

13 November 2024

Construction & Engineering | Industrial

Kelington Group (KGRB MK)

Buy (Maintained)

Sterling Quarter With Record Margins; Keep BUY

Target Price (Return): MYR3.90 (33.1%)
 Price (Market Cap): MYR2.93 (USD460m)
 ESG score: 3.3 (out of 4)
 Avg Daily Turnover (MYR/USD) 4.28m/1.00m

- **Maintain BUY with MYR3.90 TP, 33% upside and c.3% FY24F yield.** Kelington Group (KGB) delivered solid double-digit earnings growth in 9M23, on track for another record year. The favourable revenue mix, focus on profitability, and the rapidly growing industrial gas (IG) business saw margins hitting new highs for the quarter. The stock's valuation remains undemanding at 18x FY25F EPS (1.5SD below KLTEC Index's 5-year mean), backed by a compelling orderbook exceeding MYR1.4bn.
- **In-line with record margins.** 3Q24 core profit of MYR40m (+26% YoY, +59% QoQ) brought 9M24 earnings to MYR90m (+33% YoY) at 68% and 77% of ours and Street's estimates. A seasonally stronger 4Q is expected. The favourable project mix saw GP margin hitting a quarterly high of 22.8%. YTD revenue fell 15% as contributions from Singapore and Malaysia declined due to the completion of several ultra-high purity (UHP) projects. QoQ, EBIT margin jumped 3 ppt to 14% (9M24: 11.8%) as IG contributions widened (13% vs 11% in 2Q24) with higher-margin projects execution. A third interim DPS of 2 sen was declared (9M24: 6 sen), reflecting a DPR of 42%.
- **IG business is now the second largest after UHP...** While the UHP segment continues to be KGB's mainstay at 70% of revenue (3Q23: 62%), the IG segment is now the second largest contributor (13%), outpacing general contracting (GC) at 11%. GC and process engineering (PE) revenues fell 70% and 36% YoY, primarily as the Sarawak plant expansion and the tank pit project have reached the peak of their S-curves.
- **...with impressive 31% YoY growth YTD.** The commencement of the second liquid carbon dioxide (LCO2) plant in March boosted annual production capacity to 120k tonnes (from 50k tonnes), with further margin expansion. We remain optimistic on the IG business growth potential, with increasing demands from Oceania, Africa, and Indonesia markets.
- **MYR1bn new orders YTD, outstanding orderbook at MYR1.4bn.** The orders are expected to keep the group busy over the next 12 months and consists of UHP projects (74%), followed by PE (13%) and GC projects (12%). YTD-Sep 2024 new job wins stood at MYR1bn, including UHP jobs from China and a newly secured PE contract in Malaysia valued at >MYR100m. We see the extension of the US protectionist policies under the incoming Trump administration benefiting KGB with the aggressive expansion of the domestic fab capacity in China set to continue.
- **We keep our FY24-26F earnings and TP** pending the group's results briefing later today. Our TP is pegged to an unchanged target P/E of 23x FY25F EPS (+1SD from historical mean), reflecting KGB's unique exposure to robust growth in global fab capacity with China leading the expansion. A 6% ESG premium is baked into the TP. Key risks are weaker-than-expected earnings and orderbook replenishments.

Analysts

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

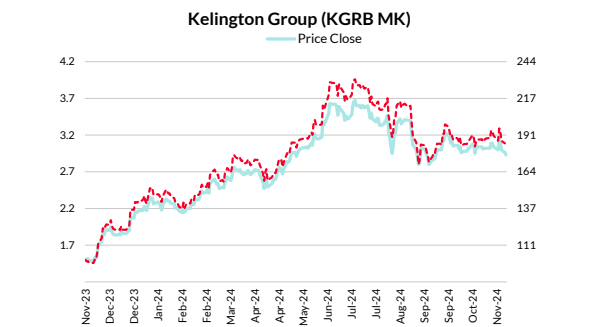


Jeffrey Tan
 +603 2302 8112
jeffrey.tan@rhbgroup.com



Share Performance (%)

	YTD	1m	3m	6m	12m
Absolute	35.0	(3.0)	(14.3)	(1.0)	94.0
Relative	24.4	(1.5)	(14.5)	(1.5)	82.6
52-wk Price low/high (MYR)				1.49	-3.67



Source: Bloomberg

Overall ESG Score: 3.3 (out of 4)

E: EXCELLENT

KGB is committed to preserve the environment through various practices, ie 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 Programme 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.

