

Plantation sector

Merger of PNB plantation companies

OVERWEIGHT

Maintained

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KDN PP 5182/10/2007

PNB to announce merger of its plantation assets

It was reported in the *Business Times* that plans are underway to amalgamate Kumpulan Guthrie, Sime Darby and Golden Hope, in what would be the largest merger in Malaysia's corporate history. According to sources, a merger vehicle by the name of Synergy Drive has been incorporated to take over all the three companies, including their listed subsidiaries. The merger's main aim is to create an entity with a large earnings capacity, along the lines of Petronas Nasional. The details of the multi-billion ringgit merger remain sketchy but banking sources said CIMB Investment Bank will announce the merger today.

Comments

The plan to merge PNB's plantation assets is not new. PNB's plan to merge the plantation companies in its stable is not new and has been the subject of wide speculation for some time now.

Lacking details on merger. There was no mention on how the deal will be structured or the pricing of the proposed merger. As such, it is unclear whether the merged entity will be taking over Sime Darby, G Hope and K Guthrie or only their plantation-related assets. There is also the possibility that the merged group will be a separate listed entity, with Sime Darby holding a majority stake, to provide investors with an investment vehicle that offers pure exposure to the plantation assets of PNB group.

Rationale for large plantation group. The merged plantation entity will have combined planted estates of around 511,000ha and land bank of about 578,337ha, making it the largest listed plantation company in South-East Asia. The combined planted area is equivalent to around 12.6% of Malaysia's total planted oil palm estates. The merger of the plantation assets could lead to further economies of scale through operating synergies and cost savings arising from the pooling of the assets. For instance, operating efficiency could be strengthened by consolidating the group's management activities in the same area. Apart from operating synergies, we feel the merged group will be able to strategise better on its expansion into Indonesia. Currently, the three PNB companies are pursuing their own expansion plans in different parts of Indonesia. However, a strong management team will be required to push through the cost savings and efficiency gains, which may not be immediate, based on the experience of the earlier merger between G Hope and I&P. Overall, we would be positive on the deal as long as the merged group is able to deliver cost savings, improve efficiency and boost future earnings. By adding G Hope to the equation, the merged group will have an immediate downstream exposure to the oil palm business that it could build on further.

Figure 2: Comparison of merged entity's planted estates vs. its peers

Companies	Planted estates (ha)	Plantable area (ha)	Total oil palm land bank (ha)
Sime + G Hope + Guthrie	511,354	66,983	578,337
K Guthrie	261,856	21,000	282,856
G Hope	169,307	5,983	175,290
IOI Corp	143,696	682	144,378
KL Kepong	121,030	1,854	122,884
Kulim	96,493	84,588	181,081
PPBO Palms	86,627	206,241	292,868
Sime Darby	80,191	40,000	120,191
Tradewinds Plant	75,353	51,627	126,980
Asiatic	56,581	6,571	63,152

M&A potential raises catalysts for stocks. Overall, we would be positive on the merger of the plantation assets if the deal were earnings accretive and the pricing fair. The merged entity will have good FFB growth potential due to G Hope's and Kumpulan Guthrie's young estates and scope for efficiency gains through cost savings, coupled with the expectation of higher CPO price in the coming years. We maintain our OUTPERFORM calls for Sime Darby and G Hope and our NEUTRAL recommendation for K Guthrie. The merger will be positive for all as it allows shareholders of the target companies to participate in the efficiency gain and growth prospects of the consolidated entity.

Sector comparisons

	Bloomberg ticker	Recom.	Price (RM)	Mkt cap (RM m)	Core P/E (x) CY06	3-yr EPS CAGR (%)	P/NTA (x) CY06	ROE (%) CY06	Div yield (%) CY07	Div yield (%) CY06	
Asiatic	ASP MK	O	3.96	2,941.9	18.2	14.4	9.3	1.8	10.8	10.9	1.9
Golden Hope	GHP MK	O	5.20	7,402.1	21.6	14.9	21.1	1.3	7.7	7.9	5.0
IOI Corp	IOI MK	N	18.90	21,638.5	22.7	19.1	10.8	3.8	17.5	18.9	2.9
KL Kepong	KLK MK	O	13.90	9,904.0	23.1	17.4	14.7	2.4	10.4	10.7	3.4
K Guthrie	KGB MK	N	4.06	4,095.3	41.9	19.5	42.9	1.5	8.0	9.7	2.0
PPB Oil Palms	PBOB MK	U	9.75	4,342.9	28.8	19.5	20.7	3.3	13.0	13.1	1.8
Simple average					26.0	17.4	19.9	2.4	11.2	11.9	2.8

O = Outperform, N = Neutral, U = Underperform, NR = Not Rated, TB = Trading Buy and TS = Trading Sell
Source: Company, CIMB/CIMB-GK Research, Bloomberg

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