

14 August 2019 | Sector Update

## PLANTATION

**Maintain NEGATIVE**

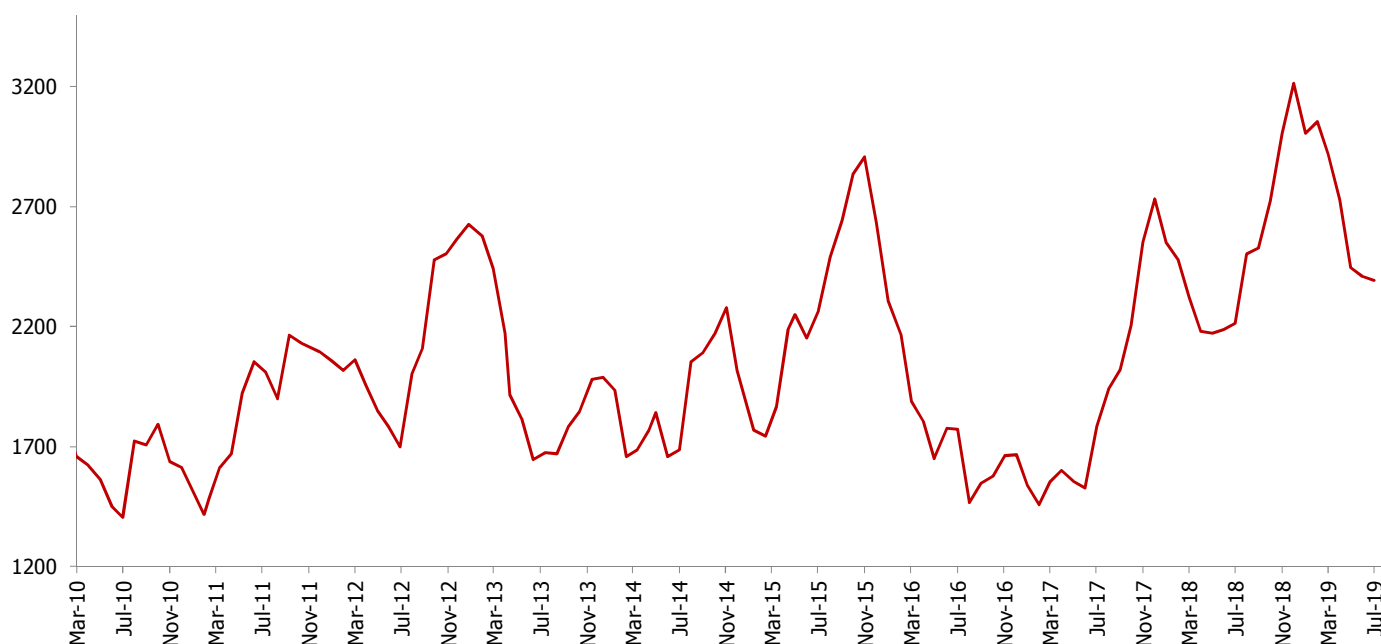
**Entering into seasonal higher output period**

### KEY HIGHLIGHTS

- July 2019 inventory came in at 2.4m metric tonnes (mt) (+8.0%yoy), representing the 25<sup>th</sup> month of increase since July 2017
- The higher production level in July 2019 (+15.6%yoy) has almost offset the impact of higher export demand (+24.1%yoy) leading to the stagnant stock level
- We opine that CPO price to remain depressed due to the protracted oversupply of palm oil amidst entering into its seasonally higher production period
- **Maintain NEGATIVE stance on the sector with an unchanged CPO target price of RM2,090/mt**

**Stagnant stockpiles level.** Malaysia's July 2019 palm oil stockpiles rose by +8.0%yoy to 2.4m mt, which came in lower than both Bloomberg and Reuters consensus by -3.2%yoy and -3.1%yoy respectively. The monthly inventory level has been on the rise on a year-over-year basis for the past 25 months since July 2017. This was mainly attributable to the higher production level as the palm oil industry enters into its high production period (i.e. July-October) which offset the higher export demand. Meanwhile, on a month-over-month basis, it recorded a marginal decline of -0.8%mom, the slowest decrease recorded since March 2019. Moving forward, we are of the view that the expected higher output in coming months to add pressure on inventory level which will continues to suppress the CPO price.

