

9 July 2018

## Kangaroo Island Plantation Timbers (KPT)

**BUY**

**Share Price:**

**A\$2.15**

### NTA uplift buffers project delays

**Target Price:**

**A\$2.71**

KPT has increased the carrying value of its standing timber to reflect higher timber prices, a stronger AUD and biological growth. While this highlights the tangible value in KPT's share price, ongoing delays in submitting the EIS report for its proposed wharf at Smith Bay mean that the company is still 12-plus months from being able realise this upside. However, based on our revised FY18 NTA estimate of \$2.51ps, the company's trailing 12-month price to FY17 NTA of 1.20x, and the outlook for timber prices, we reiterate our Buy rating and \$2.71ps target price.

#### Positive revaluation of KPT's standing timber

- KPT has increased the carrying value of its standing timber (i.e. biological asset) to \$107.8m. This compares to \$80.9m in FY17, and thus represents a year-on-year increase of \$26.9m or 52.9cps.
- The key driver of the uplift to KPT's book value of standing timber in FY18 was higher timber prices. KPT derived its book value using a timber price 5% below the current weighted market price and an AUD/USD of 0.79.

#### Woodchip prices are trending higher

- Recent comments from Midway (MWY.ASX) and research from RISI indicate that the export price for Australian E.globulus woodchips is likely to continue to trend higher over the next several years.
- RISI recently upgraded its export price growth expectations for Australian E.globulus to 2022, with China's move from spot to bi-annual price agreements being indicative of a growing structural supply shortfall.

#### EIS delays are now encroaching on FY20F earnings

- KPT has not provided a revised project timeline since scrapping its previous expectations in February 2018. In our view, ongoing delays are likely due to site plan alterations incorporating the additional land purchase.
- Our forecasts assume KPT commences operations in July 2019. These forecasts are now at risk given it will take (i) 6 months post EIS submission to reach a final decision, and (ii) 6-9 months to construct the wharf.

#### Investment view

- Assuming KPT's proposed wharf at Smith Bay does proceed as planned, we expect the company to generate a sustainable free cash flow yield in excess of 15% per annum from FY21.
- KPT offers investors exposure to an asset class that (i) has high utility and a reasonably consistent rate of growth (real and nominal), and (ii) generates returns that are uncorrelated to the broader market.

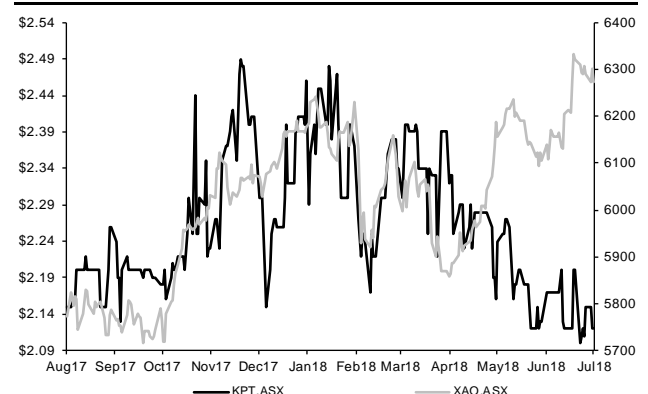
#### Company Data

Shares – ordinary (M)	50.9
Dilution (M)	0.0
Total (fully diluted) (M)	50.9
Market capitalisation (\$M)	109.4
12 month low/high (\$)	1.96 - 2.5
Average monthly turnover (\$M)	0.7
GICS Industry	Paper & Forest Products

#### Financial Summary (fully diluted/normalised)

Year End June	2018F	2019F	2020F	2021F	2022F
Revenue (A\$m)	0.2	0.2	38.6	54.3	57.3
Costs (A\$m)	-19.0	-0.9	26.6	37.2	38.8
EBITDA (A\$m)	19.2	1.1	12.0	17.1	18.5
NPAT (A\$m)	12.4	-0.9	5.8	8.3	9.6
EPS (¢)	27.1	-1.8	11.5	16.4	18.8
EPS Growth (%)	NM	-100+	100+	42.4	15.0
PER (x)	7.9	-119.0	18.7	13.1	11.4
FCF (A\$m)	-19.4	-29.8	6.9	16.8	17.8
FCFPS (cps)	-42.2	-58.5	13.6	33.0	34.9
Price to FCFPS (x)	-5.1	-3.7	15.8	6.5	6.2
EV (A\$m)	127.7	157.5	151.1	137.1	124.6
EV/EBITDA	NM	NM	12.6	8.0	6.8
Payout ratio (%)	0.0	0.0	30.5	61.2	61.1
Dividend (¢)	0.0	0.0	3.5	10.0	11.5
Net Yield (%)	0.0	0.0	1.6	4.7	5.3

#### KPT – performance over one year



#### Disclosure and Disclaimer

This report must be read with the disclosure and disclaimer on the final page of this document. Petra Capital was Broker for KPT's Placement to raise \$33.5M at \$2.00/sh on 12 April 2017 and \$15M at \$2.00/sh on 30 November 2017, for which a fee was received.

