Kim Teck Cheong (KTCC MK)

Not Rated

Consumer Cyclical - Consumer Services

Market Cap: MYR76.5m

Target Price: NA

Price: MYR0.15

Expanding Beyond The Land Below the Wind

Macro	◆◆
Risks	◆◆
Growth	◆◆
Value	◆◆

Listing Sought	Bursa Malaysia (Ace Market)
Listing Date	25 Nov 2015
Share Capital (m)	510.3
Market Cap (MYRm)	76.5

Utilisation of proceeds (MYRm)	
Capex	11.0
Purchase of equipment	3.0
Working capital	4.7
Listing expenses	2.6
Total amount raised	21.3

Major Shareholder (%) - Post IPO	
Kim Teck Cheong Holdings SB	72.2

Kim Teck Cheong Consolidated (KTC), a top-tier consumer packaged goods (CPG) distributor in East Malaysia, will be listed on Bursa Malaysia's Ace Market on 25 Nov with a price of MYR0.15 which results in a market cap for KTC of MYR76.5m. We estimate the value of the stock at 60% higher or MYR0.24, based on a 12x 2016F P/E multiple. We estimate earnings to grow by a CAGR of 23% for FY15-18F, driven by potential revenue progress via geographical expansion and margin improvements from growth of its own brands.

- **Top-tier CPG distributor in East Malaysia.** KTC is a major provider of market access and coverage of CPG in East Malaysia, where the company is involved in the distribution and warehousing of third-party brands as well as its own brands of products. As of September, it distributed approximately 10,348 stock keeping units (SKUs) and carries 194 third-party brands for 36 brand owners as well as their respective appointed distributors. The company currently has 18 distribution centres with warehousing facilities in Sabah, Sarawak and Labuan, supporting an extensive network consisting of 6,419 sales and distribution points. In 2014, the company had a market share of about 10% for CPG distribution in Sabah and Labuan and less than 1% in Sarawak.
- **Extensive distribution network to support future growth.** The company intends to utilise the IPO proceeds of MYR21.3m mainly to further strengthen its foothold in Sabah and Sarawak and expand the manufacturing business of its own brand bakery products. In addition, the company is also considering expanding its geographical footprint outside East Malaysia to Brunei via the acquisition of an existing local CPG distributor. All in, we expect its expansion strategies to help grow its FY15-18F net earnings by a CAGR of 23.3%, underpinned by: i) revenue growth via geographical expansion and an increase in sales and distribution points, and ii) margin improvements via growth of its own brands.
- **A potential 60% upside.** We value the stock at MYR0.24, pegged to a 12x FY16F P/E which represents an upside of 60% from its IPO price of MYR0.15. Our P/E target is in line with the average 12-month trailing P/E of the company's closest listed peers of 12.3x. We consider our P/E multiple undemanding given the low implied PEG ratio of 0.51x, underpinned by our expectation of FY15-18F net profit CAGR of 23.3%.
- **Key risks:** Dependency on distribution of third-party brands of CPG; Direct sourcing from brand owners. More description of risks on page 6.

Forecasts and Valuations	Jun-14	Jun-15	Jun-16F	Jun-17F	Jun-18F
Total turnover (MYRm)	230	300	352	369	384
Reported net profit (MYRm)	5.5	7.1	9.0	11.1	13.2
Recurring net profit (MYRm)	5.5	7.1	9.0	11.1	13.2
Recurring net profit growth (%)	0.0	28.5	27.7	23.1	19.4
Recurring EPS (MYR)	0.01	0.02	0.02	0.02	0.03
DPS (sen)	na	na	0.4	0.4	0.5
Recurring P/E (x)	na	7.8	7.3	6.9	5.8
P/B (x)	na	0.76	0.77	0.71	0.64
EV/EBITDA (x)	0.00	3.14	2.51	2.26	1.63
Return on average equity (%)	0.0	19.3	10.4	10.7	11.6
Net debt to equity (%)	0.0	59.7	46.5	37.9	28.4
Our vs consensus EPS (adjusted) (%)			0.0	0.0	0.0

Source: Company data, RHB

Ng Suk Yee +603 9207 7604
ng.suk.yee@rhbgroup.com

IPO Structure

IPO to raise MYR21.3m. KTC is set to list on the Ace Market of Bursa Malaysia on 25 Nov with an offering of 142.0m new shares. This represents 27.8% of the enlarged issued and paid-up capital. Based on the IPO price of MYR0.15 per share, the company expects to raise about MYR21.3m. The intended utilisation of proceeds is listed in Figure 2. Post-IPO, the stake of the major shareholder – Kim Teck Cheong Holdings SB, which is held by the founder's family, will be diluted to 72.2%.

