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Olam International: Strong Sell
September 2, 2013

Director of Research: Carson C. Block, Esq.

Not Changing the Old Ways

We continue to believe that, in a world where capital is allocated to maximize economic efficiency, Olam's shares have no value. The Company has simply borrowed too much money, and then invested in projects that will not generate sufficient returns to repay its debt obligations. In this note, we will only briefly comment on Olam's FY 2013 results. (Numerous analysts have already done so.) Instead, we will focus on qualitative points that cause us to believe Olam is not really turning over a new leaf.

Olam's FY 2013 results display the pathologies we noted in November 2012:

- Adjusted return on average assets was only 1.8%. (We adjusted net income to S$261.8 million by excluding from Olam's operational profit after tax all biological gains and changes in measurement of derivatives.[1] For an explanation of how and why we make adjustments to Olam's net income, see our initial report dated November 26, 2012.)

- Allowance for doubtful accounts more than halved from S$22.6 million to S$9.6 million, which made FY 2013 a less unfavorable a comparison to FY 2012.

- Inventory write-downs were only S$115,000, versus S$15 million last year, which also made FY 2013 a less unfavorable comparison to FY 2012.

- Free cash burn was S$800.4 million, and Olam spent S$1.1 billion on acquisitions and investments in FY 2013.

The big picture issue is that we are skeptical Olam will operate differently in the future.

- There have been no changes to the board since our initial report. This board had been complacent, at best, as Olam went on its borrowing and spending binge. It was evidently more concerned with the messenger than the message when we first spoke critically of the Company.

  Olam's board has ossified. The average tenure of Olam's independent directors is 11.4 years. Olam's IPO was only eight years ago. Only one independent director

[1] We do not ignore asset impairment charges because we see these as a likely understated, and recurring function of Olam's business.

has been appointed since Olam's IPO, and that was five years ago. These gentlemen have become too vested in Olam's mistakes to deal with them effectively.

- CEO Sunny Verghese said nothing during the call, which might be interpreted as the Company transitioning to a future without Mr. Verghese. However, what would really change if Mr. Verghese were no longer CEO? Olam has a tightknit – probably insular – core of top managers who have worked together for many years. Were the Company's new leadership to come from the existing pool of top management, which seems to lack diversity of views, what would really change?

- Olam continued to essentially invent its own performance metrics in a continuation of past less-than-best practices. For the FY 2013 results, Olam altered its definition of free cash flow, thereby excluding cash interest, taxes, and certain working capital account changes. (Our initial report explains the irrelevance of Olam's invented gross and net contribution metrics.)

- Olam was asked what its average cost of debt is, and Mr. Anatharaman did not answer the question with any specificity.

- *More birds in the bush are better than one in the hand*. Olam steadfastly refuses to provide real transparency into the Gabon fertilizer project. Reading between the lines, Tata Chemicals ("TCL") is highly unlikely to participate in the project. Rather than acknowledging this, Olam stated that it is happily looking for more possible partners who are willing to buy in (so that Olam can sell down). We believe the reality is that TCL no longer views the project as attractive (if it ever did). Our recommendation is that Olam fall on the sword, admit to investors it wasted significant money on dredging, and terminate the project.

- This brings up perhaps the most significant point: Despite Olam's new strategic plan that calls for capital spending to be curtailed (notwithstanding the Company responding to our initial criticism by defiantly pledging to increase capex and investment), Olam has not admitted having had a problem. In other words, the Company has not acknowledged that it made a number of investments that will not "gestate" into returns in excess of their costs. It is well settled that the road to any recovery begins with an acknowledgement that a problem exists. We have yet to hear anything of this sort from Olam. Investors really need to understand *why* this problem exists, and how the Company proposes to fix it. Lacking this transparency, investors have no basis to form opinions as to whether the Company is likely to improve its performance.