

George Kent (BUY ↔; EPS ↑)
INDUSTRY: OVERWEIGHT
EARNINGS EVALUATION
23 June 2017
Price Target: RM5.60 (↑)
Share price: RM3.94
Sprinting start
Results

- GKent reported 1QFY18 results with revenue of RM129.4m (-32% QoQ, +5% YoY) and core earnings (ex. forex) of RM21.4m (-42% QoQ, +36% YoY).

Deviation

- 1Q core earnings made up 23% of our full year estimates. We consider this being above our expectations after accounting for the fact that 2H generally tends to be stronger. To illustrate, 2H contributed 63-64% of full year earnings for FY16-17.

Dividends

- None declared for the quarter. Final dividend of 5 sen previously declared goes ex on 28 June (next Wed).

Highlights

- **Engineering performance continues.** Engineering revenue was flat YoY while margin (ex. JV and associates) expanded slightly from 20.8% to 21.5%, increasing PBT by 3%. The QoQ decline in revenue and PBT by 39% and 55% is not a concern given the high base last quarter (4Q is traditionally the strongest).
- **LRT3 to take off soon.** GKent has yet to book in any PDP fees from the LRT3. We understand that the JV profits recorded so far (RM1.3m in 1QFY18 and RM8.2m last year) are mainly for reimbursable costs for the project. Tenders for several viaduct packages have been called and we expect awards to materialise sometime in 3Q17. While not confirmed, we gather that the value of the LRT3 could be increased from RM9bn to RM12bn after taking into (i) higher cost environment since the PDP award in Sept 2015 and (ii) additional work scope required.
- **Strong metering delivery.** Although metering revenue rose 22% YoY, PBT grew by a much larger magnitude of 160% as margin more than doubled from 13.2% to 28.2%. We reckon this is due to more domestic deliveries which generally command higher margins.

Risks

- Delays in the rollout LRT3 would be the key risk.

Forecasts

- Given the stronger than expected results, we raise FY18-19 earnings by 8% and 7% respectively.

Rating
Maintain BUY, TP raised to RM5.60

- GKent is a key rail play with exposure to the LRT extension, LRT3 and MRT2. We believe it is in a prime position to participate in upcoming mega rail projects such as the ECRL and HSR. It also boasts solid financials with above industry ROE of 24%, 3 year projected earnings CAGR of 12% and net cash position of RM1.02/share (26% of market cap). GKent remains our top pick in the construction sector.

Valuation

- Apart from the earnings upgrade, we also raise our P/E target from 15x to 16x as we feel that GKent should be valued on par with larger cap contractors given its strong financials and exposure to mega rail jobs. Our valuation horizon is also rolled over from FY18 to mid-FY19. TP is raised from RM4.73 to RM5.60.

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KLCI	1777.4
Expected share price return	42.1%
Expected dividend return	3.4%
Expected total return	45.6%

Share price

Information

Bloomberg Ticker	GKEN MK
Bursa Code	3204
Issued Shares (m)	376
Market cap (RM m)	1,480
3-mth avg. volume ('000)	1,174
SC Shariah-compliant	Yes

Price Performance	1M	3M	12M
Absolute	-2.0	1.5	167.7
Relative	-2.6	-0.2	147.0

Major shareholders

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

Summary Earnings Table

FYE	Jan (RM m)	FY17	FY18E	FY19F	FY20F
Revenue	599	650	630	626	
EBITDA	126	135	105	91	
EBIT	122	130	101	86	
Profit Before Tax	127	137	141	154	
Core PATAMI	94	101	113	130	
vs Consensus (%)		-	-	-	
Core EPS (sen)	25.0	27.0	30.2	34.7	
P/E (x)	15.8	14.6	13.0	11.4	
P/E ex cash (x)	11.7	10.8	9.7	8.4	
Net DPS (sen)	10.0	13.5	15.1	17.4	
Net DY (%)	2.5	3.4	3.8	4.4	
BV per share	1.07	1.20	1.35	1.52	
P/B (x)	3.7	3.3	2.9	2.6	
ROE (%)	26.0	23.8	23.7	24.1	
Net Gearing (%)	CASH	CASH	CASH	CASH	

HLIB

Figure #1 Quarterly results comparison

FYE Jan (RM m)	1QFY17	4QFY17	1QFY18	QoQ (%)	YoY (%)	Comments
Revenue	123.0	189.1	129.4	(31.6)	5.3	QoQ: Lower due to high base in 4QFY17. YoY: Higher driven by metering segment (+22%).
EBIT	20.8	52.0	26.9	(48.3)	29.1	
Finance cost	(0.5)	(0.8)	(0.6)	(22.6)	15.2	
Associates & JVs	0.7	1.5	1.6	11.7	131.9	Mainly from PNG Water Ltd and LRT3 reimbursables.
PBT	21.0	52.7	27.9	(47.0)	32.9	
PAT	15.7	36.8	21.4	(41.9)	35.9	
PATMI - core	15.7	36.8	21.4	(41.9)	35.9	Above expectations (23% of full year forecast) considering that 1Q tends to be the slowest.
PATMI - reported	15.0	42.1	18.5	(56.1)	23.2	Includes forex loss of RM3m.
EPS - core	4.2	9.8	5.7			
EBIT margin (%)	16.9	27.5	20.8			QoQ: Lower due to high base in 4QFY17. YoY: Higher driven by metering segment (more domestic deliveries).
PBT margin (%)	17.1	27.9	21.6			
Company						