Figure 1: Offering size

	Shares (m)
Malaysian public (via balloting)	34.0
Eligible employees of KTC and individuals	16.3
Selected investors	91.7
Total	**142.0**

Source: Company prospectus

Figure 2: Utilisation of IPO proceeds

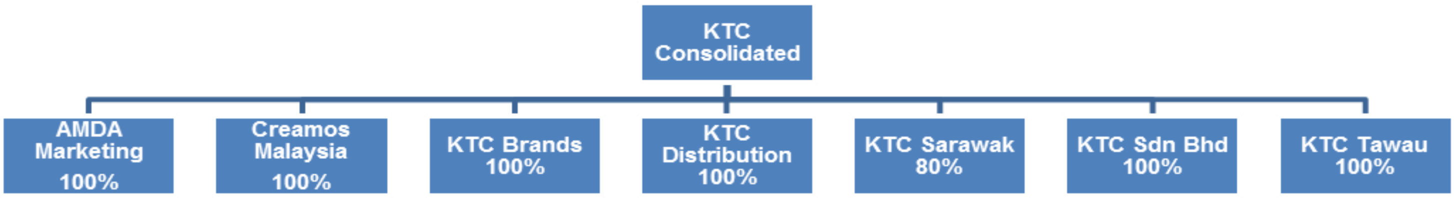
Purpose	Amount (MYRm)	%
Acquisition of warehousing facilities in Sibu, Miri and Kuching, Sarawak	9.0	42.3
Construction of new warehousing facility in Kota Kinabalu, Sabah	2.0	9.4
Purchase of equipment for:		
(i) new warehousing facility in Kota Kinabalu, Sabah	1.0	4.7
(ii) three production lines for bakery products in Sabah	1.0	4.7
(iii) a production line for bakery products in Sarawak	1.0	4.7
Working capital	4.7	22.1
Listing expenses	2.6	12.2
Total	**21.3**	**100.0**

Source: Company prospectus

Business Overview

Company background. KTC was founded by the late Datuk Lau Yeong Ching in 1938 as a sundry shop in Sabah. The company subsequently diversified into the provision of market access and coverage of consumer packaged goods (CPG), with distribution and warehousing of third-party brands as well as its own brands of products. In Feb 2014, the company began the manufacture of its own "*Creamos*" brand of bakery products, which are only available for sale in various retail outlets in Kota Kinabalu, Sandakan, Tawau and Labuan.

