

18 March 2019 | Green Conference Special Report

## Growing sustainability practices

*Addressing the myth and challenges of the Plantations sector*

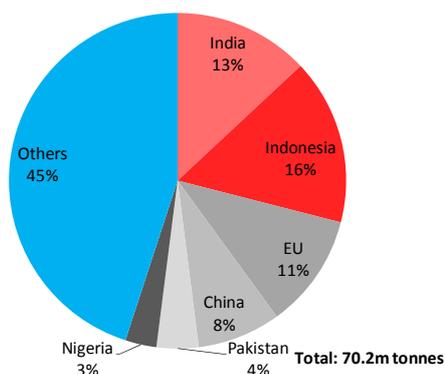
### KEY HIGHLIGHTS

- Increasing consumption of palm oil continues to be met with setbacks and backlash
- Palm oil is cheaper, better and more environmental-friendly as compared to its peers
- On-going sustainability initiatives and practices in place to rebuild the image of palm oil
- Government and industry taking a more proactive approach and implement offensive strategy on educating the masses
- Maintain NEUTRAL view on the sector

### FACING THE PRESSURE AMID RISING CONSUMPTION

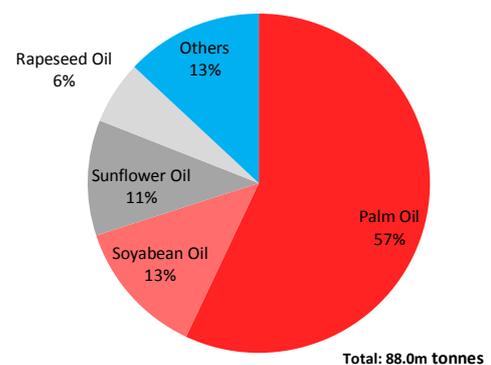
**Palm oil consumption on the rise.** Global consumption of palm oil rose from 14.6m tonnes in 1995 to 70.2m tonnes in 2018, making it the most consumed oil in the world. Palm oil's versatility and affordability has allowed it to be found in more than 50% of supermarket products ranging from foods, household and beauty products, as well as feedstock for the growing biodiesel demand. The main consumers of palm oil are Indonesia, India, European Union (EU) and China. In 2018, they accounted for a combined 48.0% of global palm oil consumption. Meanwhile, in terms of production, Malaysia and Indonesia together produced about 84% of global palm oil production.

**Chart 1: Global Palm Oil Consumption (2018)**



Source: Oil World, MPOB, MIDFR

**Chart 2: Global Palm Oil Export (2018)**



Source: Oil World, MPOB, MIDFR

**Constant uphill battle.** Palm oil has always been portrayed as the main driver of biodiversity loss, deforestation, endangerment of wildlife habitat (e.g. orangutans), destruction of livelihoods of rural communities, loss of high conservation value areas, peat lands and greenhouse gases (GHG) emission as compared to other competing vegetable oils. International media, non-profit organizations and governments globally have been condemning and protesting against the use of palm oil in their respective countries' products. This issue is more conspicuous in environmentally-sensitive countries, particularly in EU. Initially, the Amsterdam Declaration (2015) lobbied for 100% certified sustainable palm oil (CSPO) imports into EU by 2020. However, following which, the EU Renewable Energy Directorate II (RED II) calls for the phase-out of palm oil-based biofuels by 2030 with France proposed to ban palm oil by 2020. Norwegian sovereign fund has also stopped financing 33 companies dealing in palm oil. On the another note, the Roundtable on Sustainable Palm Oil's (RSPO), the global standard for sustainable palm oil, influence has been on the rise since its formation in 2004.

