



# Kawan Renergy Bhd

## Growing RE-curring Income

**Ace Market**  
**Industrial Product & Services Sector**  
**SUBSCRIBE**  
**IPO Price: RM0.30**  
**Fair Value: RM0.35**

### Valuation / Recommendation

We have a **SUBSCRIBE** recommendation on Kawan Renergy with a **FV of RM0.35 based on 13x FY25F EPS**, translating to 17% upside to IPO price. Our target PE of 13x is in line with comparable peers' average valuation. We believe the stock could re-rate in the near term on the back of: 1) Stronger orderbook win for its key engineering business; and 2) Successful bid for a new 2MW biomass plant.

### Investment Highlights

**RE projects driving growth.** Since FY22, a new revenue segment focusing on renewable energy (RE) and co-generation plant projects contributed to Kawan Renergy's growth, which accounted for 22-30% of total sales. As of March 2024, its unbilled order book stands at RM72.9m, of which RM51.8m is expected to be recognised in FY24F. The group is also tendering for four new projects - an IPE venture, a co-generation power plant, and two process plant projects - valued at RM113m total. We expect Kawan Renergy to secure more order books in the coming years, driven by the rebound in foreign direct investment into Malaysia and strong government initiatives for the RE sector.

**Steady margins.** Margins for each business segment have generally been improving over the years. Notably, margins for IPE and process plants have been quite consistent in the last two years (staying around 19-24%), helped by increased job order uptake. Due to timing differences, margins for the RE segment had a big swing (6.8% in FY22 jumping to 36.8% in FY23), which averaged out to be about 17% if we combined both financial years. Normalising for this and also factoring margin improvement for the RE segment, we expect Kawan Renergy could achieve a blended gross margin of around 20% in our FY24-26F forecasts.

**Growing recurring income.** Kawan Renergy plans to grow its RE business by bidding for a new 2MW biomass plant (in 2Q24), as well as improving its existing Bercham plant. It is estimated to cost RM15m to construct the new biomass power plant, and RM2.5m for the Bercham plant improvement. At full capacity, we estimate electricity sales from these two plants can contribute up to RM10.2m in annual revenue (assuming a FiT rate of RM0.3880/kWh), representing 8% of its FY26 revenue. Assuming a decent PAT margin of 30%, we expect RE electricity sales could potentially contribute close to 20% of earnings in FY26.

**Risk factors** for Kawan Renergy include (1) Skilled labours; (2) Fluctuations in steel metal prices; and (3) Regulation compliances.

FY Oct	FY22	FY23	FY24F	FY25F	FY26F
Revenue (RM m)	139.2	98.4	106.2	114.7	123.9
EBITDA (RM m)	20.0	21.5	19.1	21.0	22.9
PAT (RM m)	14.2	13.3	13.6	15.0	16.4
PAT Margin (%)	10.2	13.6	12.8	13.1	13.2
EPS (sen)	3.2	3.0	2.5	2.7	3.0
EPS Growth (%)	106.7	-6.2	-18.6	10.3	9.5
BV Per Share (sen)	102.6	121.4	174.4	193.5	214.4
PE (x)			12.1	11.0	10.1
Net Gearing (%)	28.3	20.1	4.9	4.4	4.0
ROE (%)			14.2	14.1	13.9

### Business Overview

Kawan Renergy Bhd operates two business segments, (i) design, build, install and commission engineering solutions, (ii) sales of electricity. The company currently focuses primarily on providing engineering solutions for industrial process equipment, process plants, and renewable energy and co-generation plants.

### Listing Details

Listing date	29 May 2024
New shares (m)	110.0
Offer for sale (m)	34.5
Funds raised (RM m)	33.0

### Post Listing

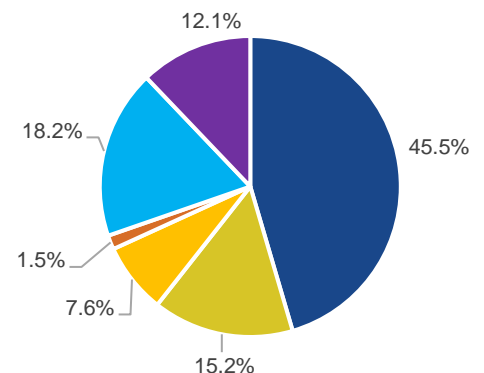
Ordinary shares (m)	550.0
Market cap (RM m)	165.0
Free float	26.3
P/E (FY24F)	12.1

