22 November 2023

Construction & Engineering | Construction

KKB Engineering (KKB MK)

Buy (Maintained)

Let The Good Times Roll; Keep BUY

Target Price (Return):	MYR1.90 (+34%)
Price (Market Cap):	MYR1.42 (USD88.1m)
ESG score:	3.0 (out of 4)
Avg Daily Turnover (MYR/USD)	0.02m/0.00m

- **Maintain BUY and MYR1.90 TP, 34% upside and c.4% FY24F yield.** KKB Engineering's 9M23 core profit of MYR22.3m (9M22: MYR4.8m) met our (79%) full-year projections, but exceeded Street's (83%). We estimate a 3-year earnings CAGR of 42% backed by better job prospects (particularly steel fabrication works) from higher Petronas spending and Sarawak's infrastructure and green energy plans.
- **Results review.** KKB recorded >100% YoY earnings growth in 3Q23 to reach MYR9.6m (3Q22: MYR1m). The strong quarterly performance was mainly underpinned by KKB's steel fabrication division which recorded turnover growth of 208% YoY in 3Q23 from ongoing projects – three standard wellhead platforms for Sarawak Shell, and the Rosmari & Marjoram onshore gas plant in Bintulu, among others. All in, PAT margin for the engineering division as a whole in 3Q23 was higher at 7.8% vs 4% in 3Q22 which we believe was achievable via prudent cost measures arising from efficient procurement strategies.
- **As at end-September, KKB's outstanding orderbook** stood at c.MYR567m (1.7x cover ratio) with MYR510m worth of new jobs clinched YTD in FY23 (vs our FY23 job replenishment target of MYR600m). We gather that KKB's tenderbook stands at c.MYR266m – of which we estimate >50% is for oil & gas (O&G) related jobs while the remainder is for engineering, construction, and manufacturing contracts. KKB plans to participate in more bids (particularly O&G) from FY24 onwards with an estimated amount which could exceed MYR1.5bn.
- **Chances of winning more O&G-related jobs** are backed by KKB's role as the primary contractor for price agreement for the EPC of standard wellhead platforms for Sarawak Shell and Sabah Shell Petroleum (effective for five years). Moreover, the recently secured job from Malaysia Marine and Heavy Engineering (MMHE MK, BUY, TP: MYR0.60) for the Kasawari Carbon Capture & Storage (CCS) should enable KKB to build its presence in the CCS space, which is a focus under the National Energy Transition Roadmap. A medium-term catalyst would be the rollout of the second phase of the Sarawak Water Supply Grid Programme (SWP) in 1H24. KKB had secured c.MYR200m worth of jobs under the first phase of SWP.
- **No changes to our earnings estimates** as results met expectations. As such, our MYR1.90 TP is unchanged, pegged to an unchanged target FY24F P/E of 17x after ascribing a 0% ESG premium/discount. The target P/E is near the KL Energy Index's 5-year mean, to reflect robust O&G domestic spending by Petronas (c.MYR113bn over CY23-27) that may benefit fabricators such as KKB. We believe KKB deserves a BUY call as we view it as a strategic Borneo play with 10.7% of the group owned by the Sarawak Economic Development Corp – putting it at the forefront of Sarawak's infrastructure wave.
- **Key risks:** Failure to secure new contracts and higher-than-estimated cost of raw materials.

Forecasts and Valuation	Dec-21	Dec-22	Dec-23F	Dec-24F	Dec-25F
Total turnover (MYRm)	392	387	435	443	450
Recurring net profit (MYRm)	30	12	28	32	36
Recurring net profit growth (%)	70.6	(58.2)	125.9	14.1	10.9
Recurring P/E (x)	12.27	31.11	14.53	12.74	11.48
P/B (x)	0.9	1.0	1.0	1.0	0.9
P/CF (x)	13.09	9.26	7.09	7.03	6.68
Dividend Yield (%)	3.9	4.2	4.1	3.9	4.4
EV/EBITDA (x)	4.21	6.08	4.37	3.82	3.33
Return on average equity (%)	7.0	2.9	7.0	7.7	8.2
Net debt to equity (%)	net cash	net cash	net cash	net cash	net cash

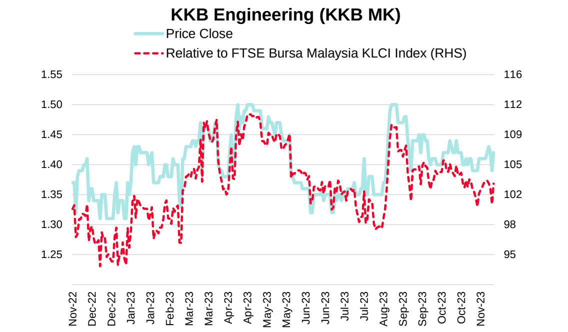
Source: Company data, RHB

Analyst

Adam Bin Mohamed Rahim
+603 9280 8682
adam.mohamed.rahim@rhbgroup.com

Share Performance (%)

	YTD	1m	3m	6m	12m
Absolute	6.0	0.0	1.4	(2.1)	4.4
Relative	8.2	(1.6)	0.2	(4.5)	3.4
52-wk Price low/high (MYR)					1.31 – 1.50



Source: Bloomberg

Overall ESG Score: 3.0 (out of 4)

E: GOOD
KKB monitors and ensures that its fuel burning system discharge complies with environmental regulations, whereby all fuel burning equipment are registered with the Department of Environment, with periodic monitoring of discharge conducted by a third party.