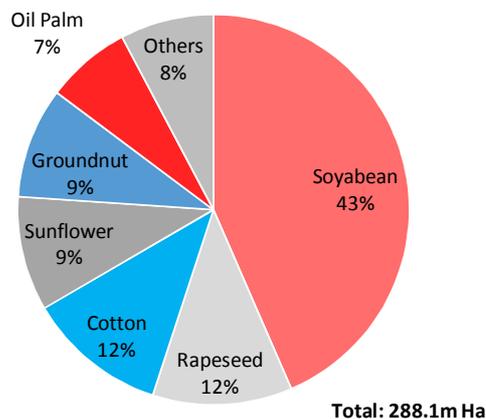
**Integral part of Malaysia's economy.** Palm oil has always been a major contributor to Malaysia's economy. In 2018, it accounted for 50.8% to RM25.5b agricultural sector in Malaysia. With EU as the second largest importer of Malaysian palm oil, the ban will undoubtedly affect the livelihood of approximately 650k smallholders and 3.0m people who depended on the palm oil industry. Moreover, the process of obtaining the CSPO status has also been adding pressure on the profitability of our local planters. For instance, in April 2016 (i.e. 4QFY16), IOI Corporation Bhd's financial performance has been severely impacted as its sustainable palm oil was suspended by RSPO. Due to the suspension, the group's major customers such as Nestle, Unilever, Kellogg and Mars ceased the trade activities. This led a loss-making 4QFY16 of -RM59.0m as compared to a profit for RM112.7m as at 4QFY15.

## DISPELLING THE MYTHS

**Oil palm, the higher yielding crop.** In 2018, despite oil palm accounted for a mere 7.0% of the total oilseeds harvested area but it has the highest production of 32.0% of the total oils and fats production (refer to Chart 3 and 4). In comparison, soybean, its closest substitute, has the highest share of harvested area of 43.0% and produced less than that of oil palm as depicted in Chart 5. The chart illustrates that soybean need nine times more land as compared to oil palm to produce the same quantity of oil.

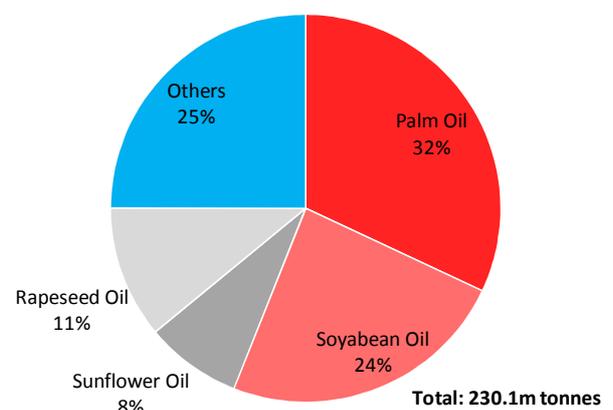
**Lower cost and better CO2 absorbent.** As compared to diesel, palm oil-based biodiesel produced 62.0% less CO2 and is the most effective carbon absorbent among other vegetable oils crop. Cultivation of oil palm also requires the least fertilizer and pesticides as well as shown in Chart 7, making it far cheaper and better than other oilseeds. Thus, it would require much larger areas of cultivated land should to produce palm oil alternative, leading to even greater species loss, deforestation and carbon emissions.

