Company Focus

Kim Teck Cheong Consolidated

Bloomberg: KTCC MK

Refer to important disclosures at the end of this report

Malaysia Equity Research

12 Nov 2015

OFFER PRICE: RM0.15
FAIR VALUE: RM0.18

Closing date : 12 Nov 2015
Listing date : 25 Nov 2015

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AT A GLANCE

LISTING DETAIL	
Issue manager	RHB Investment Bank
Funds raised (RM m):	21.3
Shares on offer (m):	142
New shares (m):	142
Vendor shares (m):	0.0
Placement shares (m):	91.7
Public shares (m):	34.0
Employee share schemes (m):	16.3
Shariah compliant:	No
POST LISTING	
Ordinary share cap (m shares):	510.3
Par value (sen):	0.10
Mkt Cap (RM m):	76.5
Est Free Float %:	27.8%
USE OF PROCEEDS (RM m)	
Acquisition of warehousing facilities	9.0
Construction of new warehousing facilities	2.0
Purchase of equipment	3.0
Working capital	4.7
Listing expenses	2.6

Forecasts and Valuation

FY Jun (RM m)	2014A	2015A	2016F	2017F
Revenue	229.5	299.9	338.6	382.8
EBITDA	10.8	16.2	18.9	21.4
Pre-tax Profit	7.4	10.4	12.9	15.4
Net Profit	5.5	7.1	8.8	10.5
Net Pft (Pre Ex.)	5.5	7.1	8.8	10.5
EPS (sen)	1.1	1.4	1.7	2.1
EPS Pre Ex. (sen)	1.1	1.4	1.7	2.1
EPS Gth (%)	N/A	29	25	19
EPS Gth Pre Ex (%)	N/A	29	25	19
PE (X)*	14.0	10.9	8.7	7.3
PE Pre Ex. (X)*	14.0	10.9	8.7	7.3
Net DPS (sen)	0.0	0.0	0.3	0.4
Net Div Yield (%)	0.0	0.0	2.3	2.7

**Based on offer price of RM0.15*
Source of all data: Company, AllianceDBS, Bloomberg L.P.

Substantial Shareholders:	
Dato' Lau Koh Sing and family	72.2

INITIAL PUBLIC OFFERING – ACE Market

- **Top tier consumer packaged goods distributor in East Malaysia**
- **Wide distribution network**
- **Business diversification to drive growth**
- **Fair value of RM0.18 pegged at 10x CY15F PE**

Growing distribution network. Kim Teck Cheong (KTC)'s distribution points increased by 30.6% CAGR from FY12 to FY15. As at its prospectus date, KTC has 18 distribution centres with 6,419 distribution points across East Malaysia, although many are in Sabah. The group plans to use most of its IPO proceeds to expand the distribution network in Sarawak and acquire warehousing facilities. The growth potential for KTC is large with market size for the distribution of consumer packaged goods (CPG) estimated at RM6.8bn in East Malaysia.

New CPG brands lined up. FY15 revenue surged after the inclusion of "Coca-Cola" into its CPG brand distribution. We foresee its revenue improving further in FY16 with the addition of personal care brands "Aqua Label", "Tsubaki", "ZA" and "Revlon" as well as household brand "Phillips" in Sabah and Sarawak. Management will continue to grow its international CPG brands distribution line-up in East Malaysia as part of its business plan.

Potential margin expansion. The diversification into its own bakery product ("Creamos") has provided KTC with a platform for future business growth and additional source of income. Besides its own bakery line, the group has diversified into other segments including F&B ("Orie") and personal care ("Bamble"). The gross profit margin of its own brands is 28.6%, which is higher than third-party CPG brands of 12.95%. As at FY15, the total revenue contribution of own brands stands at 4.7%. The GP margin should increase if management decides to further expand the distribution of its own brands relative to third party CPG brands.

