

09 August 2016

George Kent (M) Berhad

Beyond Water Meter Manufacturing

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INVESTMENT MERIT

We like George Kent (M) Berhad (GKENT) for its niche business in the construction space specialising in M&E and system related works, which propelled them to be one of the preferred rail-related contractors in recent years given their role in LRT2 and LRT3. Looking ahead, we are projecting an impressive earnings growth trajectory of 26-58% for FY17-18E backed by existing order book, and we also like them for their strong net cash position and consistent dividend pay-out >40% (FY17E yield; 3.6%). Hence, we have a TRADING BUY call on GKENT with a Sum-of-Parts (SoP)-driven Target Price of RM2.71.

It all begins with LRT2 system works. From an investment perspective, GKENT should be repositioned as a construction player, although most investors still regard them as a water meter manufacturer rather than a construction player. GKENT came into the limelight when they first bagged the c.RM1.0b system works for LRT2 in 2012 and they faced much scepticism on their ability in executing such mega projects back then. However, prior to their foray into rail infrastructure, GKENT was already actively involved with system works in the water industry. Strong projects execution enabled them in growing its construction division over the past four years with construction profits making up an average c.68% of pre-tax profits. That said, their pre-tax margins for their construction division have been fairly decent at an average of 11% over the past four years, which have improved from 7% to 14% from FY13 to FY16, which is comparable with mid-cap players such as MITRA, GADANG and KERJAYA.

Continued with LRT3 PDP role... Last year, along with their JV partner MRCB, GKENT has successfully bagged a bigger role in the rail infrastructure scene, as the PDP for LRT3 with an estimated cost of RM9.0b due to their strong execution track record for LRT2 works. Based on the 6% PDP fees, GKENT would easily register pre-tax profits of RM54.0m per annum. However, we reckon that there could be more upside to the initial estimated cost of RM9.0b as the final cost would only be concluded once the final tender is awarded.

Hungry for more jobs. Its outstanding order book stands at c.RM600.0m (excluding LRT3), will provide them visibility for a year. However, management indicated that they are still bidding for more jobs despite landing the PDP role for LRT3. Currently, management is eyeing at least two more hospital jobs worth c.RM700.0m, MRT2 track works worth c.RM1.0b and more water-related infrastructure projects for the replenishment of its bread and butter business.

Net cash with decent payout. Over the past five years, GKENT had been consistently paying out >40% of its net profits as dividends. Although not having a formal dividend policy, this is at a higher-end in terms of pay-out amongst contractors. We believe that with its strong net cash position of RM223.1m or RM0.74/share, GKENT is able to maintain its pay-out comfortably. At an assumed 40% pay out, we would be expecting DPS of 8.0 sen for FY17, which translates to a yield of 3.6% that is higher compared its peers (KERJAYA, MITRA, GADANG) average of 2.7%.

Exciting growth ahead! For FY17, we are only assuming a conservative order book replenishment of RM700.0m and net profit growth of 26-58% for FY17-18E. Our FY17E growth of 26% is backed by its outstanding order book of c.RM600.0m coupled with our assumptions of RM700.0m. Our growth for FY18 is substantially higher compared to FY17 as we assumed full contribution for LRT3 PDP fees in FY18. Based on channel checks, the 8 system and 12 civil packages for LRT3 are expected from 4QCY16 onwards which we believe GKENT would be able to reap the full benefits of its PDP fees upon the commencement works for LRT3.

Trading BUY! We value GKENT at RM2.71 based on SoP valuation methodology that implies a 12.8x FY17E PER. For its construction division (63% of SoP), we are only ascribing a valuation of 10.0x FY17E PER which is still below KERJAYA, GADANG and MITRA's applied PER of 12.0-13.0x. We see additional room for further upgrades should GKENT continue to deliver earnings performance (refer overleaf for other segment details for our SoP valuation). That said, we also believe that the next re-rating catalyst for GKENT is higher construction cost for LRT3 above RM9.0b as this would further increase their profitability based on the PDP fees of 6%. Currently, it offers a dividend yield of 3.6%, which is still far superior compared to its mid-cap peers average of 2.7%.

	Rating	Fair Value
Last Price		RM2.37
Kenanga	Trading Buy	RM2.71
Consensus	BUY	RM3.23

Stock Information

Shariah Compliant	Yes
Stock Name	GKENT BERHAD
CAT Code	3204
Industry	Industrials
Industry Sub-sector	Industrials Machinery
YTD stock price chg	45.4%
Market Cap (RM m)	712.0
Issued shares (m)	300.4
52-week range (Hi)	2.40
52-week range (Low)	1.06
3-mth avg daily vol:	990,708
Free Float	73%
Beta	1.0
Altman's Z-score	2.51

Major Shareholders

STAR WEALTH INVESTME	14.0%
SWEE BEE TAN	7.7%
HECTOMIC LTD	5.0%

Financials

FYE Jan (RM'm)	2016A	2017E	2018E
Revenue	538.1	663.8	533.4
EBIT	60.1	84.7	79.4
Net Profit (NP)	50.3	63.4	100.5
EPS (sen)	16.7	21.1	33.5
BV/Share (RM)	1.1	1.2	1.4
PER	14.2	11.2	7.1
Price/BV (x)	2.2	2.0	1.6
Net Gearing (x)	-0.7	-0.8	-0.9
DPS (sen)	7.0	8.4	8.4
Dividend Yield (%)	3.0%	3.6%	3.5%

