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Update Report 22 May 2014

Keong Hong Holdings Limited

Growing Beyond Construction

Keong Hong Holdings Limited's (Keong Hong) 1H FY14 PATMI grew by 40.6% Y-o-Y on high revenue growth of 122%. The results were within our expectations with 2H FY14 likely to account for a greater portion of full year profits. Going forward, we expect the company to win the construction contract for at least one of two co-developed projects to replenish its order book. The outlook for FY15 remains positive with 20% owned project Twin Waterfalls expected to add S$18.5m to PATMI. Finally, the company commenced construction on projects in the Maldives with completion expected in 2015/2016.

One More Contract in the Pipeline: Keong Hong currently has two co-developed projects - the Punggol Central/Edgedale Plains executive condominium project and the hotel development at East Coast Road with unawarded construction contracts. We expect the company to bag the construction contract for at least one of these projects at an estimated value of S$120m to S$130m.

More Windfall Gains from Property Development: The hotel development at East Coast Road, in our view, has the possibility of generating about S$20m to S$22m of gains for the company, based on a gross value of S$2,350 per sq. ft. on the maximum GFA of 266,041 sq ft. Retail and hotel properties typically fetch a higher price than residential properties. On the other hand, we expect Keong Hong to make relatively smaller gains of S$5.3m out of the Punggol Central/Edgedale Plains project as the units are likely to be priced competitively.

Forecasts and Valuation: A number of development projects are likely to be completed in FY15 and FY16. They include the company's airport and hotel projects in the Maldives. The hotel development at East Coast Road and the Punggol Central/Edgedale Plains project are likely to be completed between FY16 and FY17, alongside SkyPark Residences. In all, we project Keong Hong to make S$18.5m and S$21.5m from its associates in FY15 and FYY16 respectively due to its co-development projects. In this update, we revised our valuation to incorporate the company's new projects and arrived at an intrinsic value of S$0.810.

Increase Exposure

- Intrinsic Value S$0.810
- Prev Closing S$0.595

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	FY12	FY13	FY14F
Revenue	167.4	146.6	227.3
Gross Profit	29.3	30.4	34.1
EBIT	24.0	25.4	28.8
PATMI	20.0	21.6	23.8
EPS (S cts)	12.5	13.7	15.3

*FY12 EPS based on 160m shares
Source: Voyage Research Estimates

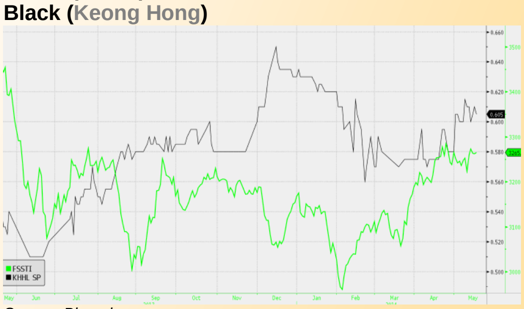
Key ratios (FY14F)

PER	3.9
P/BV	1.1
ROE	31.3%
Debt/Equity	12.5%
Current ratio	1.4

Source: Voyage Research Estimates

Indexed Price Chart

Green (FSSTI)
Black (Keong Hong)



Source: Bloomberg

52wks High-Low	*65.0 cents/ 50.0 cents*
Number of Shares	*155.5 m*
Market Capitalization	*S$92.5m*

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Hotel Development Project Holds Promise: The 8,238.5 sqm land was awarded to Keong Hong's associated company in Jan 2014. We assume that 35% of the maximum GFA will be allocated for retail purposes with the remainder being developed into about 500 hotel rooms. At a value of 600k per room, the hotel component has a potential value of S$300m, while the retail component may fetch S$3,500 per sq. ft. to yield S$326m.

Hotel and retail properties tend to have a higher value than residential properties due to their higher yield. We believe that our estimates are reasonable as we are looking at an average room size of 300 to 350 sq ft., at an average value of S$1,735 to S$2,000 per sq. ft. We noted that another hotel in the East Coast Area, the Grand Mercure Roxy Hotel has an average value of at least S$800k per room.

The company explained that they intend to either hold the hotel or the retail shops as investments via the associated company. The hotel is being designed to target both the mass and high end markets, i.e. offering a balanced offering of room types.

Based on an estimated construction cost of about S$125m (or S$470 per sq. ft.) and other operating expenses of about 3%, we estimate that Keong Hong may make about S$21.5m of net profit from this project, translating to about S$0.138 of value per share (pre-bonus issue). After incorporating a steep discount of 40%, the hotel development now adds about 8.3 S cents to our valuation. The steep discount thus takes into account some of the risks against our assumptions.

