Strong 2H performance expected for George Kent

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George Kent (Malaysia) Bhd
(June 13, RM1.49)
Upgrade to outperform with a lower target price (TP) of RM2.20: George Kent (Malaysia) Bhd's first quarter of financial year 2019 (1QFY19) core net profit (CNP) of RM18.9 million (excluding foreign exchange gains of around RM2.7 million) came in at 13% of our and consensus estimates. However, we deem the results to be in line as first-half performances are generally weaker and we expect a strong performance in the second half of FY19 (2HFY19).

1QFY19 CNP only dipped 4% year-on-year (y-o-y) despite a steep drop in revenue (-23%) as the impact was well cushioned by higher contribution from the associate/joint-venture level, which increased substantially by 479% thanks to the contribution from the light rail transit Line 3 (LRT3). The drop in revenue was driven by both its construction and metering divisions, which we believe could be due to the timing of the billings for its ongoing projects and meter orders. Quarter-on-quarter (q-o-q), 1QFY19

CNP fell 69%, underpinned by lower revenue (-42%), mainly dragged down by its construction division, which saw a 48% decrease in revenue, as they booked in several project completions in 4QFY18.

To date, the total construction cost for LRT3 has yet to be finalised by Prasarana. Based on available data and news flow which we have compiled, the construction cost for LRT3 has well exceeded RM9 billion. We are expecting the total cost for LRT3 to hover closer to RM14 billion to RM15 billion, and we believe that the government will continue with the construction works of LRT3, as most of the contracts have already been awarded to various contractors and construction works are already in progress. While we think that LRT3 is likely to proceed, we highlight that there would be significant risk to earnings and valuations on the contrary.

Post results, we made no changes to our FY19 and FY20 earnings.

We are upgrading George Kent from "underperform" to "outperform" but with a lower sum-of-parts-driven TP of RM2.20 (previously, RM3.65). To recap, we previously called an "underperform" on George Kent due to its rich valuation as it traded up to FY19 price-earnings ratio (PER) of 17.3 times. However, we see value emerging in the stock arising from the recent selldown due to the negative news flow on construction as several mega infrastructure projects have been scrapped since the change in government. Our current TP of RM2.20 is based on: i) 10 times FY19 PER for metering; ii) nine times FY19 PER for construction (lowered from 17 times PER, previously in anticipation of low contract flows going forward); iii) net present value of 6% project delivery partner fees based on RM9 billion cost; and iv) 30% discount to 1QFY19 net cash, implying FY19 PER of 8.8 times.

Key downside risks to our call are lower-than-expected margins, delay in construction works, and scrapping of the LRT3 project by the government. — *Kenanga Research*, June 13