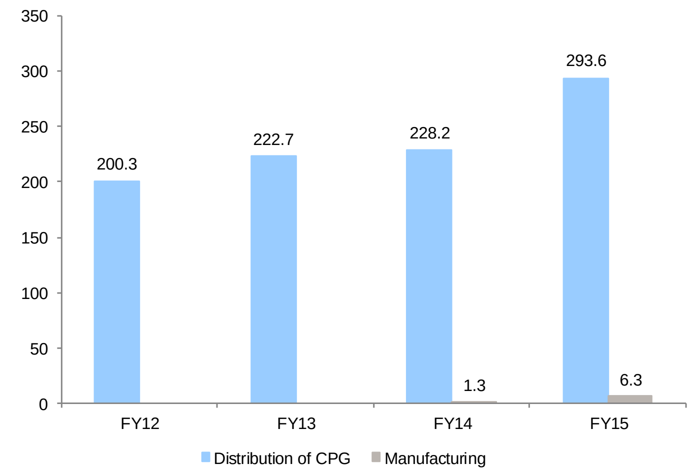
Figure 3: KTC's group structure



Source: Company prospectus

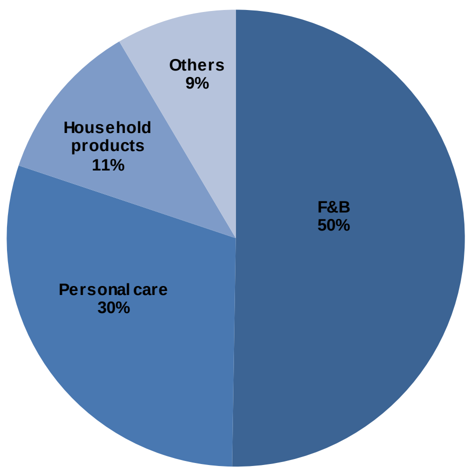
Distribution of CPG as main revenue contributor. KTC's main revenue stream (FY15: 97.9%; FY14: 99.4%) is derived from the distribution of CPG incorporating warehousing and various marketing activities including point-of-sale promotions, trade visits and product demonstrations at retail outlets, among others. Out of MYR293.6m for FY15 revenue, 97.3% is derived from the distribution of third-party brands of CPG while the remaining is from its own brands. Within the CPG products distributed by the company, food and beverage (F&B) products (including dry, frozen and chilled food, as well as beverage products) constituted the largest portion, followed by non-food products such as personal care, household, baby care, over-the-counter drugs and health supplements (see Figure 5).

Figure 4: Group's total revenue breakdown by segment



Source: Company data, RHB

Figure 5: CPG distribution revenue breakdown by product, FY15



Source: Company data, RHB

Management team. KTC is currently led by managing director Yg. Bhg. Datuk Lau Koh Sing (who took over the operation of the business from his late father in 1973), executive director Lim Hui Kiong and executive director Lau Wei Dick (the grandson of the founder). In addition, the abovementioned directors are also supported by several key management personnel who have been serving the company for more than 10 years.

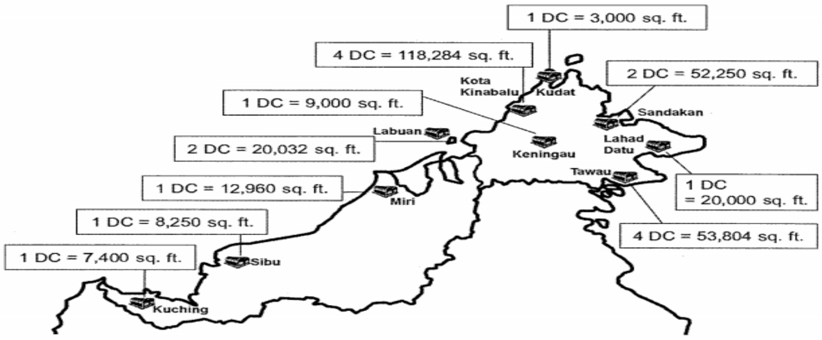
Investment Highlights

Top-tier CPG distributor in East Malaysia. KTC is a major provider of market access and coverage of CPG in East Malaysia. In 2014, the company had a market share of about 10% for CPG distribution in Sabah and Labuan and less than 1% in Sarawak. As of September, it distributed approximately 10,348 stock keeping units (SKUs) and carries 194 third-party brands for 36 brand owners as well as their respective appointed distributors.

The company benefits from economies of scale arising from bulk distribution of a wide range of CPG, and many of the third-party brands it carries are widely-recognised such as *Coca-Cola*, *Sprite*, *Darlie*, *Pantene* and *Philips*, among others. We believe this will potentially provide the company with bargaining power to obtain better commercial terms from its clients with regard to product costs, credit terms and logistics arrangements, among others.

Extensive distribution network. KTC's extensive distribution network is its competitive advantage as it enables the company to extend its product reach within the East Malaysia market (see Figure 6). As of September, its access to sales and distribution points, which include retail outlets, food service outlets, wholesalers and distributors, had grown rapidly to 6,419 from 2,678 as of Jun 2012.

Figure 6: KTC's distribution centres in East Malaysia



D.C = Distribution Centre

Note:

The built-up area of each distribution centre above comprised at the very least, a warehousing facility while other distribution centres have a combination of either a head office, an administration office or branch office together with warehousing facilities.

