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I P O
Wednesday, November 11, 2015
FBM KLCI: 1,686.11
Sector: Consumer

Kim Teck Cheong Consolidated Berhad

Distributors from the East

Fair value: **RM 0.20***(+33.3%)*

A.C.E. Market Listing

NOT RATED

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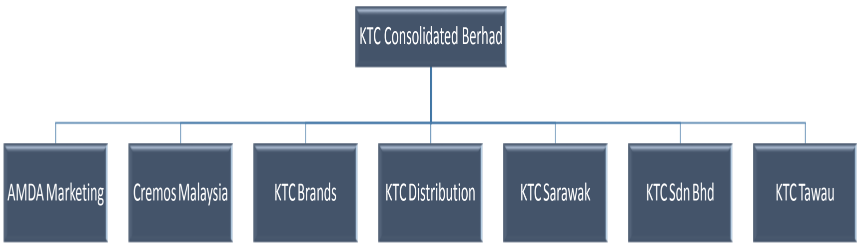
1.0 Company Background

- Kim Teck Cheong Consolidated Berhad was founded in 1938 and is headquartered in Kota Kinabalu, Malaysia. It is involved in the distribution of third party brands of consumer packaged goods (CPG) in East Malaysia, including dry, frozen, and chilled foods, as well as beverages, and non-food products, such as personal care, household, baby care, over-the-counter (OTC) drugs, and health supplements. The group also manufactures bakery products, as well as distribute its own brands of CPG products. Additionally, it runs logistics services which consists of warehousing and delivery services to external customers.

- Currently, the company distributes approximately 194 third party brands of CPG to approximately 36 brand owners as well as their own appointed distributors. In addition to third party brands, the group also distribute their own products, which includes frozen, dry food products, along with beverages products. The group's own brands include "Cremos", "Orie", and "Bamble".

Figure 1: Group Structure



Source: TA Research, Prospectus

Details of principal activities:

Companies	Principal Activities
KTC Consolidated	Investment holding
Amda Marketing	Distribution of CPG
Cremos Malaysia	Manufacture of bakery products
KTC Brands	Brand owner and procurement arm for KTC Group's own brand of products
KTC Distribution	Distribution of CPG, focusing on F&B products
KTC Sarawak	Distribution of CPG
KTC Sdn Bhd	Distribution of CPG
KTC Tawau	Distribution of CPG

Source: TA Research, Prospectus

2.0 Key Management

- Serving as it Managing Director, Datuk Lau Koh Sing has an extensive 40 years experienced in the distribution industry. He is responsible for developing the overall strategic direction of the group and has been the back bone of the company development. Datuk Lau supported by Mr. Lim Hui Kiong and Mr. Lau Wei Dick as Executive Director, who has combined experience of 55 years in the wholesale distribution.

Share Information	
Listing	Ace Market
Enlarged Share Capital (mn)	510.3
Market Cap @ RM0.15 (RM mn)	76.5
Par Value (RM)	0.10
Issue price (RM)	0.15
Oversubscription rate	N/A
Estimated free float (%)	27.8
Tentative listing date	25-Nov-15

Tentative Listing Dates

Event	Tentative Date
Opening of the IPO	28-Oct-15
Closing of the IPO	12-Nov-15
Listing	25-Nov-15

Ratio & Analysis	
Proforma NTA/Share	0.41
Price to NTA	0.36
Proforma ROE (%)	9.64
Proforma ROA (%)	3.35
Proforma Gearing (x)	0.60

Utilisation of Proceeds	RM(mn)	%
Acquisition of warehousing facilities	9.0	42.3
Construction of new warehosuing facility	2.0	9.4
Purchase of equipment	3.0	14.1
Working Capital	4.7	22.1
Estimated listing expenses	2.6	12.2
Total	21.3	100.0

