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MALAYSIA EQUITY



# **THE PALM REPORT**

**DECEMBER 2013 STATISTICS**

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FOR IMPORTANT DISCLOSURES**

# Review & Outlook of Plantation Sector



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**Lower production softened the rise in inventory**

**Maintain POSITIVE**

## HIGHLIGHTS

- *CPO production in December fell by -10.4%mom and -6.4%yoy to 1.67mmt. For 2013, production was higher by 2.3% compared to 18.8mmt recorded in 2012.*
- *Exports in December also declined -1.4%mom and -8.6%yoy to 1.51mmt. Nonetheless, palm oil exports in 2013 were still higher at 18.1mmt compared to in 2012.*
- *Due to the weaker export in December, the ending stock for 2013 increased slightly to 1.99mmt and brought SUR higher at 9.8%.*
- *The weaker export numbers perturbed the market which resulted in the ensuing selloff. CPO price closed at RM2,498pmt last Friday, which is the lowest since mid-Dec last year.*
- *Based on historical trend, we expect exports in January and February to be sequentially weaker. However, we expect total exports to strengthen year-on-year supported by better world's economic conditions in 2014. Therefore, we are maintaining our POSITIVE view on the plantation sector with average CPO price forecast of RM2,700pmt, 13.9% higher than the average CPO price in 2013.*

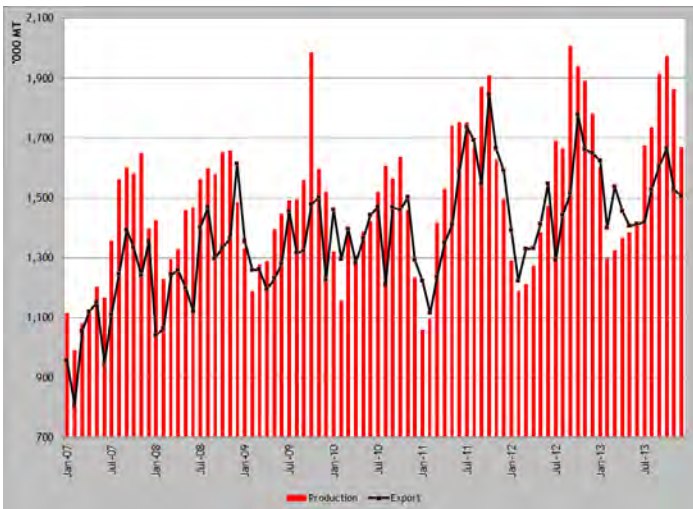
## A. REVIEW ON DECEMBER 2013 STATISTICS

**Production in December dropped on heavy rains.** CPO production in December 2013 declined by -10.4%mom and -6.4%yoy to 1.67mmt. Heavy rainfalls and floods complicate FFB harvesting process which resulted in lower FFB yield of 1.67mt/ha compared to 1.85mt/ha in December 2012. Nonetheless, for the whole year, total CPO production stood at 19.2mmt, +2.3% higher compared to total production in 2012.

**Lower purchases from India dragged exports lower.** Total exports in December 2013 declined -1.4%mom and -8.6%yoy to 1.51mmt. This was attributable to lower purchases from India (-22.0%yoy), Pakistan (-57.7%yoy) and USA (-9.7%yoy). On the other hand, palm oil exports to China and EU countries increased 3.7%yoy and 50.7%yoy to 361,793mt and 240,561mt respectively. Despite a measured economic recovery in USA and Eurozone as well as a slowdown in China, the total palm oil export in 2013 remained robust at 18.1mmt, +2.9% higher compared to in 2012.

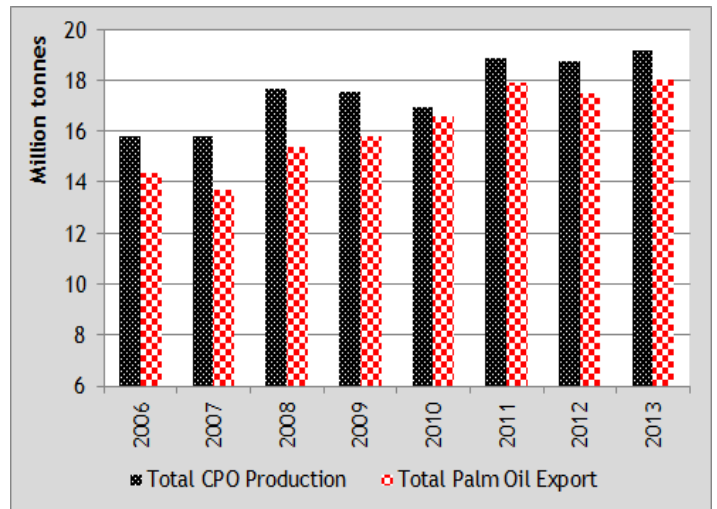
**Inventory inched up on weaker export.** Despite a lower production season, weaker export numbers in December resulted in higher inventory at 1.99mmt. The higher inventory has led stock-to-usage ratio to rise to 9.82% from 9.45% in November 2013.