Source: Company prospectus

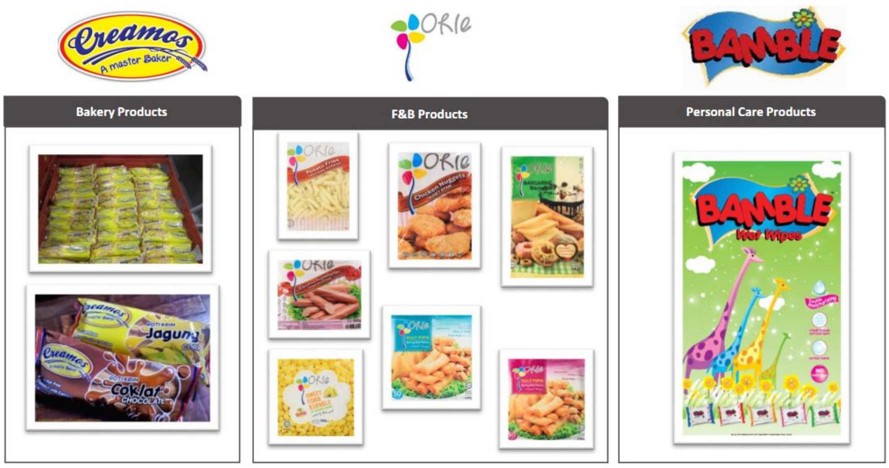
Revenue growth drivers. For FY15, KTC's revenue is mainly derived from Sabah (90.8%) and followed by Labuan (4.7%), while the remaining 4.5% was contributed by Sarawak. The company expanded into Sarawak via the acquisition of KTC Sarawak in Dec 2013 and its existing distribution operations in the state are on rented premises. The company intends to utilise part of the IPO proceeds to own larger warehousing facilities in Sarawak (to approximately 45,000 sq ft from existing 25,360 sq ft) in order to store a wider range of products. According to an independent market report by Vital Factor Consulting SB, the market size of CPG distribution in Sarawak is estimated at MYR3.9bn, which is approximately 1.3 times larger than that of Sabah. As such. we believe that there is still ample room for growth for the company in the Sarawak market.

In Sep 2014, KTC commenced the distribution of beverage products for Coca-Cola in Kota Kinabalu (designated areas), Sandakan, Tawau and Labuan. As of Sep 2015, the company had identified approximately 2,000 potential sales and distribution points that have yet to be covered by the company, mainly located in Sandakan, Tawau, Lahad Datu, Labuan and Kota Kinabalu. The figure also takes into consideration territories that are currently not included in its distributorship agreement with Coca-Cola, such as Kuching, Miri and Sibu. We think this presents an immediate opportunity for revenue growth considering that the company already has the necessary facilities and network.

Potential geographical expansion. KTC is in the midst of undertaking an internal due diligence exercise to acquire an existing distributor of CPG in Brunei. The proposed acquisition is expected to be completed by 1H16. The proposed acquisition, if successful, would potentially provide the company with access to approximately 500 sales and distribution points in the Brunei market. Total acquisition cost is estimated at about MYR1.5m, which would be financed via internally-generated funds and bank borrowings.

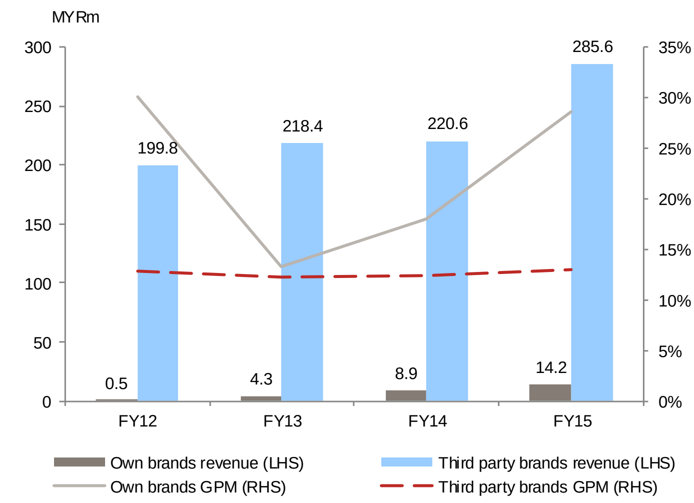
Potential margin expansion. By leveraging on its core competency in CPG distribution, the company extended its portfolio to include the distribution of its own brand products, such as F&B products "*Orie*", personal care products "*Bamble*" and bakery products "*Creamos*" (see Figure 7). KTC only manufactures the bakery products while sources the rest from contract manufacturers and repackages the products itself. In view of better margins offered by own brands, the company plans to expand the offering of its own brands, particularly its bakery products. Creamos Malaysia has recorded tremendous growth since commencing operations in Feb 2014 (see Figure 9). We expect that the company's continued expansion in manufacturing operations would likely enhance its overall GPM going forward.