Figure 2: Board of Directors

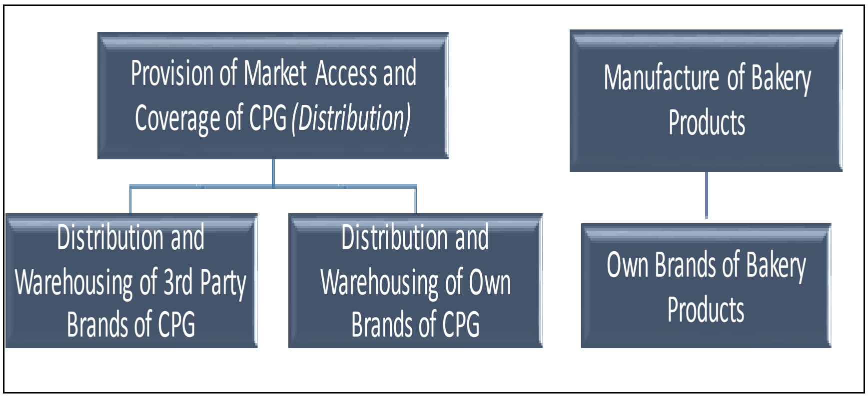
Name	Designation
Y. Bhg Datuk Deleon Quadra @ Kamal Quadra	Independent Non-Executive Chairman
Y. Bhg Datuk Lau Koh Sing @ Lau Kok Sing	Managing Director
Y.Bhg Datin Lim Fook Len @ Lim Su Chin	Non-Independent Non-Executive Director
Y.A.M Tengku Datin Paduka Setia Zatashah Binti Sultan Sharafuddin Idris Shah	Independent Non-Executive Director
Tan Jwee Peng	Senior Independent Non-Executive Director
Wee Hock Kee	Independent Non-Executive Director
Lim Hui Kiong	Executive Director
Lau Wei Dick @ Dexter Dick Lau	Executive Director

Source: TA Research, Prospectus

3.0 Business Model

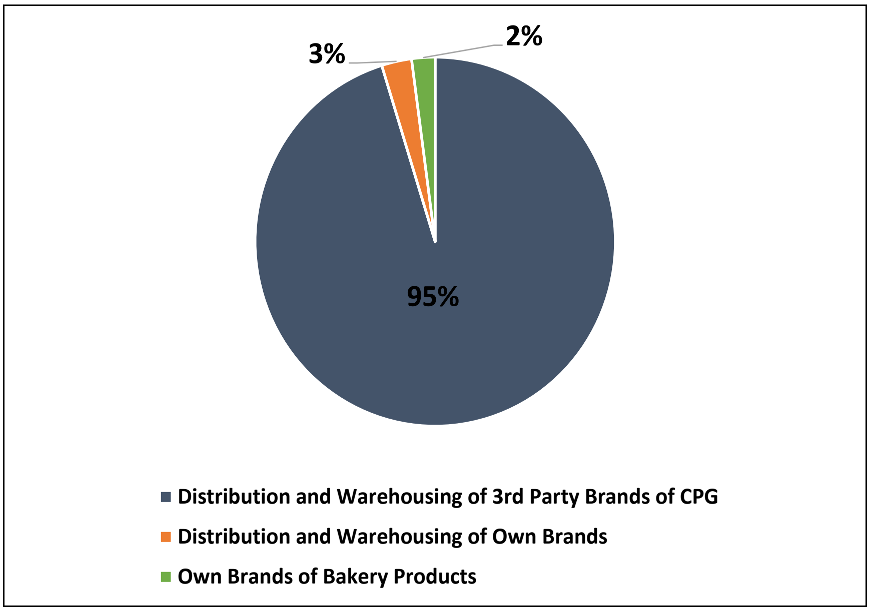
- KTC Berhad operates in 3 different markets in East Malaysia, which are Sabah, Labuan, and Sarawak. It has 18 distribution centers with warehousing facilities, of which 13 are in Sabah, 3 in Sarawak and 2 in Labuan.
- At the moment, the group's primary source of revenue comes from the distribution of third party CPG brands. This segment contributed RM285.7mn, accounting for approximately 95.3% of the group's total revenue. Meanwhile, the distribution of own brands segment accounted for RM8mn, or 2.7% of the group's total revenue. Manufacturing of the bakery products segment makes up another RM6.3mn or 2.1% to the group's top-line (See Figure 4). Its customer base consists of retailers, wholesalers, food services operators, and distributors.
- On a geographical basis, the group's biggest market is Sabah, which accounted for 90.8% of its total revenue (or RM272.3mn), followed by Labuan - 4.7% (RM14.1mn), and Sarawak - 4.5% (RM13.5mn) (see Figure 5).

