KEGALLE PLANTATIONS

INTERIM UPDATE – 4QFY11

Earnings Reach LKR838mn Posting a Staggering 123% Growth YoY

ASIA WEALTH MANAGEMENT CO. (PVT) LTD.

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KEGALLE PLANTATIONS

Earnings Reach LKR838mn Posting a Staggering 123% Growth YoY

- Kegalle Plantations (KGAL.LKR205.0), posted a net profit of LKR837.8mn FY11 (vs. a net profit of LKR376.0mn FY10), reflecting a growth of 123% YoY, where company achieved net earnings of LKR270.1mn for 4QFY11.

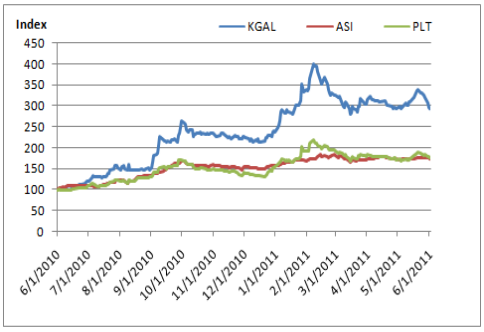
- Growth was supported primarily by the soaring rubber prices with the recovery of automobile industry, coupled with the enhanced tea production experienced during the year(tea production grew by 12% during FY11). And changing the tea and rubber grade mix to suit market conditions also contributed to this achievement. At the same time company achieved an overall NSA (Net Sales Average) of LKR481.2 in FY11 for rubber (vs. an overall Sri Lankan average of LKR403.0) which is a thumping 72.4% increase compared to last season.

- In FY11, KGAL invested LKR200 mn as Capital Expenditure, out of which LKR145mn was spent on field development including replanting and maintaining tea & rubber(147 hectares of rubber was newly planted during FY11), focusing on long term benefits. Replanting & new planting of rubber will continue to have priority which will increase its production in the long term. Company plans to invest around LKR162mn on capital expenditure in FY12, which would include new planting of 200 hectares of rubber.

- With Plantation worker wage revision took palce recently(June 2011), worker basic wage was revised upward from a current LKR285 to LKR380 per day with a minimum total pay of LKR515, it'll have a considerable impact on Profit margins in tea segment as a whole (tea is a highly labour intensive commodity). But since tea segment contributes only up to circa 7% of gross profit of KGAL, profit margins would have a lesser impact compared to its competitor firms which rely highly on tea.

- We believe KGAL has strong earnings growth potential on the back of, the strong world rubber prices, a full recovery from global recession; would place KGAL at a definite advantage as the largest rubber producer in Sri Lanka, and with KGAL's ability to adjust tea grade mix to exploit market trends. Against this backdrop we expect KGAL to record LKR991.6mn in FY12E (up by 18.4% YoY) and net earnings of LKR1,037.1mn in FY13E (up 4.6% YoY). KGAL (voting) currently trades at 5.2X forecasted FY12E net profit, 4.9X estimated FY13E net profit and 2.1X PBV, as opposed to a Plantation sector PE of circa 10.7X and a current trailing market P/E of 19X. We believe counter holds strong upside.

KGAL, PLT VS. ASI



STOCK DATA

Avg. Daily Turnover (LKR mn)	11.4
Shares in Issue(mn) [V]	25.0
Market Cap (USD mn)	106.7
market Cap (LKR bn)	11.7

PERFORMANCE

% chg.	1m	3m	12m
Voting	7.5	(1.2)	221.5

MAJOR SHAREHOLDERS

Voting (as at 30th Sep'10)	%
RPC Plantation Mgt Services	68.06%
JB Cocoshell (Pvt) Ltd	2.52%
Almar Trading Co.(Pvt)Ltd	0.89%
HSBC International Nominees Ltd –SSBT-Deustche Bank	0.80%
Tranz Dominion,L.L.C	0.74%