Figure 7: KTC's own brands



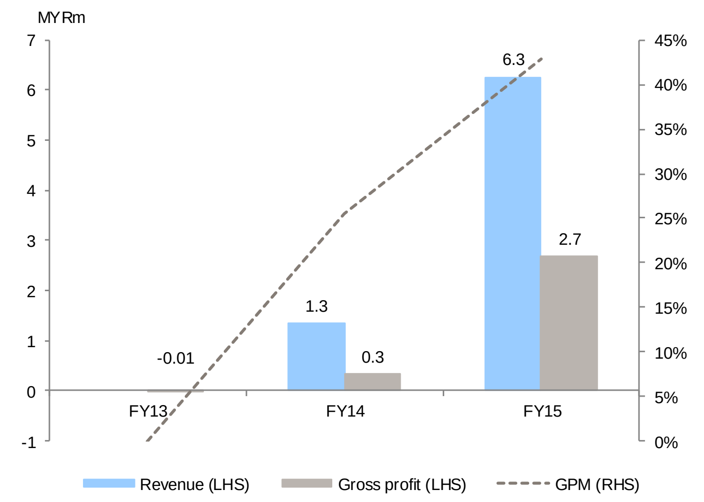
Source: Company

Figure 8: Revenue and GPM of own and third-party brands



Source: Company data, RHB

Figure 9: Revenue and gross profit from manufacturing of bakery products



Source: Company data, RHB

Earnings outlook. We forecast KTC to achieve FY15-18F net earnings CAGR of 23.3%, driven by: i) revenue growth from geographical expansion and an increase in sales and distribution points, and ii) margin improvements via growth of its own brands. As such, we forecast net earnings for FY16/FY17/FY18 at MYR9.0m/MYR11.1m/MYR13.2m respectively.

Key Risks

Dependency on distribution of third-party brands of CPG. For FY15, the company's top four suppliers (ie Coca-Cola, P&G, Danone Dumex and Wipro Unza) collectively made up 61.4% of its total purchases. Any disruptions in the business dealings with these brand owners may adversely affect its business performance. However, except for Coca-Cola, the company has established long-term business relationships with the other three key suppliers, namely P&G (33 years), Wipro Unza (32 years) and Danone Dumex (eight years). It will take time and high switching costs if these brand owners opt for alternative distributors that have similar market access and infrastructure.

Direct sourcing from brand owners. Large retail chains that have greater purchasing power are able to directly source CPG from brand owners in place of distributors. Some have even started their own in-house brands and obtained supplies directly from their contract manufacturers. If this trend increases over time, KTC's existing business model may not be sustainable. That said, some brand owners may find it more effective and efficient to appoint distributors like KTC to handle operational support (eg to ensure the availability of stocks and deliveries on a regular basis) as well as administrative and promotional support services.

Margin compression risk for CPG distribution. It is no surprise that hypermarkets and other chain retailers with significant buying power would potentially compress profit margins of suppliers, which include CPG distributors. We expect distributors with significant volume sales or represent internationally-renowned or highly-visible brands of CPG, like KTC, to have bargaining power against these retailers. Despite the fact that CPG distribution remains the bread and butter of the company, KTC has been trying to diversify into manufacturing operations, which we believe should support its overall profit margin going forward.

Valuation

Our estimate value for the stock is MYR0.24, pegged to 12x 2016F P/E which represents an upside of 60% from its IPO price of MYR0.15. At the last closing price, KTC's closest listed peers, DKSH Holdings (Malaysia) (DKSH MK, NR) and Harrisons Holdings (Malaysia) (HHM MK, NR) were trading at a 12-month trailing P/E of 13.7x and 10.8x respectively. Our P/E target is in line with the average trailing P/E of its listed peers of 12.3x. In addition, our target P/E multiple is still undemanding given the low implied PEG ratio of 0.51x, underpinned by our expectation of a net profit CAGR of 23.3% for FY15-18. The company intends to adopt a dividend payout ratio of up to 20% of its net profit going forward. This represents an estimated annual dividend yield of about 2.4-3.5% over the next three years.

