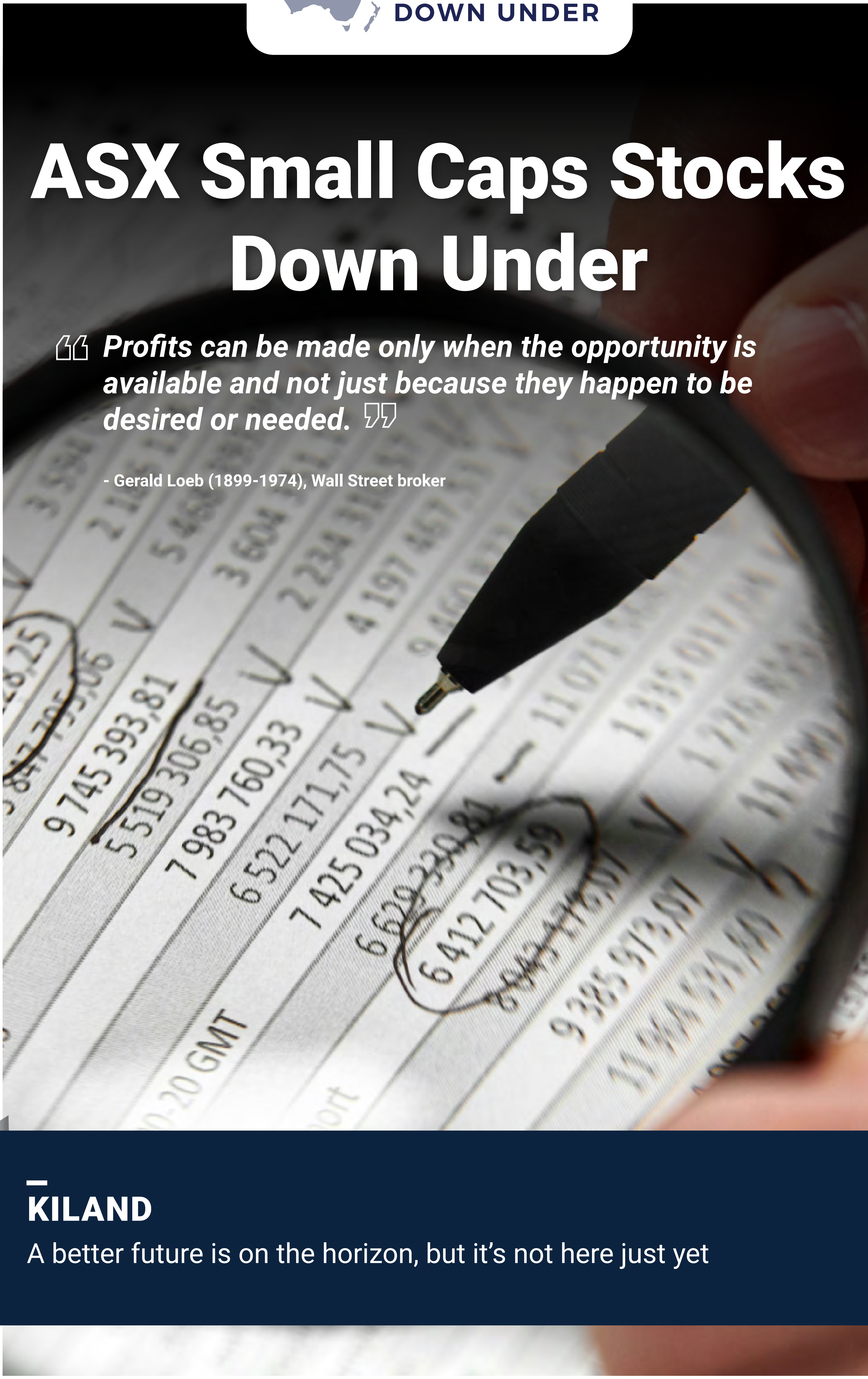
STOCKS DOWN UNDER

17 JUNE 2022



ASX Small Caps Stocks Down Under

> *Profits can be made only when the opportunity is available and not just because they happen to be desired or needed.*

- Gerald Loeb (1899-1974), Wall Street broker

KILAND

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Stocks Down Under rating: ★★

ASX: KIL
Market cap: A$98.3M

52-week range: A$1.09 / A$1.46
Share price: A$1.30

Remember Kangaroo Island Plantation Timbers? More than two years on from the tragic bushfire that wiped out its plantation, the company is still on Kangaroo Island. But it has reverted from forestry to agriculture and arguably has a brighter future now. But it will take some more time and patience by its management and shareholders to reach the promised land.