**Chart 1: Malaysia Palm Oil Inventory ('000 MT)**



Source: Malaysia Palm Oil Board (MPOB), MIDFR

**Export demand came in above market expectation.** On a year-over-year basis, July 2019 export rose by +24.1%yoy to circa 1.5m mt. This was above the Bloomberg and Reuters consensus by +3.1% and +3.5% respectively. The higher export demand was mainly due to the large purchases from India which rose by +245.6%yoy to 455.8m mt which could be due to restocking activities ahead of festivals in August 2019. In addition, the preferential trade agreement on refined palm oil products between the Malaysian and Indian governments has been a major booster to Malaysian palm oil export demand since January 2019. However, we have seen major laggards such as the exports to China (-18.8%yoy), EU (-8.1%yoy), Djibouti (-83.8%yoy), Philippines (-29.4%yoy) and Bangladesh (-89.8yoy) dragging export growth. On a year-to-date basis, India was the only importer which experienced a phenomenal import growth of the Malaysian palm oil of +100.0%ytd as compared to other top 2 importers, i.e. China and EU, which just grew by +12.3%ytd and +6.2%ytd. Moving forward, we expect demand from India to be weaker post the restocking activities.

**Table 1: July 2019 export performance (‘000 MT)**

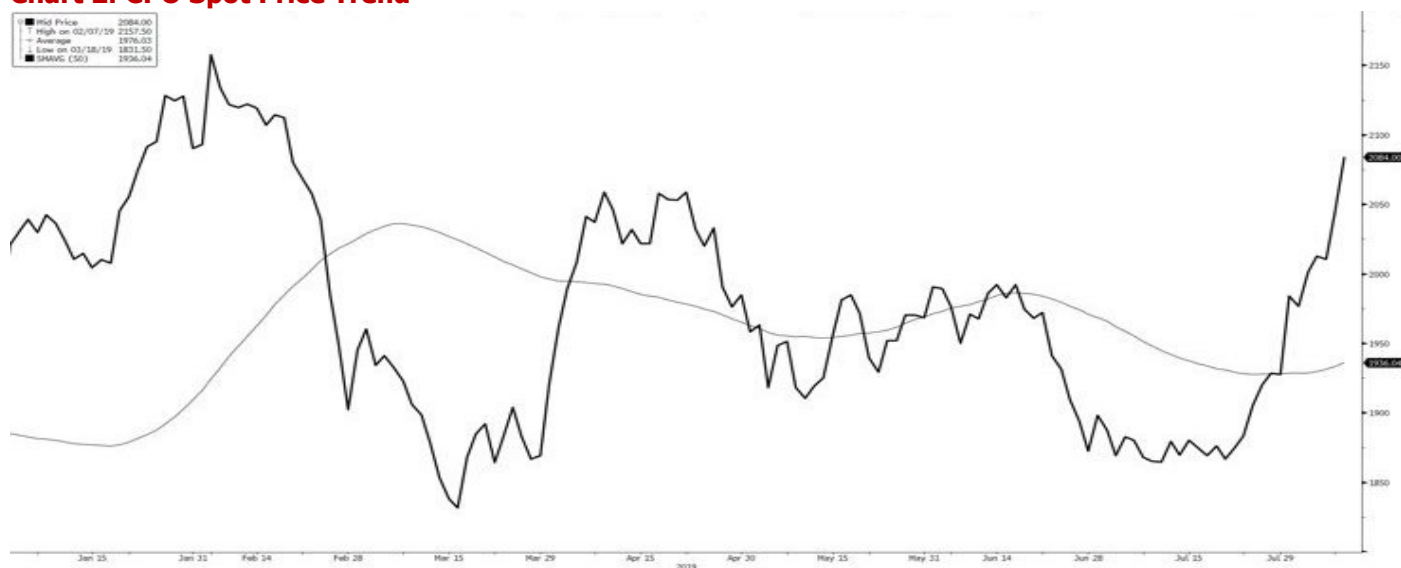
	July-19	June-19	July-18	MoM (%)	YoY (%)	7M19	7M18	YoY (%)
China	90.8	107.6	111.8	-15.7	-18.8	1,097.8	977.5	12.3
India	455.8	423.6	131.9	7.6	245.6	3,041.6	1,521.1	100.0
EU	144.5	182.0	157.2	-20.6	-8.1	1,267.6	1,193.3	6.2
Pakistan	81.1	76.7	77.7	5.8	4.4	593.3	705.5	-15.9
US	40.5	52.1	32.7	-22.4	23.7	387.8	302.8	28.1
Others	672.6	540.7	685.4	24.4	-1.9	4,474.2	4,730.6	-5.4
<b>Total</b>	<b>1,485.2</b>	<b>1,382.8</b>	<b>1,196.7</b>	<b>7.4</b>	<b>24.1</b>	<b>10,862.4</b>	<b>9,430.7</b>	<b>15.2</b>

