

25 May 2023

Construction & Engineering | Construction

KKB Engineering (KKB MK)

Buy (Maintained)

Revving Up The Engines; Keep BUY

Target Price (Return): MYR1.80 (+25%)
Price (Market Cap): MYR1.44 (USD90.9m)
ESG score: 2.95 (out of 4)
Avg Daily Turnover (MYR/USD) 0.05m/0.01m

- **Maintain BUY, new TP of MYR1.80 from MYR1.72, 25% upside with c.4% FY24F yield.** KKB Engineering's 1Q23 core profit of MYR3.4m (+53% YoY) is below estimates, at only 12% of our and Street full-year projections. The negative deviation was due to some steel fabrication and civil construction jobs that have yet to pick up pace. We estimate a 3-year earnings CAGR of 40%, backed by better job prospects from an increase in Petronas' expenditure budget, and upcoming Borneo-based projects such as the Trans-Borneo Highway.
- **Results review.** Despite recording revenue of MYR60.5m (-35% YoY) in 1Q23 (1Q22: MYR93.4m) KKB's PBT for the same quarter was >50% YoY higher. In fact, its 1Q23 PBT margin spiked up to 9.2% (1Q22: 3.4%), due to improved GPMs from the steel fabrication and civil construction divisions (due to variation orders), and supported by a better performance from its associate Edisi Optima, which is involved in the requalification and repair of LPG cylinders.
- **Orderbook.** We estimate KKB's outstanding orderbook (as at end-April) at c.MYR700m (1.7x cover ratio). We gathered that its submitted bids for c.MYR1bn worth of projects – of which 80% are for oil & gas related jobs while the remainder is for engineering, construction and manufacturing contracts (outcome to be known in 2H23). KKB's appointment as the primary contractor for the price agreement for the EPC of standard wellhead platforms for Sarawak Shell and Sabah Shell Petroleum (effective for five years) may put the group at the forefront when bidding for steel fabrication jobs from such oil majors. Looking ahead, the recently secured oil & gas jobs from Sarawak Shell and Samsung Engineering should contribute positively in the coming quarters as they move along the S-curve.
- **We cut FY23-25F earnings by 12-14%** as we have now factored in a more conservative timeline for its engineering projects. Post forecast adjustments and the rollover of our valuation base year to FY24 from FY23, we arrive at a new TP of MYR1.80, pegged to an unchanged target FY24F P/E of 17x after ascribing a 0% ESG premium based on our in-house methodology. The target P/E is near the KL Energy Index's 3-year mean – to reflect robust oil & gas spending by Petronas (c.MYR60bn pa over 2023-2027) that may benefit fabricators. This target P/E is also justified by the Sarawak State Government's estimated MYR100bn injection into its economy by 2030, which may support infrastructure expansion. With that, KKB could be a strategic Borneo play, backed by its lean balance sheet (net cash position of >MYR200m) – enabling it to easily gear up for future projects. Key downside risks include a failure to secure new contracts, higher-than-estimated cost of raw materials, and a slowdown in construction activities.
- **ESG framework update.** As there is now greater focus on the E pillar on critical climate change issues, we tweaked our ESG weightage. Henceforth, we assign a 50% weightage to the E pillar, followed by 25% each to the S and G pillars. See our [2 May thematic research](#) for more details.

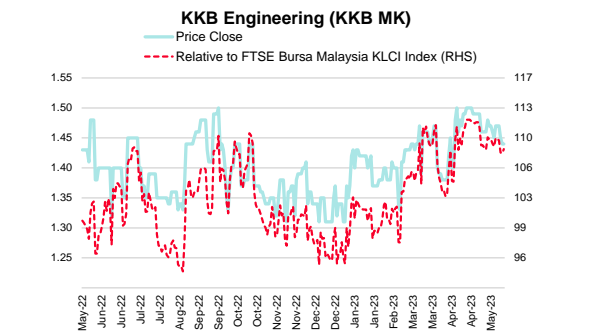
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Share Performance (%)

	YTD	1m	3m	6m	12m
Absolute	7.5	(4.0)	2.1	9.1	(2.7)
Relative	13.1	(3.2)	5.3	11.3	5.8
52-wk Price low/high (MYR)	1.31 – 1.50				