YE 31 Mar/ (LKR mn)	FY08	FY09	FY10	FY11	FY12E	FY13E
Net Profit	420.9	205.4	376.1	837.7	991.6	1,037.1
+/-% YoY	35.2%	-51.2%	83.1%	122.7%	18.4%	4.6%
EPS (LKR)	16.8	8.2	15.0	33.5	39.7	41.5
+/- %YoY	35.2%	-51.2%	83.1%	122.7%	18.4%	4.6%
PER (X)	12.2	24.9	13.6	6.1	5.2	4.9
PEG(X)	34.6	(48.7)	16.4	5.0	28.1	107.5
DPS	5.00	1.00	3.00	3.00	3.00	3.00
BVPS (LKR.)	48.5	54.7	68.4	96.4	125.0	155.5
PBV (X)	4.2	3.7	3.0	2.1	1.6	1.3
ROE	34.7%	15.0%	22.0%	34.8%	31.7%	26.7%

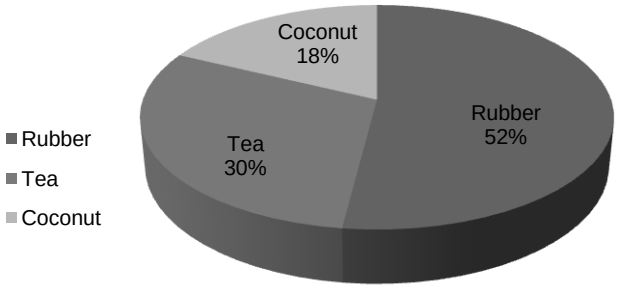
COMPANY OVERVIEW

Kegalle Plantations incorporated in 1992 is managed by RPC Plantation Management Services (Pvt) Ltd which is currently a fully owned subsidiary of Richard Pieris & Company (RPC), contributes up to 10% of RPC's total net revenue.

KGAL being the largest Rubber producing company among regional plantation companies (4.6mn kg of average production p.a.), is well positioned to emerge as the leader in the Sri Lankan plantation industry. Company has historically contributed up to 4-5% of total national rubber production in Sri Lanka. KGAL owns 21 Estates with a total land base of 10,000 Ha in & around Kegalle and Badulla Districts.

On many occasions KGAL has achieved top prices for individual grades at Colombo rubber auction (KGAL achieved an overall NSA of LKR481.2 vs. total Sri Lankan average of LKR403.0 for FY11). KGAL also maintains ISO 9001-2000 standard in all rubber manufacturing facilities which allows them to maintain the quality of the products at very high levels grabbing attractive prices.

KGAL Product Mix



KGAL cultivates tea amounting to 3mn kgs in 6 estates located in the up, mid and low country. In terms of NSA, company maintained an acceptable average of LKR327.6 during FY11 (compared to an overall Sri Lankan NSA of LKR371.5). Effective management of cost structure is vital particularly in tea segment (tea is highly labour intensive compared to rubber), where labour wage of plantation workers are to be reviewed every 2 years according to the agreement between government and trade unions (according to the latest developments plantation worker basic wage was revised upward from a current LKR285 to LKR380 per day with a minimum total pay of LKR515. This reflects a 17.5% increase in wages vs. 42% increase given in 2009).

KGAL, being the largest rubber producer in the country, is one of the leading counters in the plantation sector which is well positioned to reap benefits of a booming rubber industry, shouldered by the global market recovery. Also having a strong balance sheet and liquidity position with surplus cash invested in treasury bills, repos, KGAL would be pursuing expansion efforts both locally and overseas capitalizing on growth opportunities.

Strong backing from its parent Richard Pieris & Company, places KGAL in an advantageous position compared to its competitors, especially Richard Peiris being in to large scale rubber based manufacturing remains to be KGAL's long term reliable customer. Meanwhile, KGAL has been continuously paying attention on improving living conditions and work place safety of its plantation workers (KGAL holds a labor strength of 7,171 workers), which has enabled the company to maintain a sound relationship with its worker community which would enable the company to gain the maximum contribution from its workers particularly in implementing cost efficiency programs.

