

13 June 2018

Construction & Engineering | Engineering & Construction

George Kent Malaysia

Neutral (Maintained)

Navigating In a New Landscape

Maintain **NEUTRAL**, and a new MYR1.66 TP, from MYR3.82, with expected total return of 13%. 1QFY19 PATAMI met, at 19% of our full year forecast. The lower TP is from changes to our SOP valuation to reflect the construction industry's domestic operating landscape shift. This raises the question of earnings sustainability for the sector. We lower FY19F-20F earnings 1-4% on housekeeping. We see LRT3 PDP fee recognition (booked under a 50% JV) picking up. On the continuous effort to diversify earnings base, GKent is working to expand metering and water-related investments, organically (in the process of commercialising smart meters), and via M&As. Strong MYR5.3bn orderbook could keep its engineering segment busy for 3-5 years.

1QFY19 (Jan) revenue fell 23% YoY and 42% QoQ, as both engineering (-23% YoY and -48% QoQ to MYR73m) and metering (-22% YoY and -26% QoQ to MYR27m) segment chalked in lower revenue. The decline in engineering was from the completion of fewer projects in 2017, and 50% share contribution in Light Rail Transit 3 (LRT3) project delivery partner (PDP) role recognised under the JV line. PATAMI was +16% YoY to MYR21.5m, as the JV contributed PBT of MYR9.2m (1Q18: MYR1.7m, 4Q18: MYR7.9m). Yet, on sequential basis, it declined nearly 59%, primarily from lumpy recognition in 4Q18. No dividend was declared. Its balance sheet was healthy, with a net cash of MYR362m.

Adapting to the new environment. The engineering segment's activities for the next 3-5 years are anchored by its MYR5.3bn orderbook. The key question remains on earnings sustainability. The orderbook replenishment prospect could remain soft in view of the construction sector's current state, particularly rail-related projects. Balancing this is a continuous effort to further expand its metering business (working to commercialise smart metering products), organically and via M&A. Also, George Kent intends to grow recurring income in water-related investments. Pending more concrete development, we keep our growth forecast for this segment. We expect PATAMI to grow at an organic rate of 3-5%.

Maintain NEUTRAL. We revised our SOP valuation to arrive at a new MYR1.66 TP, with a 10x P/E for its metering segment FY19F PATAMI of MYR23m, switching from P/E to NPV at a discount rate of 13% for its engineering segment and adding the latest net cash of MYR362m. Our call is premised on the expectation that risk in the sector remains high in the near-term. Our forecasts and valuation are built on the assumption that all existing engineering contracts and respective terms would remain unchanged.

Forecasts and Valuations	Jan-17	Jan-18	Jan-19F	Jan-20F	Jan-21F
Total turnover (MYRm)	599	617	394	357	228
Reported net profit (MYRm)	101	124	127	139	158
Recurring net profit (MYRm)	101	124	127	139	158
Recurring net profit growth (%)	102.3	22.8	2.3	8.9	13.8
Recurring EPS (MYR)	0.18	0.22	0.23	0.25	0.28
DPS (MYR)	0.07	0.09	0.08	0.09	0.10
Recurring P/E (x)	8.12	6.61	6.46	5.94	5.22
P/B (x)	1.37	1.73	1.46	1.26	1.09
P/CF (x)	4.6	5.6	63.4	na	na
Dividend Yield (%)	4.6	6.5	5.4	5.9	6.7
EV/EBITDA (x)	1.65	2.16	3.68	2.84	2.57
Return on average equity (%)	28.1	28.4	24.5	22.8	22.4
Net debt to equity	net cash	net cash	net cash	net cash	net cash
Our vs consensus EPS (adjusted) (%)			(4.7)	(10.6)	

Source: Company data, RHB

Target Price:	MYR1.66
Price:	MYR1.54
Market Cap:	MYR822m
Bloomberg Ticker:	GKEN MK

Share Data

Avg Daily Turnover (MYR/USD)	12.7m/3.21m
52-wk Price low/high (MYR)	1.13 - 4.42
Free Float (%)	56
Shares outstanding (m) @MYR1 par	563
Expected Share Price Return	8%
Expected Dividend Return	5%
Expected Total Return	13%

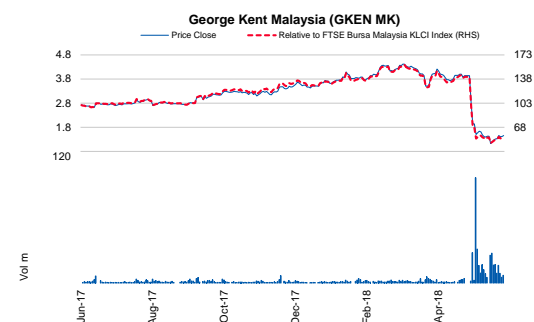
Shareholders (%)

Star Wealth Investment Ltd	14.0
Tan Swee Bee	7.7
Tan Kay Hock	4.8

Share Performance (%)