Share price chart

Source: Tradingview

The ASX's worst victim of the 2019-20 Black Summer

For investors who have forgotten, Kangaroo Island was hit by bushfires in the summer of 2019-20 with over 90% of its plantation destroyed. Kiland did not escape and was forced to substantially write-down its asset and spend several weeks in voluntary suspension. Obviously, shares sunk when the company resumed trading even though it was after the Corona Crash. And unfortunately for shareholders, the setbacks were not over.

Kiland conceived plans to build a port at Smith Bay to export wood pellets overseas, but this was rejected by the South Australian government on environmental grounds. By being out of its original business, it missed out on the home building and renovation booms that saw lumber prices rocket to all-time highs. By mid-2021, lumber prices were over 400% higher than 12 months prior at US$1,480 per thousand board feet. Now they have retreated to $600, but this is still ahead of the pre-Corona Crash level of $368.42 in February 2020. Kiland received two takeover bids in 2021; first a $20m offer for its land assets, then a Samuel Terry Asset Management offer for the entire company, but the board rejected them both.

The tide is turning

But there has been some good news too. The company finally received an insurance payout for the fires last month, coming in at $3.5m. The 60,000 tonnes of wood remaining will be shipped off Kangaroo Island in the next few years to provide timber for homes, in a project funded by the state and federal governments.

And most importantly, Kiland appears to finally have settled on a new use for its land. The company plans to use its properties for livestock grazing. This industry was likewise hurt by the Kangaroo Island fires, but to a lesser extent – only about 10% of stock was lost. If Kiland's plan went ahead, this would increase the island's flock by 50%. Kiland hopes to sustain 270,000 dry sheep equivalent capacity by 2026. Of course, there is a lot to be done before then. It has to harvest and grind the trees as well as repurpose the land for these livestock.

Too expensive considering where it's at

It is difficult to value this company given the lack of peers in the lamb space and the fact that it is essentially a pre-revenue company now. The closest comparable company is Duxton Broadacre Farms (ASX: DBF), which grows crops and livestock (including lamb). This company is profitable and has gained 18% so far in 2022, but it expects FY22 revenue and earnings to fall 60-70% from FY21 due to unfavourable weather conditions.

Wellard (ASX: WLD) is another, but it is focused on beef and exports rather than the growth of livestock and ownership of farmland. Both companies depict that if Kiland can realise its ambitions, it can be a profitable operation albeit vulnerable to agricultural conditions and commodity prices.

However, we can make some general observations about Kiland's current valuation. Currently, Kiland is trading at a discount of over 20% to its net tangible assets (at $1.53 a share). But considering it has valued its land at $50m and is capitalised at $86m, it's not necessarily the case that you're getting it on the cheap. This is especially true when you consider it will need to meet further land development costs of $65m and extra costs of $26m for heavy machinery, stock and initial operating expenses. The company has made progress towards meeting these costs, raising $40.1m in a recent rights issue, but there is more capital to be raised. We also observe that Kiland is trading at 68.1x EV/Revenue. This would be high for Tech companies pre the current market crunch, but it is particularly high for an agricultural company with its main source of revenue having been insurance payouts and the occasional government grant.

We would love to see this company get back up on its feet for the sake of its long-suffering shareholders. We take confidence in how its management have rejected multiple takeover bids. But unfortunately, we cannot justify Kiland's current valuation considering where the company is currently at. Namely, as a pre-revenue company that has big ambitions, but lacks the funding required to realise it as well as even a general timeframe for achieving them. Nor can we give it the benefit of doubt at this stage in light of supply chain issues that are impacting many ASX companies. So, it's two stars for now.

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