% in 2025, underpinned by the proliferation of artificial intelligence-driven performance chips. Chinese chipmakers' capacities are projected to grow at a much higher double-digit trajectory, with China accounting for the bulk of global fab set to come on line from 2023-2027. Phase 3 of China's "Big Fund" investment in the semiconductor sector augurs well for KGB, which has a good track record of hook-up jobs with the East Asian nation's largest foundry.
- LCO2 footprint expansion.** KGB said talks are at the tail-end of the purchase of an existing LCO2 business in Indonesia with 70,000 tonnes capacity for MYR40m. It remains committed to expanding its regional footprint on growing LCO2 demand. Aside from Oceania, where KGB has secured a strong foothold, management is also exploring the India market.
- Maintain BUY.** We maintain our forecasts, which have incorporated incrementally stronger margins and increased contributions from the fast-expanding LCO2 business. Our TP is premised on unchanged P/E of 23x on FY25F EPS with a 6% ESG premium bolted on. The target P/E is at 1SD above its historical 5-year mean, supported by tailwinds in the semiconductor sector, robust earnings delivery, and IG business' strong growth prospects.

Analysts

Jeffrey Tan
 +603 2302 8112
jeffrey.tan@rhbgroupp.com

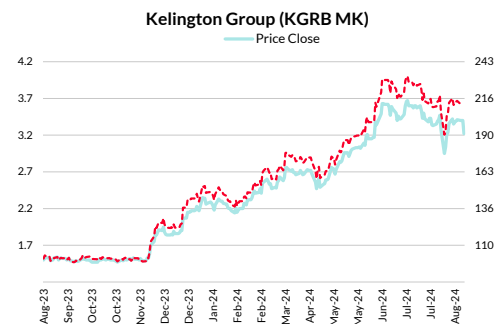


Cindy Lee
 +603 2302 8105
cindy.chin.hui@rhbgroupp.com



Share Performance (%)

	YTD	1m	3m	6m	12m
Absolute	48.4	(4.7)	6.3	32.0	116.1
Relative	36.0	(5.5)	5.5	26.2	103.4
52-wk Price low/high (MYR)				1.47	-3.67



Source: Bloomberg

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	132	139	146
Recurring net profit growth (%)	81.6	90.5	12.7	4.8	5.0
Recurring P/E (x)	45.27	23.76	21.09	20.13	19.17
P/B (x)	11.7	8.4	7.0	5.7	4.8
P/CF (x)	96.77	16.00	8.49	18.63	17.64
Dividend Yield (%)	0.6	0.9	1.7	1.7	1.8
EV/EBITDA (x)	32.07	17.62	12.92	11.94	10.99
Return on average equity (%)	25.7	35.6	36.3	31.4	27.3
Net debt to equity (%)	net cash	net cash	net cash	net cash	net cash

Source: Company data, RHB

Overall ESG Score: 3.3 (out of 4)

E: EXCELLENT

KGB is committed to preserve the environment through various practices such as reducing electricity, water and CO2 consumption. The group designed and built 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 in-placed Occupational Health & Safety Management System. Apart from that, KGB is focused on attracting and retaining talent, and helping employees develop their skills to drive further success. We also see the group put in efforts to uplift employee relations and involve actively in community engagements, such as supporting Core Liver Baby Program and Project Sambung Sekolah.

G: EXCELLENT

KGB has applied and adopted company codes and policies encompassing 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.

