VOYAGE RESEARCH PTE LTD
10 Anson Road #20-08
International Plaza
Singapore 079903
Tel: 65 6227 2107
Fax: 65 6227 2079
admin@voyageresearch.com



# Keong Hong Holdings Limited

## Pipeline of Projects to Drive Upside

*Keong Hong Holdings Limited's (Keong Hong) 9M FY15 results were stronger than expected due to margin gains in 3Q. We reviewed our forecasts and decided to revise our valuation from S$0.555 previously to S$0.600 – 6.9x FY14 P/E. The company has a strong construction net order book of S$423.0m as of 30 Jun 2015, and a pipeline of highly valuable development projects with an estimated net development value of S$108.5m. As such, we decided to value Keong Hong at a conservative sum of S$136.3m.*

**Strong Construction Order Book:** Construction order book grew by 31.3% from S$322m from the end of 2Q to S$423.0m at the end of 3Q, following the award of contracts for the construction of an executive condominium (Parc Life) worth S$163.38m in July. In August, Keong Hong was further awarded a contract (out of 5-6 prequalified contractors) to construct a medical building (Raffles Project) worth S$107.48m in August, implying an enlarged order book of around S$530m. More importantly, this contract will provide the track record for the company to bid for other healthcare projects, thus diversifying to a new niche.

**Farsighted Investments in Property Bearing Fruit:** Keong Hong has been investing in 20% stakes in various executive condominium (EC) projects since 2011. The first project Twin Waterfalls obtained TOP in June 2015 and will contribute financially in 4Q FY15. We estimate that this project increase share of results from associates to S$16.0m in FY15. We highlight that the company has been careful to switch its investments to hospitality projects following headwinds in the residential sector. Two hotels at the Katong area are expected to be completed in FY16 and FY17, and two resorts in the Maldives will respectively be completed in FY16 and FY18.

**Outlook:** Upon completion, Keong Hong's hospitality projects will complement the company's balance sheet and recurring earnings, and help to mitigate risks in the construction sector, such as higher costs and stiff competition for contracts. Instead, Keong Hong can provide construction services to the projects it invests in, to maximize the efficiency gains from "design-and-build" integration. With a strong pipeline of projects, we reiterate our Increase Exposure rating for Keong Hong.

# Increase Exposure

- Intrinsic Value S$0.600
- Previous Close S$0.460

**Main Activities**

Keong Hong Holdings Limited is a provider of a broad range of building construction services to both private and public sectors for residential, commercial, industrial and institutional projects. The company's track record includes projects in Singapore and the Maldives, as well as stakes in property developments in Singapore.

**Financial Highlights**

| (Y/E Sep) S$m | FY13 | FY14 | FY15F |
|---|---|---|---|
| Revenue | 146.6 | 272.9 | 286.5 |
| Gross Profit | 30.4 | 30.3 | 31.5 |
| EBIT | 25.4 | 23.9 | 40.5 |
| PATMI | 21.6 | 19.7 | 33.4 |
| EPS (S cts) | 13.7 | 11.1 | 14.3 |

*Source: Voyage Research Estimates*

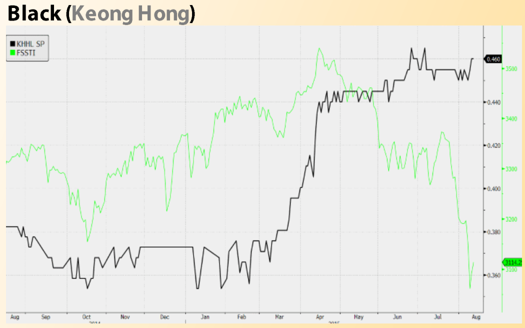
**Key ratios (FY15F)**

| | |
|---|---|
| PER | 3.1 |
| P/BV | 1.0 |
| ROE | 36.5% |
| Debt/Equity | 106.8% |
| Current ratio | 1.6 |

*Source: Voyage Research Estimates*

**Indexed Price Chart**

Green (FSSTI)
Black (Keong Hong)