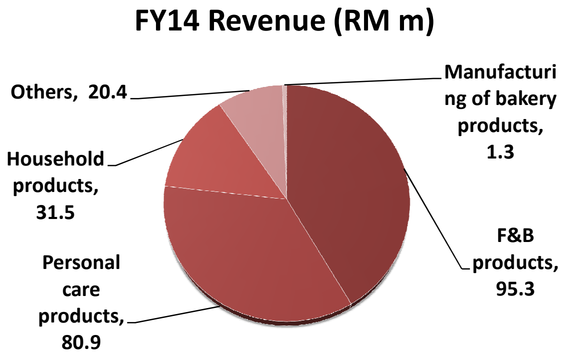
Fair value of RM0.18. We peg our valuation of KTC at 10x CY15F PE, the low end of its comparable peers and a 30% discount to DKSH Holdings (M) Bhd. We believe that the discount is justifiable in view of its small market cap and low liquidity. Its commitment to increase coverage of CPG brands distribution provides decent growth opportunities, although we note that the group is still relatively small compared with the dominant players.

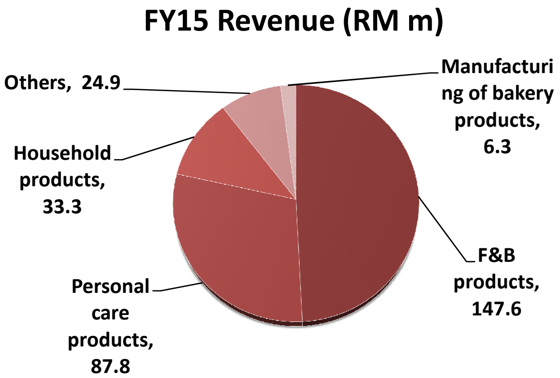
Background

Humble beginnings. Kim Teck Cheong (KTC) was established by Datuk Lau Yeong Ching in 1938, as an operator of a sundry shop in Sabah. In 1967, his son Datuk Lau Koh Sing took over the business and directed it to become a distributor of CPG brands. He further expanded the business geographically and established distribution centres around East Malaysia. The group currently holds 10% market share of CGP distribution in Sabah and Labuan.

Prior to listing, KTC has undertaken acquisitions to be merged into KTC Consolidated Sdn Bhd. It is incorporated as an investment holding company to facilitate its listing. AMDA Marketing, Creamos Malaysia, KTC Brands, KTC Distribution, KTC Sdn Bhd and KTC Tawau become its wholly-owned subsidiary companies, while KTC Sarawak became an 80% owned subsidiary.

EXHIBIT 1: Revenue breakdown by product segment





Source: Prospectus

Business Focus. KTC's CPG distribution segment accounts for more than 97% of its total revenue. FY15 revenue rose to RM299.87m (+31% y-o-y) due to addition of new CPG brands of F&B products, namely "Coco-Cola", "A&W Sarsaparilla", "Fanta", and "Sprite". CPG's F&B brand segment revenue in FY15 increased to RM147.55m (+55% y-o-y). Moving forward, its key focus is to develop its CPG brands distribution platform.

Growing across products and presence

CPG distributor in East Malaysia. KTC provides market access to a wide range of CPG covering F&B products, personal care products, household products, baby care products and OTC drugs and supplements. Currently, the group distributes 194 brands with 10,348 stock-keeping units (SKU) of CPG. One SKU represents one distinct product or stock item that can be purchased. The market size for the distribution of CPG in East Malaysia is estimated to be RM6.8bn, which provides room for KTC to expand its earnings and market share going forward.

Expanding market presence. At present, KTC has 18 distribution centres with 6,419 distribution points across East Malaysia. Albeit mostly in Sabah, its distribution points grew by CAGR 30.6% from FY12 to FY15. Distribution points consist of retailers, wholesalers, food service operators and other distributors. This shows the group has a steady growth momentum and we believe that KTC will deliver on its near term distribution expansion plan. It is focusing on Sarawak with plans to set up three distribution centres and increase the warehousing facilities from 25,360 sq ft to 45,000 sq ft (+77.4%). In Sabah, the group intends to increase its warehousing facilities from 229,542 sq ft to 265,456 sq ft (+15.6%).