Figure 10: Peer comparison

Name	Ticker	FYE	Latest Price (MYR)*	MktCap (MYRm)	P/E (x)		P/BV (x)		ROE (%)		Div Yield (%)		EPS Growth (%)	
					FY13	FY14	FY13	FY14	FY13	FY14	FY13	FY14	FY13	FY14
DKSH	DKSH MK	Dec	4.7	741.0	6.1	14.2	2.3	1.8	47.3	13.0	1.5	0.0	124.8	-65.7
Harrisons	HHM MK	Dec	3.39	232.1	7.8	na	0.7	0.8	8.9	-3.2	5.0	4.8	-7.4	-135.5
Average					**7.0**	**14.2**	**1.5**	**1.3**	**28.1**	**4.9**	**3.2**	**2.4**	**58.7**	**-100.6**

** As of 11 Nov 2015*
Source: Bloomberg

Financial Exhibits

Profit & Loss (MYRm)	Jun-14	Jun-15	Jun-16F	Jun-17F	Jun-18F
Total turnover	230	300	352	369	384
Cost of sales	(201)	(259)	(306)	(319)	(330)
Gross profit	**29**	**41**	**46**	**50**	**54**
Gen & admin expenses	(7)	(9)	(11)	(12)	(12)
Selling expenses	(13)	(18)	(20)	(21)	(21)
Other operating costs	(1)	(2)	(1)	(2)	(2)
Operating profit	**9**	**12**	**14**	**16**	**19**
Operating EBITDA	9	14	16	19	22
Depreciation of fixed assets	-	(2)	(3)	(3)	(3)
Operating EBIT	**9**	**12**	**14**	**16**	**19**
Other recurring income	1	2	1	1	1
Interest expense	(2)	(4)	(3)	(3)	(3)
Pre-tax profit	**7**	**10**	**12**	**15**	**18**
Taxation	(2)	(3)	(3)	(4)	(4)
Minority interests	(0)	(0)	(0)	(0)	(0)
Profit after tax & minorities	**5**	**7**	**9**	**11**	**13**
Reported net profit	**5**	**7**	**9**	**11**	**13**
Recurring net profit	**5**	**7**	**9**	**11**	**13**

Source: Company data, RHB

Cash flow (MYRm)	Jun-14	Jun-15	Jun-16F	Jun-17F	Jun-18F
Operating profit		**12**	**14**	**16**	**19**
Depreciation & amortisation	**-**	**2**	**3**	**3**	**3**
Change in working capital	**-**	**4**	**(14)**	**(3)**	**(3)**
Other operating cash flow		2	1	1	1
Operating cash flow	**-**	**20**	**4**	**17**	**20**
Interest received	-	0	-	-	-
Interest paid	-	(0)	(0)	(0)	(0)
Tax paid		(3)	(3)	(4)	(4)
Cash flow from operations	**-**	**17**	**0**	**13**	**15**
Capex	-	(10)	(14)	(3)	(3)
Other investing cash flow	-	3	-	-	-
Cash flow from investing activities	**-**	**(7)**	**(14)**	**(3)**	**(3)**
Dividends paid	-	-	(2)	(2)	(3)
Proceeds from issue of shares		-	19	-	-
Increase in debt	-	12	(15)	-	-
Other financing cash flow	-	(6)	(3)	(2)	(2)
Cash flow from financing activities	**-**	**6**	**(0)**	**(4)**	**(5)**
Cash at beginning of period		13	30	16	21
Total cash generated	**-**	**17**	**(14)**	**5**	**7**
Forex effects					
Implied cash at end of period	**-**	**30**	**16**	**21**	**29**