Source: Bloomberg

Forecasts and Valuation	Dec-21	Dec-22	Dec-23F	Dec-24F	Dec-25F
Total turnover (MYRm)	392	387	415	439	450
Recurring net profit (MYRm)	30	12	25	31	34
Recurring net profit growth (%)	70.6	(58.2)	102.8	20.4	12.3
Recurring P/E (x)	12.44	31.55	16.41	13.63	12.14
P/B (x)	0.9	1.0	1.0	1.0	0.9
P/CF (x)	13.27	9.39	7.64	7.53	7.04
Dividend Yield (%)	3.9	4.2	3.0	3.7	4.1
EV/EBITDA (x)	4.32	6.24	4.72	3.99	3.47
Return on average equity (%)	7.0	2.9	6.3	7.3	7.9
Net debt to equity (%)	net cash	net cash	net cash	net cash	net cash

Source: Company data, RHB

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 is 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 its 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 members being made up of independent directors.

Note:

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

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Financial Exhibits

Asia	Financial summary (MYR)	Dec-21	Dec-22	Dec-23F	Dec-24F	Dec-25F
Malaysia	Recurring EPS	0.12	0.05	0.09	0.11	0.12
Construction & Engineering	DPS	0.06	0.06	0.04	0.05	0.06
KKB Engineering	BVPS	1.55	1.38	1.42	1.48	1.54
KKB MK	Return on average equity (%)	7.0	2.9	6.3	7.3	7.9
Buy						
	Valuation metrics	Dec-21	Dec-22	Dec-23F	Dec-24F	Dec-25F
	Recurring P/E (x)	12.44	31.55	16.41	13.63	12.14
	P/B (x)	0.9	1.0	1.0	1.0	0.9
	FCF Yield (%)	7.3	10.4	11.9	12.1	13.0
	Dividend Yield (%)	3.9	4.2	3.0	3.7	4.1
	EV/EBITDA (x)	4.32	6.24	4.72	3.99	3.47
	EV/EBIT (x)	5.59	8.97	5.88	4.75	4.02
	Income statement (MYRm)	Dec-21	Dec-22	Dec-23F	Dec-24F	Dec-25F
	Total turnover	392	387	415	439	450
	Gross profit	72	58	69	79	86
	EBITDA	49	35	48	56	61
	Depreciation and amortisation	(11)	(11)	(9)	(9)	(8)
	Operating profit	38	24	39	47	52
	Net interest	(3)	0	(4)	(4)	(4)
	Pre-tax profit	34	25	37	45	51
	Taxation	(5)	(7)	(9)	(11)	(12)
	Reported net profit	26	12	25	31	34
	Recurring net profit	30	12	25	31	34
	Cash flow (MYRm)	Dec-21	Dec-22	Dec-23F	Dec-24F	Dec-25F
	Change in working capital	(5.7)	19.2	18.2	12.0	11.0
	Cash flow from operations	28.0	42.0	54.4	55.2	59.1
	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)	(12.7)	(15.3)
	Cash flow from financing activities	33.6	(15.6)	(18.5)	(14.0)	(16.8)
	Cash at beginning of period	38.3	34.4	16.1	12.4	9.1
	Net change in cash	(3.9)	(18.5)	(3.5)	(3.2)	(2.1)
	Ending balance cash	34.4	15.9	12.7	9.1	7.0
	Balance sheet (MYRm)	Dec-21	Dec-22	Dec-23F	Dec-24F	Dec-25F
	Total cash and equivalents	192	221	228	236	249
	Tangible fixed assets	148	135	143	136	129
	Total investments	7	8	9	11	13
	Total assets	517	551	571	594	617
	Short-term debt	0	0	0	0	0
	Total long-term debt	0	0	0	0	0
	Total liabilities	77	108	112	116	118
	Total equity	440	443	459	478	499
	Total liabilities & equity	517	551	571	594	617
	Key metrics	Dec-21	Dec-22	Dec-23F	Dec-24F	Dec-25F
	Revenue growth (%)	(4.0)	(1.2)	7.4	5.7	2.4
	Recurrent EPS growth (%)	70.3	(60.6)	92.2	20.4	12.3
	Gross margin (%)	18.3	14.9	16.5	18.0	19.0
	Operating EBITDA margin (%)	12.6	9.1	11.6	12.6	13.5
	Net profit margin (%)	6.6	3.0	6.1	6.9	7.6
	Dividend payout ratio (%)	55.5	148.0	50.0	50.0	50.0
	Capex/sales (%)	0.2	0.2	1.2	1.1	1.1
	Interest cover (x)	12.1	56.9	9.4	10.7	11.7