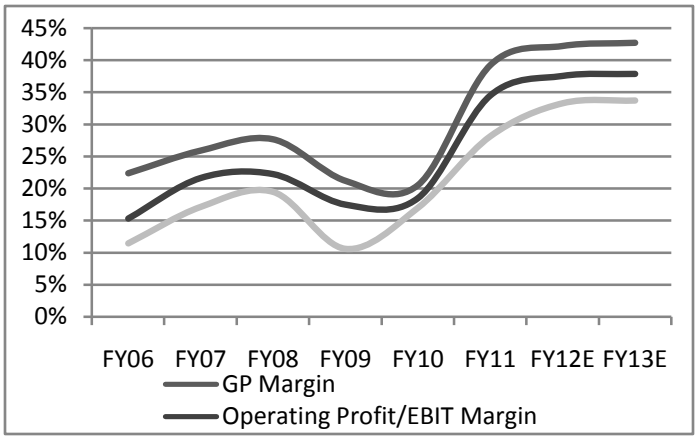
QUARTERLY PERFORMANCE AT A GLANCE

Income Statement Y/E 31st March LKR'MN	*FY11*	*FY10*	*% Chg*	*4QFY11*	*4QFY10*	*% Chg*
Revenue	2,991.8	2,216.5	35.0%	900.96	692.48	30.1%
COS	(1,818.0)	(1,762.4)	3.2%	(478.11)	(437.51)	9.3%
GP	**1,173.8**	**454.1**	**158.5%**	**422.85**	**254.97**	**65.8%**
		51.0				
Other Operating income	106.0	82.6	28.2%	28.52	24.45	16.6%
Management fees	(193.5)	(82.2)	135.4%	(63.69)	(43.99)	-6.2%
Administrative expenses	(54.6)	(44.5)	22.7%	(11.31)	(12.05)	44.8%
Reversal/(Provision) for doubtful receivable	-	51.0		-	50.96	-100.0%
Operating Profit/EBIT	**1,031.6**	**410.1**	**151.5%**	**376.38**	**274.34**	**37.2%**
Net finance cost	(114.5)	(62.4)	83.5%	(62.08)	(16.92)	266.9%
Associate profit/loss	(41.7)	-		(30.55)	-	
Goodwill written off	-	-				
Profit before tax/EBT	**875.4**	**398.7**	**119.6%**	**283.75**	**257.43**	**10.2%**
Taxation	(34.0)	(22.5)	51.0%	(14.17)	(12.87)	10.1%
Net profit from continuing operations	**841.4**	**376.1**	**123.7%**	**269.58**	**244.56**	**10.2%**
loss after tax from discontinued operations	(3.7)	-		0.55	(7.48)	-107.4%
Profit for the period	**837.7**	**376.1**	**122.7%**	**270.13**	**237.08**	**13.9%**

Top line posts LKR900.9mn reflecting an impressive 30% growth YoY for 4QFY11.

KGAL's top line recorded impressive LKR900.9mn for 4QFY11, reflecting circa 30% YoY growth backed mainly by the soaring rubber prices. This has enabled the company to post a record NSA of LKR481.2 for rubber (vs. LKR279.1 recorded in FY10, reflecting a massive 72% growth YoY). This enabled KGAL to mitigate the impact from the 11% dip in rubber output experienced due to bad weather conditions prevailed during FY11, where as the tea output inclined by a significant 12% during the year. Increase in tea volumes led to a downward trend on tea NSA's particularly in high grown category, where overall NSA dropped by circa 6% YoY during FY11.

Margin Analysis



As a consequence of cost efficiency programs implemented Cost of Sales remained at reasonable levels with a slight 9% increment YoY during 4QFY11. Further for FY11, revenue expenditure remained stable with a marginal 3% increase YoY, which was an outstanding achievement despite the pressure on labour & energy costs.

