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Kelington banks on industrial gases

BY GURMEET KAUR

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Engineering company eyes steady earnings stream from new venture

Engineering solutions provider Kelington Group Bhd aims to derive more than a quarter of its earnings from its recent diversification into the supply of industrial gases.

Chairman and chief executive officer Raymond Gan Hung Keng says the new business will give the small-cap company a stable earnings stream that will buffer its exposure in the cyclical semiconductor industry.

Explaining the rationale, he adds that since "the company's project tenures are fairly short-term in the range of six to nine months, there was always the question of continuity".

So, it has been looking for a good source of recurring income.

"This new business is long-term in nature and will give us the stability in terms of earnings visibility. Earnings from the maiden venture is expected to kick in in 2018 and if all goes according to plan, we hope to grow the contribution to about 30% of revenue in three to five years' time," Gan tells *StarBizWeek*.

Kelington currently specialises in the provision of ultra-high purity (UHP) gas and chemical delivery system solutions. It also provides end-to-end process engineering services encompassing design, fabrication and maintenance, plus general contracting and construction management services.

Its clients are mostly multinationals involved in the electronics/semiconductor industry and other high-technology manufacturers.

About two weeks ago, the company bagged a letter of award from one of the largest photovoltaic manufacturers in Malaysia for the onsite supply of nitrogen gas, marking its diversification into the new segment.

Under the contract, Kelington will set up an onsite generator to produce nitrogen gas at the manufacturing plant in the Klang Valley .

In return, the latter will pay a fixed facility fee amounting to about RM20mil over a period of 10 years.

"So, for the next few years, we have locked in a certain amount of money. It is a breakthrough and we hope to get more of these kinds of jobs, which complements our current business in the high-tech sector."

UHP delivery systems currently account for 55% of revenue, with general contracting at 39% and the rest from process engineering.

Malaysia and Singapore are its biggest markets, contributing over 70% of earnings in financial year 2016 (FY16).

The other markets where it has a presence in are China and Taiwan, which contributed 8% and 10%, respectively, to earnings in FY16.

It has also clinched jobs in the Philippines and Indonesia.

Earlier this week, it bagged two new contracts from China amounting to RM19.3mil for the installation of UHP gas delivery systems, bringing its outstanding orderbook to RM239.3mil to date.

Its tender book size is around RM800mil to RM1bil and it secures about RM200mil to RM300mil of jobs yearly, according to Gan.

However, while previously the company had operated a fairly asset-light business model, it may have to gear up under the new business.

"Because we have to invest a certain amount of money to put up the new plant, it will result in a slightly higher gearing. But we have a strong balance sheet for this and in return for that investment, get a recurring income."

Kelington's gearing as at the end of last year stood at 0.4 times, while net cash was at RM17.6mil.

Its borrowings totalled RM24.8mil and were mainly short-term in nature for project financing.

Besides the plan to grow its existing and new businesses, the company has been working to improve margins and productivity.

It is targeting to achieve a 12% gross profit margin and a 5% profit-after-tax margin by 2020.

Gan says that in the first ten years of its inception in 2000, the company's focus was predominantly on UHP work. Due to the cyclical electronics industry, it took on larger-volume jobs in process engineering and general contracting.

These have boosted revenue and gave it entry into turnkey projects, but at the expense of gross margins due to competitive pricing to demonstrate capability and gain track record.

"So, while our orderbook has grown about 20% in the past few years, margins have thinned."

"But from last year, we have been focusing on growing margins as opposed to the previous strategy of growing revenue."

One way, he says, is to take on more project engineering works, while on the cost control side, measures like centralised purchasing and shared resources across the country have been put in place.

In FY16, the company returned to the black with a net profit of RM8.7mil on a revenue of RM340.2mil - the highest achieved in the last five years.

Singapore, which it expanded into about five years ago, recorded the biggest growth year-on-year at 81%.

In the previous financial year, it made a net loss of RM2.5mil after recognising impairment losses on certain projects, trade receivables and amounts owing by contract customers.

For FY17, the company anticipates to win more contracts from China on the back of heavy investments in the manufacturing capacity of memory chips and integrated circuits in line with the Chinese Government's semiconductor development plan to make China the epicentre of the global semiconductor industry.

Gan and Ong Weng Leong, who is the company's chief operating officer, are Kelington's substantial shareholders with 45.83%, held through private vehicle Palace Star Sdn Bhd. Its other substantial shareholder is Sun Lead International Ltd at 9%, which has been a strategic investor in the company from the beginning.

Two months ago, Lembaga Tabung Angkatan Tentera ceased to be a major shareholder after selling its 12.6% stake in the company. The pilgrim fund had been a shareholder since 2012.

The bright side of this is that there is now more liquidity in the stock.

Kelington's share price has been on an uptrend since November and is up 110% year-to-date.

It closed at 59.5 sen yesterday for a market cap of RM135.6mil. At this price, the stock is trading at a price earnings multiple of 15.19 times.