**Chart 3: Global Oilseeds Harvested Area (2018)**



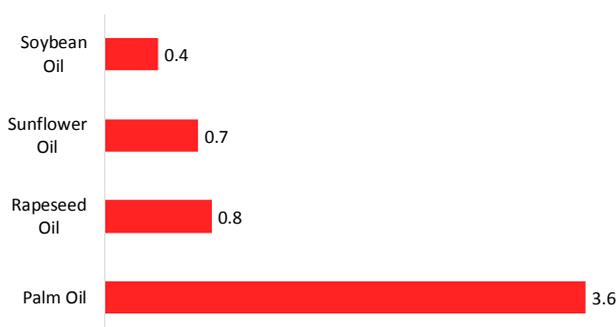
Source: Oil World, MPOB, MIDFR

**Chart 4: Global 17 Oils and Fats Production (2018)**



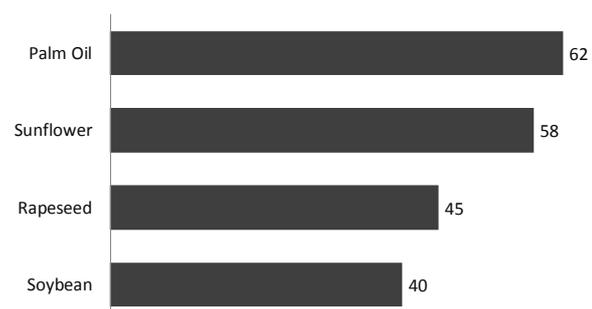
Source: Oil World, MPOB, MIDFR

**Chart 5: Oil Yield (MT/Ha)**



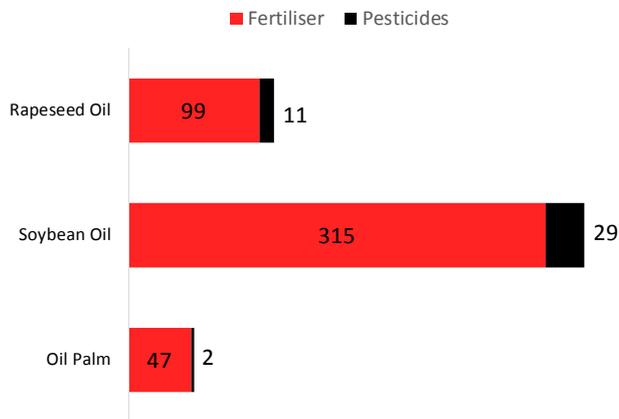
Source: Oil World, MPOB, MIDFR

**Chart 6: Co2 reduction as compared to diesel (%)**



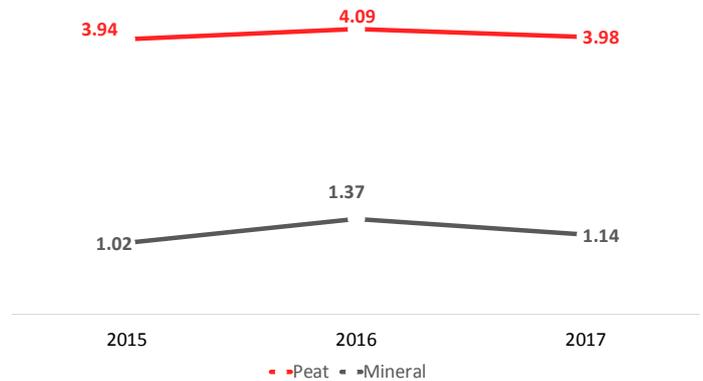
Source: GAPKI, MIDFR

**Chart 7: Fertiliser & Pesticide Usage (kg/MT oil produced)**



Source: Sime Darby, MIDFR

**Chart 8: Annual Average Emissions Intensity (tCO2e/tCPO)**



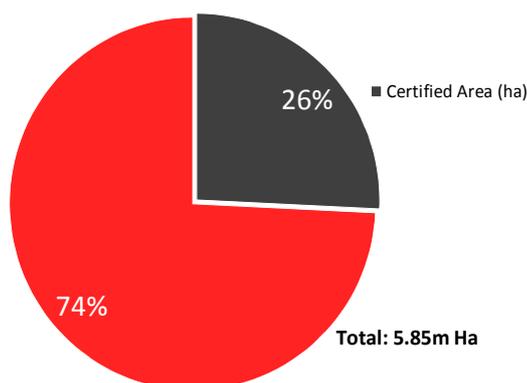
Source: RSPO, MIDFR

## STATUS OF MALAYSIA'S PALM OIL SUSTAINABILITY

**Towards global standard.** According to RSPO, 19.0% of global palm oil produced which is approximately 13.6m tonnes, is CSPO certified (refer. which amounted to about 13.6m tonnes as shown in Chart 13). Malaysian oil palm land area that have been certified by RSPO is approximately 1.0m ha, accounting for about 30.0% share of the total RSPO certified land size of 3.18m ha globally. This indicated that Malaysia's efforts in producing sustainable palm oil that is in line with the global standard. Note that both EU and North America committed to fully source for 100% CSPO. Meanwhile, India, China and Indonesia are seeking to source at least 30.0%, 10.0%, and 50.0% of CSPO respectively by 2020.

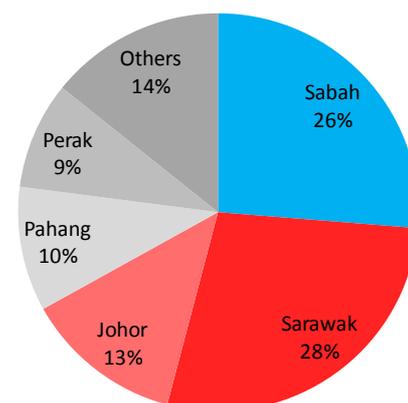
**Embarking on national standard.** To recall, the Malaysian Sustainable Palm Oil (MSPO) national certification scheme was launched in 2015. It is currently managed by Malaysian Palm Oil Certification Council (MPOCC) to ensure all oil palm groups can be sustainably certified and as a means to promote image, increase productivity and traceability for Malaysian palm oil. MPOCC has provided certification to over 1.5m ha as of February 2019 from just 0.1m ha back in 2015 (refer to Chart 11). This currently accounted for 26.0% of the total oil palm area which mainly consist of Sabah, Sarawak and Johor (refer to Chart 10). Moving forward, the target is to achieve 100.0% of oil palm entities to be certified by end of 2019 as shown in Table 1.