Quarterly

Financial Data	3Q16	4Q16	1Q17
Revenue	96.9	267.5	123.0
PBT	16.7	28.0	20.3
Net Profit (NP)	12.1	19.9	15.0
EPS (sen)	4.0	6.6	5.0
EPS Growth (QoQ)	42%	65%	-24%
Revenue Growth (QoQ)	-15%	176%	-54%
PBT Margin	17%	10%	16%

Peers Comparisons	PER (FY17)	Div. Yld (%)	Mkt Cap (RM'm)
KERJAYA	10.5	2.3	1161
MITRA	10.0	3.0	936
GADANG	6.4	2.7	639
Average	9.0	2.7	912
GKENT	11.2	3.6	712
FBMKLCI	15.1	3.1	1.0T

Sum of Parts Valuation

Division	Market Cap (RM'm)	% of SoP
Metering - 8x FY17 PER (comparable with ENGTEX)	97.7	12%
Construction - 10x FY17 PER (Below peers i.e. KERJAYA, MITRA, GADANG of 12-13x)	512.2	63%
PDP NPV (WACC at 10%) with an applied discount of 30%	107.5	13%
Net Cash (1Q17) with an applied discount of 43% inline with PTARAS	95.9	12%
Total	813.3	
Shares Outstanding	300.4	
Target Price	2.71	

Source: Bloomberg, Kenanga Research

Daily Charting – George Kent (M) Berhad



Comment: GKENT has been on the limelight over the past few weeks, particularly after it staged a technical breakout from its 2-week consolidation zone to surge another 12.9% to close at RM2.37 last Friday. The primary trend of the share price is still positive, as it is currently trading above all its uptrending key SMAs. MACD histogram is also portraying a bullish convergence to lend a hand on the bullish outlook, while RSI and Stochastic are also hooking up albeit already in their respective overbought condition. All in, while the overall technical picture is still positive, we do not discount the possibility of the stock consolidating to neutralize its overbought condition after it had already achieved its upside target objective (as shown on chart based on its previous run up). We advocate interested investors to Buy On Weakness whenever the stock consolidate towards the RM2.22 (S1), while taking note of the following RM2.10 (S2)/ RM2.00 (S3) support levels. Overhead resistance are envisaged at RM2.40 (R1) / RM2.55 (R2) / RM2.70 (R3).

About the stock:

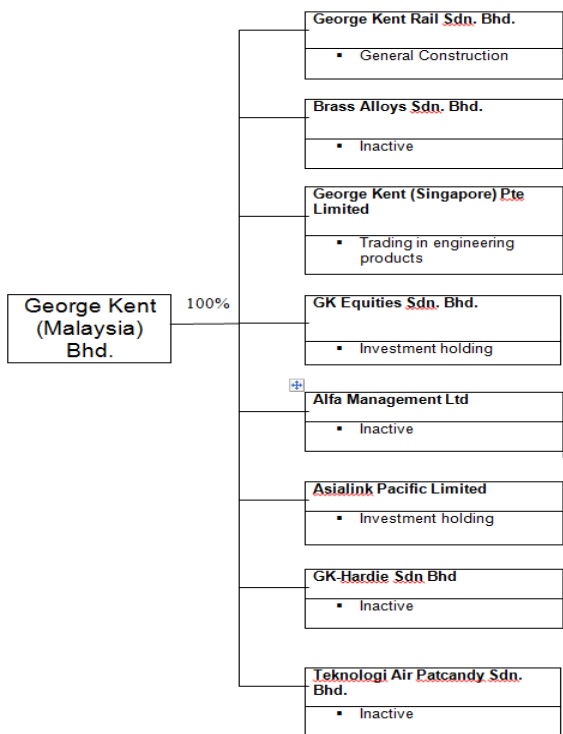
Name : George Kent (M) Berhad
Bursa Code : GKENT
CAT Code : 3204

Key Support & Resistance level

Resistance : RM2.40 (R1) RM2.55 (R2) RM2.70 (R3)
 Support : RM2.22 (S1) RM2.10 (S2) RM2.00 (S3)
 Outlook : Bullish

Source: Kenanga Research

CORPORATE STRUCTURE



BUSINESS OVERVIEW

- George Kent has its origin in Penang as a service branch office of George Kent Limited, U.K. in 1936. The company set up a manufacturing plant on a 4-acre site in Shah Alam in July 1968. Four years later, George Kent was listed on the Kuala Lumpur Stock Exchange (KLSE).
- George Kent underwent expansion when it moved to a 17-acre modern and integrated manufacturing facility in Puchong, Selangor in January 1997.
- George Kent is a world-renowned and leading manufacturer of water meters, valves and fittings and brass products, exporting to more than 40 countries in several continents including Singapore, Vietnam, Thailand, Cambodia, Indonesia, Philippines, Papua New Guinea, Australia, Hong Kong, Sri Lanka, Kenya, South Africa, Colombia and the United Kingdom.

BUSINESS SEGMENTS

- **Engineering:** Includes water supply infrastructure, rail transportation and hospitals. Have undertaken various projects and has accumulated valuable experience in the turnkey design and build as well as conventional construction of water-treatment plants. The engineering division has also kept the Group in a forward-moving course as it has enabled the Group to deliver more than 30 projects in the water infrastructure, water works and services, rail transportation and healthcare sectors.
- **Metering:** Includes metering, industrial products, industrial process manufacturing and OEM.

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