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## Analysis

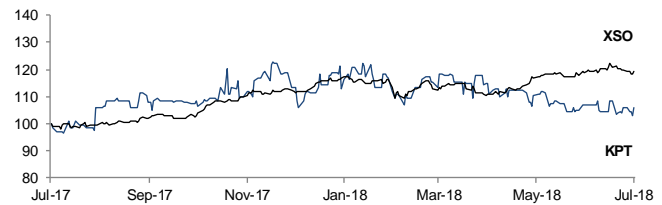
### Kangaroo Island Plantation Timbers

Year End June

#### MARKET DATA

Recommendation		Buy
Price	\$	2.15
Price target (12-month)	\$	2.71
52 week high / low	\$	1.95 - 2.5
Market capitalisation	\$m	109.4
Shares on issue (basic)	no.	50.9
Performance rights	no.	0.0
Other equity	no.	0.0
Shares on issue (diluted)	no.	50.9

#### 12-MONTH SHARE PRICE PERFORMANCE



#### INVESTMENT FUNDAMENTALS

	2018F	2019F	2020F	2021F	2022F
Reported net profit	\$m 12.4	(0.9)	5.8	8.3	9.6
Normalised net profit	\$m 12.4	(0.9)	5.8	8.3	9.6
Reported EPS (diluted)	¢ 27.1	(1.8)	11.5	16.4	18.8
Normalised EPS (diluted)	¢ 27.1	(1.8)	11.5	16.4	18.8
....Growth	% NM	-100+	100+	42.4	15.0
Normalised diluted PER	x 7.9	NM	18.7	13.1	11.4
Operating CFPS	¢ (20.8)	(17.3)	18.0	37.4	39.3
FCFPS	¢ (42.2)	(58.5)	13.6	33.0	34.9
Price to FCFPS	x (5.1)	(3.7)	15.8	6.5	6.2
Free cash flow yield	% NM	NM	6.3	15.4	16.2

#### Dividend per share

	2018F	2019F	2020F	2021F	2022F
Dividend per share	¢ 0.0	0.0	3.5	10.0	11.5
Payout ratio	% 0.0	0.0	30.5	61.2	61.1
Yield	% 0.0	0.0	1.6	4.7	5.3
Franking	% 0.0	0.0	0.0	0.0	75.0

#### Enterprise value

	2018F	2019F	2020F	2021F	2022F
Enterprise value	\$m 127.7	157.5	151.1	137.1	124.6
EV/EBITDA	x NM	NM	12.6	8.0	6.8
EV/EBIT	x NM	NM	15.4	9.2	7.6
Price to book (NAV)	x 0.86	0.86	0.84	0.82	0.79
Price to NTA	x 0.86	0.86	0.84	0.82	0.79

#### KEY RATIOS

	2018F	2019F	2020F	2021F	2022F
EBITDA margin	% NM	NM	31.0	31.4	32.2
EBIT margin	% NM	NM	25.5	27.5	28.5
Net profit margin	% NM	NM	15.2	15.3	16.7
Return on avg equity	% NM	NM	4.5	6.3	7.0
Return on avg assets	% NM	NM	4.5	6.5	6.8

#### NTA per share

	2018F	2019F	2020F	2021F	2022F
NTA per share	¢ 250.6	248.8	256.8	263.1	270.5
Net debt/(cash)	\$m 18.3	48.1	41.7	27.7	15.2
Interest cover (EBIT)	x 13.5	0.5	2.9	4.9	6.2
Leverage (net debt/ EBITDA)	x 1.0	43.0	3.5	1.6	0.8
Gearing (ND/ND+E)	% 12.6	27.5	24.2	17.1	10.0

#### DUPONT ANALYSIS

	2018F	2019F	2020F	2021F	2022F
Net Profit Margin	% NM	NM	15.2	15.3	16.7
Asset Turnover	x NM	NM	0.2	0.2	0.2
Return on Assets	% NM	NM	2.6	3.5	3.9
Financial Leverage	x NM	NM	1.7	1.8	1.8
Return on Equity	% NM	NM	4.5	6.2	7.0