Source: Company data, RHB

Financial Exhibits

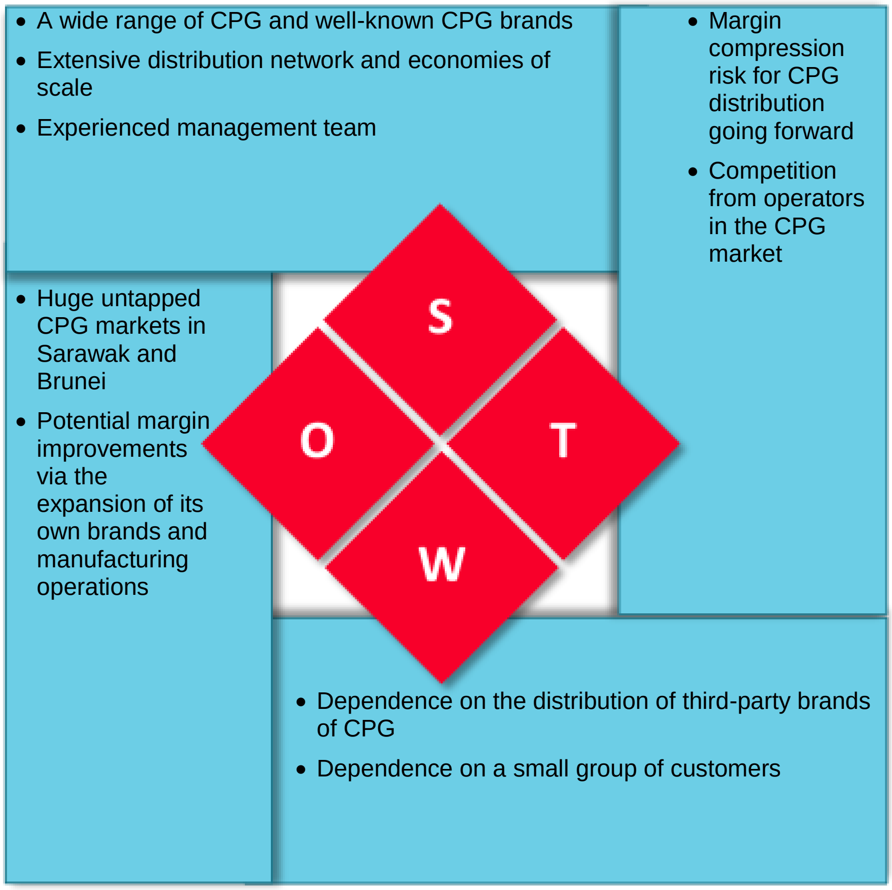
Balance Sheet (MYRm)	Jun-14	Jun-15	Jun-16F	Jun-17F	Jun-18F
Total cash and equivalents	-	30	16	21	29
Inventories		55	62	65	68
Accounts receivable		44	40	42	43
Other current assets	-	17	17	17	17
Total current assets	**-**	**146**	**136**	**146**	**158**
Tangible fixed assets	-	60	72	72	73
Intangible assets	-	5	5	5	5
Total non-current assets	-	65	76	77	77
Total assets	**-**	**211**	**213**	**223**	**235**
Short-term debt		64	50	50	50
Accounts payable		42	32	33	35
Other current liabilities	-	16	15	15	15
Total current liabilities	**-**	**121**	**98**	**99**	**100**
Total long-term debt		10	13	13	13
Other liabilities	-	5	2	2	2
Total non-current liabilities	**-**	**15**	**14**	**14**	**14**
Total liabilities	**-**	**137**	**112**	**113**	**115**
Share capital		37	51	51	51
Retained earnings reserve		30	36	44	55
Other reserves	-	7	13	13	13
Shareholders' equity	**-**	**73**	**100**	**108**	**119**
Minority interests		1	1	1	1
Other equity	-	(0)	(0)	0	(0)
Total equity	**-**	**74**	**100**	**109**	**120**
Total liabilities & equity	**-**	**211**	**213**	**223**	**235**

