

10 March 2016 | Sector Update

PLANTATION*Calm Before The Storm***Maintain POSITIVE****KEY HIGHLIGHTS**

- **Bullish view on CPO price from POC 2016.**
- **Mr. Dorab Mistry CPO price target is between RM2800/MT to RM3200/MT.**
- **Mr. Thomas Mielke CPO price target is between RM2700/MT to RM3000/MT until Jun-2016.**
- **Dr. James Fry CPO price target is RM2750/MT by Jun-2016.**
- **We maintain our view that CPO price should rise to RM3000/MT in 2Q2016 as inventory is expected to drop to the critical level of 1.50m MT.**
- **Maintain POSITIVE view on the sector and our top pick is IOICORP (TP: RM5.40).**

Bullish view on CPO price from POC 2016. Palm and Lauric Oils Price Outlook Conference & Exhibition (POC) ended yesterday with all three world-renowned speakers (Mr. Dorab Mistry, Mr. Thomas Mielke and Dr. James Fry) shared their bullish view on CPO price. Organised by Bursa Malaysia Derivatives, the event is one of the biggest and most followed event in the oil palm plantation industry.

Mr. Dorab Mistry CPO price target is between RM2800/MT to RM3200/MT. The forecast is higher than his previous forecast of CPO price rising to RM2700/MT in 2Q2016 (made at Pakistan Edible Oils Conference on 7-Feb-2016). He mentioned that the severe El Nino impact to palm oil production is "enormous". Hence, global palm oil production should drop 3.0m MT on-year causing overall vegetable oil production to increase only by 0.2m MT on-year. As global demand is expected to increase by 4.5m MT, stocks should be depleted and cause CPO price to appreciate. His key assumptions are crude oil price to range between USD30 to USD50 per barrel, US Fed Reserve should not raise interest rate in 1H2016 and US Dollar has peaked against Ringgit and Rupiah.

Mr. Thomas Mielke CPO price target is between RM2700/MT to RM3000/MT until Jun-2016. He believes that the current El Nino will cause global production to drop by 0.2m MT on-year (against 5-year average annual growth of +3.0m MT). On the demand side, better demand for biodiesel from Indonesia should increase the biodiesel usage to 2.40m MT (from 1.42m MT last year). Lastly, he believes that India trend of increased import of palm oil should continue in 2016.

Dr. James Fry CPO price target is RM2750/MT by Jun-2016. Dr. James Fry believes that global palm oil production could fall by over 2.0m MT this year because of the drought caused by the El Nino weather event (which is the worst since 1997). He also highlighted that production may fall by another 0.4m MT if La Nina occurs in 2H2016. Key assumption behind his forecast is Brent crude oil price of USD35 per barrel.

We maintain our view that CPO price should rise to RM3000/MT in 2Q2016 as inventory is expected to drop to the critical level of 1.50m MT. We believe that Malaysia palm oil inventory should decline all the way to the critical level of 1.50m MT in 2QCY2016. The impact of El Nino is now established and we believe that production will be significantly lower than what it used to be in 1HCY2016. As a result, the CPO discount against soybean oil (SBO) should diminish and we expect CPO to trade on par with SBO. Such a rare phenomenon occurs before in Feb-2011 in which CPO price surge to RM3800/MT as inventory drop to 1.48m MT. Our key assumptions are SBO price to improve slightly to USD725/MT and USD/MYR rate of 4.15. We believe that the current situation of "calmness" in the market due to ample inventory of 2.31m MT as of end-Jan 2016 should end soon. As inventory gets to the critical level of 1.50m MT, the "storm" of acute shortage of CPO in the market is expected to gather strength and CPO price should surge to RM3000/MT.

Maintain POSITIVE view on the sector. Top pick is IOICORP (TP: RM5.40). Our prediction made on 15-Dec-2015 that CPO price should exceed RM2500/MT in 1Q2016 has been accurate so far. We maintain our bullish view on CPO price and expect it to surge higher in 2Q2016 up to RM3000/MT. Our top pick is IOICORP due to: i) the stock is attracting wider investors' interest after it regained its Shariah status on 30-Nov, ii) strong earnings growth of +22%yoy to RM778m in 1HFY16, and iii) its earnings profile has the most pure (100%) exposure to palm oil among the big cap index-linked planters. 