**Chart 9: Total Malaysia Oil Palm Land (Feb 2019)**



Source: MPOCC, MIDFR

**Chart 10: Total Certified Malaysia Oil Palm Land (Feb 2019)**



Source: MPOCC, MIDFR

**Incentivising the adoption of MSPO.** The Malaysian government has announced financial supports to be given to all oil palm entities for adopting the MSPO certification. The savings will come in the form of reduced audit cost as shown in Table 2. As circa 40.0% of the total oil palm growers are small holders, the Government has set aside RM130.0m to help them to obtain the certification.

**Table 1: Timelines for Mandatory MSPO Certification**

Deadline to Obtain MSPO by:	Stages needed for Mandatory MSPO Certification
31 December 2018	With certification (e.g. RSPO, ISCC) for all estates and processing
30 June 2019	Without any certification for all estates and processing
31 December 2019	All independent and organized smallholders

Source: MPOCC, MIDFR

**Table 2: Financial Incentives for MSPO Certification**

Entities	MSPO auditing fee covers Stage 1 and Stage 2 audits
Small holders <40.46 ha	100%*
Estates 40.46 ha – 1,000 ha	70%
Estates > 1,000 ha	30%
Processing facilities (Mills, Kernel Crushers, Refineries)	30%

Source: MPOCC, MIDFR

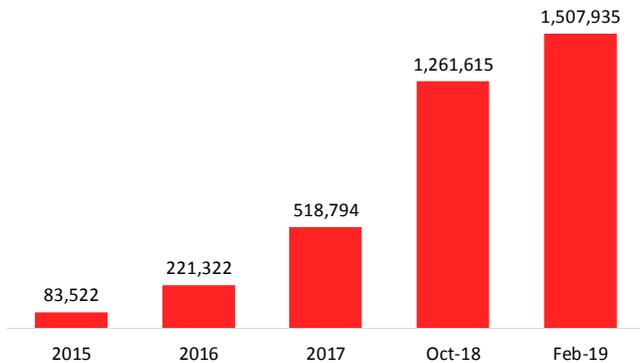
\*Includes cost of stores for pesticides and fertilisers, Personal Protective Equipment (PPE), training and documentation

**Commitment to preserve forested area.** The Malaysian government is committed to maintaining its pledge during the 1992 UN Rio Earth Summit of preserving at least 50% of its total land mass as natural forest cover. All the oil palm areas in the Malaysia are undertaken in the land areas which are earmarked as land banks for agriculture under state or alienated land and not on forest reserve, according to Primary Industries Minister Teresa Kok. Forestry departments already using satellite imageries and digital mapping and have their own Geographical Information System (GIS) such as Light Detection and Ranging as well as Hyperspectral system to facilitate the agencies in carrying out their duties in managing and monitoring their forested area.

**Land expansion cap.** The Ministry of Primary Industries has proposed to put a cap on the expansion of oil palm plantations in Malaysia at 6.5m ha by 2023, from current 5.8m ha in 2018. Peat lands, which produce higher average emissions intensity (*refer to Chart 8*), will inevitably be capped, especially in Sabah and Sarawak. This is seen to appease the negative sentiments of palm oil as a cause of deforestation. Moving forward, the focus in the industry will be on improving seedlings and yields of our oil palm planting. In addition, the Ministry also seeks approval from the Cabinet to open up Malaysian oil palm plantation maps to stakeholders to enhance transparency of planted areas.

