Share Jinji: Planting Stock Assessment Using Tetralogy

By Master of Cold Stock Market Fundamentals

KUALA LUMPUR – With a history spanning more than a 100 years, it has been proven that the plantation industry is the most time-tested of all industries. This is because plantation companies own the most important asset – land, which will continuously increase in value. This is proven from an analysis of a number of listed companies under this sector, such as Kuala Lumpur Kepong and United Malacca.

Despite the intense fluctuations in commodity prices, palm oil will remain the most competitive commodity as it has low production cost with diversified usage.

In the last 40 plus years, palm oil's market share of the cooking oil sector rose from 5% to 40%, indicating the increasingly high demand of this commodity.

As the world population grows, countries are increasingly becoming richer and simultaneously with the growth of gross national product and the increasing trend of consuming cooking oil made from palm oil; this provides brighter prospects for the future of the industry.

Plantation Stocks

Retail investors are not familiar with the palm oil industry and are therefore unable to evaluate the value, so they have missed the opportunity to buy plantation stocks at a low price.

Now I would like to use TDM Berhad as an example and share with everyone how to assess plantation stocks; and through the same way, we can evaluate the price of other planting stocks.

I must emphasise here that this perspective is based on my business investment experience. Evaluation of plantation stocks can be assessed through these four methods (tetralogy), especially in the preliminary assessment.

Before embarking on a proper assessment, we should have a basic understanding of the company.

History: TDM Berhad's development over 45 years.
Plantation Location: In Terengganu.

Main Shareholders: The Company is owned by the Terengganu state government's investment arm (53%) while the state development agencies have a 14.9% stake.

Plantation area:

(A) Owns 64,649 acres of oil palm plantation producing 26,162 metric tonnes of palm oil;

(B) In total, the company manages 81,292 acres of palm oil plantation producing 32,897 metric tonnes;

(C) Other lands comprise 16,640 acres of palm oil plantation producing 6734 metric tonnes.

Businesses:

1. Palm oil plantation
2. Health services: It has three small-scale hospitals
3. Food industry: Poultry farming

Palm oil plantation is the main source of revenue, followed by healthcare services.

Capital: Paid-up capital – RM221,135,000 at par value per share of RM1. Current market price is RM2.70 sen per share making the market value at RM600 mil.

Source: 2009 Annual Report and Q3/2010 financial year result on Sept 30.

Tetralogy Assessment

First, the Purchase Price per Acre

To purchase TDM's stock at the current share price of RM2.70 is equivalent to how much you pay for an acre of palm oil plantation.

The company's capital of RM221,135,000 times its current price of RM2.70 per share, gives it a market capitalisation of about RM600 mil.

If you order RM600 mil of stocks in the company, then the company's 64,649 acres of palm oil palm is yours.

The company on Sept 30 this year owns approximately RM120 mil in cash (net of liabilities). If you use RM600 mil to purchase all the shares of the company, then you own this RM120 mil cash.

Subtract RM120 mil cash from the RM600 mil, you will get RM480 mil that can be used to buy 64,649 acres of the company's palm oil plantation, hence the purchase price per acre is RM7,425.

So, for the purchase price of RM2.70 sen per share in TDM Berhad is equivalent to RM7,425 per acre to buy the company's palm oil plantation.

With hospitals and farms:

The company also owns hospitals and poultry farms, but we have not included these assets, because the number of these assets is insubstantial, and we do not know their current value.

The company is also helping Terengganu state government to manage 81,292 acres of palm oil plantation producing 32,897 metric tonnes. I cannot substantiate the value of the income as I do not have details of the management condition.

Therefore, RM7,424 per acre is just an estimate rather than the precise value.

Second, the Net Tangible Asset Value per Share

The company, as on Sept 30 this year presented the net tangible asset value per share of RM3.03.

This is the company's book value of plantation, not market value.

The company's annual report on page 129-130, listed the production report from the palm oil mill.

According to this table, the book value of the company's plantation is worth 1,771 per acre value of the ringgit.

Unless there is a full valuation, we aren't able to know the plantation's current market value per acre as most neighbouring areas are leased, with only 60 years left.

However, it is certain that the value per acre is more than the current bound RM1,771. So, if the company re-evaluates the value of their plantations, then the net tangible asset value per share is certainly more than RM3.03.

Third, the Financial Know-How

The company's track record is its ability to earn the most powerful evidence.

Net income per share is to assess the earning power of the most important information.

TDM's development in five years had a payout ratio of net income per share, see the following chart.

It can be seen from the company's records in 2007 that they were showing a mediocre performance with the stock price undergoing long-term slump.

After 2007, the profits surged due to the following reasons:

1. Production increased

   Fresh fruit bunch (FFB) per hectare in 2006 yielded only 15 metric tonnes, but now it will increase to 20 tonnes and is in line with the national average yield.

2. Crude palm oil prices

   In 2006, crude oil palm was selling at RM1,500 per metric tonne and in 2007, it was RM2,152. It rose to RM2,844 in 2008 and in 2009, the price was RM2,237.

   Production volume and prices surged simultaneously

3. This palm oil company will not be involved in any replanting for the next five years

   Expenditure reduction means a corresponding rise in profits. Only 5% needs to be replanted 5 years later.

4. Significant increase in the group's profit in healthcare services

   Net income per share for the first three quarters of this year reached 27.48 sen. The third quarter net profit is 12.82 sen. If the fourth quarter earnings are maintained like the third quarter earnings, then full-year 2010 net profit will exceed 40 sen per share. As the share price is at RM2.70 per share, the earnings ratio is 6.75 times which means it is equivalent to the earnings of large-scale plantation companies, equal to one-third of 20 times earnings ratio.

Year	Net Profit (EPS/sen)	Net Dividend (sen)
2005	7.69	-
2006	7.18	2.00
2007	17.93	5.5
2008	45.37	10.5
2009	25.03	13.00
2010	27.48 (3Q)	-

Fourth, the Growth Area

The company's progress:

1. In Indonesia, the company has acquired 98,844 acres of agricultural land which produces 40,000 metric tonnes in Kalimantan, of which 61,777 acres producing 25,000 metric tonnes has been planted.

   This year, they will plant 7,413 acres which can produce 3,000 metric tonnes. The company's acreage is expected to be increased over the next few years.

   The Company has RM120 mil cash in hand ringgit, with huge yearly profits, sufficient to develop new areas without borrowings.

2. The Group will continue to develop healthcare business into a profitable group. Currently, the Company has three small hospitals and will build a new 150-bed hospital Kuantan.

Summary

1. At RM2.70 per share of TDM equals to an acre of palm oil plantation worth RM7.424.

   Currently, the price of palm oil plantation is between RM2-3 million depending on the size, location and quality.

2. The palm oil plantation company's book value per acre is only RM1,771, with the revaluation; the net tangible asset value per share will definitely be over RM3.03.

3. At the current RM3,700 per metric ton of crude palm oil prices, the company's net profit this year should exceed 40 sen per share and expected earnings ratio is 6.75 times.

4. Palm oil plantation in Indonesia and commitment on the development of new medical services will be the company's growth areas.

5. Every year, the company announces that the Board will allocate at least 30% of the net profit to be distributed to shareholders as dividends as a result of the company's solid financial foundation. With this growth forecast, the company will continuous provide generous dividends.

Ends.