ALLIANCE RESEARCH

KDN: PP 7766/03/2011 (028011)

Kim Loong Resources

28 February 2011

Buy

Target Price: RM3.16

INITIATING COVERAGE

Small player with interesting potential

INVESTMENT HIGHLIGHTS

- **A pure oil palm player.** Kim Loong Resources (KLR) was established in 1967 with activities spanning across estate operations and milling activities in Johor, Sabah and Sarawak. The group was listed on the Main Board of Bursa Malaysia in 2000. Other than the upstream business, the group has also actively tapped into renewable energy from biomass and biowaste from oil palm as well as selling carbon credit.
- **Stronger earnings growth in FY11 and FY12.** We project 9-14% earnings growth, driven by stronger CPO price due to tight current CPO supply. Production, however, is expected to recover in the second half this year thanks to favourable weather in Malaysia.
- **Going green.** While aggressively growing its plantation business, the group also dedicates itself to the environment by maximising the utilisation of waste. Kim Loong Resources has become a fully integrated complex by venturing into biomass utilisation and biogas power plant. As the plant is eco-friendly, it qualifies as a Clean Development Mechanism (CDM) project under the Kyoto Protocol, which entitles the plants to receive carbon credits.
- **Initiate with BUY and target price of RM3.16.** We are initiating coverage on Kim Loong Resources with a **BUY** call based on a forward P/E of 13x. Our target price implies a 16.1% potential growth coupled with 2.9% dividend yield. We like the stock due to 1) potential double-digit growth in FFB production due to young profile of estates and 2) long-term growth from landbank acquisition in Sarawak.

Investment Data

Stock Code	**5027**
Website	**www.kimloong.com.my**
IR Contact	
Price	RM2.20
Potential upside	43.6%
Expected yield	3.3%
Expected return	46.9%

Indices Constituent	Main Market
Market / Sector	Plantations
Market cap	RM671.7m
Issued shares @ RM0.50 par	305.3m
52 week high/low	RM2.75/ RM1.80
3m avg daily vol	0.1m shares

	Old	**New**
Recomm.	-	**BUY**
TP	-	**RM3.16**

Major s/holders	**%**
Syarikat Kim Loong	64.4

Key Stock Statistics	2011	2012F
EPS (sen)	22.4	24.3
PER (x)	9.8	9.1
Dividend/Share (sen)	6.7	7.3
NTA/Share (RM)	2.1	2.2
Book Value/Share	1.6	1.7
Issued Cap. (m shares)	305	305
52-weeks Share Price Range	1.80 -	2.75

Per Share Data	2009	2010	2011F	2012F
Book Value (RM)	1.4	1.5	1.6	1.7
Cash Flow (sen)	27.6	28.3	28.6	30.5
Earnings (sen)	27.2	19.7	22.4	24.3
Payout Ratio	132.6	50.8	30.0	30.0
PER (x)	8.1	11.2	9.8	9.1
P/CF (x)	8.0	7.8	7.7	7.2
P/BV (x)	1.6	1.5	1.3	1.2
DY (%)	16.4	4.5	3.0	3.3
ROE (%)	19.5	13.0	13.8	13.9
Net Gearing (%)	0.1	0.1	0.1	0.1

Sources: Alliance Research, Bloomberg

P&L Analysis (RM m)