Reducing single customer dependency. Servay Group of hypermarket companies is KTC's largest customer, accounting for 16.6%/15.8%/13.5% of total revenue in FY13/FY14/FY15. The declining trend in the composition of total revenue indicates KTC's declining dependency on a single customer group. Additionally, KTC has highlighted 2,000 potential distribution points in Sabah and Sarawak to be realised in the near term. The increase in customer distribution points will further improve KTC's customer base in East Malaysia.

Variety of CPGs offered. One of the key revenue growth drivers is the demand of CPG brands in KTC's portfolio. KTC tied up a non-exclusive distributorship with "Coca-cola" in Sep 2014 for Sabah and Labuan, and this has positively impacted FY15 revenue. The distributorship will end in Aug 2016, but we believe it will be renewed with inclusion of Sarawak territory.

Moreover, FY16 revenue is expected to improve with the addition of Aqua Label", "Tsubaki", "ZA" ,"Revlon" and "Phillips". We anticipate KTC to continue seeking well-known brands to add to its portfolio.

Business diversification. One of KTC's main short term initiatives is to expand its bakery line into the Sarawak market. It plans to appoint bakery line distributors and set up a new manufacturing facility in Sarawak. Manufacturing of bakery products makes up just 2% of total revenue in FY15. Bakery products should grow in tandem with third party CPG brands distribution.

IPO proceeds and future plans

EXHIBIT 2: Use of proceeds

Utilisation	Time frame (from IPO)	RM m	%
Acquisition of warehousing facilities	24 mths	9.0	42.3%
Construction of new warehousing facilities	18 mths	2.0	9.4%
Purchase of equipment	18 mths	3.0	14.1%
Working capital	12 mths	4.7	22%
Listing expenses	Immediate	2.6	12.2%
		21.3	

Source: Prospectus, AllianceDBS

Expansion of distribution facilities. The biggest chunk of proceeds (42.3%) is for KTC's acquisition of warehousing facilities. KTC's existing distribution operations in Sarawak are rented premises. As part of its future plans, the group intends to acquire premises in Sibu, Miri and Kuching, each with an estimated built up area of 15,000 sq ft at a total cost of RM9m. In addition, RM1m will be set aside for construction of a new warehouse and RM2m for purchasing new equipment for warehousing facilities in Sabah. The group has also set up a new distribution platform in Brunei costing RM1.54m, which will be funded via cash and borrowings.

Commitment to own brands of CPG. KTC plans to expand its line of bakery products through the appointment of new distributors and acquisition of new manufacturing premises in Sabah and Sarawak. Prior to the date of prospectus, KTC's bakery line was only available in Sabah. The IPO proceeds will allow KTC to develop its bakery line distribution network into Sarawak. Furthermore, KTC also plans to increase its F&B product offerings through its brands "Orie" and "Creamos".

EXHIBIT 3: Future Plans and Strategies

Type of CPG	Value & Time Frame	Financing
New distribution centre in Brunei	RM1.54m, FY16-FY17	Cash and borrowings
Acquisition warehouse facilities in Sarawak (Sibu, Miri and Kuching)	RM9m, FY16-FY17	IPO proceeds
New warehousing facility in Sabah	RM6.5m, FY17	RM1m – IPO proceeds, RM5.5m - Cash and borrowings
Warehousing facility equipment in Sabah	RM2m, FY16	IPO proceeds
Expansion of own brands of CPG	RM8.43m, FY16	RM2m – IPO proceeds, RM6.73m – Cash and borrowings

Source: Prospectus, AllianceDBS

Prospects

Increase in warehousing facilities. KTC plans to expand its warehousing space by approximately 86,000 sq ft in FY16-FY17, from its current total capacity of 274,428 sq ft. The warehouse utilisation rate has been declining - 92%/90%/84% in FY13/FY14/FY15 - as a result of acquisitions and aggressive business expansion. However, we believe the utilisation rate would stabilise in FY16-FY17 due to streamlining of distribution lines and new warehouse equipment. We expect the increased warehousing facilities to contribute positively to revenue in the coming financial years.