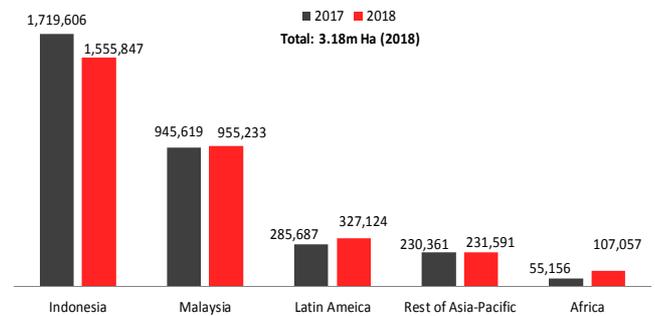
**Biodiversity conservation.** The establishment of Malaysian Palm Oil Wildlife Conservation Fund (MPOWCF) in 2006 was a joint effort between the Government and the industry to conserve biodiversity in Malaysia through sustainable means. It was launched with an initial funding of RM20.0m, which is equally sponsored by the Government and the industry. The fund, which is administered by Malaysian Palm Oil Council (MPOC), is utilise to fund the various conservation projects in Malaysia. A few notable projects included the "Orang Utan Island", "Orang Utan Conservation Colloquium", "Wildlife Rescue Centre", and initiatives that monitor and act against poaching of protected wildlife.

**Chart 11: Malaysia Certified Oil Palm Area (ha) (2015-Feb 2019)**



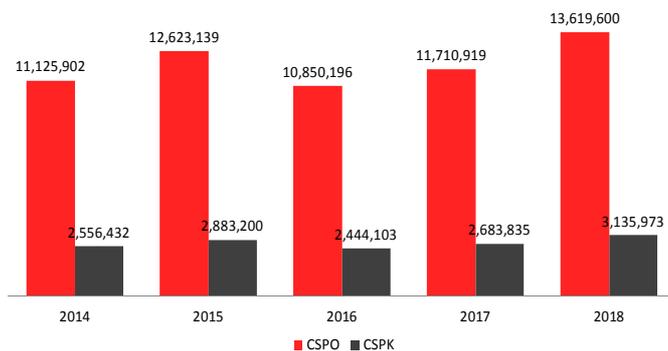
Source: MPOCC, MIDFR

**Chart 12: Certified Oil Palm Area by RSPO**



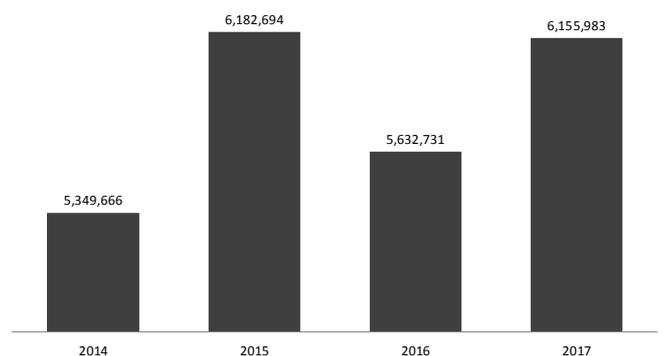
Source: RSPO, MIDFR

**Chart 13: Annual Certified Production of CSPO and CSPK (MT)**



Source: RSPO, MIDFR

**Chart 14: Annual Sales of CSPO (2014-2017) (MT)**



Source: RSPO, MIDFR

## CONCLUSION

**Effort made; not yet reciprocated.** The global consumption of vegetable oil continues to grow. To meet the escalating demand and minimise unwanted repercussion on the environment, we view that palm oil is the most suited oil to be produced mainly due to its high-yielding properties. However, due to discriminatory action, the palm oil industry has been put in a bad light as compared to its peer. Comprehending the situation, the Government and the industry has been actively dispelling the myths. This includes adherence to the green practices as guided by RSPO as well as educating the masses on the actual facts and figures. We view that the move would indirectly aid palm oil companies in getting the well-deserved price premium of approximately US\$30/ton for observing the various "green" requirements set by RSPO. Premised on the uphill battle that the industry stakeholder is facing, we are maintaining our **NEUTRAL** view on the sector. 

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BUY	Total return is expected to be >10% over the next 12 months.
TRADING BUY	Stock price is expected to <i>rise</i> by >10% within 3-months after a Trading Buy rating has been assigned due to positive newsflow.
NEUTRAL	Total return is expected to be between -10% and +10% over the next 12 months.
SELL	Total return is expected to be <-10% over the next 12 months.
TRADING SELL	Stock price is expected to <i>fall</i> by >10% within 3-months after a Trading Sell rating has been assigned due to negative newsflow.

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POSITIVE	The sector is expected to outperform the overall market over the next 12 months.
NEUTRAL	The sector is to perform in line with the overall market over the next 12 months.
NEGATIVE	The sector is expected to underperform the overall market over the next 12 months.