Gross Profit saw a growth of 65.8% YoY, whilst Gross Margin jumped to 47%.

Gross Profit saw an outstanding growth of 66% YoY, whilst Gross Margin improved substantially reaching 47% vs. 37% recorded during 4QFY10. This was achieved

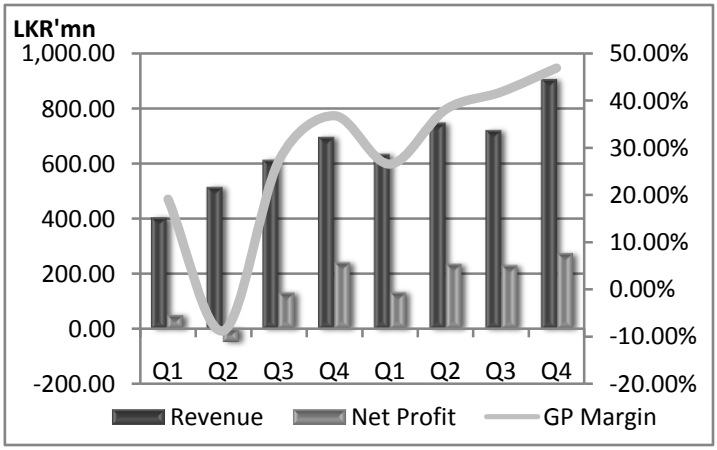
due to the impressive growth experienced in revenue whilst keeping revenue related expenditure at stable levels. Further, cumulative GP Margin for FY11 witnessed a twofold growth posting 39%.

Operating profit increased by 37% YoY to LKR376.4 mn in 4QFY11 which is directly attributable to high gross profits. However it should be noted that excluding the management fee of LKR63.7mn (up 44.8% YoY), the company has recorded an operating profit of LKR440.1 mn. Furthermore, EBIT margin improved slightly by 200 basis points recording 42%.

EBT recorded LKR283.7mn, reflecting a nominal growth of 10% YoY. EBT recorded a nominal growth of 10%whilst EBT Margin dipped by 600 basis points posting 31%. This was mainly due to the thumping growth experienced in finance cost (277% YoY) which was owing to the settlement of accrued government lease rental balance. Meanwhile the contribution from the KGAL's associate (Richard Pieris Natural Foams Ltd) remained negative with a loss of LKR30.6mn during 4QFY11.

Annual Cumulative net earnings reach LKR837.8mn vs. LKR376.0mn recorded for FY10.

KGAL posted an impressive 122.7% YoY growth in cumulative annual earnings in FY11, where for the quarter under review company recorded an LKR270.1mn of net earnings (14% growth YoY). Growth was triggered primarily by the outstanding improvement in rubber market conditions with the recovery of global automobile industry, which led rubber prices to historical high levels during 4QFY11. This drove the GP Margin to record twofold growth reaching 39.2%, whilst the NP Margin also jumped to 28% from a 17% posted in FY10.



QUICK PERFORMANCE REVIEW	2008	2009	2010	2011	2012E	2013E
Profitability						
Revenue Growth	19%	-10%	14%	35%	8%	2%
Gross Profit Margin	28%	21%	20%	39%	39%	40%
EBIT Margin	22%	17%	19%	34%	34%	35%
EBT Margin	20%	11%	18%	29%	32%	32%
Net Profit Margin	19%	11%	17%	28%	31%	31%
Efficiency						
Trade Receivables Days	61.4	51.3	44.3	28.8	30.2	28.7
Payables Days	35.8	31.7	42.0	53.1	55.8	53.0
Inventory Days	50.4	35.7	51.7	79.0	82.9	78.8
Current Ratio	3.4	4.3	3.9	5.3	5.4	7.2
Acid Test	2.6	3.6	3.2	4.2	4.4	6.2
Interest Cover	2.4	3.4	4.4	5.4	6.4	7.4
Gearing(debt/equity)	53.2%	47.2%	40.9%	27.5%	22.2%	18.8%
Investor Ratios						
ROE	34.7%	15.0%	22.0%	34.9%	31.7%	26.7%
ROA	19.9%	13.2%	12.8%	26.2%	23.2%	20.7%
Asset Turnover	0.9	0.8	0.7	0.8	0.7	0.6