### Top 3 Shareholders

Lim Thou Lai	70.5%
Chong Hon Choong	1.2%
Heng Siew Aun	2.0%

### Utilisation of Proceeds

	RM m
Working capital	15.0
Investment into a new 2MW power plant	5.0
Improvement of Bercham Plant output	2.5
Purchase of additional machinery	0.5
Repayment of bank borrowings	6.0
Estimated listing expenses	4.0



Source: Company, Mercury Securities



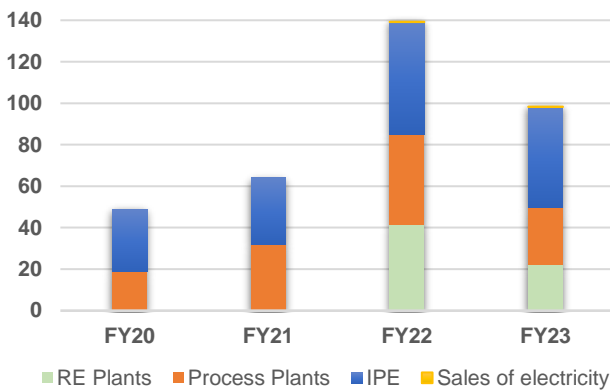
## Financial Highlights and Valuation

**Growth driven by new RE segment starting FY22.** Kawan Renergy saw a significant jump in revenue from only about RM49m in FY20, to reach a new high of RM98-139m over FY22-23. Starting FY22, a new revenue segment focusing on RE and co-generation plant projects contributed to the growth, which accounted for 22-30% of total sales. Besides that, projects were also picking up for its other two key business segments, namely IPE and process plants (RM76-98m combined sales in FY22-23 vs. RM64m in FY21).

**Steady margins.** While there were some fluctuations, gross margins for each business segment have generally been improving over the years. Notably, margins for IPE and process plants have been quite consistent in the last two years (staying around 19-24%), helped by increased job order uptake. Due to timing differences, margins for the RE segment had a big swing (6.8% in FY22 jumping to 36.8% in FY23), which averaged out to be about 17% if we combined both financial years. Normalising for this and also factoring margin improvement for the RE segment, we expect Kawan Renergy could achieve a blended gross margin of around 20% in our FY24-26 forecasts.

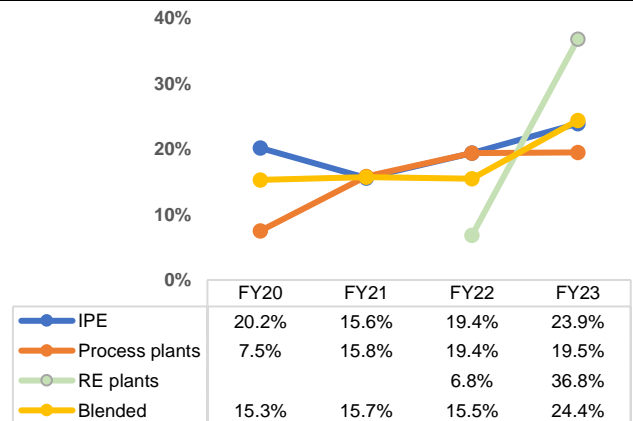
**Stable orderbook.** As of March 2024, the group has successfully secured an unbilled order book amounting to RM72.9m. Of this total, RM51.8m (71%) is anticipated to be recognised in FY24F. The group has also engaged in preliminary talks for four new projects - an IPE venture, a co-generation power plant, and two process plant projects - collectively valued at RM113m. We expect Kawan Renergy to secure more order books in the coming years, driven by the rebound in foreign direct investment into Malaysia and strong government initiatives for the RE sector. This underpins our 8.0% revenue growth assumption for Kawan Renergy in FY24-25F respectively.