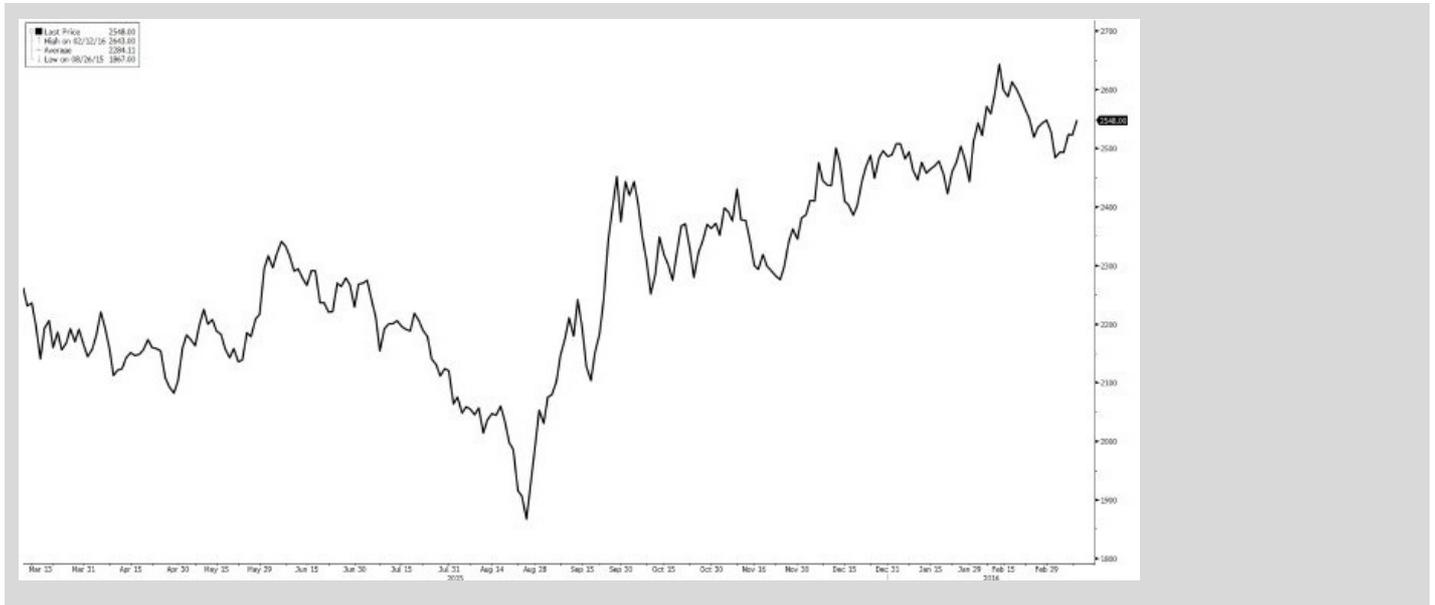
Table 1: Basis of valuation

| Company | TP | Call | Valuation Basis |
|---------|-------|---------|--|
| SIME | 7.30 | NEUTRAL | SOP with plantation sector @ 25.1x FY17E PE. 25.1x is the average of IOICORP and KLK Target PE. |
| IOICORP | 5.40 | BUY | 26.6x Fwd. PE on FY16F earnings reflecting +0.5SD valuation. |
| KLK | 22.50 | NEUTRAL | 23.5x Fwd. PE on FY16F earnings reflecting mean valuation. |
| PPB | 18.20 | NEUTRAL | 21.6x Fwd. PE on FY16F earnings reflecting +0.5SD valuation. |
| FGV | 1.33 | SELL | 1.0x Price to Net Tangible Asset (P/NTA). |
| GENP | 9.53 | NEUTRAL | SOP with plantation sector @ 23.1x FY16E PE. 23.1x is the lower valuation between IOICORP and KLK. |
| IJMP | 3.30 | NEUTRAL | 18.6x Fwd. PE on FY17F earnings reflecting mean valuation. |
| TSH | 2.00 | NEUTRAL | 22.3x Fwd. PE on FY16F earnings reflecting mean valuation. |
| TAANN | 6.50 | BUY | 16.6x Fwd. PE on FY16F earnings reflecting mean valuation. |

Source: MIDF Research Estimate

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Chart 1: CPO price movement



Source: Bloomberg, MIDF Research

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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. |