

PP14767/09/2012(030761)

Thursday, August 20, 2015

Kuala Lumpur Kepong

“Draggs by Lower Plantation and Manufacturing Divisions”

Results Review

- **Actual vs. expectations.** Kuala Lumpur Kepong Berhad (KLK) 9M15 earnings performance was below our estimates although revenue actually increased by 16% y-o-y to RM9.72 billion from RM8.35 billion in 9M14. Y-o-y, earnings slipped by 17% to RM684 million dragged by weaker-than-expected profits contribution from both the plantation and manufacturing division which fell by 25% y-o-y and 47% y-o-y respectively, weighed by 1) lower CPO, PK and rubber selling prices; 2) higher production cost of CPO; and 3) lower margins from the downstream business.
- **Dividend.** No dividend declared during this quarter.
- **Q-o-Q performance.** Q-o-q profits showed some improvement after shooting up by 10.9% (y-o-y: +15.5%) at the back of an increase in revenue of RM3.54 billion (2Q15: RM3.07 billion; 3Q14: RM2.92 billion) mainly driven by higher dividend income of RM53.4 million (3Q14: RM14.6 million) from overseas investment and the release of RM12.6 million on inter-company interest income upon disposal of subsidiary. Excluding the inter-company interest income upon disposal of subsidiary, net profit actually increased by 5% q-o-q and 10% y-o-y.
- **Plantation division.** Plantation division segment profit shrunk 25% y-o-y to RM585 million compared to RM775 million in 9M14, as margin decreased by 8pps to 12% (9M14: 20%), in line with the deceleration in palm products prices and increase in CPO production cost. The unsatisfactory performance has been expected on account of lower average commodity selling price as average CPO price realised decreased by 11% to RM2,155/MT (9M14: RM2,430/MT), while average rubber

HOLD (TP: RM21.21)

Current Price (RM)	RM20.22
New Target Price (RM)	RM21.21
Previous Target Price (RM)	RM21.50
Previous Recommend.	HOLD
Upside To Target Price	4.9%
Dividend Yield (FY15F)	2.8%

Stock Code

Bloomberg	KLK MK
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Stock & Market Data

Listing	MAIN MARKET	
Sector	Plantation	
Shariah Compliance	Yes	
Issued Shares (mn)	1,065.0	
Market Cap (RM mn)	21,534	
YTD Chg In Share Price	-11.3%	
Beta (x)	1.22	
52-week Hi/Lo (RM)	RM23.86	RM19.60
3M Average Volume ('000shrs)	683mn	
Estimated Free Float	22%	

Major Shareholders

Batu Kawan	46.57%
EPF	13.61%
ASB	6.11%

price realised declined by 19% to RM6.70/Kg (9M14: RM8.29/Kg). This was also further weighed by the decline in rubber production by 11% y-o-y to 10.5 million kg (9M14: 11.7 million kg) offset to some extent by the mild increase in FFB and CPO production of 2% and 4% to 2.762 million MT and 624.6k MT respectively.

- **Manufacturing sector.** The manufacturing sector revenue improved 7% to RM4.52 billion in 9M15 from RM4.22 billion in 9M14. However, the segment profit slumped by 47% to RM151.7 million against RM284.2 million in 9M14 mainly led by lower profit from oleo-chemicals sub-segment that tanked by 48.6% to RM142.2 million. Excluding the unrealised fair value loss on foreign currency forward exchange contract valued of RM22.7 million in 9M15 and unrealised gains of RM10.3 million in 9M14, the segment profit of RM174.4 million is 36% lower than the underlying profit of RM273.9 million made in 9M14. On top of that, performance was also impacted by cheap petroleum prices which gave cost edge to synthetic products in fatty alcohol business.
- **Property.** Property segment revenue increased by 26% to RM101.6 million in 9M15 from RM80.6 million in 9M14. In line with the increase in revenue, segments profit rose 57% y-o-y to RM50.5 million against RM32.2 million in 9M14, resultant from higher profit recognition from Bandar Seri Coalfields development and surpluses from the sale of industrial and commercial land during the period under review.
- **Sector outlook.** At this stage we maintain our **NEUTRAL** call on plantation sector but if the landscapes change, we may review our call on the sector. At this junction, we stick to our CPO price assumption that is expected to average at RM2,300/MT in 2015. As we mentioned in recent report, the weak sentiment on plantation sector is not really or totally a fundamental issue but more related to macro issues weighed by uncertainty of the world economy. Until then, global commodities prices movement i.e. palm oil may suffer volatility, pushing importing countries like China and India to wait at the side-lines until asset prices stabilise. In the past 10 years, the CPO price (MPOB) has been averaging at RM2,441/MT and we expect probability of price to go bottom to RM1,805/MT (based on 1-SD below its 10-yrs average price) could materialise if demand continued to be slow dampen further by burgeoning global soybean supplies with slumping global crude oil prices.
- **Change in forecast.** With the current state of the economy that is weighed by uncertainties, we are of the view that plantation sector would continue to be soft with no strong catalyst seen to chart higher CPO price this year and next year. As such, we have tweaked our FY15 and FY16 earnings forecast to RM996 million (-6.0%) and RM1,078 million (-8.7%) respectively to impute our view of challenging business conditions moving forward, given slower demand as well as stiff competition on all business divisions i.e. plantation, manufacturing and property divisions. However, we are still banking on the stock given its strong management, larger planted land bank and sizeable prime age profile which may provide visible revenue and earnings growth if CPO price starts to rebound.