*Source: Bloomberg*

| | |
|---|---|
| *52wks High-Low* | *47 cents/ 34 cents* |
| *Number of Shares* | *225.95 m* |
| *Market Capitalization* | *S$103.98m* |

**Analyst:**
**Liu Jinshu, Deputy Head of Research**
jinshu@voyageresearch.com
Tel: 6227 2107

**Figure 1: Results Overview**

| | 1Q FY14 | 2Q FY14 | 3Q FY14 | 4Q FY14 | 1Q FY15 | 2Q FY15 | 3Q FY15 | 4Q FY15F | Revised FY15F | | 9M FY15 | Previous FY15F | 9M % of Forecast |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Revenue | 61.59 | 79.80 | 69.95 | 61.54 | 73.20 | 68.19 | 62.92 | 82.22 | 286.5 | | 204.31 | 286.5 | 71.3% |
| Gross Profit | 8.43 | 5.67 | 8.28 | 8.20 | 7.56 | 6.55 | 8.49 | 8.92 | 31.5 | | 22.60 | 22.9 | 98.7% |
| Other Income | 0.29 | 0.58 | 0.32 | 1.59 | 1.20 | 1.08 | 1.24 | 0.48 | 4.0 | | 3.52 | 1.0 | NM |
| JV and associates | -0.20 | -0.15 | 0.01 | -0.25 | -0.13 | -0.15 | -0.20 | 16.47 | 16.0 | | -0.47 | 15.0 | NM |
| EBIT | 7.23 | 4.31 | 6.94 | 5.47 | 6.95 | 4.59 | 7.69 | 21.30 | 40.5 | | 19.22 | 30.9 | 62.2% |
| PATMI | 6.29 | 2.97 | 5.79 | 4.63 | 5.67 | 3.59 | 6.32 | 17.79 | 33.4 | | 15.57 | 25.4 | 61.3% |
| | | | | | | | | | | | | | |
| Gross Margin | 13.7% | 7.1% | 11.8% | 13.3% | 10.3% | 9.6% | 13.5% | 10.9% | 11.0% | | 11.1% | 8.0% | |
| EBIT Margin | 11.74% | 5.40% | 9.92% | 8.88% | 9.50% | 6.72% | 12.21% | 25.90% | 14.14% | | 9.41% | 10.79% | |
| Operating Exp | -1.29 | -1.81 | -1.68 | -4.08 | -1.68 | -2.90 | -1.85 | -4.58 | -11.00 | | -6.42 | -8.00 | |

Source: Company, Voyage Research

**Results Overview:** 9M revenue was about 3.7% or S$11m lower than forecast, which should present little challenge to full year estimates given the company's high order book. On-going projects that are likely to progress at full swing include J Gateway, SkyPark Residences, The Amore and the Raffles Project. We estimate that these four projects provide average revenue of S$7.0m to S$7.5m per month, translating to S$84m to S$90m of revenue per quarter. Moreover, the company may have some residual billings from recently TOP projects such as Twin Waterfalls and Alexandra Central, which may add a few more million to topline.

9M gross margin exceeded forecasts by 3.1% points. The company explained that margin improvements came about from lower subcontracting costs, cost savings from design-and-build projects that resulted in favorable variances from budget, and finalization of accounts (and costs) for certain projects. We are encouraged by the higher margin and revised construction gross margin to 11% for FY15 and 10% for FY16 and FY17. We are more conservative about longer term margins to ward against any one-off factors that may have temporarily boosted FY15 margins.

Although 9M EBIT and PATMI were 61% and 62% of forecasts rather than 70% to 80%, 4Q results will be substantially boosted by contribution from Twin Waterfalls. We estimate that this project may contribute about S$18.5m of net profit to Keong Hong. However, we remained conservative by plugging in a figure of S$16.0m for share of associates' results for FY15. Therefore, risks against our forecasts is to the upside for FY15.