Figure #2 SOP based valuation for GKent

SOP Component	Amount (RM m)	Multiple (x)	Valuation (RM m)	Per Share
Mid-FY19 core earnings	107	16	1,719	4.58
Net cash	383	1	383	1.02
SOP Value			2,102	5.60

HLIB estimates

Financial Projections for George Kent

Balance Sheet

FYE Jan (RM m)	FY16	FY17	FY18F	FY19F	FY20F
Cash	242	430	373	440	510
Receivables	241	267	285	276	275
Inventories	48	43	66	64	63
PPE	121	128	129	130	129
Others	31	41	41	41	41
Assets	683	910	894	951	1,017
Debits	27	57	52	47	42
Payables	326	440	379	384	390
Others	8	12	12	12	12
Liabilities	361	510	443	443	445
Shareholder's equity	322	400	451	507	573

Cash Flow Statement

FYE Jan (RM m)	FY16	FY17	FY18F	FY19F	FY20F
Profit before taxation	61	127	137	141	154
Share of JV and associates	(2)	(7)	(10)	(43)	(70)
Depreciation & amortisation	4	4	4	4	4
Changes in working capital	69	93	(102)	16	8
Taxation	(21)	(33)	(36)	(27)	(23)
Others	16	(4)	(3)	37	62
CFO	127	179	(10)	128	135
Net capex	3	(6)	(5)	(5)	(3)
Others	(5)	9	-	-	-
CFI	(2)	4	(5)	(5)	(3)
Changes in borrowings	(31)	30	(5)	(5)	(5)
Issuance of shares	2	44	-	-	-
Dividends paid	(16)	(21)	(38)	(51)	(57)
Others	13	(49)	-	-	-
CFF	(33)	3	(43)	(56)	(62)
Net cash flow	92	186	(57)	67	70
Forex	2	5	-	-	-
Others	(16)	(3)	-	-	-
Beginning cash	164	242	430	373	440
Ending cash	242	430	373	440	510

Income Statement

FYE Jan (RM m)	FY16	FY17	FY18F	FY19F	FY20F
Revenue	536	599	650	630	626
EBITDA	65	126	135	105	91
EBIT	61	122	130	101	86
Finance cost	(3)	(3)	(3)	(3)	(3)
Associates & JV	2	7	10	43	70
Profit before tax	61	127	137	141	154
Tax	(21)	(33)	(36)	(27)	(23)
PATMI (core)	40	94	101	113	130
Exceptionals	10	8	-	-	-
PATMI (reported)	50	101	101	113	130

Valuation & Ratios

FYE Jan (RM m)	FY16	FY17	FY18F	FY19F	FY20F
Core EPS (sen)	10.7	25.0	27.0	30.2	34.7
P/E (x)	36.9	15.8	14.6	13.0	11.4
P/E (x) ex. cash	27.4	11.7	10.8	9.7	8.4
EV/EBITDA (x)	16.9	8.7	8.1	10.4	12.1
DPS (sen)	5.6	10.0	13.5	15.1	17.4
Dividend yield	1.4%	2.5%	3.4%	3.8%	4.4%
BVPS (RM)	0.86	1.07	1.20	1.35	1.52
P/B (x)	4.6	3.7	3.3	2.9	2.6
EBITDA margin	12.1%	21.0%	20.7%	16.7%	14.5%
EBIT margin	11.4%	20.3%	20.1%	16.1%	13.8%
PBT margin	11.3%	21.1%	21.1%	22.4%	24.5%
Net margin	7.5%	15.7%	15.6%	18.0%	20.8%
ROE	13.2%	26.0%	23.8%	23.7%	24.1%
ROA	6.2%	11.8%	11.2%	12.3%	13.2%
Net gearing	CASH	CASH	CASH	CASH	CASH

Assumptions

FYE Jan (RM m)	FY16	FY17	FY18F	FY19F	FY20F
Contracts secured	4,500	1,136	300	300	300

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BUY	Positive recommendation of stock under coverage. Expected absolute return of more than +10% over 12-months, with low risk of sustained downside.
TRADING BUY	Positive recommendation of stock not under coverage. Expected absolute return of more than +10% over 6-months. Situational or arbitrage trading opportunity.
HOLD	Neutral recommendation of stock under coverage. Expected absolute return between -10% and +10% over 12-months, with low risk of sustained downside.
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OVERWEIGHT	The sector, based on weighted market capitalization, is expected to have absolute return of more than +5% over 12-months.
NEUTRAL	The sector, based on weighted market capitalization, is expected to have absolute return between -5% and +5% over 12-months.
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