Figure 3: Group's business model



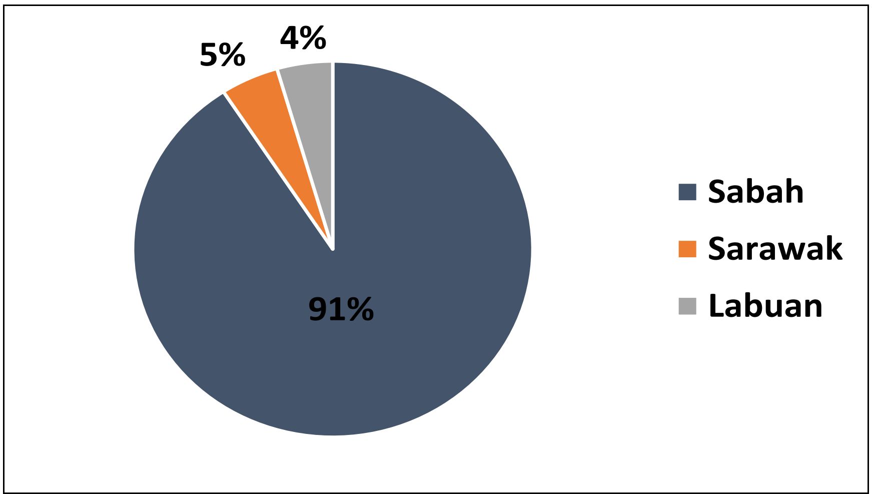
Source: TA Research, Prospectus

Figure 4: Group's revenue contribution by segment



Source: TA Research, Prospectus

Figure 5: Group's revenue contribution by geography

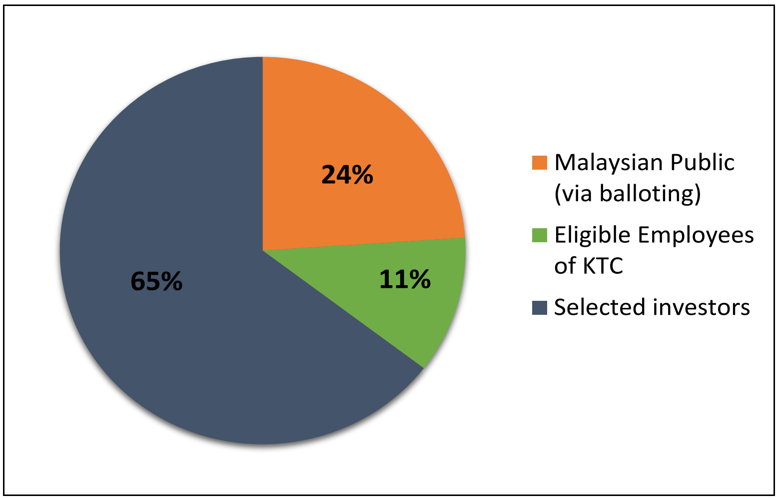


Source: TA Research, Prospectus

4.0 Statistics of the IPO

- The IPO will entail the issuance of 142mn new shares, representing 27.8% of the enlarged issued and paid-up share capital (510.3mn shares). The amount consists of: 1) 34mn to the Malaysian public, 2) 16.3mn to eligible directors, employees & business associates, and 3) 91.8mn by way of private placement to selected investors (see Chart 6). In total, the above will raise gross proceeds of RM21.3mn, valuing the company at a market capitalization of RM76.5mn.

Figure 6: KTC's IPO structure



Source: TA Research, Prospectus

5.0 Utilisation of proceeds and future plans

- The group intends to utilize the proceeds in the following manner:

Purpose	Timeframe	Amount of Proceeds (RMmn)	%
Acquisition of warehousing facilities	Within 24 months	9.0	42.26
Construction of new warehousing facility	Within 18 months	2.0	9.39
Purchase of equipment	Within 12-18 months	3.0	14.07
Working Capital	Within 12 months	4.7	22.07
Estimated listing expenses	Upon listing	2.6	12.21
Total		21.3	100.00

Source: TA Research, Prospectus

Expansion of warehousing facility

1. Sarawak

- The group's plans to utilize RM9mn of the proceeds to acquire warehousing facilities including land and building with a built-up area of approximately 15k sq ft each in Sibu, Miri, and Kuching, Sarawak within 24 months from the listing date. This would enable the group to save on rental expenses of nearly RM288k per year. Presently, all the distribution operations including offices and warehousing facilities in Sarawak are on rented premises.