S: EXCELLENT
The group's commitment to operate responsibly in a safe and healthy workplace for employees is reflected through the record of around 6.2m safe-working man hours (FY21: 5.9m) with zero lost time injury for the completed and ongoing contracts as of 31 Mar 2022.

G: GOOD
Board characteristics are within the requirements stipulated by Bursa Malaysia, with half of the board consisting of independent directors.

Note:
Small cap stocks are defined as companies with a market capitalisation of less than USD0.5bn.

Financial Exhibits

Asia
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Buy

Valuation basis

FY24F P/E of 17x. KKB's net cash position allows it to gear up for more jobs moving forward.

Key drivers

KKB Engineering's earnings are backed by an outstanding order backlog of c.MYR470m as of end-Jun 2022, which mainly comes from construction contracts and oil and gas contracts.

Key risks

i. Failure to secure new contracts;
ii. Higher-than-estimated cost of raw materials.

Company Profile

KKB Engineering is primarily involved in steel fabrication, civil construction and the manufacturing of steel pipes and liquefied petroleum gas (LPG) cylinders.

Financial summary (MYR)	Dec-21	Dec-22	Dec-23F	Dec-24F	Dec-25F
Recurring EPS	0.12	0.05	0.10	0.11	0.12
DPS	0.06	0.06	0.06	0.06	0.06
BVPS	1.55	1.38	1.42	1.47	1.54
Return on average equity (%)	7.0	2.9	7.0	7.7	8.2

Valuation metrics	Dec-21	Dec-22	Dec-23F	Dec-24F	Dec-25F
Recurring P/E (x)	12.27	31.11	14.53	12.74	11.48
P/B (x)	0.9	1.0	1.0	1.0	0.9
FCF Yield (%)	7.4	10.6	12.9	13.0	13.8
Dividend Yield (%)	3.9	4.2	4.1	3.9	4.4
EV/EBITDA (x)	4.21	6.08	4.37	3.82	3.33
EV/EBIT (x)	5.46	8.74	5.39	4.55	3.86

Income statement (MYRm)	Dec-21	Dec-22	Dec-23F	Dec-24F	Dec-25F
Total turnover	392	387	435	443	450
Gross profit	72	58	72	80	86
EBITDA	49	35	50	56	61
Depreciation and amortisation	(11)	(11)	(9)	(9)	(8)
Operating profit	38	24	40	47	52
Net interest	(3)	0	(1)	(2)	(2)
Pre-tax profit	34	25	42	48	53
Taxation	(5)	(7)	(10)	(11)	(13)
Reported net profit	26	12	28	32	36
Recurring net profit	30	12	28	32	36

Cash flow (MYRm)	Dec-21	Dec-22	Dec-23F	Dec-24F	Dec-25F
Change in working capital	(5.7)	19.2	17.5	12.6	11.1
Cash flow from operations	28.0	42.0	57.8	58.3	61.4
Capex	(0.8)	(0.8)	(5.0)	(5.0)	(5.0)
Cash flow from investing activities	(65.6)	(44.9)	(39.4)	(44.4)	(44.4)
Dividends paid	(10.3)	(14.4)	(17.3)	(16.9)	(16.1)
Cash flow from financing activities	33.6	(15.6)	(18.6)	(18.4)	(17.7)
Cash at beginning of period	38.3	34.4	16.1	15.7	11.2
Net change in cash	(3.9)	(18.5)	(0.2)	(4.5)	(0.7)
Ending balance cash	34.4	15.9	16.0	11.2	10.5

Balance sheet (MYRm)	Dec-21	Dec-22	Dec-23F	Dec-24F	Dec-25F
Total cash and equivalents	192	221	231	238	252
Tangible fixed assets	148	135	143	136	129
Total investments	7	8	9	11	13
Total assets	517	551	580	597	620
Short-term debt	0	0	0	0	0
Total long-term debt	0	0	0	0	0
Total liabilities	77	108	122	119	120
Total equity	440	443	458	478	500
Total liabilities & equity	517	551	580	597	620

Key metrics	Dec-21	Dec-22	Dec-23F	Dec-24F	Dec-25F
Revenue growth (%)	(4.0)	(1.2)	12.5	1.8	1.5
Recurrent EPS growth (%)	70.3	(60.6)	114.2	14.1	10.9
Gross margin (%)	18.3	14.9	16.5	18.0	19.0
Operating EBITDA margin (%)	12.6	9.1	11.5	12.6	13.5
Net profit margin (%)	6.6	3.0	6.5	7.3	7.9
Dividend payout ratio (%)	55.5	148.0	60.0	50.0	50.0
Capex/sales (%)	0.2	0.2	1.1	1.1	1.1
Interest cover (x)	12.1	56.9	22.3	20.5	22.6