DUPONT ANALYSIS

The DuPont analysis critically analyses the elements comprising the Return on Equity of an organization. Here a breakdown of ROE is given under three basic elements representing operational efficiency, Asset efficiency & financial leverage.

Year	ROE	Tax Burden	Interest Burden	EBIT Margin	Asset Turnover	Equity Multiplie
FY08	34.7%	97.5%	89.7%	22.2%	0.9	2.0
FY09	15.0%	93.7%	64.5%	17.5%	0.8	1.9
FY10	22.0%	94.3%	97.2%	18.5%	0.7	1.9
FY11	34.9%	95.7%	84.9%	34.5%	0.8	1.6
FY12E	29.3%	96.8%	92.3%	31.9%	0.7	1.5

EQUITY MULTIPLIER

The asset to equity ratio (Equity Multiplier) determines the degree to which the company is relying on debt to finance its assets. Higher equity multiplier indicates higher financial leverage. KGAL on average recorded an asset to equity ratio of 1.8X for the past 4 year period. Since KGAL's debt financing remained at stable levels during past few years, coupled with substantial improvement in net earnings the ratio has improved considerably from 2.0X in FY08 to 1.6X in FY11. Moving forward with KGAL's possession of strong retained earnings shouldered by strong liquidity position with circa 1.3bn short term investments, company is in a strong position to fund their capital expenditure internally, thus we expect financial leverage to reduce further.

ASSET TURNOVER

Asset turnover ratio measures a firm's efficiency at using its assets in generating revenue. KGAL posted an asset to turnover ratio of 0.8X on average during past five years. The relatively lower asset efficiency is mainly due to the nature of industry KGAL is catering. Agricultural & Plantation companies in general has a lower asset efficiency since they are highly capitalized. Further it should be noted that circa 33% of KGAL's asset base comprise of short term investments, which indicates substantial amount of funds remained without being utilized for revenue generation.

NET PROFIT MARGIN

NP Margin of KGAL has been highly volatile over the past few years, reflecting the fluctuating nature of the product prices. But on a positive note margin has remained above 10% over the last 6 year period with a peak of 28% during FY11. KGAL's interest burden has remained at similar levels as company has maintained its borrowings at a stable level whilst the EBIT Margin recorded 23% on average during past 4 year period.

RETURN ON EQUITY

KGAL's ROE has remained attractive over the past four year period despite heavy fluctuations in commodity prices where ratio has remained above 15% consecutively. ROE which stood at 34.7% in FY08 saw drastic decline in the year followed recording 15%, which was owing to the unfavourable market conditions prevailed for rubber during the particular period with recessionary impact. But gradually with the recovery of the global economic conditions, rubber demand took a u-turn leading earnings to grow at an accelerated rate. This led ROE to rebound towards 34.5% during FY11, where it's expected to remain at similar levels within the next few years.

FUTURE OUTLOOK

The Company's main strategy for future is to take maximum advantage of fluctuations in market prices with effective management of grade mix. This will enable the company to adjust itself appropriately to prevailing market conditions and maintain their competitive position in the market. (Plantation industry is a sector which is subject to drastic fluctuations due to external forces such as weather, global economic conditions, etc.)

Planned replanting of rubber will continue to have priority which will enable the company to continue its position as the largest rubber producer in the country whilst continuing to take advantage of attractive rubber prices. KGAL currently enjoys a GP Margin of circa 57% for rubber. High yielding new clones have been replanted which will undoubtedly contribute to an escalated production when such extents come in to bearing. Further the Company has been rain guarding its high yielding rubber extents by investing Rs. 6.9 Mn. Company plans to invest around LKR162mn on capital expenditure in FY12, which would include new planting of 200 hectares of rubber.