2. Sabah

- Construction of new warehousing facility in Kota Kinabalu will utilize RM3mn from the IPO proceeds, and will be built on 105.9k sq ft of land. This will allow the group to expand the distribution of its CPG products. The total cost of construction of the new warehousing facility including the procurement of new equipment is estimated to be in the region of RM8.5mn, of which, RM6.5mn will be used for construction and the balance of RM2mn for the purchase of equipment. RM3mn from the IPO proceeds will be used to support expansion plans. Additional capex need will be funded via internally generated funds or bank borrowings.

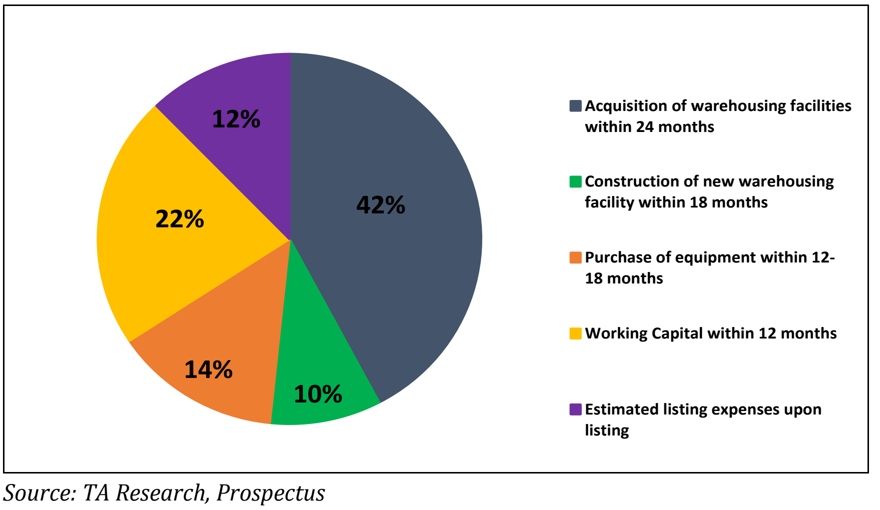
Expansion of manufacturing operations

- The group is also looking to grow their bakery segment via the setting up of a new facility in Sarawak, while expanding their current production lines in Sabah. The group intends to spend RM2mn from the proceeds to cater for the development of their bakery manufacturing segment. The total cost of procuring the equipment for the expansion is approximately RM2.5mn, of which RM2mn (Sabah – RM1mn, Sarawak RM1mn) will be funded by IPO proceeds, while the balance through internally internal generated funds or bank borrowings. The Sabah and Sarawak expansion plans are expected to be completed by 2H2015 and 2016, respectively.

Working capital

- In tandem with the expansion plans, the group expects to use another 22.1% of the proceeds as additional working capital to finance its daily operations, in which 73.1% of its will be used to purchase inventories for own brands CPG, and the remaining (26.9%) for purchasing raw materials and operational expenses for its manufacturing segment.