Maldives Projects Gaining Momentum: Over at the Maldives, Keong Hong is expanding the Kooddoo domestic airport, including the extension of its existing runway. This project is slated for completion in 1Q 2015 (or FY15). At the same time, Keong Hong will develop an airport hotel and a resort hotel on the same atoll. These projects are likely to be completed in FY15 and FY16. We reckon that the projects may have a cost of about S$100m based on a prior project (the 94-villa resort hotel on Falhumaafushi Island).

Currently, the company intends to rope in more strategic partners into the Maldives projects. Upon the completion of the hotel and resort, Keong Hong will engage a hotel operator to manage the hotels and earn recurring income from the Maldives. In the longer term, we gathered the company intends to explore for more projects in the Maldives.

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Figure 1: Assumptions on East Coast Hotel

Land Area	88,678	sqft
Max GFA	266,041	sqft
% Retail	93,114	@ 35%
% Hotel	172,927	@ 65%
Est. Value per sq ft, retail	3500	S$ psf
Value of Retail Component	**325.9**	**S$m**
Est. Value per hotel room	0.6	est. S$m
Est. No of Rooms	500	est.
Value of Hotel Component	**300**	**S$m**
Implied Value / sq ft, hotel	1735	S$
Implied Area per room	346	sqft
Total Value	**625.9**	**S$m**
Land Cost	-352.8	
Construction Cost	-125	
Implied con cost/sqft	469.9	S$/sqft
Other Exp	-18.8	3%
Tax	-22.0	
Net Profit	107.3	
Keong Hong's share	**21.5**	**@20%, S$m**

Source: Voyage Research

Figure 2: Assumptions on Punggol EC

Land Area	146,010	sqft
GFA	438,031	sqft
Est. Selling Price	750	S$/sqft
Est. Value	**329**	**S$m**
Land Cost	-156	S$m
Construction Cost	-120.0	S$m
Implied con cost/sqft	274	S$
Other Exp	-9.9	3%
Tax	-7.3	
Net Profit	35.4	
Keong Hong's share	**5.3**	**@15%, S$m**

Source: Voyage Research

Co-development Projects Offsetting Lower Margins in Construction Segment: We maintained our forecasts for FY14, since the 1H FY14 results remained in line with our expectations. However, we reduced estimated gross margins for FY15 and FY16 to 5%. This is to factor in higher operating costs in the construction segment as reflected by the management. However, we also noted that Keong Hong is likely to earn average annual net profit of close to S$20m over FY15 and FY16 from its associated company's development projects.

Factoring in gains from the property development projects in Singapore, we estimate cumulative net profit attributable to shareholders from FY14 to FY16 to be S$65.8m versus S$69.7m previously. As such, gains from property development are substantially offsetting lower profitability from construction projects.

The bulk of the gains are likely to be from Twin Waterfalls (the company's maiden development venture) and the hotel at East Coast Road. SkyPark Residences and the Punggol Central executive condominium projects are likely to fetch a lower margin due to more competitive selling prices.

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Shifting Sights Overseas: In spite of the gains from co-developing certain projects, we gathered that the company is mindful of the more challenging environment in the Singapore market and has accordingly shifted its strategy. For instance, the company is less excited about taking on new residential development projects, but is open opportunities in other sectors, such as hospitality, and in other countries. The management has also viewed sites in Malaysia and Thailand; and is desirous of building a larger presence in the Maldives.

Our View: We are encouraged by Keong Hong's tactical moves to expand revenue sources without further raising its exposure to the residential market. In this update, we revised our valuation model to take into account the growing property development business as a separate segment. In all, we value the construction business at S$0.609 per share and the property business at S$0.201 per share, to arrive at a total valuation of S$0.810. We also raised cost of equity to 11.0% (previously 10.2%). We do not incorporate any gains from the Maldives projects in this update due to limited visibility at the moment, e.g. Keong Hong's eventual stake in the projects and their margins.

There is a risk that FY14 gross margin may underperform should the company commence work on some of the lower margin projects earlier. Nonetheless, the impact is unlikely to be high as we have already factored in lower construction margins in FY15 and FY16.

Bonus Issue: Keong Hong has received approval from the SGX for the listing and quotation of one bonus share for every two outstanding shares. The book closure date has yet to be confirmed.