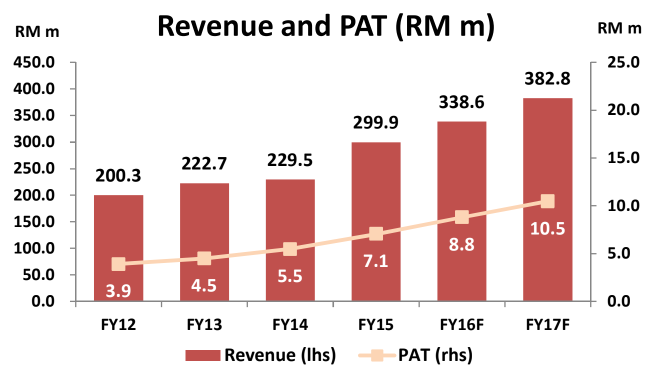
International CPG brands to drive growth. The success of "Coca-Cola" brand distribution in Sabah has paved the way for other well-known brands to engage with KTC in the near future. "Aqua Label", "Tsubaki", "ZA", "Revlon" and "Phillips" are among the new CPG brands coming in FY16 for both Sabah and Sarawak. We foresee more brands enlisting KTC as a distributor in East Malaysia.

Financial highlights

Quantum leap from FY12-FY15. KTC's earnings rose significantly in FY15 (FYE Jun), as a result of the introduction of "Coca-Cola" brand in its third party CPG distribution chain with F&B segment's revenue increasing by RM52.3m (+55% y-o-y). Management does not provide the breakdown of contributions specifically from "Coca-Cola" but we understand that the bulk of the increase in its F&B segment in FY15 was boosted by the latter. The group's FY16-FY17 revenue is forecasted to increase steadily by 13% CAGR, in line with increasing warehouse capacity and addition of new third party brands.

We forecast 13% top-line growth. We forecast revenue to grow by 13% in FY16, supported by the introduction of several personal care products and household product brands. These two CPG brand segments are expected to be its key earnings growth drivers for FY16-FY17.

EXHIBIT 4: Revenue and PAT



Source: Prospectus, AllianceDBS

PAT is estimated to grow in tandem with top-line in FY16-FY17 with CAGR of 21.9%. A big portion of costs of goods comes from distribution costs of third party CPG brands. Cost of goods over revenue ratio is 87.7%/87.4%/86.3% in FY13/FY14/FY15. Improvement of PAT was due to economies of scale as warehousing capacities increase in FY16-FY17.

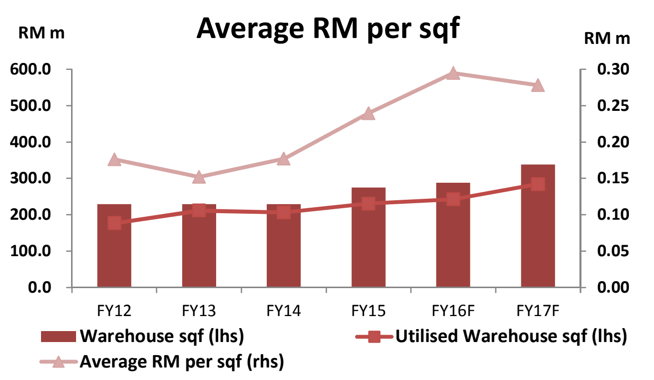
EXHIBIT 5: Revenue forecast breakdown

Revenue breakdown	FY14 RM'm	FY15 RM'm	Growth (%)	FY16 RM'm	Growth (%)
Distribution of CPG	**228.2**	**293.6**	**29%**	**330.8**	**13%**
F&B products	95.3	147.6	55%	152.0	3%
Personal care products	80.9	87.8	8%	109.7	25%
Household products	31.5	33.3	6%	41.7	25%
Others	20.4	24.9	22%	27.4	10%
Manufacturing of bakery products	**1.3**	**6.3**	**364%**	**7.8**	**25%**
TOTAL	**229.5**	**299.9**	**31%**	**338.6**	**13%**