Figure 7: Utilisation of Proceeds



Source: TA Research, Prospectus

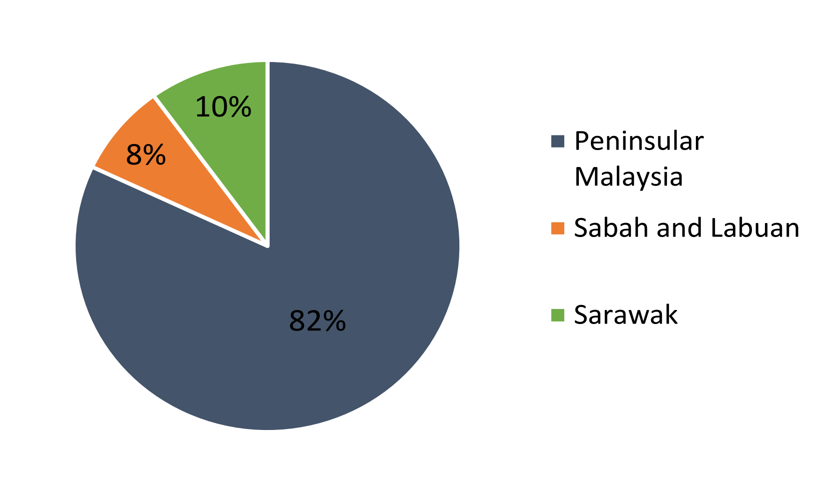
6.0 Investment Thesis

6.1 CPG Market

- According to Vital Factor Consulting, the size of the CPG market in Malaysia is estimated at RM38bn in 2014. This is based on revenues of identified local players. It excludes data from foreign peers. Overall, the KTC Group owns less than 1% of the distribution of CPG in Malaysia as it is largely dominated by DKSH Holdings Berhad and Harrisons Holdings Berhad. In terms of market share in East Malaysia, KTC Group owns approximately 10% of the distribution of CPG in Sabah and Labuan.

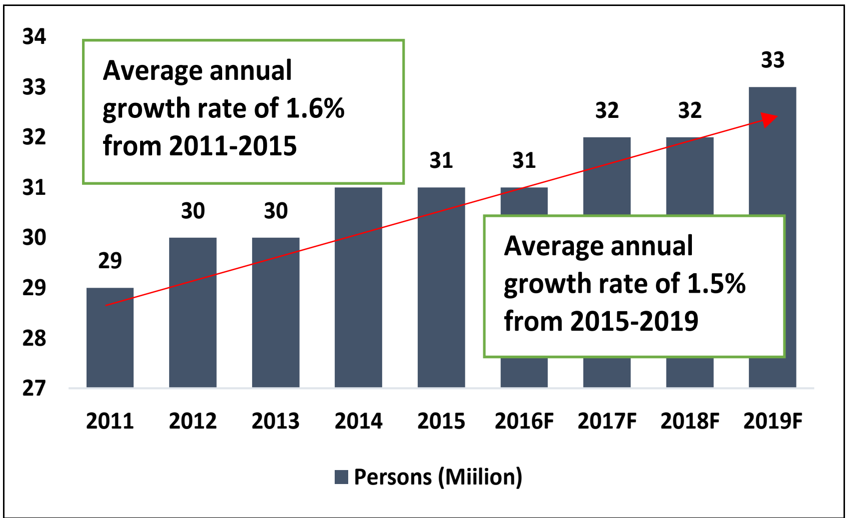
- Stable increase in general population should help support demand growth for CPG. The average population of Malaysia grew at an annual average growth rate (AAGR) of 1.6% from 2011 to 2015 with a forecasted average population for 2015 at 31mn. Going forward, Malaysia's population is estimated to climb at an AAGR of 1.5% from 2015 to 2019, thus benefiting KTC Group in the long run (see Figure 9).

Figure 8: CPG's market size in Malaysia



Source: TA Research, Vital Factor Consulting

Figure 9: Population in Malaysia expected to grow at a stable pace provides steady demand growth



Source: TA Research, Vital Factor Consulting

6.2 Covers a wide range of CPG products and recognised brands

- Currently, KTC Group distributes approximately 10,348 stock keeping unit (sku) covering various locations in Sabah, Labuan, and Sarawak. Five major CPG products includes: 1) F&B products, 2) personal care products, 3) household products, 4) baby care products, as well as 5) OTC drugs. Distributing strong brand names also helps to support the demand of the CPG products supplied by the group. Some of the recognised brands include Ayamas, Ribena, Tefal, Hughes diapers, and Panadol.

6.3 Extensive distribution network and economies of scale

- Massive distribution method enables the group to enhance their economies of scale as the fixed costs is well spread across a large number of products. This in turn, helps the company to manage its costs efficiently. In FY15, most of the group's revenue came from retailers, which accounted for 87.9% of the group's total revenue. KTC caters for 4,604 retailers, which includes hypermarkets, supermarkets, and departmental stores.

6.4 Experienced key management personnel

- Combined, key management team of KTC Group has 95 years of experienced in the distribution and wholesale business. The extensive experience would help bring competitive advantage to the company in terms of better market understanding and knowledge as well as provide some personal touch to the long existing clients.