Source: MPOB, MIDFR


**Output level rebounded.** July 2019 production level recorded at 1.7m mt, representing an increase of +15.6%yoy and rebounded to the level last seen in January 2019. The higher output was mainly attributable to higher production from the state of Kelantan (+67.3%yoy), Pahang (+50.1%yoy), Terengganu (+47.8%yoy), and Negeri Sembilan (+32.8%yoy). The higher output represented the seventh month of year-over-year increase. This also came in higher than the Bloomberg and Reuters consensus by 2.3% and 2.7% respectively. We are of the view that monthly output level to remain at about current level throughout third quarter which is the Malaysian palm oil industry's historical higher output period. On a year-to-date comparison, 7MCY19 CPO production remained elevated (+10.6%ytd) due to higher output primarily from the state of Kelantan (+33.7%ytd), Terengganu (+28.0%ytd), and Pahang (+22.4%ytd).

**Price remains below RM2,000/mt.** Despite the average July 2019 CPO spot price has rebounded to RM1,927/mt from RM1,872/mt in June 2019, it still represented a fall of -10.5%yoy as compared to the month of July in prior year. Making reference to *Chart 2*, the recent rally in CPO price has been primarily attributable to the price of its competing soybean oil futures in China which surged to its highest level in about 21 months. This is in view of the tightening supplies of soybean oil which resulted from lower crushing of soybean amidst the African swine fever in China. In addition, we view that the decline in the strength of the Ringgit Malaysia (RM) against the USD might be a supporting factor for the CPO price as weaker ringgit would normally boost export demand for Malaysian palm oil. However, the sustained low CPO price in 1H19 has led to the year-to-date CPO average price to be at just RM1,976/mt which is still below our CPO target price of RM2,090/mt. Coupled with both the current oversupply issues and higher output period, we expect some resistance in the recovery of CPO price to above RM2,000/mt level in the near term.