**Sales at Existing EC Projects Have Improved:** Keong Hong's second EC project 20% owned SkyPark Residences (TOP FY16) is already more than 80% sold versus 70% since our last update in April. The third project 15% owned The Amore (TOP FY17) is about 32% sold versus 25% previously. In particular, sales at SkyPark Residences picked up to 48 units during July 2015 at an average price of S$769 per sq. ft. (psf), against a low of 6 units at S$754 psf. in February 2015. Currently, the average price at SkyPark Residences is about S$791 psf and remains higher than our assumption of S$780 psf.

VOYAGE RESEARCH
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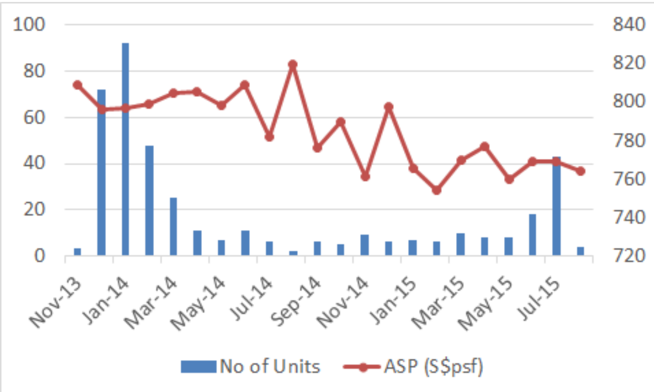
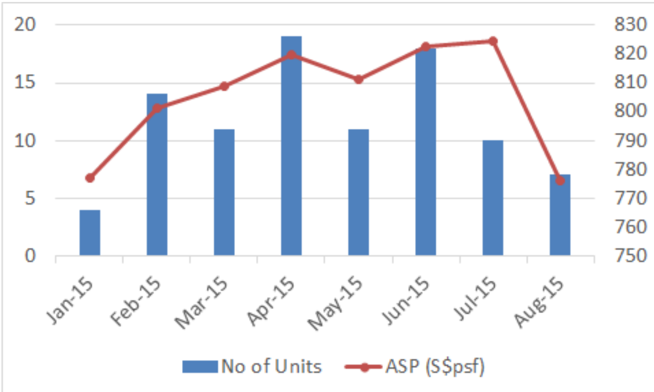
On the other hand, 10 to 20 units are sold each month at The Amore. The average selling price since launch is about S$810 psf and is still significantly above our updated assumption of S$780 psf. The fourth and last EC project in Keong Hong's pipeline 20% owned Parc Life (at Sembawang Crescent) will be launched at the end of this year.

### Figure 2: SkyPark Residences




Source: URA, Voyage Research

### Figure 3: The Amore




Source: URA, Voyage Research

The improved sales at SkyPark Residences and consistent turnover at The Amore increased our confidence in Keong Hong, which spurred our positive outlook on the company. We finetuned our selling price assumptions for both projects and now expect SkyPark Residences to contribute net profit of about S$12.4m (previously S$6.8m) in FY16 and The Amore to contribute S$2.26m (previously S$5.3m) in FY17. The estimated contribution from The Amore went down due to revision of others costs upwards for this project. In our forecasts, we deduct 10% of sales value for other costs, such as marketing, administrative and interest costs.