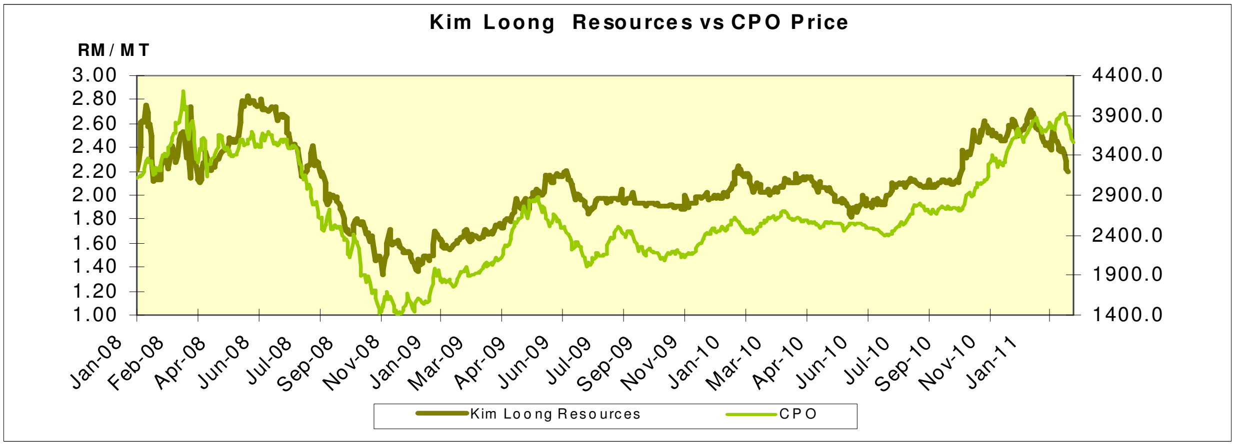
FYE JAN	2009	2010	2011F	2012F
Revenue	507.0	451.5	544.3	560.6
Operating Profit	105.0	80.8	89.0	96.8
Depreciation	16.3	19.9	20.9	21.9
Interest Expenses	-0.6	-1.3	-1.6	-1.9
Pre-tax Profit	104.4	79.5	87.4	94.9
Effective Tax Rate	21.8%	25.0%	22.0%	22.0%
Net Profit	81.5	59.4	68.2	74.0
Operating Margin	20.7	17.9	16.3	17.3
Pre-tax Margin	20.6	17.6	16.1	16.9
Net-Margin	16.1	13.2	12.5	13.2

Balance Sheet and Other Financial Data

FYE JAN	2008	2009	2010
Total Assets	532.5	594.2	632.9
Fixed Assets	169.5	185.2	210.2
Current Assets	128.2	152.2	147.7
LT Assets	355.8	404.3	442.0
Current Liabilities	42.1	35.3	41.1
LT Liabilities	61.0	78.3	93.6
Share Capital	209.9	302.3	304.2
Shareholders Funds	399.0	418.8	459.7

Sources: Alliance Research, Bloomberg

Figure 1 : Kim Loong Resources' share price vs CPO price



Sources: Alliance Research, Bloomberg

INVESTMENT CASE

- **Venture into Sarawak.** In early 2010, KLR had inked a deal with Tetangga Akrab Sdn Bhd for the acquisition of 60% interest in Winsome Pelita (Pantu) Sdn Bhd, which owned 10,471ha of landbank in Sg.Tenggang and Kranggas, Sarawak. The acquisition is considered timely as 95% of its existing landbank are fully utilized. The group expects earnings contribution would start to kick in FY11 and the 6,500 ha plantable area would last for at least the next four years.
- **Positive CPO prospects.** CPO demand remains robust following the effect of El Nino and La Nina, which dampened world agriculture production for the last two years. Additionally, the lifting of import quota on edible oil by India has also encouraged more consumption on CPO. Hence, given the sustained demand and tightening supplies on CPO, we believe CPO price will average RM3,100/mt and RM2,800/mt for 2011 and 2012, respectively. The stronger CPO price is expected to lift earnings for FY11 and FY12.
- **Potential FFB growth.** The bulk of KLR's palm trees is young averaging between 3-10 years accounting for 8,253ha or 60% of total planted area. Due to the young profile and unfavourable weather, KLR suffered from lower FFB yield at below 21 tonnes per hectare over the last 2 years. Looking ahead, we expect FFB production to improve by 11-20% in the next 2 years thanks to the maturing tree profile as well as contribution from the recent acquisition of landbank in Sarawak.
- **Capability to grow further.** With a healthy balance sheet, a cash level of RM42m and net gearing of 0.1x, the group should have no problems raising debt for funding potential acquisitions should any opportunity arise. Due to limited landbank, the group is still actively looking for additional plantation land in Johor, Sabah and Sarawak.