Figure 1: Monthly CPO production and export



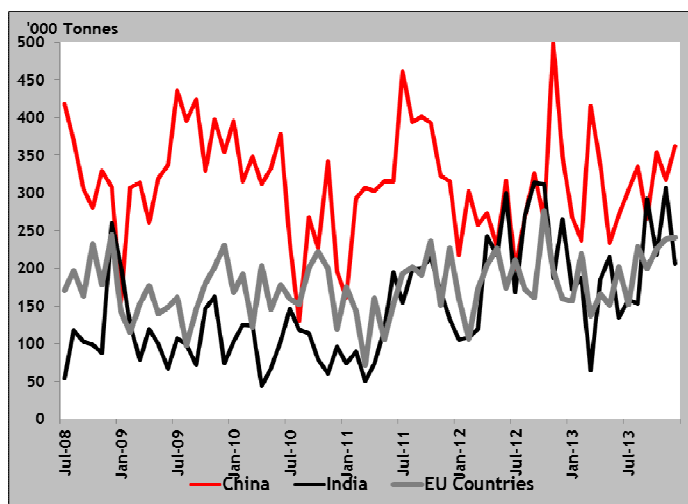
Source: MPOB, MIDFR

Figure 2: Total production & export, 2006-2013



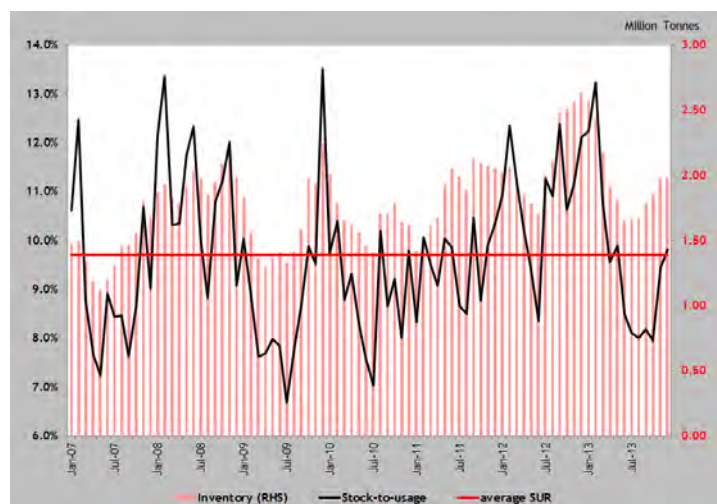
Source: MPOB, MIDFR

Figure 3: Palm oil exports to China, India & EU



Source: MPOB, MIDFR

Figure 4: Inventory and stock-to-use ratio (SUR)



Source: MPOB, MIDFR

## B. SUPPLY OUTLOOK

**Weather will remain neutral.** According to the Australian Bureau of Meteorology (ABM), since mid-2012, the tropical Pacific has remained neutral with respect to the El Niño-Southern Oscillation (ENSO). The latest indicators show (see Table 1) that there is no likelihood for El Niño or La Niña to occur in the immediate term. The ABM added that this neutral ENSO phase would be in neutral territory for approximately two years.

**Low production expected to continue in the next two months.** However, for Malaysia, the northeast monsoon season is expected to prolong until early March. Hence, we expect the low output cycle to continue in January and February with CPO production to be within the range of 1.1mmt to 1.3mmt per month. Total production was quite stable during the past three years (see Fig. 2), but however, as far as tree biological cycle is concerned, we do not discount the likelihood of tree stress event this year. This will limit the rise in inventory and help CPO price to stabilize.

Table 1: ENSO Indicators

Indicator	Latest anomaly (as of 31 <sup>st</sup> Dec 2013)	Note
i. Southern Oscillation Index (SOI)	+0.6 <sup>*</sup>	SOI gives an indication of the development and intensity of El Niño or La Niña events in the Pacific Ocean.  Sustained positive SOI values above about +8 indicate a La Niña event while sustained negative values below about -8 indicate an El Niño.
ii. Sea Surface Temperature (SST)	+0.0°C <sup>^</sup>	Neutral state is within -0.5°C to +0.5°C.
iii. Indian Ocean Dipole (IOD) Index	-0.3°C <sup>^</sup>	Positive IOD events are often associated with El Niño and negative events with La Niña.

\* 30-day value

<sup>^</sup> Weekly value

Source: Australian Bureau of Meteorology (ABM)

## C. DEMAND OUTLOOK


**Higher Indian import duty.** Last week, India announced an increase in their import duties on refined edible oils, including palm oil, to 10% from 7.5%. The hike was meant to protect its local refiners against cheaper imported supplies. The move taken by India may result to lower purchases of palm refined products from Malaysia. On the flip side, higher duty on refined edible oils also could shift demand to crude palm oil (CPO). We believe the shift in demand preference will benefit Malaysian exporters as the country charges a lower duty on CPO exports compared to Indonesia.