#### Key assumptions

	2018F	2019F	2020F	2021F	2022F
Harvest	0.0	0.0	353.6	482.1	499.1
- Hardwood (gmt)	0.0	0.0	203.6	332.1	349.1
- Softwood (gmt)	0.0	0.0	150.0	150.0	150.0
Average price	106.3	109.7	112.0	114.3	116.8
- Hardwood (A\$/gmt)	106.7	108.8	111.0	113.2	115.5
- Softwood (A\$/cbm)	96.0	97.9	99.9	101.9	103.9
Key costs (A\$/gmt)	0.0	0.0	(50.8)	(51.0)	(52.0)
- Plantation maintenance and mgmt	0.0	0.0	(5.1)	(4.0)	(4.1)
- Harvest preparation	0.0	0.0	(1.2)	(1.2)	(1.2)
- Harvesting	0.0	0.0	(19.8)	(20.2)	(20.6)
- Chipping	0.0	0.0	(5.1)	(6.2)	(6.4)
- Haulage	0.0	0.0	(10.2)	(10.4)	(10.7)
- Pre-export cost	0.0	0.0	(6.8)	(6.2)	(6.3)
- Marketing commission	0.0	0.0	(2.7)	(2.7)	(2.8)

#### PROFIT AND LOSS

	2018F	2019F	2020F	2021F	2022F
Total revenue	\$m 0.2	0.2	38.6	54.3	57.3
EBITDA	\$m 19.2	1.1	12.0	17.1	18.5
Depreciation & amortisation	\$m 0.0	0.0	2.1	2.1	2.1
EBIT	\$m 19.2	1.1	9.8	14.9	16.3
Net interest	\$m 1.4	2.4	3.3	3.0	2.6
Non-operating income	\$m 0.0	0.0	0.0	0.0	0.0
Pretax Profit	\$m 17.8	(1.3)	6.5	11.9	13.7
Tax expense	\$m 5.3	(0.4)	0.6	3.6	4.1
Minorities	\$m 0.0	0.0	0.0	0.0	0.0
Operating NPAT	\$m 12.4	(0.9)	5.8	8.3	9.6
Significant items	\$m 0.0	0.0	0.0	0.0	0.0
Reported NPAT	\$m 12.4	(0.9)	5.8	8.3	9.6

#### GROWTH PROFILE

	2018F	2019F	2020F	2021F	2022F
Operating revenue	% NM	0.0	100+	40.7	5.5
EBITDA	% NM	(94.2)	100+	42.8	8.2
EBIT	% NM	(94.2)	100+	52.0	9.3
Operating NPAT	% NM	-100+	100+	42.4	15.0
Normalised EPS	% NM	-100+	100+	42.4	15.0
DPS	% NM	NM	100+	185.7	15.0

#### BALANCE SHEET

	2018F	2019F	2020F	2021F	2022F
Cash	\$m 6.7	8.9	15.3	29.3	41.8
Receivables	\$m 0.0	0.0	1.9	2.7	2.9
Inventory	\$m 0.0	0.0	1.9	2.7	2.9
Other	\$m 0.8	0.8	0.8	0.8	0.8
Current	\$m 7.4	9.7	19.9	35.5	48.3
Prop, plant & equip	\$m 55.6	76.6	76.7	76.8	76.9
Standing timber	\$m 107.8	117.5	117.1	113.4	109.5
Other	\$m 8.7	9.5	9.5	9.2	8.9
Non current	\$m 172.1	203.5	203.3	199.3	195.3
Total assets	\$m 179.6	213.2	223.2	234.8	243.5
Accounts Payable	\$m 0.0	0.0	1.9	2.7	2.9
Borrowings	\$m 25.0	57.0	57.0	57.0	57.0
Other	\$m 27.1	29.6	33.6	41.2	46.1
Total liabilities	\$m 52.1	86.6	92.5	100.9	105.9
Net assets	\$m 127.5	126.6	130.7	133.9	137.6
Equity	\$m 127.5	126.6	130.7	133.9	137.6
Minorities	\$m 0.0	0.0	0.0	0.0	0.0
Shareholder's equity	\$m 127.5	126.6	130.7	133.9	137.6
Shares on issue	m 50.9	50.9	50.9	50.9	50.9