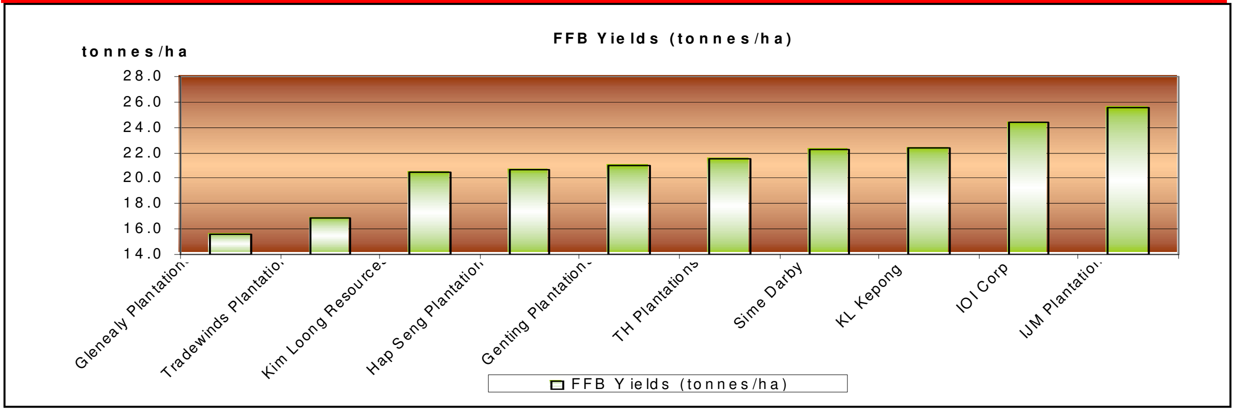
- **More contribution from downstream activities.** KLR possesses a nutraceutical plant, which is involved in the extraction of high quality tocotrienol-rich fraction (Vitamin E) from CPO. Current production is experimental but KLR is further improving its yield for commercial production and sales. The group expects the commercial production to start in FY12 and will be sold under the brand name *e-Life Gold*. KLR projects initial revenue contribution of RM1m from this segment. It also plans to collaborate with a local pharmaceutical company to package and market its vitamin E heath supplement.

- **Going green.** While aggressively growing its plantation business, the group also dedicates itself to the environment by maximising the utilisation of waste. KLR implemented an integrated approach by venturing into biomass utilisation and biogas power plant. As the plants are eco-friendly, they qualify as a Clean Development Mechanism (CDM) project under Kyoto Protocol, which entitles the plants to receive carbon credits.

  1) Biomass palm oil plant located in Kota Tinggi, Johor, which has commenced operations in FY07, uses empty fruit bunches (EFB), shells and mesocarp fibre to produce bio-fertiliser, which enhances soil fertility in its plants as well as generating small contribution by supplying to other planters.

  2) Biogas power plants provide electricity supply from wastewater generated from palm oil milling process or palm oil mill effluent (POME). The first and second biogas power plants located in Kota Tinggi and Keningau have been fully commissioned and the group is developing a third plant at Telupid mill. Going forward, other than supplying for its own usage, the group also plans to supply the electricity to TNB National and Syarikat SESCO Berhad in Sarawak, which would provide additional earnings stream for KLR.

Figure 2 : FFB yield

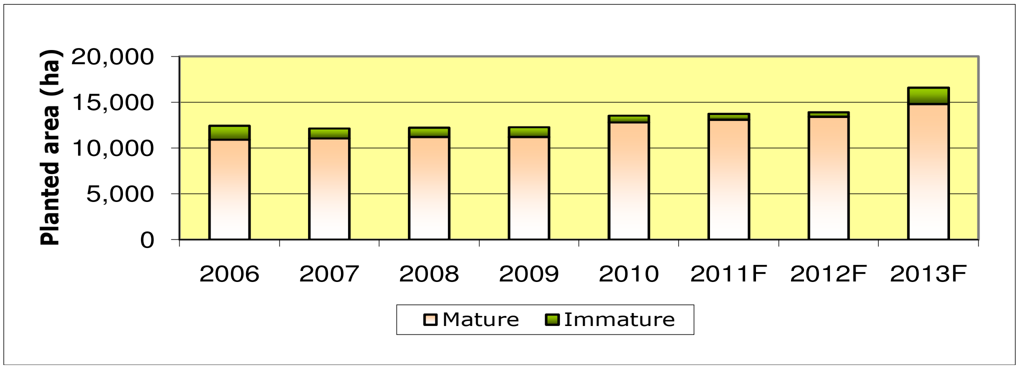


Sources: Alliance Research, Bloomberg

- **More room to reach the peak-yielding level.** KLR has one of the lowest FFB yields among the listed plantation companies on our radar screen. Its FFB yield of 20.5 tonnes/ha is the third lowest after Tradewind Plantation. The group has plenty of potential production as more than 60% of its plantation estates are immature.