- **Valuation & recommendation.** We have rolled forward our valuation to FY16 based on 21x PER over CY16 EPS of RM1.01 and thus, deriving a new target price of RM21.21 compared to RM21.50 previously. Hence, the stock is HOLD.

Table 1: Results Review - Quarterly figures

FYE 30 Sept (RM'M)	3Q14	2Q15	3Q15	q-o-q	y-o-y	9M14	9M15	y-o-y
Revenue	2,924	3,065	3,538	15.4%	21.0%	8,352	9,718	16.4%
EBIT	291	309	336	9.0%	15.5%	1,117	956	-14.4%
Pretax profit	277	297	311	5.0%	12.4%	1,079	902	-16.4%
Taxation	-59	-69	-57	-17.8%	-2.8%	-221	-193	-12.6%
Minority interest	-4.6	-4.6	-7.4	59.8%	58.7%	-37	-25	-32.0%
Net Profit	214	223	247	10.9%	15.5%	821	684	-16.7%
EPS (sen)	20.1	20.9	23.2	10.9%	15.3%	77.1	64.2	-16.8%
Net gearing (x)	0.17	0.20	0.24	16.1%	36.8%	0.17	0.24	36.8%
EBIT margin (%)	10.0	10.1	9.5			13.4	9.8	
PBT margin (%)	9.5	9.7	8.8			12.9	9.3	
Net margin (%)	7.3	7.3	7.0			9.8	7.0	

Source: Bursa Malaysia, M&A Securities

Table 2: Financial Summary

YE: Sept (RM million)	2012	2013	2014	2015F	2016F
Revenue	10,570	9,147	11,130	10,931	11,269
EBIT	1597	1251	1369	1474	1578
PBT	1560	1200	1318	1383	1498
Net profit	1211	918	992	996	1078
EPS (sen)	113.7	86.2	93.1	93.5	101.3
Pre-tax margin	15%	13%	12%	13%	13%
Net profit margin	11%	10%	9%	9%	10%
PER (x)	17.8	23.5	21.7	21.6	20.0
P/BV (x)	3.0	2.9	2.8	2.5	2.4
ROE	17.1%	12.5%	13.5%	13.1%	12.9%
ROA	10.8%	7.9%	8.1%	7.6%	8.1%
Dividend (RM)	0.65	0.50	0.55	0.56	0.61
Dividend Yield	3.2	2.5	2.7	2.8	3.0