### Figure 4: Assumptions and Forecasts for EC Projects

| | Twin Waterfalls | SkyPark Residences | The Amore | Parc Life |
|---|---|---|---|---|
| Launch | Feb-12 | Oct/Nov 2013 | Dec 2014/Jan 2015 | End 2015 |
| Saleable GFA (sq.ft.) | 771,970 | 621,840 | 416,129 | 635,335 |
| ASP (S$/sq.ft.) | 710 | 780 | 780 | 750 |
| Sales Value (S$m) | 548.10 | 485.04 | 324.58 | 476.50 |
| Land Cost (S$m) | 219.50 | 211.9 | 156 | 214 |
| Construction Cost (S$m) | 162.50 | 149.9 | 118 | 163.38 |
| Other Costs (S$m) | 54.81 | 48.50 | 32.46 | 47.65 |
| Tax (S$m) | 18.92 | 12.70 | 3.08 | 8.75 |
| Est. Profit (S$m) | 92.37 | 62.03 | 15.04 | 42.72 |
| Keong Hong's Stake | 0.20 | 0.20 | 0.15 | 0.20 |
| **Attributable.Profit ( S$m)** | **18.47** | **12.41** | **2.26** | **8.54** |
| TOP | Jun-15 | FY16 | FY17 | FY18/FY19 |
| Progress | Fully sold, In handover of units | >80% sold. Construction about 70% completed | About 35% sold. Construction about 20% completed | Some site clearance work done |
| Revenue Recognition | 4Q FY15F | FY16 | FY17 | FY18/FY19 |

Source: Voyage Research

**Hotels to Complement EC Projects:** While our forecasts suggest that each subsequent EC is less profitable than the previous one, we noted that Keong Hong's 20% owned hotel projects at Katong/East Coast Road will provide upside in FY16 and FY17. Hotel Indigo Singapore and Holiday Inn Express Singapore Katong will together boost a total of 582 rooms. We revised our previous forecasts by assuming a value of S$0.75m per room from S$0.6m previously, to derive an average value of S$2,343 psf. In comparison, the Grand Mercure Roxy Singapore has a value per room of S$0.95m. As a result of these changes, we now expect the two hotels to be worth S$35.56m to Keong Hong.

**Maldives Hotels:** Previously, we have valued Keong Hong's 45% owned hotels under development at the Maldives by assuming 10% return over the total development cost of US$120m. We revised our model by applying a cap rate of 5% to the projected net profit of these hotels (unchanged), and arrived at a RNAV of S$31.2m.

**Figure 5: Hotel Indigo Singapore and Holiday Inn Express Katong**

| | Retail | Hotel |
|---|---|---|
| Est. GFA sq. ft. | 79812.3 | 186228.7 (582 rooms) |
| Est. Value per sq.ft. / room (S$) | 3,500 | 750,000 |
| Est. Value (S$m) | 279.3 | 436.5 |
| Land Cost (S$m) | 105.8 | 247.0 |
| Construction Cost (S$m) | 37.5 | 87.5 |
| Other Costs (S$m) | 13.60 | 10.20 |
| Tax (S$m) | 20.81 | 15.61 |
| Gain/Valuation (S$m) | 101.6 | 76.2 |
| **Keong Hong's share @ 20%** | **20.32** | **15.24** |
| Fair Value/Revenue Recognition | 50% FY16 / 50% FY17 | FY17 |

Source: Voyage Research

**Figure 6: Maldives Projects**

| | Mercure Maldives Koodoo | Pullman Maldives |
|---|---|---|
| No of Villas | 68 | 120 |
| Room rate (US$/villa) | 350 | 600 |
| Average Occupancy | 85% | 85% |
| Revenue (350 days) | 7.08 | 21.42 |
| Operating margin | 35% | 35% |
| Operating Profit (US$m) | 2.48 | 7.50 |
| Tax (15%) | 0.37 | 1.12 |
| Net Profit | 2.11 | 6.37 |
| Valuation (US$m - 5% cap rate) | 42.13 | 127.45 |
| USD SGD | 1.4 | 1.4 |
| Valuataion (S$m) | 59.0 | 178.4 |
| Total | 237.4 | |
| Development Cost | 168 | (US$120m x 1.4) |
| RNAV | 69.4 | |
| **Attributable to Keong Hong (S$m)** | **31.2** | 45% stake |
| Completion | 2016 | 2017 |