- **Yield superior to state average in Sabah.** We compare KLR's FFB yields to Sabah state's average. It achieved an FFB yield of 25.4 tonnes per ha, 10% higher than Sabah's average of 20.1 tonnes per ha, while its CPO yield per ha was 5.6 tonnes, 10% higher than the industry average in Sabah.

Figure 3: Increasing planted acreage



Sources: Alliance Research, Company

KLR has experienced limited landbank since 2006 as almost 95% of its landbank are fully utilized for plantation. Until 2010, the company acquired 60% equity interests in Winsome Pelita Sdn Bhd, where it specifically has landbank held under Native Customary Rights in the area known as Sg. Tenggang Block (6,870ha) and Kranggas/Mawang Block (3,601ha) Out of the total gross land area of 10,471 Ha, the preliminary estimated plantable area is approximately 6,500 Ha. To date, 1,400ha have already been planted. The group plans to develop the remaining plantable land within the next 4 years. We project that the planting development will be carried on from 2012 onwards; growing averagely at 10-20% p.a and significant contribution would be coming in 2014.

Figure 4 : Comparison of FFB yields amongst the peers

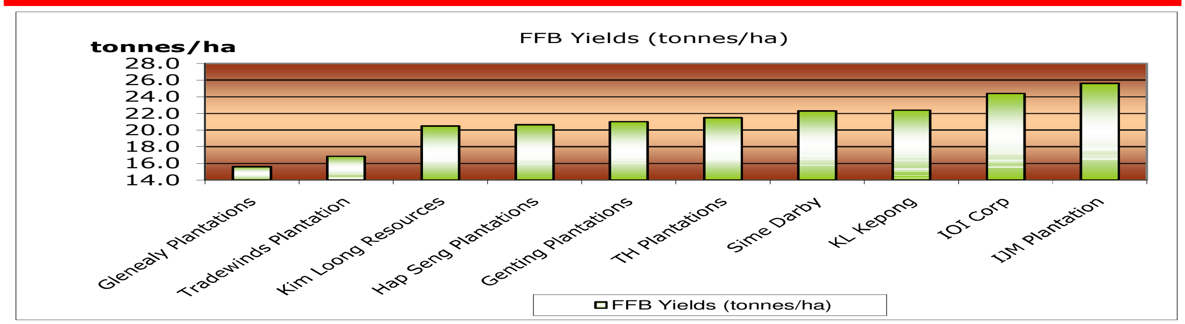
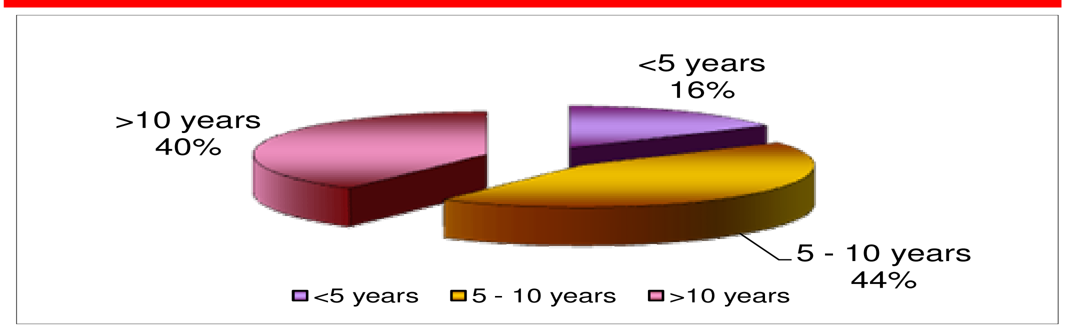