**Chart 2: CPO Spot Price Trend**



Source: Bloomberg

**Maintain NEGATIVE.** The higher CPO output suggests that the palm oil industry has entered into its seasonal high production period which typically falls between August and October. This would continue to impede the Malaysian CPO inventory drawdown amidst the weaker demand prospects in second half of the year. Should export demand not able to keep pace with the production level, we may see the stockpiles to rebound to above 2.4m mt level. Note that Indonesia has been actively engaging with the Indian government to lobby for the same preferential tariff treatment as Malaysia. If that materialises, it would have negative repercussions on the Malaysian CPO environment as India is currently our main engine for export demand growth due to the preferential trade agreement which has largely helped to ease the inventory level thus far. In addition, we do not discount the possibility that demand from India to trend lower post the restocking activities. We also opine that the increasing supplies of cheaper Indonesian palm oil may be the primary factor of weaker-than-expected export demand for Malaysian palm oil which could continue throughout the second half of the year. Coupled with the CPO output in overdrive mode and potential rebound in stockpiles level, we are maintaining our **NEGATIVE** stance on the sector with an unchanged 2019 CPO price target of **RM2,090/mt.** 

**Table 2: Palm Oil Statistics for July 2019 ('000 MT)**

	July-19	June-19	Difference	MoM (%)	July-18	YoY (%)
<b>Opening Stocks</b>	<b>2,410.7</b>	<b>2,447.4</b>	<b>(36.7)</b>	<b>-1.5</b>	<b>2,187.0</b>	<b>10.2</b>
<b>Production</b>	<b>1,738.4</b>	<b>1,518.2</b>	<b>220.1</b>	<b>14.5</b>	<b>1,503.2</b>	<b>15.6</b>
Imports	36.7	101.3	(64.6)	-63.8	44.0	-16.7
<b>Total Supply</b>	<b>4,185.8</b>	<b>4,066.9</b>	<b>118.8</b>	<b>2.9</b>	<b>3,734.3</b>	<b>12.1</b>
Exports	1,485.2	1,382.8	102.5	7.4	1,196.7	24.1
Dom Disapp	308.9	260.4	48.5	18.6	322.9	-4.4
<b>Total Demand</b>	<b>1,794.1</b>	<b>1,643.1</b>	<b>151.0</b>	<b>9.2</b>	<b>1,519.6</b>	<b>18.1</b>
<b>End Stocks</b>	<b>2,391.7</b>	<b>2,410.7</b>	<b>(19.0)</b>	<b>-0.8</b>	<b>2,214.7</b>	<b>8.0</b>
<b>Stock/Usage Ratio (%)</b>	<b>11.1</b>	<b>12.3</b>			<b>12.1</b>	

Source: MPOB, MIDF

**Table 3: Peer comparison**

Stock	FYE	Rec.	Price @	Tgt Price	Core EPS (sen)		CORE PE (x)		Net DPS (sen)		Net Dvd Yield (%)	
			13-Aug-19	(RM)	FY19F	FY20F	FY19F	FY20F	FY19F	FY20F	FY19F	FY20F
Genting Plantation	Dec	SELL	9.59	8.90	25.0	31.8	38.4	30.2	13.3	15.9	1.4	1.7
IOI Corporation	Jun	SELL	4.20	3.48	11.6	13.9	36.2	30.2	9.0	10.5	2.1	2.5
IJM Plantation	Mar	SELL	1.37	1.13	-1.3	5.2	-105.4	26.3	2.0	3.0	1.5	2.2
Kuala Lumpur Kepong	Sep	SELL	23.56	18.77	62.7	78.2	37.6	30.1	45.0	45.0	1.9	1.9
PPB Group	Dec	NEUTRAL	18.76	17.48	70.8	72.4	26.5	25.9	21.2	21.7	1.1	1.2
Ta Ann Holdings	Dec	NEUTRAL	2.15	2.22	15.4	18.6	14.0	11.6	10.0	10.0	4.7	4.7
Sime Darby Plantation	Dec	NEUTRAL	4.60	4.50	8.8	13.6	52.3	33.8	4.9	8.2	1.1	1.8
TSH Resources	Dec	NEUTRAL	0.90	0.89	3.6	4.6	24.8	19.5	1.0	1.2	1.1	1.3
FGV Holdings	Dec	BUY	1.09	1.40	1.5	2.4	72.7	45.4	N/A	N/A	N/A	N/A

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#### 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.