

22 November 2017 | Sector Update

PLANTATION

Maintain POSITIVE

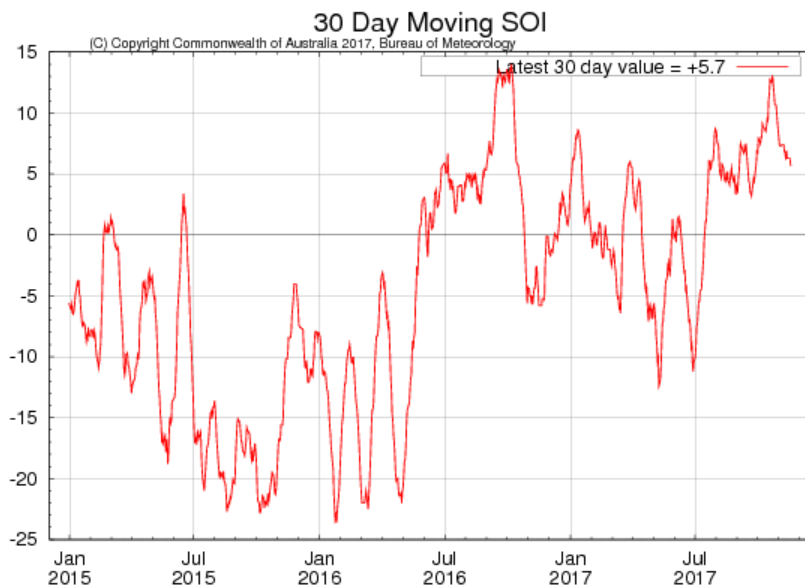
70% of La Niña by year end

KEY HIGHLIGHTS

- **70% of La Niña to happen by year end**
- **Palm oil production to be affected slightly**
- **Upside for CPO is at RM2900 to RM3100 per tonne if weak La Niña materializes**
- **Maintain our contrarian bullish view on plantation**
- **Top pick is IOICORP**

70% of La Niña to happen by year end. Australia Bureau of Meteorology has activated its La Niña ALERT (from WATCH) yesterday with 70% chance (previously 50%) of La Niña forming in late 2017. According to ABM, “The tropical Pacific is approaching La Niña thresholds. If the current progression continues, and thresholds are exceeded for a sustained period, 2017–18 will be considered a La Niña event. As a result, the Bureau’s ENSO Outlook has been raised to La Niña ALERT meaning there is approximately a 70% chance—or triple the normal likelihood—of La Niña occurring. Climate models suggest that any event is likely to be weak and short-lived.”

Chart 1: Southern Oscillation Index



Source: Australia Bureau of Meteorology

Palm oil production to be affected slightly. If La Niña is confirmed, we expect excessive rains in Malaysia and Indonesia which usually cause flood. The production in flood prone states may be affected. Overall, the news is slightly positive to palm oil price but the magnitude of impact will depend on the whether La Niña eventually materializes and its strength. As the guidance is now for a weak and short lived La Niña (instead of strong one), we have temporary abandon the possibility of palm oil price to surge to RM3500 per tonne.

Upside for CPO is at RM2900 to RM3100 per tonne if weak La Niña materializes. While the impact of weak La Niña is limited on palm oil production, we believe that its impact will be more severe on soybean production in South America. Historically, La Niña has often led to drier planting seasons in South America. The impact to soybean yield will be severe if the dryness happens from December 2017 to February 2018 which is the period where soybeans plant in Brazil need the water most as it will reach its mid to late reproductive stages. Hence, we believe that soybean oil price will appreciate if the weak La Niña materializes between December 2017 and February 2018. Accordingly, palm oil price is expected to increase to the range of RM2900 to RM3100 per tonne depending assuming weak La Niña.


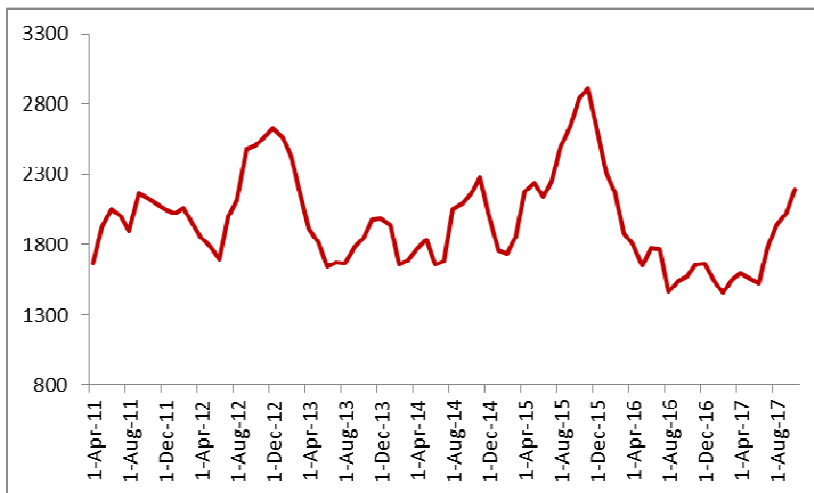
Maintain our contrarian bullish view on plantation. Our contrarian palm oil price estimate of average RM2900 per tonne for 2018 is maintained. For 2017, we expect CPO price to be at RM2825 per tonne. Our top pick for plantation sector is IOICORP. We like IOICORP for three reasons: i) its sale of 70% stake in Loders Croklaan (a low margin business) is likely to result in investment in upstream plantation business which command much better margin, ii) special dividend of 13.0 sen in the next 12 months and iii) substantial improvement in balance sheet after the 70% stake sale in Loders. We also have BUY calls on KLK, GENP, TSH, TAANN and FIMACORP. 

Chart 2: Malaysia palm oil inventory ('000 MT)



Source: Malaysia Palm Oil Board (MPOB)

Table 1: Basis of valuation

Company	TP	Call	Valuation Basis
SIME	9.25	NEUTRAL	SOP with plantation sector @ 26.8x FY18F PE. 26.8x is the higher of IOICORP and KLK Target PE.
IOICORP	5.50	BUY	26.3x Fwd. PE on FY18F earnings reflecting +1.0SD valuation.
KLK	29.65	BUY	26.8x Fwd. PE on FY17F earnings reflecting +1.0SD valuation.
PPB	17.69	NEUTRAL	1.0x Price to Book Value
FGV	1.59	NEUTRAL	1.0x Price to Book Value
GENP	12.60	BUY	SOP with plantation sector @ 24.7x FY17F PE. 24.7x is the lower valuation between IOICORP and KLK.
IJMP	3.15	NEUTRAL	18.6x Fwd. PE on FY18F earnings reflecting mean valuation.
TSH	2.25	BUY	22.3x Fwd. PE on FY17F earnings reflecting mean valuation.
TAANN	4.50	BUY	16.6x Fwd. PE on FY17F earnings reflecting mean valuation.
FIMACOR	2.60	BUY	SOP with plantation sector @ 11.5x FY18F PE. 11.5x is based on 40% discount to average Target PE for mid cap planters.

Source: MIDF Research Estimate

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MIDF AMANAH INVESTMENT BANK : GUIDE TO RECOMMENDATIONS

STOCK RECOMMENDATIONS

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.

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.