**Figure 1: Revenue breakdown, by segment (in RM m)**



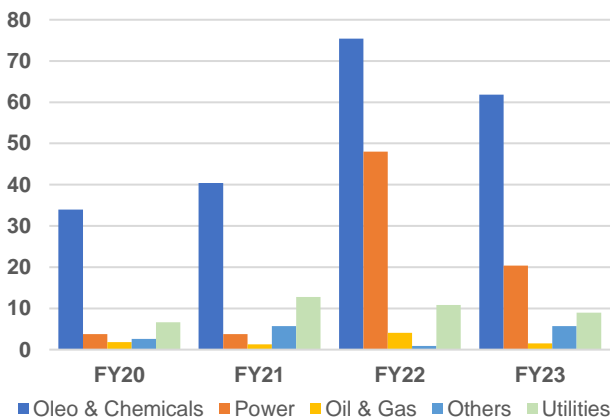
Source: Company, Mercury Securities

**Figure 2: Gross margins, by business segment (%)**



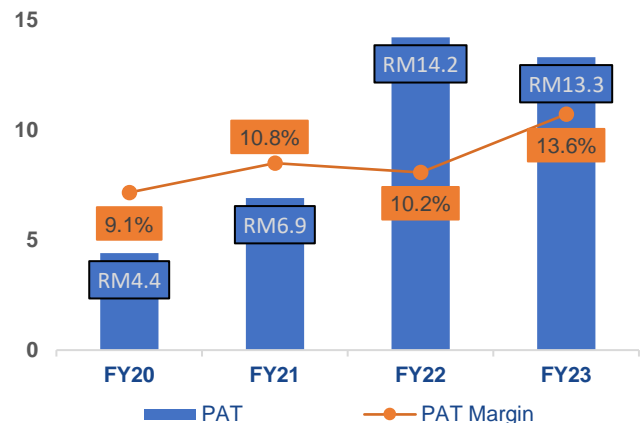
Source: Company, Mercury Securities

**Figure 3: Revenue breakdown, by industry (in RM m)**



Source: Company, Mercury Securities

**Figure 4: PAT (RM m) and PAT margin (%)**



Source: Company, Mercury Securities



**Diversification into RE.** To grow recurring income, Kawan Renergy acquired Magenko Group in August 2022, which owns and operates a biomass plant in Bercham. This plant has a net electricity export capacity of 1MW, but it's currently outputting only 6% due to pipe blockage issues. To optimise the electricity output, Kawan Renergy intends to install an anaerobic digestion system (costing RM2.5m) and use agricultural waste as additional feedstock.

If its bid is successful (the application is expected to open in 2Q24), Kawan Renergy also plans to invest an additional RM17.5 m in constructing a new 2MW biomass plant that will roughly take 18 months to complete. At full capacity, we estimate electricity sales from these two plants can contribute up to RM10.2m in annual revenue (assuming a FIT rate of RM0.3880/kWh), representing 8% of its FY26 revenue. Assuming a decent PAT margin of 30%, RE electricity sales could potentially contribute close to 20% of earnings in FY26.

**Solid balance sheet.** Kawan Renergy has consistently maintained a net cash position in the last four years, with the latest FY23 figure closing at RM34m. We believe the increase in net cash from the IPO proceeds would allow the group to tender for more jobs as well as undertake larger-scale projects from its clients.

**Dividend policy.** The company does not have a formal dividend policy. However, it has a history of paying dividends annually at an average of 40% in the past four years. We expect the company to adopt a dividend policy of at least 30%, considering its strong net cash position and stable recurring cashflow once its biomass plants are completed in the future.

**RM0.35 FV based on 13x FY25F EPS.** Valuation wise, we peg a target PE of 13x for Kawan Renergy, which is in line with comparable peers' average valuation (see Table below). We believe the stock could re-rate in the near term on the back of: 1) Stronger orderbook win for its key engineering business; and 2) Successful bid for a new 2MW biomass plant

**Peer Comparison (as of 10 May 2024)**

Company	Bloomberg Ticker	Share Px (RM)	Mkt Cap	EPS Growth (%)		P/E (x)		P/B		ROE (%)		Net Dividend Yield (%)	
				2024	2025	2024	2025	2024	2025	2024	2025	2024	2025
			RM m										
Wasco Bhd	WSC MK	1.45	1,122.8	(10.7)	8.0	11.6	10.7	1.4	1.2	12.0	11.3	-	-
BM Greentech	BMGREEN MK	1.21	624.4	7.7	13.4	20.3	17.9	2.3	2.1	12.4	12.5	1.6	1.6
Critical Holdings	CHB MK	0.93	343.9	-	20.5	15.2	12.6	-	-	61.0	53.2	1.7	2.0
<b>Simple Average</b>				<b>(1.5)</b>	<b>14.0</b>	<b>15.7</b>	<b>13.7</b>	<b>1.9</b>	<b>1.7</b>	<b>28.5</b>	<b>25.7</b>	<b>1.6</b>	<b>1.8</b>