Source: Voyage Research

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**Forecasts and Valuation:** As a result of the projects in Singapore, we are able to formulate share of results of associates and joint venture of S$16.0m/S$22.6m/ S$25.4m for FY15/FY16/FY17. These gains will in turn drive the company's growth even if construction EBIT is expected to remain flat at around S$22m in FY16 and FY17. Our profit forecasts only incorporate fair value gains out of the hotels in Singapore, and excluded the Maldives resorts in view of forecasting risks. Likewise no hotel operating income has been incorporated into our forecasts. However, our valuation takes into account all EC, local and foreign hotel assets, and value the total RNAV of S$108.5m at a hefty 60% discount to arrive at a value of S$43.4m or 19.2 S cents per share. The construction business is in turn valued at S$92.9m (41.1 S cents) or 5.35 times FY15 construction PATMI, based on WACC of 11% to 12%. Combining both businesses together, we arrived at a valuation of S$0.603 per share (rounded to S$0.600), translating to an upside of 31% from previous close of S$0.460.

**Figure 7: List of Construction Projects**

| | Contract Value | Est. TOP | Joint Developer? | Remarks |
|---|---|---|---|---|
| **Singapore – Construction Only** | | | | |
| Paterson 2 | 70.5 | 2H 2015 | NA | Substantially finished, pending TOP |
| J Gateway | 161.9 | Sep-16 | NA | About 30% completed |
| SkyPark Residences | 149.9 | FY16 | 20% | About 70% completed |
| The Amore | 118.0 | FY17 | 15% | About 20% completed |
| Parc Life | 163.4 | FY18/FY19 | 20% | Pending Launch |
| Raffles Project | 107.5 | 2017 | NA | Awarded in August |
| Total | 771.2 | | | |
| Net Order Book as of June | 423 | | | |

Source: Company, Voyage Research

**Figure 8: Valuation of Construction Business**

| S$ m | FY15F | FY16F | FY17F |
|---|---|---|---|
| Construction Revenue | 286.5 | 300.9 | 315.9 |
| Construction EBIT | 24.5 | 22.0 | 22.3 |
| Tax on EBIT | -4.2 | -3.7 | -3.8 |
| NOPLAT | 20.3 | 18.2 | 18.5 |
| Invested Capital* | 123.7 | 132.4 | 146.6 |
| % of Debt | 21.8% | 51.5% | 53.7% |
| % of Equity | 78.2% | 48.5% | 46.3% |
| WACC (%) | 14.6% | 11.7% | 11.5% |
| Capital Charge | -18.1 | -15.5 | -16.9 |
| Economic Profit | 2.2 | 2.7 | 1.6 |
| Terminal Value | | | 11.1 |
| Discount Factor | 0.87 | 0.80 | 0.72 |
| Present Value | 2.0 | 2.2 | 1.2 |
| Book Value | 79.6 | Risk Free Rate | 2.5% |
| Explicit Value | 5.3 | Beta | 1.1 |
| Terminal Value | 8.0 | Market RP | 7.7% |
| Total Value – Construction only (S$m) | 92.9 | Cost of Equity | 11.0% |
| FY15F Construction PATMI | 17.4 | Cost of Debt | 3.0% |
| P/E | 5.35x | LT Growth | 2.0% |

*Based on total assets less investments and amounts due from JVs and associates. % Debt is based on group level invested capital, i.e. assume same level of leverage across businesses.

Source: Voyage Research

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International Plaza
Singapore 079903
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Fax: 65 6227 2079
admin@voyageresearch.com


## Figure 9: Valuation – Group Level

| | |
|---|---|
| **Construction Business (A)** | **92.93** |
| **Property & Hospitality** | |
| Twin Waterfalls | 18.47 |
| SkyPark Residences | 12.41 |
| The Amore | 2.26 |
| Parc Life | 8.54 |
| Katong Hotels - Retail | 20.32 |
| Katong Hotels - Hotel | 15.24 |
| Maldives Hotel | 31.2 |
| **Total RNAV** | **108.48** |
| 60% Discount | -65.09 |
| **Adjusted RNAV (B)** | **43.39** |
| **Total Valuation (A+B)** | **136.33** |

