

02 August 2017 | Sector Update

PLANTATION**Maintain NEUTRAL*****CPO price to hit RM3,000 per MT?*****KEY HIGHLIGHTS**

- **United States soybean production outlook has deteriorated**
- **Soybean oil price has appreciated**
- **Palm oil production growth on-year in the 2H2017 should be less than 1H2017**
- **Maintain our July-2017 inventory estimate at 1.65m MT**
- **Maintain NEUTRAL at this juncture but CPO price could surge to RM3,000 per MT by year end if dry weather condition in United States continues throughout August**
- **BUY KLK (TP: RM29.25), TAANN (TP: RM4.30) and TSH (TP: RM2.15)**

United States soybean production outlook has deteriorated. Soybean crop condition in the United States has worsened throughout July due to lower than average rainfall and high temperature. As of 31-July 2017, about 41% of United States soybean field were rated either "fair", "poor" or "very poor". This is much worse than only 29% registered during the same period last year. Only 10% of United States soybean field were rated "excellent". We gather that the most affected areas are northern US, parts of the Midwest and Mississippi. Refer Page 2 for the details.

Soybean oil price has appreciated. In July, soybean oil price has increased 5.4% to 35.13 US cents per pound (or USD774 per MT). This is likely to be caused by raising concerns on the potential soybean crop loss caused by the detrimental weather conditions in the United States. We are positive on the increase in SBO as this should lead to higher demand for palm oil as both are commonly used as substitute in the food industry.

Palm oil production growth on-year in the 2H2017 should be less than 1H2017. In Malaysia, palm oil production has improved 15%yoy in the first six months of 2017 to 8.72m MT. The strong growth was due to the recovery in production from a low base in 1H2016 which was affected by the lagged effect of El Nino weather phenomenon. In the 2H2017, we estimate that production growth should weaken to 12%yoy growth to 10.88m MT. All in, Malaysia palm oil production is estimated to recover by 13.2% to 19.60m MT in 2017. As for Indonesia, we expect the production to grow by 11.2% to 35.71m MT. The smaller growth in Indonesia is due to the timing of the recovery from El Nino which has started earlier in 4Q2016 up to most of 2Q2017.

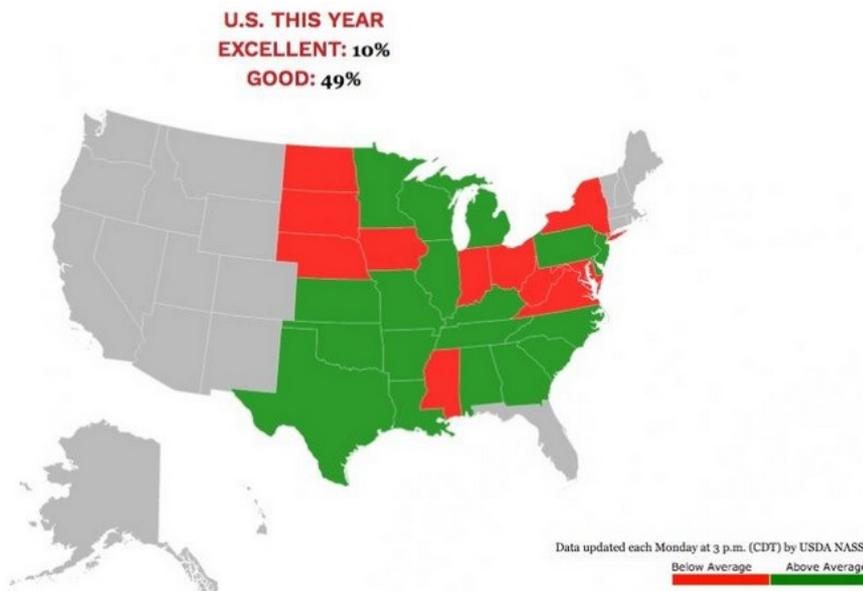
Maintain our July-2017 inventory estimate at 1.65m MT. Although we have estimated stronger production growth on-month for production, we have also increased our export growth outlook hence the unchanged inventory forecast of 1.65m MT. Details of the estimate changes include: i) production increase growth on-month has been increased to 13.5% (from 8%), and ii) export growth is now pegged at 4% (previously a decline of 2%mom).