Source: Company data, RHB

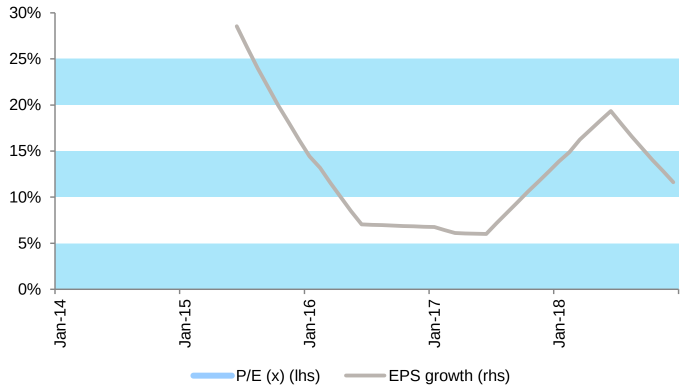
Key Ratios (MYR)	Jun-14	Jun-15	Jun-16F	Jun-17F	Jun-18F
Revenue growth (%)	0.0	30.6	17.5	4.7	4.1
Operating profit growth (%)	0.0	39.5	11.4	17.7	17.5
Net profit growth (%)	0.0	28.5	27.7	23.1	19.4
EPS growth (%)	0.0	28.5	7.1	6.0	19.4
BVPS growth (%)	0.0	0.0	(1.8)	8.9	9.8
Operating margin (%)	3.9	4.1	3.9	4.4	5.0
Net profit margin (%)	2.4	2.4	2.6	3.0	3.4
Return on average assets (%)	0.0	6.7	4.3	5.1	5.8
Return on average equity (%)	0.0	19.3	10.4	10.7	11.6
Net debt to equity (%)	0.0	59.7	46.5	37.9	28.4
DPS	0.000	0.000	0.004	0.004	0.005
Recurrent cash flow per share	0.00	0.05	0.00	0.02	0.03

Source: Company data, RHB

SWOT Analysis

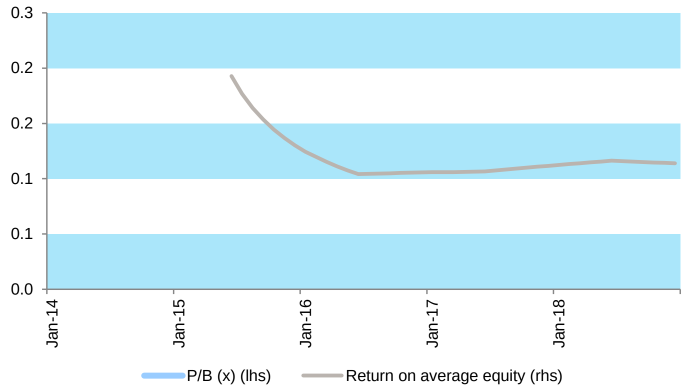


P/E (x) vs EPS growth



Source: Company data, RHB

P/BV (x) vs ROAE



Source: Company data, RHB

Company Profile

Kim Teck Cheong Consolidated (KTC) is primarily involved in the provision of market access and coverage of consumer packaged goods (CPG), specifically the distribution and warehousing of third-party as well as its in-house brands of products in East Malaysia.

RHB Guide to Investment Ratings

Buy: Share price may exceed 10% over the next 12 months
Trading Buy: Share price may exceed 15% over the next 3 months, however longer-term outlook remains uncertain
Neutral: Share price may fall within the range of +/- 10% over the next 12 months
Take Profit: Target price has been attained. Look to accumulate at lower levels
Sell: Share price may fall by more than 10% over the next 12 months
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Kuala Lumpur	Hong Kong	Singapore
RHB Research Institute Sdn Bhd Level 11, Tower One, RHB Centre Jalan Tun Razak Kuala Lumpur Malaysia Tel : +(60) 3 9280 2185 Fax : +(60) 3 9284 8693	**RHB Securities Hong Kong Ltd.** 12th Floor World-Wide House 19 Des Voeux Road Central, Hong Kong Tel : +(852) 2525 1118 Fax : +(852) 2810 0908	**RHB Research Institute Singapore Pte Ltd (formerly known as DMG & Partners Research Pte Ltd)** 10 Collyer Quay #09-08 Ocean Financial Centre Singapore 049315 Tel : +(65) 6533 1818 Fax : +(65) 6532 6211

Jakarta	Shanghai	Bangkok
PT RHB Securities Indonesia Wisma Mulia, 20th Floor Jl. Jenderal Gatot Subroto No. 42 Jakarta 12710, Indonesia Tel : +(6221) 2783 0888 Fax : +(6221) 2783 0777	**RHB (China) Investment Advisory Co. Ltd.** Suite 4005, CITIC Square 1168 Nanjing West Road Shanghai 20041 China Tel : +(8621) 6288 9611 Fax : +(8621) 6288 9633	**RHB Securities (Thailand) PCL** 10th Floor, Sathorn Square Office Tower 98, North Sathorn Road, Silom Bangrak, Bangkok 10500 Thailand Tel: +(66) 2 862 9999 Fax : +(66) 2 862 9799