Source: Company data, RHB

Figure 1: KKB's results review

FYE Dec (MYRm)	1Q22	4Q22	1Q23	QoQ (%)	YoY (%)	Comments
Revenue	93.4	81.7	60.5	-26.0	-35.2	Lower revenue from civil construction and steel fabrication
EBIT	2.6	13.9	2.7	-80.3	4.2	
<i>EBIT Margin (%)</i>	<i>2.8%</i>	<i>17.0%</i>	<i>4.5%</i>			
Interest expense	0.0	-0.2	-0.3	20.1	nm	
Interest income	0.1	0.1	0.2	28.4	66.7	
JV/Associates	0.0	0.8	0.3	-55.4	nm	
EI/Others	-0.2	1.0	0.0	nm	-82.9	
Pretax profit	3.2	14.6	5.6	-61.9	76.7	
<i>Pretax Margin (%)</i>	<i>3.4%</i>	<i>17.9%</i>	<i>9.2%</i>			
Tax	-1.1	-4.2	-1.0	-77.3	-13.1	
<i>Effective tax rate (%)</i>	<i>34.9%</i>	<i>-28.8%</i>	<i>17.1%</i>			
Minority Interest	0.3	-3.7	-1.2	-67.4	-44.6	
Net Profit	2.4	6.7	3.4	-49.1	42.4	
Core Profit	2.2	7.6	3.4	-55.9	53.2	Below expectations
<i>Core Net Margin (%)</i>	<i>2.4%</i>	<i>9.4%</i>	<i>5.6%</i>			

Source: Company data, RHB

Recommendation Chart

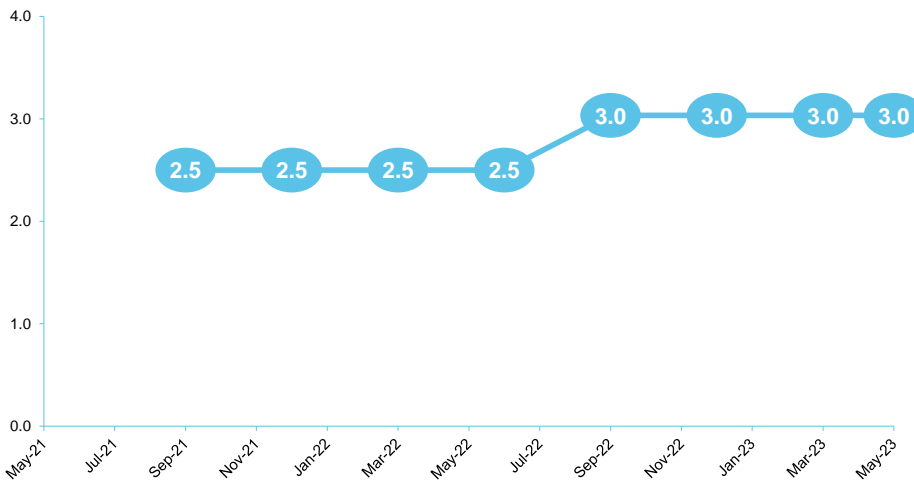


Date	Recommendation	Target Price	Price
2023-04-10	Buy	1.72	1.40
2023-03-21	Buy	1.72	1.44
2023-02-24	Buy	1.72	1.41
2023-01-18	Buy	1.72	1.42
2022-11-17	Buy	1.60	1.36
2022-10-03	Buy	1.85	1.44
2022-09-21	Buy	1.85	1.44
2021-09-15	Buy	1.68	1.31
2020-10-22	Buy	2.00	1.43

Source: RHB, Bloomberg

Source: RHB, Bloomberg

ESG Rating History



Source: RHB

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Trading Buy:	Share price may exceed 15% over the next 3 months, however longer-term outlook remains uncertain
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