

11 January 2017 | Sector Update

PLANTATION

Maintain POSITIVE

December inventory is within expectation

KEY HIGHLIGHTS

- **December inventory came in within expectation**
- **Production is down 6% mom but it has increased yoy for the first time in 12 months**
- **Temporary slowdown in demand from China**
- **Expect Jan-2017 inventory to decline 4% mom to 1.60m MT**
- **Maintain POSITIVE view with BUY calls on KLK, IOICORP, SIME and TAANN**

December inventory came in within expectation. Malaysia palm oil inventory level of 1.67m MT as of end-December 2016 is within expectation as it falls within the consensus estimate of 1.63m MT and our estimate of 1.70m MT. Against last month, inventory level is flattish (+0.2%mom) as the impact of export decline of 7% is neutralized by the decline in production by 6%. Against same period last year, inventory remains significantly lower yoy as it has tumbled 37%yoy.

Production is down 6% mom but it has increased yoy for the first time in 12 months. The monthly decline in production driven by lower production in Sabah (down 10% mom to 384,160 MT). This is followed by Peninsular Malaysia in which production slipped 7% mom to 774,394 MT. Lastly, Sarawak production fell 2% mom to 315,163 MT. On a yearly basis, production has increased by 5% and this suggests that the palm trees have started to recover from the impact of severe El Nino.

Temporary slowdown in demand from China. Export to China dropped 27% mom to 159,024 MT but we are not overly concerned as it has recovered strongly in the first ten days of January (against same period in December). We believe that the stocking activity ahead of Chinese New Year festival should continue to support the export in Jan-2017. Meanwhile, export to India grew by 25% mom to 164,678 MT as the country recovers from the short term economy disruption caused by the Government's decision to ban 500- and 1000 rupee notes.

Expect Jan-2017 inventory to decline 4% mom to 1.60m MT. Key assumptions are: i) export growth of 2% mom and ii) production decline of 3% mom. We are expecting export recovery as China is expected to restock ahead of Chinese New Year. Our export growth of 2% is conservative as cargo surveyors' data shows export growth of 8%mom in the first ten days of January. For production growth we are using seasonal factor to estimate the 3% decline.

BUY KLK (TP: RM29.25), IOICORP (TP: RM5.30), SIME (TP: RM9.05) and TAANN (TP: RM4.70). Our top pick is KLK as 70% of its earnings came from upstream plantation division which will benefit from high CPO price. We also like IOICORP as its upstream plantation division (63% profit contributor) should benefit from high CPO price. The Company's downstream division profit is also expected to recover in FY17 after the uplift of RSPO suspension. We like SIME as we expect positive news flow resulting from potential corporate exercise to unlock the value of the conglomerate. For mid and small cap, we like TAANN due to its FFB production growth which is the strongest among peers (+8%yoy in 9MFY16) and better outlook for timber division due to recent strengthening of USD.

Table 1: Palm Oil Statistics for December-2016 ('000 MT)

	Dec-16	Nov-16	Diff.	MoM %	Dec-15	YoY%
Opening Stocks	1,663	1,574	89	5.6%	2,909	-42.8%
Production	1,474	1,575	(101)	-6.4%	1,399	5.3%
Imports	45	63	(19)	-29.5%	82	-45.8%
Total Supply	3,181	3,213	(31)	-1.0%	4,391	-27.5%
Exports	1,268	1,370	(102)	-7.5%	1,483	-14.5%
Dom Disapp	248	179	68	38.1%	276	-10.2%
Total Demand	1,516	1,550	(34)	-2.2%	1,759	-13.8%
End Stocks	1,665	1,663	3	0.2%	2,631	-36.7%
Stock/Usage Ratio	9.2%	8.9%			12.5%	

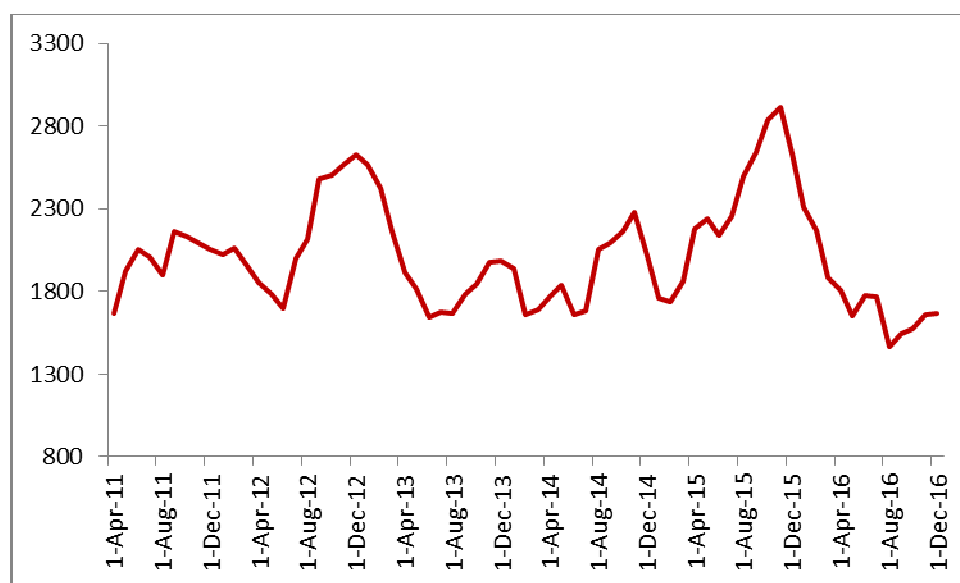
Source: MPOB, MIDF Research

Table 2: Monthly Exports and YTD Exports ('000 MT)

Country	Dec-16	Nov-16	Dec-15	MoM%	YoY%	12M16	12M15	YoY%
China	159	218	95	-27%	68%	1,872	2,380	-21%
India	165	131	333	25%	-51%	2,820	3,683	-23%
EU	173	162	266	7%	-35%	2,049	2,414	-15%
Pakistan	96	91	48	6%	100%	880	706	25%
US	35	42	72	-16%	-51%	590	696	-15%
Others	640	727	670	-12%	-4%	7,806	7,561	3%
Total	1,268	1,370	1,483	-7%	-15%	16,017	17,440	-8%

Source: MPOB, MIDF Research

Chart 1: Malaysia palm oil inventory ('000 MT)



Source: Malaysia Palm Oil Board (MPOB)

Table 3: Basis of valuation

Company	TP	Call	Valuation Basis
SIME	9.05	BUY	SOP with plantation sector @ 25.1x FY17E PE. 25.1x is the average of IOICORP and KLK Target PE
IOICORP	5.30	BUY	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	16.80	NEUTRAL	1.0x Price to Book Value (previously PE valuation)
FGV	1.77	NEUTRAL	1.0x Price to Book Value
GENP	11.50	NEUTRAL	SOP with plantation sector @ 24.7x FY17E PE. 24.7x is the lower valuation between IOICORP and KLK
IJMP	3.30	NEUTRAL	18.6x Fwd. PE on FY17F earnings reflecting mean valuation
TSH	2.15	NEUTRAL	22.3x Fwd. PE on FY17F earnings reflecting mean valuation
TAANN	4.70	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.