Source: Bloomberg



## Company Background

**End-to-end engineering solutions provider.** Kawan Renergy specializes in designing, fabricating, and installing industrial process equipment for various sectors, including food processing, chemical processing, oil and gas, waste recovery, utilities, and power plants. The group currently operates from its three factories in Ipoh, Perak with a total built-up area of 166,392 sqft.

Based on FY23 sales, the group’s business segment can be divided into four segments - IPE (49%), process plants (28%), RE and co-generation plants (22%) and sales of electricity (1%). The company serves a diverse clientele across various industries, with a significant portion of its customer base concentrated in the oleochemical and chemical sectors, accounting for 63% of FY23 sales and the power industry at second (21% of FY23 sales).

**Figure 5: Business Overview**

	<b>Our principal activities</b>	<b>Other business activity</b>
	<b>Design, fabrication, installation and/or commissioning solutions</b>	<b>Power generation and sale of electricity</b>
<b>Our engineering solutions</b>	Industrial process equipment: <ul style="list-style-type: none"> <li>• Heat exchangers</li> <li>• Pressure vessels</li> <li>• Boilers and heaters</li> </ul> Process plants: <ul style="list-style-type: none"> <li>• Food processing</li> <li>• Oleochemical and chemical processing</li> <li>• Waste recovery</li> </ul> Renewable energy and co-generation plants: <ul style="list-style-type: none"> <li>• Co-generation and tri-generation</li> <li>• Biomass</li> <li>• Combined cycle</li> <li>• Biogas / landfill</li> <li>• Waste incineration</li> <li>• Organic rankine cycle</li> </ul>	<ul style="list-style-type: none"> <li>• Sale of electricity to the distribution licensee</li> </ul>
<b>Our product application</b>	Examples of applicable industries: <ul style="list-style-type: none"> <li>• Food processing</li> <li>• Oleochemical and chemical processing</li> <li>• Oil and gas</li> <li>• Waste recovery</li> <li>• Power plant</li> </ul>	<ul style="list-style-type: none"> <li>• Not applicable</li> </ul>

Source: Company, Mercury Securities

**Legacy of Kawan Renergy.** In 1996, Mr. Lim Thou Lai founded Kawan Renergy alongside its original founding shareholders and directors, many of whom have since departed from the company and divested their shares. Since he took over the position of managing director in 2011, Mr. Lim Thou Lai has led the overall management, business strategies, and growth initiatives of the Group.