Source: Voyage Research

## Figure 10: Financial Forecasts and Estimates

| | FY11 | FY12 | FY13 | FY14 | FY15F | FY16F | FY17F |
|---|---|---|---|---|---|---|---|
| Revenue | 189.5 | 167.4 | 146.6 | 272.9 | 286.5 | 300.9 | 315.9 |
| Gross Profit | 13.8 | 29.3 | 30.4 | 30.3 | 31.5 | 30.1 | 31.6 |
| EBIT | 12.2 | 24.0 | 25.4 | 23.9 | 40.5 | 44.6 | 47.7 |
| PATMI | 9.4 | 20.0 | 21.6 | 19.7 | 33.4 | 36.7 | 39.3 |
| | | | | | | | |
| Total Current Assets | 110.9 | 119.3 | 117.8 | 195.5 | 197.9 | 211.6 | 209.2 |
| Total Non-Current Assets | 5.0 | 6.7 | 14.6 | 26.2 | 106.7 | 197.2 | 227.5 |
| Total Current Liabilities | 83.6 | 74.2 | 66.0 | 138.6 | 120.9 | 159.4 | 129.8 |
| Total Non-Current Liabilities | 0.9 | 0.4 | 1.1 | 3.0 | 80.2 | 120.2 | 150.2 |
| Total Equity | 31.4 | 51.4 | 65.2 | 80.1 | 103.5 | 129.2 | 156.7 |
| | | | | | | | |
| Cash from Operating Activities | 10.4 | 25.3 | 4.2 | 47.1 | 4.1 | 66.7 | 14.0 |
| Cash from Investing Activities | 7.1 | -4.3 | -7.9 | -12.5 | -89.2 | -97.1 | -37.0 |
| Cash from Financing Activities | -2.9 | 4.1 | -33.2 | -13.2 | 77.6 | 29.0 | 18.2 |
| | | | | | | | |
| Receivable Days | 120 | 123 | 113 | 75 | 85 | 90 | 90 |
| Payable Days | 124 | 134 | 141 | 111 | 120 | 120 | 120 |
| | | | | | | | |
| Return on Common Equity | 41.6% | 50.2% | 37.7% | 27.3% | 36.5% | 31.7% | 27.6% |
| Return on Assets | 10.4% | 16.0% | 16.5% | 11.1% | 12.7% | 10.3% | 9.3% |
| Gross Debt / Common Equity | 5.6% | 1.7% | 7.0% | 28.1% | 106.8% | 116.6% | 115.2% |
| Current Ratio | 1.3 | 1.6 | 1.8 | 1.4 | 1.6 | 1.3 | 1.6 |
| | | | | | | | |
| EPS (S cents) | 5.9 | 12.5 | 13.7 | 11.1 | 14.3 | 15.8 | 16.9 |
| BV/Share (S cents) | 18.4 | 31.4 | 41.3 | 34.2 | 44.2 | 55.2 | 67.1 |
| P/E | 12.6 | 11.1 | 5.2 | 4.8 | 3.1 | 2.8 | 2.6 |
| P/BV | 6.7 | 3.5 | 2.1 | 1.6 | 1.0 | 0.8 | 0.7 |

*EPS and BV based on post-IPO number of shares
Source: Voyage Research

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Singapore 079903
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**Rating Definition:**

**Increase Exposure –** The current price of the stock is significantly lower than the underlying fundamental value. Readers can consider increasing their exposure in their portfolio to a higher level.
**Invest –** The current price of the stock is sufficiently lower than the underlying fundamental value of the firm. Readers can consider adding this stock to their portfolio.
**Fairly Valued –** The current price of the stock is reflective of the underlying fundamental value of the firm. Readers may not need to take actions at current price.
**Take Profit –** The current price of the stock is sufficiently higher than the underlying fundamental value of the firm. Readers can consider rebalancing their portfolio to take advantage of the profits.
**Reduce Exposure -** The current price of the stock is significantly higher than the underlying fundamental value of the firm. Readers can consider reducing their holdings in their portfolio.

**IMPORTANT DISCLOSURE:**