## D. CPO PRICE OUTLOOK & RECOMMENDATIONS

**Outlook on CPO price.** For the past few weeks, the movement in CPO price was quite volatile. Last Friday, CPO price tumbled from RM2,522pmt to RM2,498pmt. We believe this was mainly attributable to the weaker export numbers released by MPOB. Based on historical trend, we expect exports in January and February to be sequentially weaker. However, we expect total exports to strengthen year-on-year supported by better world's economic conditions in 2014.

**Maintain POSITIVE.** We are maintaining our POSITIVE view on the plantation sector. In the next 3 months, we expect CPO price to remain sideways within RM2,400pmt to RM2,600pmt range. For the full year, we expect CPO price to average at RM2,700pmt, 13.9% higher than the average CPO price in 2013.

**Valuation to revert back to normal levels.** The expectation of better CPO price in 2014 drove the share prices of most plantation stocks higher during the past several months. Consequently, the prevailing share prices imply a higher PER multiple of 25 to 30 times, which in our opinion is too high for the industry. Furthermore, we had imputed the expectation of better CPO price in our earnings forecasts thus we do not foresee any upward surprise in earnings going forward. We expect the PER multiple to revert back to the normal industry average of about 16 to 20 times in the coming years.

**Stock recommendations.** Our top picks for the plantation sector are Sime Darby (BUY, TP:RM10.80), TH Plantation (BUY, TP:RM2.10) and Felda Global Ventures (TP: RM5.20). We also continue to recommend NEUTRAL calls on the remaining stocks under our coverage, namely KL Kepong (TP: RM21.40), IJM Plantations (TP: RM2.90), Kulim (RM3.70), TSH (TP: RM2.50), IOI Corp (under review, TP: RM5.67), Genting Plantations (TP: RM9.50) and Ta Ann Holdings (under review, TP: RM3.87). 

## MPOB Palm Oil Statistics (Tonnes)

	Dec-12	2013				2012	2013	
		Nov-13	Dec-13	m-o-m	y-o-y	Jan - Dec	Jan - Dec	y-o-y
Opening Stock	2,565,745	1,845,936	1,977,895					
Production	1,780,153	1,861,084	1,667,003	-10.4%	-6.4%	18,785,030	19,214,794	2.3%
Imports	87,224	14,859	24,574	65.4%	-71.8%	1,391,013	555,776	-60.0%
Exports	1,650,192	1,528,281	1,507,554	-1.4%	-8.6%	17,575,487	18,087,095	2.9%
Consumption	155,511	215,703	176,703	-18.1%	13.6%	2,031,537	2,325,679	14.5%
Closing Stock	2,627,419	1,977,895	1,985,215	0.4%	-24.4%	1,977,895	1,985,215	0.4%

Source: MPOB

## Major Palm Oil Exports Destinations (Tonnes)

	Dec-12	2013				2012	2013	
		Nov-13	Dec-13	m-o-m	y-o-y	Jan - Dec	Jan - Dec	y-o-y
China	348,740	317,378	361,793	14.0%	3.7%	3,501,677	3,699,575	5.7%
EU Countries	159,581	238,750	240,561	0.8%	50.7%	2,220,899	2,316,327	4.3%
Pakistan	156,974	64,181	66,427	3.5%	-57.7%	1,346,933	1,428,877	6.1%
India	264,645	306,837	206,304	-32.8%	-22.0%	2,607,205	2,292,507	-12.1%
USA	88,167	78,462	79,634	1.5%	-9.7%	1,029,402	1,076,814	4.6%
Bangladesh	22,834	9,422	17,294	83.5%	-24.3%	273,262	442,055	61.8%

Source: MPOB

## CPO Output by Region (mt)

	Dec-12	2013				2012	2013	
		Nov-13	Dec-13	m-o-m	y-o-y	Jan - Dec	Jan - Dec	y-o-y
Peninsular Malaysia	916,057	987,124	839,020	-15.0%	-8.4%	10,319,774	10,328,025	0.1%
Sabah	599,107	566,102	549,590	-2.9%	-8.3%	5,542,649	5,776,459	4.2%
Sarawak	264,989	307,858	278,393	-9.6%	5.1%	2,922,607	3,110,310	6.4%
<b>Total</b>	<b>1,780,153</b>	<b>1,861,084</b>	<b>1,667,003</b>	<b>-10.4%</b>	<b>-6.4%</b>	<b>18,785,030</b>	<b>19,214,794</b>	<b>2.3%</b>

Source: MPOB

## Daily CPO Price Chart



Source: Bloomberg

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#### STOCK RECOMMENDATIONS

BUY	Total return is expected to be >15% over the next 12 months.
TRADING BUY	Stock price is expected to <i>rise</i> by >15% within 3-months after a Trading Buy rating has been assigned due to positive newsflow.
NEUTRAL	Total return is expected to be between -15% and +15% over the next 12 months.
SELL	<i>Negative</i> total return is expected, by -15% or more, over the next 12 months.
TRADING SELL	Stock price is expected to <i>fall</i> by >15% within 3-months after a Trading Sell rating has been assigned due to negative newsflow.

#### SECTOR RECOMMENDATIONS

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.