Source: Prospectus, AllianceDBS

Upside potential from increase in utilisation rate. Warehouse capacity is expected to increase gradually after KTC's listing with most of the acquisitions to be done in FY17. We estimate the utilisation rate to remain stable at 84% (FY15) without improving substantially due to the on-going expansion. Average revenue per sq ft is calculated based on total inventory over total utilised warehouse capacity. We believe the influx of new CPG brands will drive sales and improve average revenue per sq ft of warehouse capacity in FY16F to RM290k per sq ft from RM240k per sq ft in FY15.

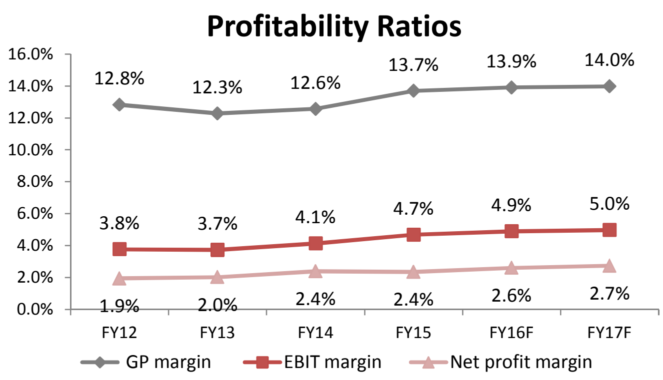
EXHIBIT 6: Capacity and utilisation



Source: Prospectus, AllianceDBS

Stable profitability outlook. KTC's key profitability margins are largely influenced by its wide gross profit. This is attributable to steady increase in revenue and lower average distribution costs, resulting from economies of scale. We believe margins will continue to improve moving forward. This is supported by announcement of new CPG brands to drive revenue and increase in warehousing capacity to reduce average costs. In the longer term, we believe that the group margin will improve gradually due to higher contributions from its own brands which command better margin. Nonetheless, we understand that it will take time for KTC to fully-develop its own brand distribution line-up. As at FY15, more than 95% of KTC's revenue comes from third party CPG brands distribution.

EXHIBIT 7: Trend of key profitability margins



Source: Prospectus, AllianceDBS

Gearing ratio unlikely to increase substantially despite expansion. On proforma basis, KTC's net gearing ratio will be 60.4% as at 30 June 2015 post IPO. Management does not expect to increase its borrowings substantially especially with the IPO proceeds. Therefore, financing costs is unlikely to rise significantly in the near future.

Prospective dividends. KTC stated in the prospectus that it envisages a dividend payout ratio of 20% of its net profits for the upcoming financial years. This implies dividend yields of 2.3%/2.7% in FY16/FY17 based on the IPO price.

Redeemable cumulative preference shares. KTC' share base will expand to 510.3m shares after its listing, from 368.3m shares. Further to this, redeemable cumulative preference shares (RCPS) of 24m shares has been set up as a performance incentive for directors and key employees. Each RCPS share can be redeemed for approximately 6.66 shares. Full conversion of RCPS into shares will result in EPS declining from 1.72sen to 1.31sen in FY16 with dilution of 6.67%. However, full conversion of RCPS may not be not possible as it could cause the public spread to decline to 21.2%. Upon maturity date in July 2020, any RCPS not converted will automatically lapse.

Risks

Competition. KTC is a top three first tier distributor with revenue exceeding RM200m in Sabah. Nevertheless, it falls far behind the top two distributors that have revenue exceeding RM1bn. With market share of only 10% in Sabah and Labuan, KTC is seeing stiff competition due to its relatively small size.