Maintain NEUTRAL at this juncture but CPO price could surge to RM3,000 per MT if dry weather condition in United States continues throughout August. Our NEUTRAL view on the sector is maintained with average CPO price of RM2,750 per MT for 2017. We believe that there is little downside risk to our estimate as YTD CPO price is RM2,897 per MT and we expect CPO price to be well supported at above RM2,500 per MT throughout 2H2017. We are monitoring the dry weather condition in the United States closely as it could cause significant rise in soybean oil price and hence CPO price as well. If the dry weather condition continues

throughout August (which is the crucial stage for soybean seed yield), we expect the production outlook for United States to deteriorate significantly. In such scenario, CPO price could rise to as high as RM3,000 per MT by end-December due to the rise in soybean oil price as inventory stays well below 2.0m MT and possibly drop to the critical level of 1.40m MT by end-December.

BUY KLK (TP: RM29.25), TAANN (TP: RM4.30) and TSH (TP: RM2.15). We like KLK for the Company earnings resiliency and its good FFB production growth estimated at 8% (highest among index-linked plantation stocks). We also like TSH due to: i) its strong 1QFY17 Core Net Profit which has grown 71%yoy, ii) attractive valuation at close to its -0.5SD level, and iii) its young age profile of ~7.3 years old which should allow them to register better FFB growth in the long run. Lastly, we have BUY call on TAANN as: i) its plantation division earnings growth should remain strong due to high FFB volume expected at 10%, and ii) timber division is expected to remain profitable due to the support from high export logs price.

Picture 1: Soybean Crop Condition in United States



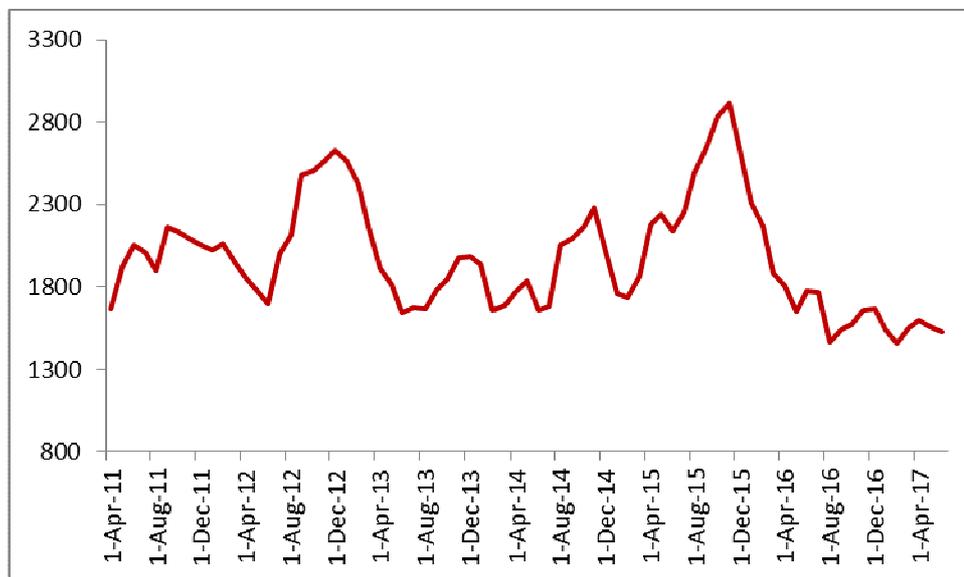
Source: United States Department of Agriculture (USDA)

Chart 1: Soybean Oil Prices in US cents per pound



Source: Bloomberg

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



Source: Malaysia Palm Oil Board (MPOB)

Table 3: Basis of valuation

Company	TP	Call	Valuation Basis
SIME	9.00	NEUTRAL	SOP with plantation sector @ 26.8x FY17E PE. 26.8x is the higher of IOICORP and KLK Target PE.
IOICORP	5.00	NEUTRAL	24.7x Fwd. PE on FY17F earnings reflecting +0.5SD valuation.
KLK	29.25	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	11.55	NEUTRAL	SOP with plantation sector @ 24.7x FY17E PE. 24.7x is the lower valuation between IOICORP and KLK.
IJMP	3.53	NEUTRAL	18.6x Fwd. PE on FY17F earnings reflecting mean valuation.
TSH	2.15	BUY	22.3x Fwd. PE on FY17F earnings reflecting mean valuation.
TAANN	4.30	BUY	16.6x Fwd. PE on FY17F earnings reflecting mean valuation.

Source: MIDF Research Estimate

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MIDF AMANAH INVESTMENT BANK : GUIDE TO RECOMMENDATIONS

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	Total return is expected to be <-15% 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.