Figure 5 : Tree profile

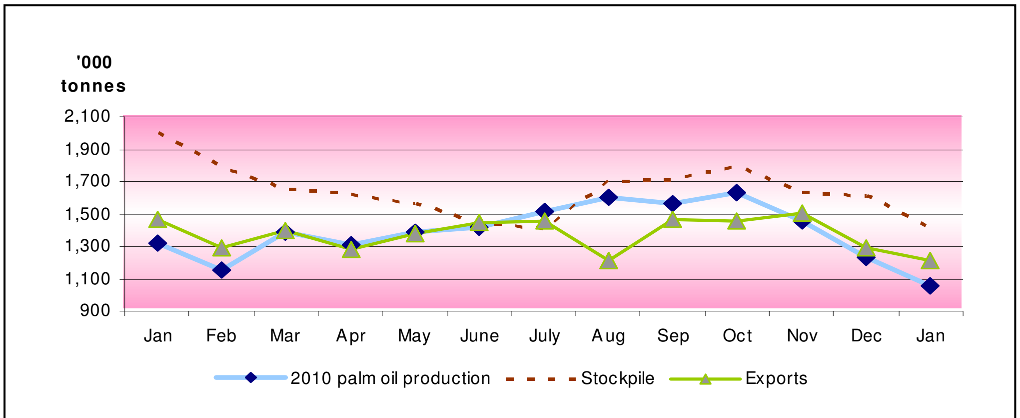


Sources: Alliance Research, Company

Among the listed plantation companies in Malaysia, KLR's FFB yield of 20.5 tonnes/ha is the third lowest on our radar screen, based on the latest financial year. There is a clear indication that there are plenty rooms to grow its productivity as the tree profile are generally young with 60% is less than 10 years.

Sector Outlook

Figure 6: Monthly Malaysian palm oil statistics



Sources: Alliance Research, Company

- Malaysia CPO production has experienced a decline for the last two years. In 2009, output dipped to 17.6m tonnes from 2008's record high of 17.7m tonnes. Last year, it plunged further to 17.0m tonnes as planters were encountering shortage of foreign workers to harvest fruit brunches and abnormal rainfall caused the difficulty in transporting fruits to mills nearby. We expect the stockpiles would remain low for the 1HFY11 due to seasonal production and the recovery of production is expected to come in 2HFY11. For this year, we estimate the world demand for crude palm oil to remain steady, grown by 5%.

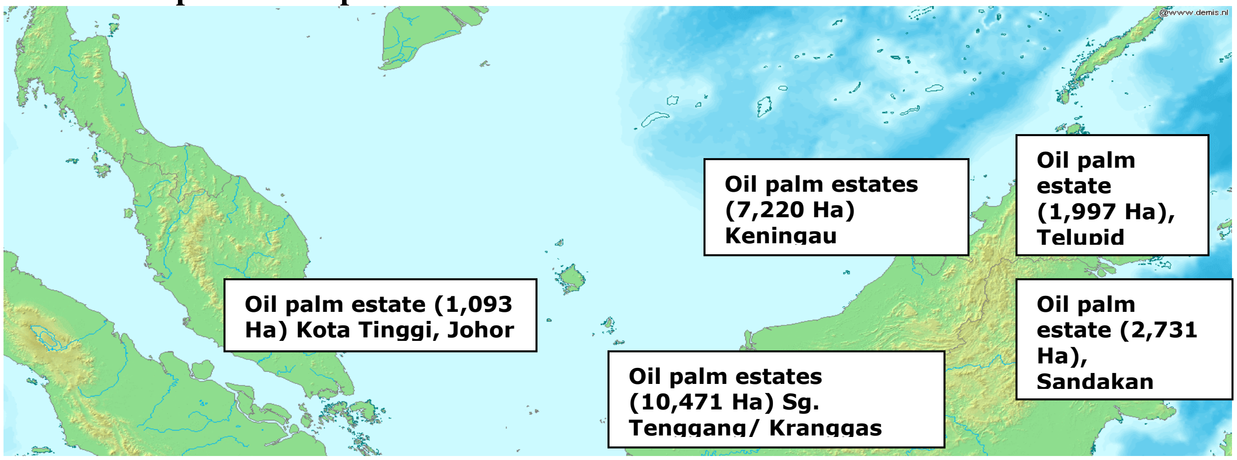
Figure 7 : Export to major countries

Countries ('000 tonne)	Jan-Dec 09	Jan-Dec 10	YoY (%)
China	4,027	3,484	-13.5
India	1,354	1,170	-13.6
Pakistan	1,769	2,134	20.6
Netherlands	990	1,098	10.9
United States	859	1,028	19.7
Egypt	609	939	54.2
Japan	539	551	2.2
UAE	187	448	139.6
Singapore	353	401	13.6
Others	5,193	5,406	4.1
Total	**15,880**	**16,659**	**4.9**

Sources: Alliance Research, Company

- China, Pakistan and India are the major consumers, comprising of 40% in world crude palm oil consumption. With the increasing world population, we project that the demand for crude palm oil would remain sustainable. In addition, the recovery of economies in UK and US are still ongoing with an estimated GDP growth of 2-3% for this year. Hence, we do not see a downward trend in CPO consumption going forward. Recent flooding and wet weather in Johor and Sabah would also become a major concern in Malaysian palm oil estates. Meanwhile, *Oil World* in its latest forecast expects world palm oil production to increase by 3.2m tonnes to 3.4m tonnes this year while Malaysian Palm Oil Council (MPOC) aims to achieve 17.6m tonnes of crude palm oil this year, about 3.5% increase compared to last year production.

Location of plantation operations:



Sources: Alliance Research, Google Search

Telupid mill

Kota Tinggi mill

Keningau mill

Figure 8 : Details of its milling facilities

Mill	Year built	Age of mill	Capacity (FFB tonnes/hr)	OER (%)
Kota Tinggi	1996	15	100	19.7
Keningau	2003	8	60	24.7
Telupid	2008	3	45	22.3
Total capacity			**205**	

Sources: Alliance Research, Company

FINANCIAL HIGHLIGHTS

Figure : Kim Loong Resources earnings and margins, FY09-FY13

FYE Jan	2009	2010	2011F	2012F	2013F
RM (m)					
Revenue	507.0	451.5	544.3	560.6	563.7
PBT	104.4	79.5	87.4	94.9	89.3
Net profit	81.6	59.6	68.2	74.0	69.7
EPS	27.2	19.7	22.4	24.3	22.8
Revenue growth (%)	7.9	-10.9	20.6	3.0	0.6
Net profit growth (%)	12.6	-23.9	10.0	8.5	-5.9
PBT margin (%)	20.6	17.6	16.1	16.9	15.8
Net margin (%)	16.1	13.2	12.5	13.2	12.4

Sources: Alliance Research, Company

FY09: Higher FFB production. KLR recorded double-digit growth in earnings thanks to 14% increase in plantation operation, attributable to a 10% growth in FFB production. However, the profit for palm oil milling operation declined by 19% due to inventory write-down as a result of the steep decline in palm oil product prices in the 2HFY09. The group also declared a bonus issue of 2 new shares for every 5 existing shares.

FY10: Lower CPO price. In FY10, net profit growth dropped 23.9% due to lower FFB price and lower FFB production. The profit from the plantation operation recorded a drop of 40%. Nevertheless, the palm oil milling operation recorded an increase of 68%, underpinned by the opening of a new mill in Telupid, Sabah despite the sharp decline in CPO price in 2HFY10.

FY11: Higher CPO price despite lower FFB production. Despite experiencing reduction in FFB production due to the effect of El Nino and La Nina, we expect KLR to achieve double-digit growth thanks to strong palm oil prices, especially crude palm oil and palm kernel oil, which are expected to be higher by 25-50%.

FY12-13: CPO will come down in correspondence to the recovery of FFB production. For the next 2 years, we expect profit to come down by 7-10% despite the recovery of FFB production. In corresponding to higher FFB production, we also expect average CPO price to decline from RN3,100/mt to RM2,800/mt.

RISKS AND CONCERNS

1. **Worse-than-expected production yields.** Severe rains would dampen FFB harvest and make it difficult for transportation between estate and mills while drier weather would affect yield productivity and stunt new planting. In recent years, the occurrences of abnormal rains especially in Sabah and Sarawak as well as several parts in Johor had dampened the yields between the months of Oct to Jan.
2. **Imposition of new ruling on imports and exports.** Implementation of new policy on imports and exports would affect the demand and supply. Recent hike in Indonesia's export tax and the lift of ban in India's export policy have substantially affected the consumption of vegetable oils.
3. **Global economy decelerating.** Demand for vegetable oils has strong correlation with economic growth. Currently, strong economic growth in emerging markets such as China and India, is stimulating demand for vegetable oils. However, if the global economy recovery suffered from another downturn, KLR's milling operation would be affected by the sluggish demand, resulting in high inventories and low margins.

VALUATION AND RECOMMENDATION

Figure 10: Valuation comparison against peers

Plantation companies	Mkt Cap (RM m)	PER11 (x)	PER12 (x)	P/NTA (x)	ROE (%)	Div Yld (%)
Glenealy Plantations	570.1	NA	NA	4.6	5.9	NA
Kim Loong Resources	**671.1**	**9.8**	**9.1**	**2.2**	**11.8**	**4.2**
TH Plantations	997.5	9.4	9.0	1.0	12.6	4.9
IJM Plantation	2,427.9	15.2	14.6	1.3	7.8	2.5
Hap Seng Plantations	2,600.0	12.2	11.7	2.1	6.0	4.7
Tradewinds Plantation	3,727.2	10.5	10.9	2.7	3.8	2.1
Genting Plantations	6,411.9	16.7	14.7	3.4	9.6	1.2
KL Kepong	23,591.8	15.8	15.2	5.3	17.4	3.2
IOI Corp	38,758.9	16.5	15.3	1.6	21.3	3.0
Sime Darby	56,369.1	17.7	16.9	3.5	3.5	3.1
AVERAGE		***14.0***	***13.5***	***2.6***		

Sources: Alliance Research, Company

We value KLR at PER of 13x EPS12 of 24.3sen, implying a target price of RM3.16. The target PER of 13x is about 7% discount to the sector average PER of 14x. We deem the discount is justifiable based on the 1) market capitalization and landbank and 3) smaller milling operations. Nevertheless, we like the stock due to 1) strong CPO price, 2) potential double-digit growth in FFB production due to young profile of estates, 3) long-term growth with the recent acquisition of 10,471ha landbank in Sarawak.

APPENDIX A: OPERATIONAL BACKGROUND

- **A pure oil palm player.** KLR was established in 1967 with activities spanning across estate operations and milling activities in Johor, Sabah and Sarawak. The group was listed on the Main Board of Bursa Malaysia in 2000. At the helm of management, Gooi Seong Heen is the Managing Director and has been serving the plantation company since 1972. Other than the upstream business, the group has also actively tapped into renewable energy from biomass and biowaste from oil palm as well as trading of carbon credits.

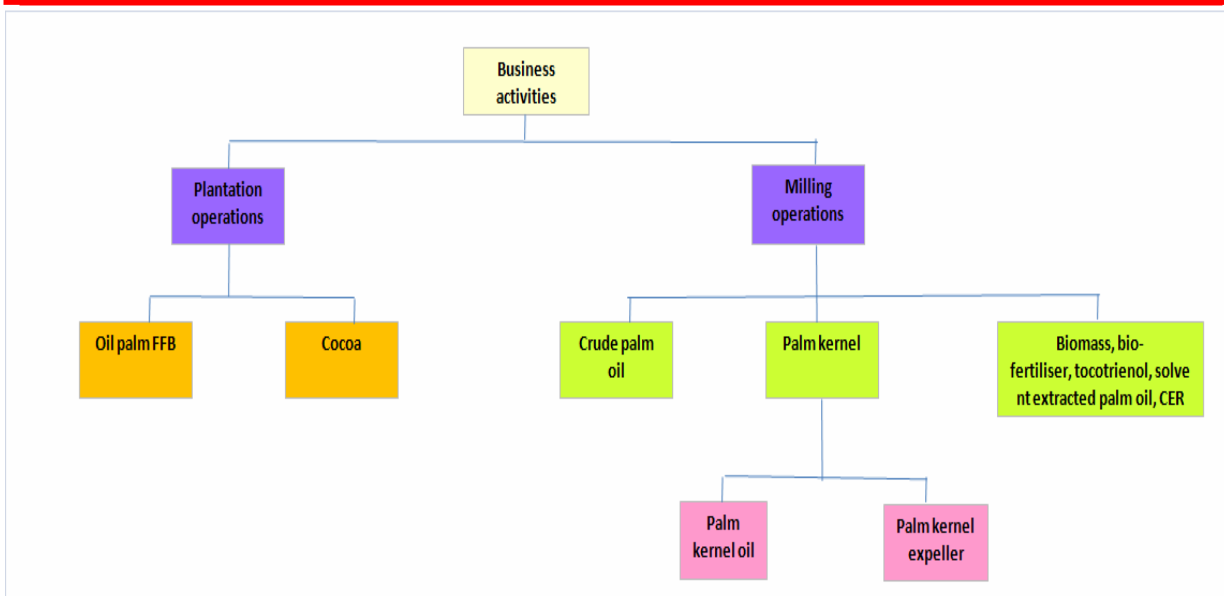
- **95% of existing landbank planted with oil palms.** About 95% of its total land bank of 14,000ha is planted with oil palms and 8.8% is reserved for infrastructure. This leave the group with only 1,549ha (4%) of plantable reserves. Nevertheless, in the beginning of FY10, the group has managed to secure additional landbank of 10,471ha by acquiring 60% equity interests in Winsome Pelita (Pantu) Sdn Bhd.

- **Small-size planter among the Malaysia's listed plantation companies.** Relative to the big-cap plantation players, the group's estate size is small, measuring only 10% of Genting Plantations's planted area. KLR's planted oil palm estates make up only 1% of the total planted oil palm area in Sabah and 0.3% of the planted oil palm area in Malaysia.

- **Its mills churned out 1% of Malaysia's CPO output.** The group processed all the FFB output from its contiguous estates at its own mills. The group also buys production from small planters which accounts for 63% of total production, as some planters have no milling operations or it is not economical for the group to transport the FFB to its own mills. It operates three mills with a total milling capacity of 205/mt FFB per hour.

- **Marketing and distribution.** It sells its CPO on spot basis or through forward contracts with refiners.

Figure 11 : Business structure



Sources: Alliance Research, Company

Figure 12: Relationship between Average CPO price and Kim Loong Resources's TP

	PER (x)					
RM/MT	**13**	**14**	**15**	**16**	**17**	**18**
2,495	0.94	1.01	1.08	1.15	1.22	1.30
2,595	1.50	1.61	1.73	1.84	1.96	2.07
2,695	2.04	2.20	2.36	2.51	2.67	2.83
2,795	2.60	2.80	3.00	3.20	3.40	3.60
2,895	3.16	3.40	3.65	3.89	4.13	4.37
2,995	3.71	3.99	4.28	4.56	4.85	5.13
3,095	4.26	4.59	4.92	5.25	5.58	5.90
3,195	4.82	5.19	5.57	5.94	6.31	6.68
3,295	5.38	5.80	6.21	6.62	7.04	7.45
3,395	5.93	6.38	6.84	7.30	7.75	8.21

Sources: Alliance Research, Bloomberg

Recommendation Framework

STOCK RECOMMENDATIONS

OUTPERFORM	:	The stock's total return is expected to exceed KLCI's total return by 10% or more in the next 12 months.
MARKET PERFORM	:	The stock's total return is expected to be within +10% or –10% of KLCI's total return.
UNDERPERFORM	:	The stock's total return is expected to be below KLCI's total return by 10% or more in the next 12 months.
TRADING BUY	:	The stock's total return is expected to exceed KLCI's total return by 10% or more within the next 3 months.
TRADING SELL	:	The stock's total return is expected to be below KLCI's total return by 10% or more within the next 3 months.
NOT RATED	:	Stock is not within our regular coverage

SECTOR RECOMMENDATIONS

OVERWEIGHT	:	The industry as defined by the analyst is expected to outperform the KLCI over the 12 months.
NEUTRAL	:	The industry as defined by the analyst is expected to perform in line with KLCI over the 12 months.
UNDERWEIGHT	:	The industry as defined by the analyst is expected to underperform the KLCI over the next 12 months.
total return	**=**	**capital gain + dividend yield**

Common Abbreviation

Adex = Advertising Expenditure
bn = billion
BV = Book Value
CF = Cashflow
CAGR = Compounded Annual Growth rate
Capex = Capital Expenditure
CY = Calendar Year
Div yld = Dividend Yield
DCF = Discounted Cashflow
DPS = Dividend Per Share
EBIT = Earnings Before Interest & Tax
EBITDA = EBIT before Depreciation and Amortisation
EPS = Earnings per share
EV = Enterprise Value
1QFY12/07 = 1st Quarter for FY Dec 07
2HFY12/07 = 2nd Half for FY Dec 07

FCF = Free Cashflow
FV = Fair Value
FY = Financial Year
KLCI = Kuala Lumpur Composite Index
m = million
MoM = month on month
MP = Market Perform
NAV = Net Assets Value
NM = Not Meaningful
NTA = Net Tangible Assets
NR = Not Rated
p.a. = per annum
PAT = Profit after tax
Pretax profit = Profit before tax
PE = Price Earnings Ratio

PEG = PE ratio to growth
PER = PE ratio
QoQ = Quarter on Quarter
OP = Outperform
RM = Ringgit
RM bn = RM billion
RM m = RM million
ROA = Return on Assets
ROE = Return on Equity
ROSF = Return on shareholders funds
TP = Target Price
UP = Under Perform
WACC = Weighted Average Cost of Capital
YoY = Year on Year
YTD = Year to date

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