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	0.38	0.46	0.56	0.67
KGRB MK	Return on average equity (%)	25.7	35.6	36.3	31.4	27.3
Buy						
	Valuation metrics	Dec-22	Dec-23	Dec-24F	Dec-25F	Dec-26F
Valuation basis	Recurring P/E (x)	45.27	23.76	21.09	20.13	19.17
23x PE on FY25F	P/B (x)	11.7	8.4	7.0	5.7	4.8
	FCF Yield (%)	(0.3)	3.8	11.1	4.7	5.0
Key drivers	Dividend Yield (%)	0.6	0.9	1.7	1.7	1.8
i. The recovery in the semiconductor sector	EV/EBITDA (x)	32.07	17.62	12.92	11.94	10.99
ii. New contract wins	EV/EBIT (x)	34.97	18.99	13.88	12.82	11.79
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 tech sector and orderbook replenishment.	Gross profit	148	230	248	261	272
	EBITDA	87	153	187	195	204
	Depreciation and amortisation	(7)	(11)	(13)	(13)	(14)
	Operating profit	79	142	174	182	190
	Net interest	(5)	(11)	(9)	(8)	(8)
	Pre-tax profit	74	131	166	174	182
	Taxation	(16)	(28)	(33)	(35)	(36)
	Reported net profit	55	102	132	139	146
	Recurring net profit	62	118	132	139	146
	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	329	150	158
	Capex	(38)	(69)	(20)	(20)	(20)
	Cash flow from investing activities	(38)	(68)	27	(20)	(20)
	Dividends paid	(13)	(19)	(0)	(46)	(49)
	Cash flow from financing activities	157	(117)	(5)	(51)	(54)
	Cash at beginning of period	106	260	269	552	630
	Net change in cash	148	(11)	351	79	85
	Ending balance cash	251	255	620	630	715
	Balance sheet (MYRm)	Dec-22	Dec-23	Dec-24F	Dec-25F	Dec-26F
	Total cash and equivalents	260	269	552	630	715
	Tangible fixed assets	107	169	176	182	188
	Total assets	1,056	1,071	1,255	1,342	1,438
	Short-term debt	206	119	104	89	74
	Total long-term debt	32	56	66	76	86
	Total liabilities	813	733	853	850	851
	Total equity	243	338	402	492	587
	Total liabilities & equity	1,056	1,071	1,255	1,342	1,438
	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	12.7	4.8	5.0
	Gross margin (%)	11.6	14.2	15.2	15.9	16.3
	Operating EBITDA margin (%)	6.8	9.5	11.5	11.9	12.2
	Net profit margin (%)	4.3	6.3	8.1	8.4	8.7
	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	20.5	21.5	23.4

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 KGB undertaking more jobs.

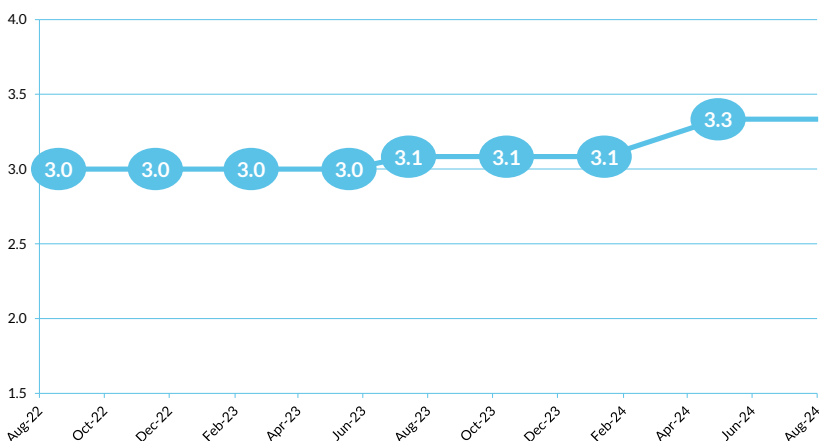
Emissions (tCO2e)	Dec-21	Dec-22	Dec-23
Scope 1	10,688	11,173	12,495
Scope 2	2,270	3,004	3,807
Scope 3	5,470	33,605	24,137
Total emissions	18,428	47,782	40,439

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
2024-08-14	Buy	3.90	3.38
2024-05-27	Buy	3.85	3.09
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

Source: RHB, Bloomberg

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**KUALA LUMPUR**

RHB Investment Bank Bhd
Level 3A, Tower One, RHB Centre
Jalan Tun Razak
Kuala Lumpur 50400
Malaysia
Tel : +603 2302 8100
Fax : +603 2302 8134

JAKARTA

PT RHB Sekuritas Indonesia
Revenue Tower, 11th Floor, District 8 - SCBD
Jl. Jendral Sudirman Kav 52-53
Jakarta 12190
Indonesia
Tel: +6221 509 39 888
Fax : +6221 509 39 777

BANGKOK

RHB Securities (Thailand) PCL
10th Floor, Sathorn Square Office Tower
98, North Sathorn Road, Silom
Bangrak, Bangkok 10500
Thailand
Tel: +66 2088 9999
Fax :+66 2088 9799

SINGAPORE

RHB Bank Berhad (Singapore branch)
90 Cecil Street
#04-00 RHB Bank Building
Singapore 069531
Fax: +65 6509 0470