#### CASH FLOW

	2018F	2019F	2020F	2021F	2022F
Operating EBITDA	\$m (7.7)	(6.4)	14.4	22.9	24.3
Change in working capital	\$m (0.4)	0.0	(1.9)	(0.8)	(0.2)
Net interest	\$m (1.4)	(2.4)	(3.3)	(3.0)	(2.6)
Tax paid	\$m (0.0)	0.0	0.0	0.0	(1.5)
Other	\$m 0.0	0.0	0.0	0.0	0.0
Operating cash flow	\$m (9.5)	(8.8)	9.2	19.1	20.0
Capital expenditure	\$m (9.8)	(21.0)	(2.2)	(2.2)	(2.2)
Acquisitions/divestment/other	\$m 0.0	0.0	0.0	0.0	0.0
Investing cash flow	\$m (9.8)	(21.0)	(2.2)	(2.2)	(2.2)
Free cash flow	\$m (19.4)	(29.8)	6.9	16.8	17.8
Equity	\$m 20.0	0.0	0.0	0.0	0.0
Increase / (decrease) in debt	\$m 0.0	32.0	0.0	0.0	0.0
Dividend/other	\$m 0.0	0.0	(0.5)	(2.8)	(5.3)
Financing cash flow	\$m 20.0	32.0	(0.5)	(2.8)	(5.3)
Net cash flow	\$m 0.6	2.2	6.4	14.0	12.5

Source: Petra Capital

### Positive revaluation of KPT’s standing timber underpins NTA

KPT has upwardly revised the carrying value of its standing timber (i.e. biological value). The key points to note are as follows:

- Book value, as at 30 June 2018, has increased to A\$107.8m, compared to \$80.9m in the previous corresponding period;
- The key driver of the change in the carrying value of KPT’s standing timber has been higher timber prices, both hardwood chips and softwood logs;
- Key inputs underpinning the revised book value include a (i) timber price that is 5% below the current weighted headline FOB price, (ii) AUD/USD of 0.79, and (iii) discount rate of 11.65%.

Factoring in the revised carrying value of KPT’s standing timber, and after making some modest adjustments to our operating costs, capital expenditure and timber price assumptions, our NTA estimate for FY18 increases to \$2.51ps. This compares to our previous FY18 estimate of \$2.24ps and the FY17 NTA of \$1.87ps (based on current shares outstanding).

Based on KPT’s average price to FY17 NTA of 1.20x (Figure 1) in the past 12 months, it is reasonable in our view to expect the company’s share price to trend higher in response to the revised FY18 NTA. Note that implicit in the reported book value of KPT’s standing timber (in both FY17 and FY18) is the assumption that the DA for the company’s proposed wharf at Smith Bay will get the green light.

**Figure 1: KPT’s price to FY17 NTA**



Source: Kangaroo Island Timber Plantations, Iress, Petra Capital

### Woodchip prices are trending higher

Recent comments from Midway (MWY.ASX) and research from RISI indicate that the export price for Australian E.globulus woodchips is likely to continue trending higher in the near-to-medium-term. In particular, we note:

- Comments from Midway that the export price for hardwood woodchips from Portland to China in 1Q18 was circa US\$170 per BDMT FOB. This represents a slight premium to the export price to Japan over the same period, and a marked increase on the price in the poc of circa US\$152 per BDMT FOB to Japan and circa US\$158 per BDMT FOB to China; and
- Recent Research from RISI, which featured (i) an update to the company’s price growth forecast for Australian E.globulus exports to Japan between 2016-2021, with a revised CAGR of 3.2%, up from 2.5% previously (Figure 2), and (ii) confirmation that China remains the world’s largest woodchip importer, having surpassed Japan in 2016.

**Figure 2: Japan Woodchip Prices, 2012-2017, and Price Predictions, 2018-2022**

Nominal FOB Prices, Annual Average						
Year	US Douglas-fir	Australian Radiata	Australian <i>E.globulus</i>	South African Eucalyptus	Chilean <i>E.globulus</i>	Vietnamese Acacia
	US\$ per BDU FOB		US\$ per BDMT FOB			
2012	164	160	199	142	147	135
2013	138	141	177	127	142	137
2014	152	150	159	121	133	136
2015	165	156	153	121	132	142
2016	149	149	149	114	125	132
2017	139	145	152	117	127	128
2018F	172	167	166	128	136	132
2022F	174	171	174	135	143	144
2017-22 CAGR	3.2%	2.8%	3.2%	3.4%	2.8%	1.8%
Previous forecast for 2016-2021	2.2%	2.3%	2.5%	2.7%	2.6%	1.6%

Source: International Pulpwood Trade Review, RISI 2018, Midway Limited

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