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	1,629	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)	41.19	21.62	19.19	18.31	17.45
P/B (x)	10.6	7.6	6.4	5.2	4.4
P/CF (x)	88.05	14.56	7.72	16.96	16.05
Dividend Yield (%)	0.6	1.0	1.8	1.9	2.0
EV/EBITDA (x)	29.16	15.98	11.57	10.65	9.75
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

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)	41.19	21.62	19.19	18.31	17.45
23x PE on FY25F	P/B (x)	10.6	7.6	6.4	5.2	4.4
	FCF Yield (%)	(0.4)	4.1	12.2	5.1	5.4
Key drivers	Dividend Yield (%)	0.6	1.0	1.8	1.9	2.0
i. The recovery in the semiconductor sector;	EV/EBITDA (x)	29.16	15.98	11.57	10.65	9.75
ii. New contract wins;	EV/EBIT (x)	31.80	17.22	12.43	11.44	10.47
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

Results At A Glance

Figure 1: KGB's 9M24 results

FYE Dec (MYRm)	3Q23	2Q24	3Q24	QoQ (%)	YoY (%)	9M23	9M24	YoY (%)	Comments
Revenue	401.8	321.2	307.3	-4%	-24%	1,135.7	967.8	-15%	Lower contribution from conventional businesses
Gross profit	59.3	55.5	70.1	26%	18%	143.3	178.5	25%	
<i>Gross profit margin (%)</i>	14.8%	17.3%	22.8%			12.6%	18.4%		Higher GPM due to higher contribution from higher-margin-projects and IG segments
Other income	1.8	3.3	1.4	-57%	-21%	6.7	5.8	-14%	
Finance costs	(2.8)	(2.4)	(2.4)	-1%	15%	(8.0)	(7.2)	10%	
Pretax profit	39.1	34.8	42.8	23%	9%	86.1	110.4	28%	
<i>Pretax margin (%)</i>	9.7%	10.8%	13.9%			8%	11%		
Tax	(7.1)	(7.7)	(9.2)	-20%	-29%	(17.2)	(24.0)	-40%	
Effective tax rate (%)	18%	22%	22%			20%	22%		
Minority interest	0.3	0.5	0.7	35%	98%	2.0	2.0		
Net profit	31.7	26.7	32.9	23%	4%	66.9	84.4	26%	
Core profit	31.8	25.1	40.0	59%	26%	67.4	89.7	33%	Results met expectations
<i>Core net margin (%)</i>	7.9%	7.8%	13.0%			5.9%	9.3%		

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 group undertaking more jobs.

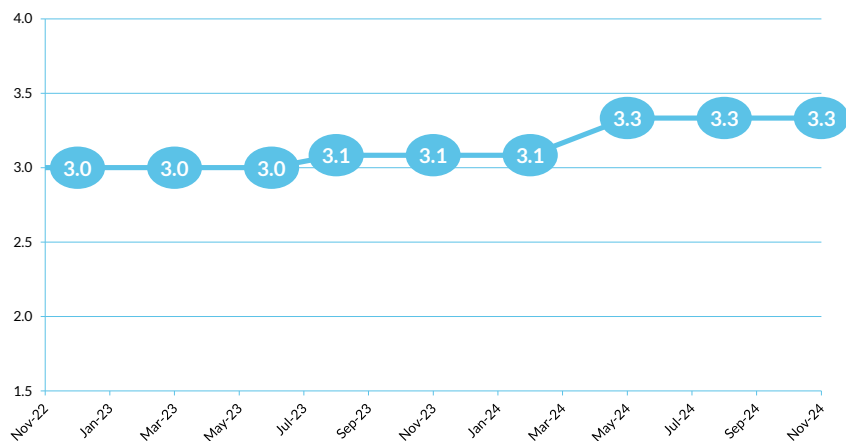
Emissions (tCO2e)	Dec-21	Dec-22	Dec-23
Scope 1	10,688	11,173	12,495
Scope 2	2,270	3,004	3,807
Scope 3	5,470	33,605	24,137
Total emissions	18,428	47,782	40,439

Source: Company data, RHB

Latest ESG-Related Developments

- The group has successfully achieved its target to reduce CO2 emission intensity by 20% in 2024 vs a 2020 baseline. The focus will be on cutting Scopes 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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Neutral:	Share price may fall within the range of +/- 10% over the next 12 months
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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