Source: Bursa Malaysia, M&A Securities

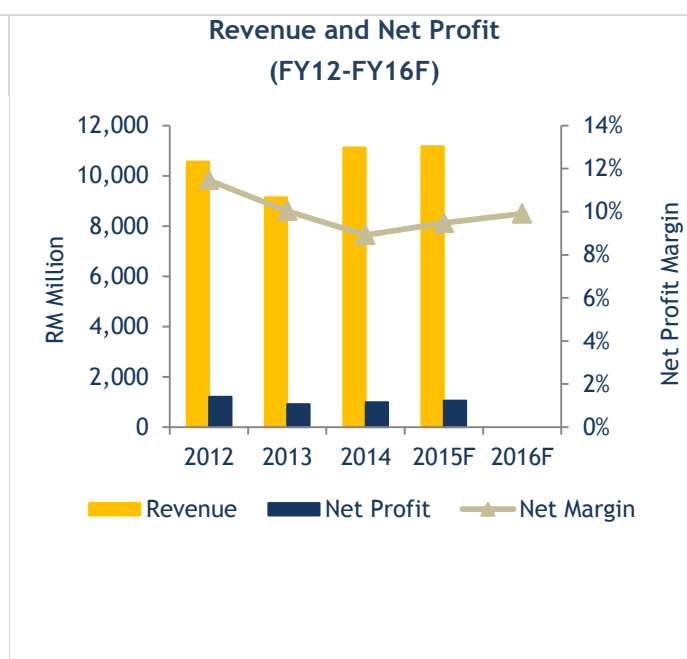
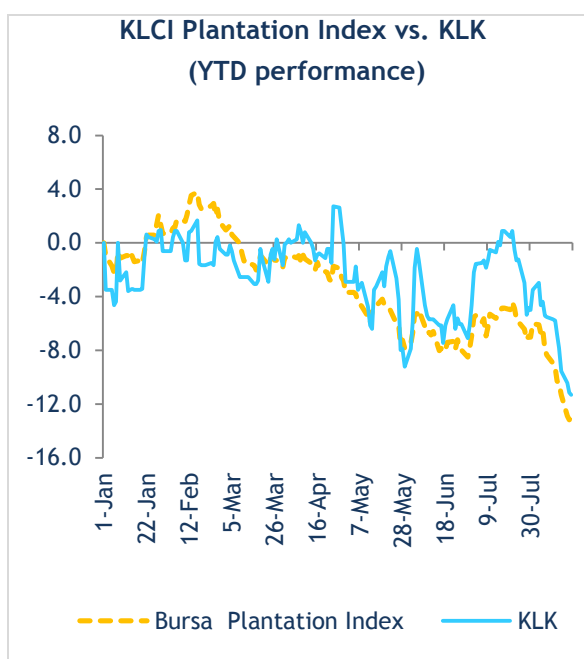
Table 3: Results Analysis - Segmental Breakdown

FYE: September (RM' Million)	9M14	9M15	y-o-y
Plantation	3,938.6	4,935.8	25%
Manufacturing	4,219.6	4,521.2	7%
Property Development	80.6	101.6	26%
Investment Holding/Others	113.0	159.3	41%
Segment Result:			
Plantation	775.1	584.9	-25%
Manufacturing	284.2	151.7	-47%
Property Development	32.2	50.5	57%
Investment Holding/Others	9.7	49.1	404%

Table 5: Plantation Statistics

FYE: September	9M15	9M14	y-o-y	3QFY15	2QFY15	3QFY14	q-o-q	y-o-y
FFB production (MT)	2,762,067	2,719,885	2%	981,809	825,549	873,104	19%	12%
CPO Production (MT)	624,579	602,128	4%	218,647	188,778	193,008	16%	13%
Rubber ('000 kg)	10460.5	11728.4	-11%	2700.6	4220.7	3115.0	-36%	-13%
Crude Palm Oil (RM/MT ex-mill)	2,155	2,430	-11%	2,126	2,212	2,507	-4%	-15%
Palm Kernel (RM/MT ex-mill)	1,488	1,615	-8%	1,517	1,607	1,783	-6%	-15%
Rubber (RM/KG net of cess)	6.70	8.29	-19%	6.6	6.89	7.78	-4%	-15%

Source: Bursa Malaysia, M&A Securities



Source: Bloomberg, M&A Securities

M&A Securities

STOCK RECOMMENDATIONS

BUY	Share price is expected to be $\geq +10\%$ over the next 12 months.
TRADING BUY	Share price is expected to be $\geq +10\%$ within 3-months due to positive newsflow.
HOLD	Share price is expected to be between -10% and $+10\%$ over the next 12 months.
SELL	Share price is expected to be $\geq -10\%$ over the next 12 months.

SECTOR RECOMMENDATIONS

OVERWEIGHT	The sector is expected to outperform the FBM KLCI over the next 12 months.
NEUTRAL	The sector is expected to perform in line with the FBM KLCI over the next 12 months.
UNDERWEIGHT	The sector is expected to underperform the FBM KLCI over the next 12 months.

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M & A Securities Sdn Bhd (15017-H)

(A wholly-owned subsidiary of INSAS BERHAD)

A Participating Organisation of Bursa Malaysia Securities Berhad

Principal Office:

Level 1,2,3 No.45 & 47,43-6

The Boulevard, Mid Valley City,

Lingkaran Syed Putra,

59200 Kuala Lumpur

Tel: +603 - 2282 1820 Fax: +603 - 2283 1893

Website: www.mnaonline.com.my