	YTD	1m	3m	6m	12m
Absolute	(58.4)	(63.0)	(65.4)	(58.1)	(46.6)
Relative	(57.2)	(59.2)	(61.7)	(61.4)	(45.9)

Source: Bloomberg



Source: Bloomberg

Additional Data

Bursa Code	3204
Listing Market	Main Market
Beta	1.7
3-Month Average Volume ('000)	7,300
ROA (%)	12.5

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Financial Exhibits

Financial model updated on: 2018-06-12

Asia	Financial summary	Jan-17	Jan-18	Jan-19F	Jan-20F	Jan-21F
Malaysia	Recurring EPS (MYR)	0.18	0.22	0.23	0.25	0.28
Construction & Engineering	EPS (MYR)	0.18	0.22	0.23	0.25	0.28
George Kent Malaysia	DPS (MYR)	0.07	0.09	0.08	0.09	0.10
Bloomberg GKEN MK	BVPS (MYR)	1.07	0.84	1.00	1.16	1.34
Neutral	Weighted avg adjusted shares (m)	563	563	563	563	563
Valuation basis	Valuation metrics	Jan-17	Jan-18	Jan-19F	Jan-20F	Jan-21F
Our valuation is based on SOP:	Recurring P/E (x)	8.12	6.61	6.46	5.94	5.22
i. P/E of 10x on metering segment FY19F PATAMI of MYR23m;	P/E (x)	8.12	6.61	6.46	5.94	5.22
ii. NPV of its engineering segment's contracts at discount rate of 13%;	P/B (x)	1.37	1.73	1.46	1.26	1.09
iii. Net near-cash balance as of 30 Apr of MYR362m.	FCF Yield (%)	21.1	17.6	1.0	(7.2)	(12.7)
	Dividend Yield (%)	4.6	6.5	5.4	5.9	6.7
	EV/EBITDA (x)	1.65	2.16	3.68	2.84	2.57
	EV/EBIT (x)	1.70	2.24	4.02	3.11	2.90
Key drivers	Income statement (MYRm)	Jan-17	Jan-18	Jan-19F	Jan-20F	Jan-21F
i. Outstanding orderbook of MYR5.3bn;	Total turnover	599	617	394	357	228
ii. Success in commercialisation of smart metering.	Gross profit	149	190	93	95	82
	EBITDA	129	145	61	62	49
	Depreciation and amortisation	(4)	(5)	(5)	(5)	(6)
	Operating profit	125	140	56	57	43
	Net interest	2	2	3	4	4
	Income from associates & JVs	7	18	109	121	160
	Pre-tax profit	134	160	167	182	207
	Taxation	(33)	(36)	(40)	(44)	(50)
	Recurring net profit	101	124	127	139	158
Key risks	Cash flow (MYRm)	Jan-17	Jan-18	Jan-19F	Jan-20F	Jan-21F
i. Slower-than-expected project executions;	Change in working capital	89	41	(5)	(70)	(95)
ii. Renegotiation of contract terms;	Cash flow from operations	179	148	13	(54)	(99)
iii. Contracts cancellation.	Capex	(5)	(3)	(5)	(5)	(5)
	Cash flow from investing activities	4	(5)	49	59	85
	Dividends paid	(29)	(44)	(45)	(48)	(55)
	Cash flow from financing activities	3	(47)	(15)	(18)	(25)
	Cash at beginning of period	242	430	511	558	545
	Net change in cash	186	96	47	(13)	(40)
	Ending balance cash	430	510	558	545	505
Company Profile	Balance sheet (MYRm)	Jan-17	Jan-18	Jan-19F	Jan-20F	Jan-21F
George Kent Malaysia (GKent) is the largest water meters manufacturer in Malaysia. Besides the domestic market, GKent also exports its water meters overseas (more than 40 countries). The group is also engaged in engineering works, covering rail, dam and hospital-related engineering and construction works.	Total cash and equivalents	430	521	558	545	505
	Tangible fixed assets	128	129	129	129	128
	Intangible assets	5	6	5	5	5
	Total investments	33	43	125	216	336
	Total other assets	1	2	1	1	1
	Total assets	910	952	1,014	1,072	1,086
	Short-term debt	56	54	84	114	144
	Total long-term debt	1	2	1	1	1
	Other liabilities	0	2	0	0	0
	Total liabilities	510	476	451	419	331
	Shareholders' equity	400	476	563	653	756
	Total equity	400	476	563	653	756
	Net debt	(373)	(465)	(473)	(430)	(360)
	Total liabilities & equity	910	952	1,014	1,072	1,086
	Key metrics	Jan-17	Jan-18	Jan-19F	Jan-20F	Jan-21F
	Revenue growth (%)	11.7	3.0	(36.1)	(9.5)	(36.0)
	Recurrent EPS growth (%)	102.3	22.8	2.3	8.9	13.8
	Gross margin (%)	24.8	30.8	23.5	26.5	36.0
	Operating EBITDA margin (%)	21.5	23.6	15.5	17.5	21.5
	Net profit margin (%)	16.9	20.2	32.3	38.8	69.1
	Dividend payout ratio (%)	37.1	43.0	35.0	35.0	35.0
	Capex/sales (%)	0.9	0.5	1.3	1.4	2.2
	Interest cover (x)	46.6	58.0	18.6	19.0	14.5