Direct sourcing from brand owners. KTC faces risk of being disregarded by some larger retail outlets. This is because some modern retail chain namely hypermarkets, supermarkets and convenience stores prefer to source supplies directly from brand owners.

Non-renewable of contract with "Coca-Cola". The inclusion of "Coca-Cola" in FY15 has boosted the growth in the revenue from the F&B segment by RM52.3m (+55% y-o-y). Based on this, we estimate the "Coca-Cola" brand to contribute more than RM50m annually. KTC has a risk of losing this portion of its revenue in FY17 if its contract with "Coca-Cola" is not renewed when it expires in August 2016. In the event of this happened, KTC's growth prospects will be adversely impacted.

Delayed introduction of new products. We foresee the main driver for KTC's FY16 revenue to be the addition of personal care and household third party CPG brands such as "Aqua Label", "Tsubaki", "ZA","Revlon" and "Phillips". As such, any delay or cancellation of new CPG brands will negatively affect KTC's earnings prospects.

Valuation

Fair value of RM0.18. We peg KTC's fair value at 10x CY15F PE, towards the low end of its peers' 10-13x range and a 30% discount to DKSH Holdings (M) Bhd. We believe that the discount is justifiable in view of its small market cap and low liquidity. Its commitment to increase coverage of CPG brands distribution provides decent growth opportunities, although we note that the group is still relatively small compared with the dominant players.

EXHIBIT 8: Peer comparison

					EPS (FD) Growth (YoY)		P/E (FD)		Price/ BVPS		Dividend Yield		ROE	
	Call	Fair Value (LC)	Price (LC)	Mkt Cap (MYR m)	CY2014	CY2015	CY2014	CY2015	CY2014	CY2015	CY2014	CY2015	CY2014	CY2015
DKSH	NR	NR	4.70	741.0	(86%)	(64%)	14x	13x	1.8x	1.5x	N/A	N/A	13.1%	11.6%
Harrisons	NR	NR	3.39	232.8	(27%)	N/A	N/A	10x	0.8x	0.7x	N/A	N/A	(2.6%)	7.3%
KTC Consolidated	NR	0.18	0.15	76.5	N/A	29%	N/A	11x	N/A	0.8x	N/A	N/A	N/A	19.3%

Sources: AllianceDBS, Bloomberg

DISCLOSURE

Stock rating definitions

STRONG BUY	-	> 20% total return over the next 3 months, with identifiable share price catalysts within this time frame
BUY	-	> 15% total return over the next 12 months for small caps, >10% for large caps
HOLD	-	-10% to +15% total return over the next 12 months for small caps, -10% to +10% for large caps
FULLY VALUED	-	negative total return > -10% over the next 12 months
SELL	-	negative total return of > -20% over the next 3 months, with identifiable catalysts within this time frame

Commonly used abbreviations

Adex = advertising expenditure
bn = billion
BV = book value
CF = cash flow
CAGR = compounded annual growth rate
Capex = capital expenditure
CY = calendar year
Div yld = dividend yield
DCF = discounted cash flow
DDM = dividend discount model
DPS = dividend per share
EBIT = earnings before interest & tax
EBITDA = EBIT before depreciation and amortisation

EPS = earnings per share
EV = enterprise value
FCF = free cash flow
FV = fair value
FY = financial year
m = million
M-o-m = month-on-month
NAV = net assets value
NM = not meaningful
NTA = net tangible assets
NR = not rated
p.a. = per annum
PAT = profit after tax

PBT = profit before tax
P/B = price / book ratio
P/E = price / earnings ratio
PEG = P/E ratio to growth ratio
q-o-q = quarter-on-quarter
RM = Ringgit
ROA = return on assets
ROE = return on equity
TP = target price
trn = trillion
WACC = weighted average cost of capital
y-o-y = year-on-year
YTD = year-to-date

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Wong Ming Tek, Executive Director

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