The world rubber prices are expected to sustain at current attractive levels; on the back of, the current growth in automobile industry coupled with the vast potential in China & India and as well with the substantial supply deficit in the market. And in the medium term rubber prices are expected to neutralize at current attractive levels, with the increased production volumes from major producing countries, with the substantial undertakings that have been taking place in replanting & new planting of rubber. This will ensure KGAL sustain its earnings in the years to come provided weather permits KGAL to enhance its production as planned. Furthermore, KGAL has historically achieved premium prices for rubber compared with Sri Lankan averages due to maintaining quality at a superior level. This gives KGAL an edge over competitors to perform better even during difficult times.

In terms of tea production KGAL's main contribution comes from High Grown tea, but company adopts a strategy of changing its grade mix to take advantage of price fluctuations. Demand conditions for tea are also expected to enhance further with global economic recovery and with emerging trend towards tea, from other beverages.

However, in the ***tea segment with labor cost accounting to around 55% of total cost of production,*** and plantation workers' wages were revised upwards recently, it will have a severe impact on overall cost of production of the company in the years to come. Thus company's future performance will rest heavily on the fact that company adopt effective cost control measures and improve productivity particularly in tea production. As a result of the cost efficiency programs implemented KGAL has achieved a significant improvement in the productivity in the tea segment (tea COP declined by 4% recording LKR292.5 per kg during FY11).

KGAL's management is positive about its future outlook and is very optimistic of strong growth and profitability. With the strong Balance sheet and liquidity position expansion plans both local and overseas would be pursued in the long term.

VALUATION

Forecast KGAL to post net earnings of LKR991.6mn in FY2012E (up 18% YoY) and reach LKR1,037.1mn in FY2013E (up 5% YoY).

In terms of a price earnings multiple based valuation, we believe that the share is fairly valued at 5.3X forecast FY2012E net profits and 4.9X forecast FY2013E net profits showing attractive value potential.

Based on an analysis of a historic 52 week price movement (Voting), we derived a price movement of +/-LKR 52.7 on a mean of LKR159.7 Hence, the flux is approximately +/- 33%. Furthermore, if it is assumed that the same upside price movement is seen pushing the price to LKR266.0 levels (from a current level of LKR200.0) the forward PE multiples would be 6.7X for FY2012E and 6.6X for FY2013E. Furthermore, when adjusting KGAL's returns to its risk (deviation of the share price), Sharpe ratio of the counter is at 2.5 whilst the Plantation sector is at 2.8. KGAL's risk adjusted return is lower because its deviation has been much higher at 44.7% as opposed to the sector's deviation of 17% over the past one year trading period. Hence, KGAL shows a lower risk adjusted return when compared to the sector.

Valuation Dashboard				
KGAL.N : LKR205.00	*FY10*	*FY11*	*FY12E*	*FY13E*
EPS (LKR)	15.0	33.5	39.7	41.5
P/EBIT	12.5	5.0	4.6	4.4
P/E	13.6	6.1	5.2	4.9
PBV	3.0	2.1	1.6	1.3
Sharpe Ratio - KGAL	2.5			
Sharpe Ratio - Plantation Sector	2.8			
Sector P/E	10.7			
Sector PBV	2.4			
Market P/E	18.9			
Market P/BV	2.9			

*Assimilation of Price Movements **	*FY2012E*		*FY2013E*	
(LKR)	272.7	272.6	272.7	272.6
P/EBIT	6.2	6.2	5.9	5.9
P/E	39.7	6.9	6.6	6.9

KGAL.N - * Price of LKR266.0 is based on incorporating an upside growth of 33%, derived via 52 week standard deviation of market price, whilst LKR272.7 is based on the maximum appreciation during Past 52 weeks.

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