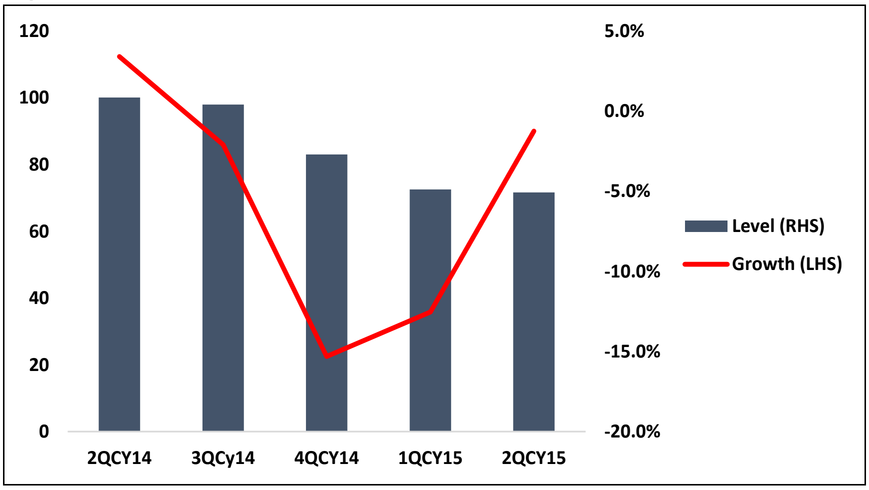
7.0 Risks

7.1 Superior peers

- Two major competitors – DKSH and Harrisons Bhd are well established with bigger financial resources at their disposal. Going forward, the group may find it challenging to compete in the areas of logistics, marketing as well as talent acquisition.

7.2 Weak sentiment post-GST and various subsidies rationalisation

Figure 10: Consumer sentiment index



Source: TA Research, Vital Factor Consulting

- Consumer sentiment in Malaysia has fallen to a 6-year low of 71.7. This is underpinned by declining discretionary income due to increasing cost of living. Coupled with rising inflationary pressures, this may dampen demand for CPG. Eventually, it would result in margin compression.

7.3 Dependency on third party CPG products

- The group depends heavily on distributing third party CPG products, which accounts for 95.3% of KTC Group's total revenue. At the moment, most of the KTC clients have very close business relationship with the group. Some of the uninterrupted business relationships stretches up to 33 years. However, historical performance of the group could not protect the group from potential risk of losing distribution rights of any of its clients. Besides that, some of the contracts between KTC Group and its clients do not state the exact end date (till terminated by either party), which could bring the risk of contract termination at any time.

8.0 Valuation

- KTC Consolidated Berhad is priced at RM0.15 per IPO share. This is based on 10.9x FY15 EPS of approximately RM1.38 sen. derived from proforma PAT of RM7.1mn for FY15.
- We derive a fair value of RM0.20 for KTC Group after assigning a 10x PER, which is 20% discount to the market-cap weighted average PER for distribution industry peers. The discount is to reflect KTC Group's relatively lower market cap and ROE compared to its peers. Overall, we think the company is well positioned for earnings growth going forward.
- The immediate outlook for CPG market is undesirable given the weakened oil price, MYR, and waning consumer sentiment. However the mid-term prospect is favorable mainly due population growth, urbanisation and stable economic growth in Malaysia. All in, given its proven and established track record, wide distribution network, and experienced key management team, we believe KTC would be able to continue registering sustainable growth in the distribution industry especially in East Malaysia.

Dividend Policy

- Currently, KTC does not have any formal dividend policy. However, upon listing, the board intends to distribute approximately 20% of the group's profits as dividends to its shareholders. This is subject to various factors and not only limited to financial performance. We estimate dividend yield to be approximately 2.2% and 2.8% for FY16 and FY17 respectively.

Earnings Summary (RM mn)

FYE June 30		FY13	FY14	FY15	FY16F	FY17F
Revenue		222.7	229.5	299.9	329.9	379.3
Core EBITDA		28.5	30.1	43.2	47.5	54.8
EI		1.0	2.0	3.0	4.0	5.0
Pretax profit		13.6	7.4	10.4	11.3	14.5
Net profit		11.6	5.5	7.1	8.5	10.9
Core Net Profit		11.6	5.5	7.1	8.5	10.9
EPS	(sen)	3.1	1.5	1.9	1.7	2.1
Core EPS Growth	(%)	197.3	(52.6)	28.5	(13.3)	28.5
PER	(x)	4.8	10.1	7.8	9.0	7.0
Dividend	(sen)	0.0	0.0	0.0	0.3	0.4
Div Yield	(%)	0.0	0.0	0.0	2.2	2.8

Disclaimer

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