Figure 3: Results Summary

	1H FY14	2H FY13	1H FY13	2H FY12	1H FY12
Revenue	118.0	93.8	52.8	72.2	95.2
Gross Profit	13.7	21.9	8.6	21.0	8.3
EBIT	9.9	18.3	7.1	17.4	6.5
PATMI	8.8	15.4	6.2	15.3	4.7
Gross Margin	11.6%	23.3%	16.2%	29.1%	8.7%
EBIT Margin	8.4%	19.5%	13.4%	24.2%	6.9%

Source: Company, Voyage Research

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Figure 4: List of Construction Projects and Investments

	Contract Value	Est. TOP	Joint Developer?	Remarks
Singapore				
Paterson 2	70.5	Feb-14	NA	
The Terrasse	110.5	May-14	NA	
Twin Waterfalls	162.5	Dec-14	20%	Fully Sold
Alexandra Central	101.08	Mar-15	NA	
J Gateway	161.9	Sep-16	NA	
SkyPark Residences	149.9	Oct-16	20%	Launched, 60% sold
Punggol Central / Edgedale Plains	NA	NA	15%	To be launched 4Q 2014
East Coast Road Hotel	NA	NA	20%	
Total	756.4			
Net Order Book as at 31 Mar	494			
Maldives	**Status**			
Kooddoo Domestic Airport	Work has commenced for completion in 2015/2016. Pending further announcements from company			
Tourist Hotel				
Tourist Resort				
Kori Holdings Limited	**Status**			
S$5m convertible loan from Keong Hong to Kori at 5% interest per year, maturing in 2016 Convertible at any time until maturity into 11.9m Kori shares at S$0.42 each.				

Source: Company, Voyage Research

Figure 5: Valuation

S$ m	FY14F	FY15F	FY16F
Revenue	227.3	250.0	275.0
EBIT	28.8	6.6	7.6
Tax on EBIT	-4.9	-1.1	-1.3
NOPLAT	23.9	5.5	6.3
Invested Capital	48.0	58.1	49.6
% of Debt	9.4%	18.9%	20.2%
% of Equity	90.6%	81.1%	79.8%
WACC (%)	10.5%	10.1%	10.0%
Capital Charge	5.1	5.9	5.0
Economic Profit	18.8	-0.4	1.3
Terminal Value			16.6
Discount Factor	0.9	0.8	0.8
Present Value	17.0	-0.3	1.0
Book Value	64.2	Risk Free Rate	2.5%
Explicit Value	17.7	Beta	1.1
Terminal Value	12.5	Market RP	7.7%
Add Discounted RNAV of Projects (Fig. 6)	31.3	Cost of Equity	11.0%
Value of Equity	125.6	Cost of Debt	5.4%
Number of Shares (m)	155.5	LT Growth	2.0%
Value per share (S$)	0.810		

*Invested capital now excludes disclosed and est. debt held by associates or JV, but secured by Keong Hong, as these funds are typically deployed in co-development projects.
Source: Voyage Research

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Figure 6: Estimated RNAV

Project	RNAV S$m	Remarks
Twin Waterfalls	18.5	
SkyPark Residences	6.8	
Punggol Central / Edgedale Plains	5.3	As per Fig 2
East Coast Road Hotel	21.5	As per Fig 1
Total RNAV	52.1	
After 40% Discount	31.3	

Source: Voyage Research

Figure 7: Financial Forecasts and Estimates

	FY11	FY12	FY13	FY14F	FY15F	FY16F
Revenue	189.5	167.4	146.6	227.3	250.0	275.0
Gross Profit	13.8	29.3	30.4	34.1	12.5	13.7
EBIT	12.2	24.0	25.4	28.8	21.6	29.0
PATMI	9.4	20.0	21.6	23.8	17.9	24.1
Total Current Assets	110.9	119.3	123.7	181.7	158.6	201.6
Total Non-Current Assets	5.0	6.7	14.3	34.8	50.2	59.8
Total Current Liabilities	83.6	74.2	71.9	127.6	107.4	143.2
Total Non-Current Liabilities	0.9	0.4	1.1	0.2	0.2	0.2
Total Equity	31.4	51.4	65.0	88.7	101.2	118.0
Cash from Operating Activities	10.4	25.3	4.2	33.7	25.3	19.2
Cash from Investing Activities	7.1	-4.3	-7.9	-2.0	-2.0	-4.2
Cash from Financing Activities	-2.9	4.1	-33.2	-8.7	-5.4	-7.2
Receivable Days	120	123	120	120	120	120
Payable Days	124	134	125	120	120	120
Return on Common Equity	41.6%	50.2%	37.8%	31.3%	19.0%	22.1%
Return on Assets	10.4%	16.0%	16.2%	13.4%	8.4%	10.2%
Gross Debt / Common Equity	5.6%	1.7%	7.0%	12.5%	10.0%	8.5%
Current Ratio	1.3	1.6	1.7	1.4	1.5	1.4
EPS (S cents)	5.9	12.5	13.7	15.3	11.5	15.4
BV/Share (S cents)	18.4	31.4	41.2	56.3	64.4	75.1
P/E	10.3	4.8	4.4	3.9	5.2	3.9
P/BV	3.3	1.9	1.5	1.1	0.9	0.8

*EPS and BV based on post-IPO number of shares

Source: Voyage Research

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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:
