Section B : Stock Selection

Stocks selected under this section are meant for medium and/or long-term investments. Capital Dynamics could use either a top-down/market-timing approach or a strictly bottom-up style or a combination of both when selecting stocks. When stocks are recommended under Section B, it does not mean that its price will take 1 or 2 years to move. If the price moves too fast, i Capital® may recommend a sell. Or if it is still attractive after holding for a while and its price has gone up, we may still recommend holding or even buying more. Or if it declines, i Capital® quotes Warren Buffett who was supposed to have said this : "If you aren't prepared to see your stocks go down 50%, you shouldn't own them. Be prepared for declines – and arrange your financial affairs such that you won't have to sell out".

(1) Kim Loong Resources (KMLOONG, 5027)

Principal activities
Oil palm cultivation.

Major shareholder/s
Sharikat Kim Loong S/B.

Financial highlights (RM mln) – 31 January

	2007	2008	2009	2010	2011*
Sales	263.1	469.9	507.1	451.5	563.8
Pretax profit	30.44	96.04	104.4	79.46	90.62
Net profit	22.45	58.97	65.38	48.14	58.20
Adjusted net profit	21.58	83.49	98.80	71.95	N/A
Depreciation	6.93	7.68	9.07	12.22	N/A
Finance cost	1.39	0.88	0.66	1.36	1.95
Current assets	64.76	146.3	128.2	152.5	166.3
Current liabilities	28.01	42.12	35.31	41.18	52.45
Fixed assets	338.0	353.5	399.5	435.6	444.9
Return on equity (%)	7.05	23.86	25.43	17.70	N/A

Latest paid-up:
305.5 mln shares @ RM1.00
Market capitalisation:
RM669.0 mln @ RM2.19
2012 PE ratio:
Around 11 times @ RM2.19

1st quarter *RM mln*	30/04/2011	30/04/2010
Sales	175.2	127.0
Pretax profit	35.16	20.89
Net profit	19.91	13.36
Finance cost	0.43	0.46

* *Unaudited figures.*

This week, *i* Capital updates Kim Loong Resources Bhd (KLR), an oil palm plantation and milling company that has recently released its latest unaudited financial results for the first quarter of financial year (FY) 2012. For more details on the business segments of the group, see *i* Capital dated 28 Oct 2010.

Updates on business background

KLR was listed on Bursa Malaysia on 2 Aug 1999. KLR started with 1,000 acres of land in Johor, and subsequently expanded to other states in Malaysia, particularly Sabah and Sarawak. To-date, KLR owns 15,200 hectares (ha) of land and almost 80% of its estates are located in Sabah. The group currently owns 3 mills with an aggregate annual milling capacity of 950,000 tonnes of fresh fruit bunches (FFBs). **Table 1** summarises the crude palm oil (CPO) production statistics for each of the 3 mills in FY2010.

Table 1: Mill operations

Mill Location	Kota Tinggi, Johor	Keningau, Sabah	Telupid, Sabah
Year commissioned	1996	2003	2009
Capacity (tonnes of FFB/hour)	100	60	45
Utilisation rate (%)	80	80	100
FFB processed (tonnes)	395,052	263,060	130,887
Portion of own fruits (%)	10	50	50
CPO produced (tonnes)	78,105	64,924	29,118
OER*	19.77	24.68	22.25
State average OER in 2009*	19.83	21.35	21.35

** KLR's OER is for the period Feb 2009 – Jan 2010 whereas state average is for the period Jan-Dec 2009.*

KLR owns a palm-pressed fibre oil extraction plant in Kota Tinggi, Johor. It is the only one in Malaysia which uses the solvent extraction technology to recover residual palm oil from palm-pressed fibres, contributing to a higher oil extraction rate (OER). Palm-pressed fibres are a form of recovered fibres from which palm oil has already been extracted. The solvent extraction technology is used to extract any remaining oil from palm-pressed fibre before these fibres are processed for downstream activities such as biomass. Following the favourable results of the initial implementation in the Kota Tinggi plant, the group has decided to further construct a palm kernel oil (PKO) solvent extraction plant in Kota Tinggi which utilises the same technology to extract residual PKO. Expected to be completed by Sep this year, the PKO extraction rate is likely to increase by approximately 2%. At an average market price of RM5,000 per tonne for PKO, the group will be able to improve its revenue by at least RM1 mln annually.

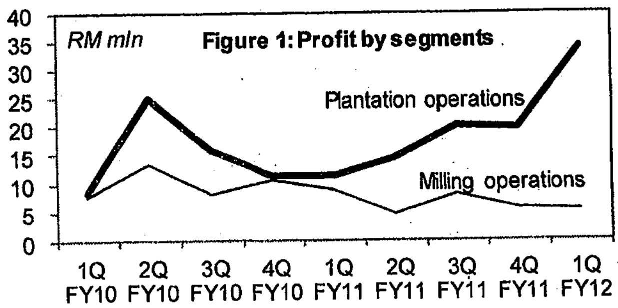
Meanwhile, KLR has also extended its solvent extraction technology to its Keningau mill in order to improve its CPO extraction rate in Sabah. This plant was completed in Aug 2010 at an estimated cost of RM9 mln and is expected to increase the OER at that plant by 0.5%.

In 2010, KLR upgraded its mill in Kota Tinggi by substituting its FFB cages with FFB conveyors, which are more hygienic, more efficient and require less maintenance. FFB conveyors are used to transport FFBs from the ground to the sterilisers, where FFBs are boiled and softened to separate fruitlets from empty fruit bunches (EFBs). The group has also replaced its old horizontal sterilisers with 7 units of vertical sterilisers which require less manpower to operate. As sterilisers are vertically placed, it has also improved its space efficiency.

Performance review

For the three months ending 30 Apr 2011, KLR's revenue advanced 38% from the corresponding period last year to RM175.2 mln, while its net profit attributable to equity holders increased 49% year-on-year (y-o-y) to RM19.91 mln. **Figure 1** shows KLR's quarterly profit by business segments. The net profit from its plantation operation has tripled from a year ago due to high palm oil prices as well as the increase in FFB production from its estates in Keningau. Its milling operations, on the other hand, faced tight competition from its surrounding mills. Thus, despite processing a higher amount of CPO, profit for the segment fell by 40% y-o-y to RM5.30 mln as its profit margin was squeezed.

Figure 1: Profit by segments



Downstream activities

As mentioned in *i* Capital dated 28 Oct 2010, KLR embarked on a clean development management (CDM) project under the United Nations by deploying biogas plants in its mills. With the objective to reduce greenhouse gas emissions from palm oil mill effluent (POME), this project captures and turns methane gas emissions into power or steam for KLR's mill operations. Apart from lowering the costs of steam and electricity, the project will result in lower methane gas emissions and will allow KLR to sell Certified Emission Reduction to Annex 1 Countries defined under the Kyoto Protocol.

The group also generates its own power using biomass, including mesocarp fibre, EFB and palm shells. In its Kota Tinggi mill, the group owns 3 waterboiler units which are able to produce 20, 30 and 52 tonnes of steam per hour respectively. Steam produced from boilers is converted into heat and electrical energy to be used in all stations in its mills as well as quarters. The group only uses self-generated power in all of its mills. Meanwhile, the government is looking to implement the Renewable Energy Fund which pays a premium tariff rate for companies which supply green energy to the national grids, i.e. Tenaga Nasional Bhd in Peninsula Malaysia, Sabah Electricity S/B in Sabah, and Syarikat SESCO Bhd in Sarawak. The premium tariff rate will be financed by a feed-in-tariff mechanism. As soon as the fund is put into practice, KLR will apply to supply biogas-generated power to the national grids.

KLR has embarked on the extraction of high quality tocotrienol-rich fraction from CPO and its conversion into health supplements in the form of capsules to be commercialised under the brand name e-Life Gold™. Tocotrienol is a member of the vitamin E family which occurs at low levels in nature, making it difficult for one to attain its beneficial effects such as anti-cancerous qualities and cardiovascular diseases prevention from normal diets. The group is currently in the process of modifying its production process in order to lower the content of α-tocopherol in its capsules, an undesirable component which will lower the potency for disease prevention. However, despite its Kota Tinggi mill producing 1,500 kg of palm tocotrienols a year, the contribution from this segment will not be significant in the next few years.

Update on land acquisition

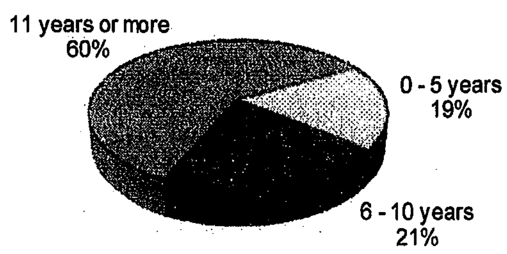
As part of its efforts to increase its landbank and subsequently raise its FFB production yield, KLR acquired a 60% stake in a joint venture (JV) company, Winsome Pelita (Pantu) S/B in Sarawak for a cash consideration of RM25 mln in Dec 2009, allowing it to develop land held under native customary rights in Sg. Tenggang and Kranggas, meausring 6,870 ha and 3,601 ha respectively. The JV company, however, is currently facing several legal claims by the natives for customary rights, involving approximately 500 ha of the Sg. Tenggang land. Currently, the group's harvesting activities in the area are still on-going, as it has been granted a stay of execution of the High Court's judgement. The outcome of the case is still uncertain. In the worst case scenario, where the Court places its judgement in favour of the natives, KLR will lose 500 ha of land costing RM3 mln, borne by the JV company, while it would also face minor transport disruptions. Its development in other parts of the land owned in Sarawak, totalling 10,000 ha, will not be affected in other ways.

Conclusion and Advice

At RM2.19, KLR is capitalised at RM669.0 mln. For this, what do investors get in return ?

Figure 2 shows the age profile of KLR's oil palm estates as at 31 Jan 2011. 40% of its oil palm trees are in young and prime ages, while 60% are more than 10 years old. The group only replants in areas where trees are older than 25 years old, therefore it has little replanting plans for the next few years. The group has also mechanised its weeding and fertiliser application processes to reduce its dependance on manual workers, which is a main problem faced by plantation companies due to shortage of labour.

Figure 2: Age profile as at 31 Jan 2011



KLR is different from the usual oil palm plantation companies as the group is not only involved in oil palm cultivation and milling, but is also involved in a variety of downstream activities. As explained above, it fully utilises waste from palm oil planting and milling to improve its extraction efficiency and generate additional revenue. After fruitlets are removed from bunches, EFBs are burned for power generation. The amount of power generated is sufficient for the group to run its milling activites in all of its three plants. Mesocarp fibres are transferred to the solvent extraction plant to extract residual palm oil before being converted into bio-fertilisers. Methane gas released from POME are captured and converted into heat and electrical energy. A portion of its EFBs and palm shells is also used to produce compost and bio-fertilisers which are distributed to Vietnam and Korea. These activities demonstrate KLR's strong focus on improving its productivity and efficiency, as well as its capability in managing cost prudently.

Table 2: Cash vs current liabilities *(RM mln)*

	FY07	FY08	FY09	FY10	FY11	FY12*
Cash, bank balances and deposits	39.83	101.6	76.38	94.53	115.1	157.3
Current liabilities	28.01	42.12	35.31	41.18	52.33	74.44

** Figures for the first quarter ended 30 Apr 2011*

On top of its prudent cost management, the group also maintains a strong balance sheet. In terms of borrowings, the group has an average debt-to-equity ratio of 0.27 in the past five years. **Table 2** shows that the group's cash holdings cover all of its current liabilities from FY2007 to FY2011. With a five-year average cash ratio of 2.10, coupled with few plans to increase its external financing within the next few years, the group is expected to preserve its strong cash position. With its prudent cost management strategies and a strong balance sheet position, KLR would be able to withstand the bearish turbulence in the near future. However, due to the uncertain economic and palm oil price outlook, *i* Capital retains its rating for Kim Loong Resources as a Hold.