Source: Company data, RHB

Figure 1: KKB's results review

FYE Dec (MYRm)	3Q22	2Q23	3Q23	QoQ (%)	YoY (%)	9M22	9M23	YoY (%)	Comments
Revenue	**102.0**	**104.4**	**140.1**	**34.2**	**37.3**	**305.1**	**304.9**	**-0.1**	Lower revenue from civil construction
EBIT	**5.7**	**14.7**	**13.7**	**-6.5**	**>100**	**10.5**	**31.1**	**>100**	
EBIT Margin (%)	*5.6*	*14.1*	*9.8*			*3.5*	*10.2*		
Interest expense	-0.1	-0.4	-0.6	34.0	**>100**	-0.2	-1.3	**>100**	
Interest income	0.1	0.2	0.3	19.5	**>100**	0.3	0.7	**>100**	
JV/Associates	0.4	0.5	0.4	-30.2	-4.4	0.7	1.2	77.6	
EI/Others	0.0	-0.3	-0.1	-61.6	**>-100**	-0.2	-0.7	**>100**	
Pretax profit	**4.5**	**16.4**	**15.4**	**-5.6**	**>100**	**10.5**	**37.4**	**>100**	
Pretax Margin (%)	*4.4%*	*15.7%*	*11.0%*			*3.4%*	*12.3%*		Better cost management
Tax	-0.9	-3.7	-3.6	-2.2	**>100**	-2.4	-8.3	**>100**	
Effective tax rate (%)	*20.3*	*-22.8*	*23.6*			*23.0*	*22.3*		
Minority Interest	-2.6	-2.7	-2.1	-24.8	-88.0	-3.0	-6.0	98.1	
Net Profit	**1.0**	**9.9**	**9.7**	**-1.6**	**>100**	**5.0**	**23.0**	**>100**	
Core Profit	**1.0**	**9.6**	**9.6**	**0.1**	**>100**	**4.8**	**22.3**	**>100**	Within expectations
Core Net Margin (%)	*1.0%*	*9.2%*	*6.9%*			*1.6%*	*7.3%*		

Source: Company data, RHB

Emissions And ESG

Trend analysis

N/A

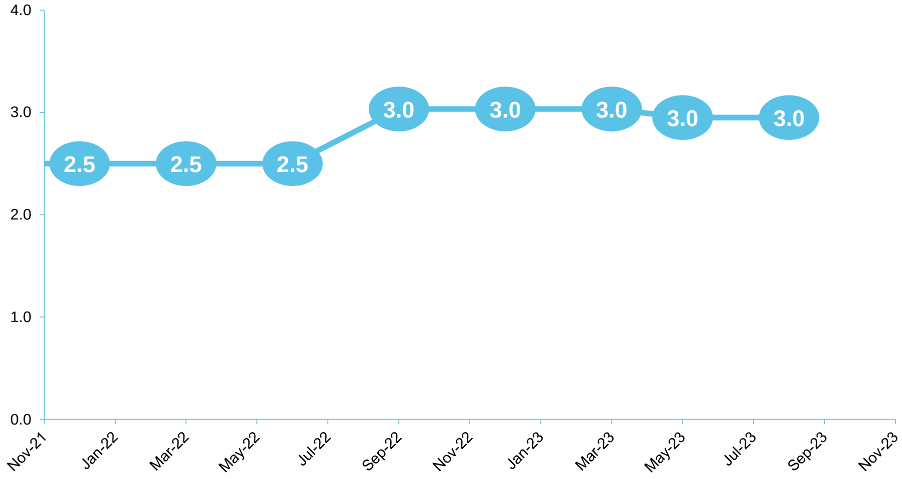
Emissions (tCO2e)	Dec-20	Dec-21	Dec-22
Scope 1	-	-	-
Scope 2	-	-	-
Scope 3	-	-	-
Total emissions	na	na	na

Source: Company data, RHB

Latest ESG-Related Developments

- Introduction of new decanter has significantly reduced the emission of smoke. The very small amount of smoke emitted from the decanter is properly channelled through the ducting and dispersed through the chimney.
- Spent hydraulic oil is being reused as lubrication for heavy duty machineries such as shovel trucks and forklifts. Machine parts which are constantly soiled by cement waste water are coated with this spent oil as a release agent to minimise efforts in doing cleaning.

ESG Rating History



Source: RHB

Recommendation Chart

Source: RHB, Bloomberg

Date	Recommendation	Target Price	Price
2023-08-21	Buy	1.90	1.45
2023-05-25	Buy	1.80	1.44
2023-04-10	Buy	1.72	1.40
2023-03-21	Buy	1.72	1.44
2023-02-24	Buy	1.72	1.41
2023-01-18	Buy	1.72	1.42
2022-11-17	Buy	1.60	1.36
2022-10-03	Buy	1.85	1.44
2022-09-21	Buy	1.85	1.44
2021-09-15	Buy	1.68	1.31
2020-10-22	Buy	2.00	1.43

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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Analyst	Company
-	-

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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 9280 8888
Fax : +603 9200 2216

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