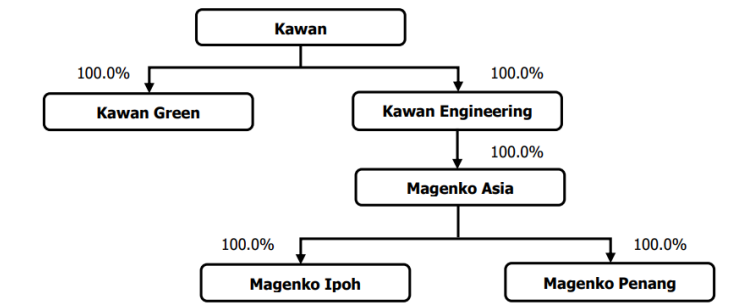


**Figure 6: Key Management Team**

Name and Designation	Age	Profile
<b>Lim Thou Lai</b> Managing Director MD	45	<ul style="list-style-type: none"> <li>Responsible for overall, management, business strategies and growth of the Group.</li> <li>More than 31 years of experience in the engineering industry.</li> <li>Bachelor in Engineering from Universiti Teknologi Malaysia.</li> <li>A member of the Institution of Engineers (2006), the Federation of Malaysian Manufacturers (2010-2011) and a registered Electrical Energy Manager with the EC (2024).</li> </ul>
<b>Chong Hon Choong</b> Executive Director Head of Department (Project)	45	<ul style="list-style-type: none"> <li>Ensures projects are completed within the timeline and scope.</li> <li>22 years of experience in the engineering industry.</li> <li>Higher National Diploma in E&amp;E Engineering, Nottingham Trent University, UK.</li> <li>Bachelor of Engineering, Nottingham Trent University, UK.</li> </ul>
<b>Heng Siew Aun</b> Executive Director General Manager	39	<ul style="list-style-type: none"> <li>Responsible for spearheading the growth and operations of Kawan Engineering.</li> <li>14 years of experience in the engineering industry.</li> <li>Bachelor of Engineering (Chemicals) UPM</li> <li>Members of the Institution of Engineers (2010), Graduate Engineer of the Board of Engineers Malaysia (2010), and a registered Electrical Energy Manager with the EC (2024).</li> </ul>
<b>Doris Tan Chuen Chuen</b> Chief Financial Officer	53	<ul style="list-style-type: none"> <li>Primarily responsible for overseeing finance functions, managing financial planning and budgeting, enhancing monitoring and collection systems, implementing cost-saving initiatives and driving improved cost awareness.</li> <li>Diploma in Commerce (FA) Tunku Abdul Rahman College, ACCA Chartered Accountant, ACCA Fellow Member, Public Accountant by the Malaysian Institute of Accountants.</li> </ul>

Source: Company

**Figure 7: Group Structure Post Listing**



Source: Company, Mercury Securities



## Future Plans & Business Strategies

**Improving Bercham plant output.** The group intends to strengthen the Bercham Plant, which only generates 6.3% of the maximum allowable electricity sale due to gas piping blockages. To increase output, the group plans to utilize agricultural waste as additional feedstock, installing an anaerobic digestion system. This initiative is expected to enable the generation of approximately 24MWh of electricity per day, potentially increasing annual revenue to RM3.4m. The estimated cost for installing the system, RM2.5m, will be covered fully by listing proceeds.

**Constructing a new 2MW biomass power plant.** The group intends to construct a new 2MW biomass power plant utilizing locally sourced biomass feedstock. The estimated construction cost for the plant is RM15.0m, with RM5.0m allocated from the IPO proceeds. Construction is expected to be completed 18 months after successful SEDA 2MW quota application approval. The plant will be situated at Factory 3, utilizing 40k square feet of unused space and the existing grid connection. The bid application process is anticipated to open in 2Q24. If the initial bid is unsuccessful, the group plans to participate in subsequent exercises over the next 18 months, potentially extending the timeframe or reallocating proceeds if necessary.

**Machinery purchase.** The group has earmarked RM0.5m (1.5%) from the IPO proceeds to fund the purchase of new machinery. One fibre laser cutting machine and two adjustable rotators will be purchased to improve production efficiency and support their IPE segment.

## Key Risks

**Skilled labour.** The company heavily relies on skilled workers such as welders, machinists, and fitters for its fabrication activities. It is imperative for the group to both retain its existing skilled workers and attract new competent individuals to ensure the continuity of its daily business operations.

**Exposure to global steel price fluctuations.** The prices of certain raw materials such as steel plates and steel tubes are subject to price fluctuations. Steel plates and tubes constitute 45% of the group's FY23 purchases in 2023.

**Regulation compliance.** The manufacturing licenses for Factory 2 and 3 in Ipoh mandate that at least 80% of the workforce must be Malaysian citizens. As of FY23, only 72% of Kawan Group's workforce are Malaysian citizens. Failure to meet this criterion could result in the suspension or revocation of the group's license. Additionally, due to the construction of a biomass plant and the existing one in Bercham, the group must also adhere to regulations from REA 2011.

## IPO Details

	Offer for Sale (m)	Public Issue (m)	Total (m)	(%)
<b><u>Retail Offering</u></b>				
Malaysian Public (Bumiputera)	-	13.75	13.8	2.5
Malaysian Public (Non-Bumiputera)	-	13.75	13.8	2.5
Pink form allocations	-	19.25	19.3	3.5
<b><u>Institutional Offering</u></b>				
Bumiputera investor approved by MITI	5.5	63.25	68.8	12.5
Selected investors	29.0	-	29.0	5.3
<b><u>Total</u></b>	<b>34.5</b>	<b>110.0</b>	<b>144.5</b>	<b>26.3</b>

Source: Company





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