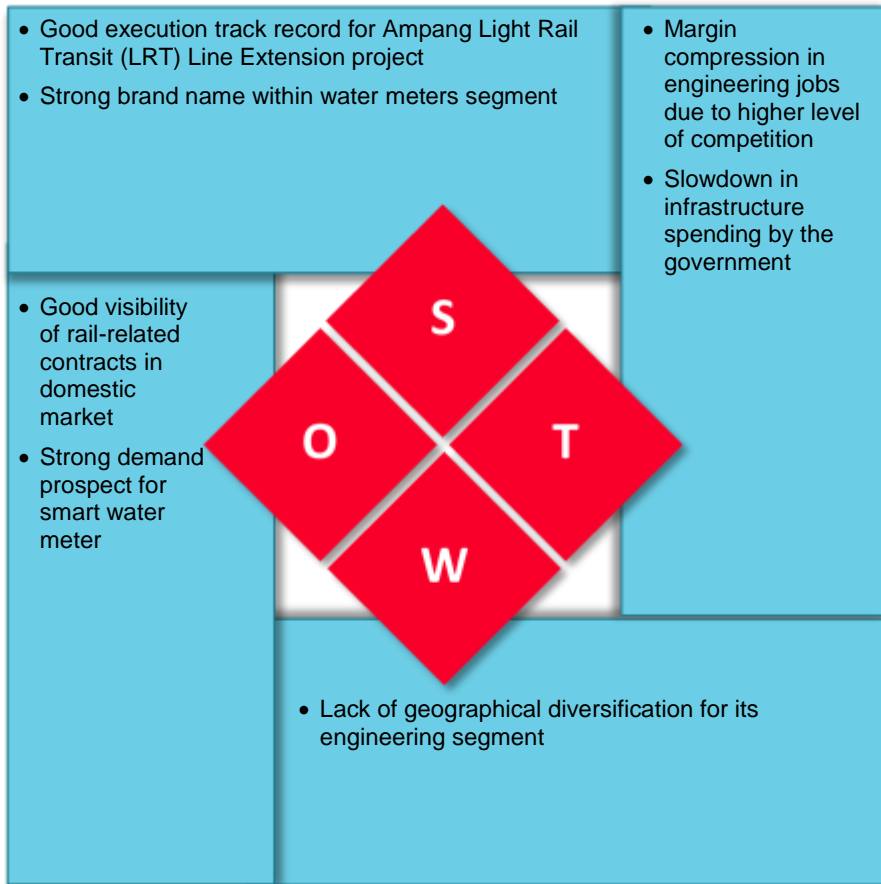
Source: Company data, RHB

Figure 1: Results review

FYE Jan (MYR'm)	1Q18	4Q18	1Q19	QoQ	YOY
Revenues	129	173	100	(42.3)	(22.9)
Cost of sales	(95)	(96)	(75)	(21.6)	(21.2)
Gross Profit	33.9	76.9	24.5	(68.1)	(27.7)
Other operating items - net	(9.9)	(18.9)	(7.6)	(59.8)	(23.4)
Operating profit	24.0	58.0	16.9	(70.8)	(29.5)
Finance costs	(0.6)	(0.6)	(0.7)	9.5	15.3
Share of results of associate	0.3	0.3	0.2	(18.1)	(35.6)
Share of results of joint venture	1.3	7.9	9.2	16.4	>100
Profit before taxation	25.0	65.6	25.7	(60.8)	2.6
Taxation	(6.5)	(13.7)	(4.2)	(69.7)	(36.5)
PATAMI	18.5	51.9	21.5	(58.5)	16.4
<i>Gross margin %</i>	26.2%	44.5%	24.6%	(44.7)	(6.2)
<i>Operating margin %</i>	18.5%	33.5%	17.0%	(49.4)	(8.5)
<i>PBT margin %</i>	19.3%	37.9%	25.8%	(32.1)	33.1
<i>Net margin %</i>	14.3%	30.0%	21.6%	(28.1)	51.0

Source: Company data, RHB

SWOT Analysis



Recommendation Chart



Date	Recommendation	Target Price	Price
2018-05-14	Neutral	3.82	2.76
2018-03-20	Buy	5.19	4.30
2018-02-12	Buy	5.03	3.76
2017-12-06	Buy	4.16	3.42
2017-10-12	Buy	3.78	3.29
2017-09-28	Buy	3.78	3.05
2017-08-29	Buy	3.78	2.77

Source: RHB, Bloomberg

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