

# PLANTATION

**Maintain NEGATIVE**

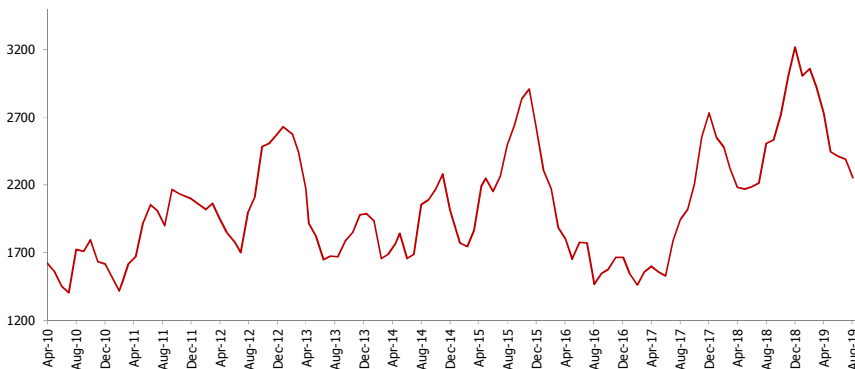
## Export demand from India is expected to taper off

### KEY INVESTMENT HIGHLIGHTS

- August 2019 inventory came in at 2.2m metric tonnes (mt) (-10.1%oyoy), representing the first year-over-year decline since July 2017
- The export demand in August 2019 grew at a faster pace (+57.6%oyoy) than production (+12.4%oyoy), mainly due to the phenomenal growth from India (+117.7%oyoy)
- However, we expect the growth in export demand to taper off as India increased its import duty on Malaysian refined palm oil by 5% on 4th September 2019
- Consequently, we believe the weaker export demand outlook amidst the high production season in 2HCY19 to weigh on inventory which provide some resistance in the recovery of CPO price
- Maintain NEGATIVE stance on the sector with an unchanged CPO target price of RM2,090/mt

**Higher-than-expected stockpiles.** Malaysian palm oil stockpiles in August 2019 declined by -10.1%oyoy to 2.2m mt, representing the first year-over-year decline since July 2017. This was mainly due to growth in export of +57.6%oyoy which outpace the increase in production of +12.4%oyoy. However, the inventory level still came in higher than both Bloomberg and Reuters consensus by +1.4%oyoy. Meanwhile, we are of the view that the export demand to taper off in coming months due to India's recent increased rate of duty of customs. Coupled with the seasonal higher production level, we believe this could possibly cause the inventory level to remain elevated and provide some resistance to the recovery in CPO price.

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



Source: Malaysia Palm Oil Board (MPOB), MIDFR

**Export demand expected to taper off...** On a year-over-year basis, August 2019 export rose by +57.6%oyoy to circa 1.7m mt. This came in both higher than Bloomberg and Reuters consensus by +1.9%. The higher export demand was mainly due to the large purchases from India which rose by +307.2%oyoy to 566.2m mt. We believe this could be due to advance purchases by commercial buyers in India before the increase of import duty by 5% on Malaysian refined palm oil. We gathered that the hike would be effective from 4th September 2019 for 180 days which would weaken export demand. This is primarily premised on Malaysia losing its preferential tariff treatment and will be competing on a level-playing field with Indonesia at 50% whose palm oil has a competitive pricing advantage than Malaysian palm oil.

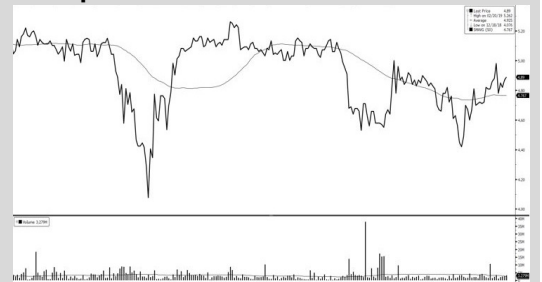
### COMPANY IN FOCUS

#### Sime Darby Plantation Bhd

Maintain **SELL** | Unchanged Target price: RM4.08  
Price @ 10<sup>th</sup> September 2019: RM4.60

- Low CPO price continues to negatively impact the group's upstream operations
- Cost management efforts is insufficient to provide meaningful buffer
- We expect dividend payout to be unattractive leading to dividend yield of less than one percent

#### Share price chart

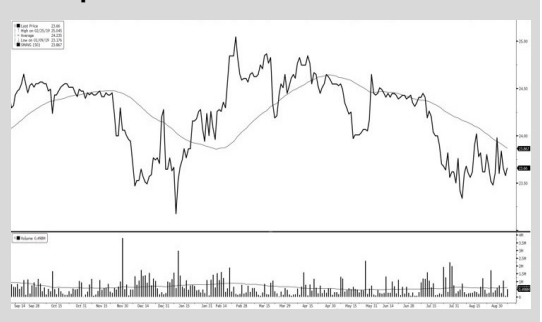


#### Kuala Lumpur Kepong Bhd

Maintain **SELL** | Unchanged Target price: RM18.78  
Price @ 10<sup>th</sup> September 2019: RM23.56

- Low CPO price continues to negatively impact the group's plantation division
- We are concerned on the thinning margin from its European operation
- Property segment's profit has improved considerably but minimal profit contribution

#### Share price chart



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...partially moderated by export demand gaining strength from China. Nonetheless, we opine that the export demand from China could possibly further strengthen in view of the African swine fever and the heightened U.S.-China trade war. This would result in tight supplies of soybean oil as there was lower crushing of soybean. Note that palm oil is a close substitute to soybean oil. We believe this could partially offset the expected decline from India's export demand. Moving forward, we are of the view that export demand to trend lower in coming months.

**Table 1: August 2019 Export Performance ('000 MT)**

	Aug-19	Jul-19	Aug-18	MoM%	YoY%	8M19	8M18	YoY%
China	308.5	90.8	111.7	239.9	176.1	1,407.0	1,089.2	29.2
India	566.2	455.8	139.1	24.2	307.2	3,613.3	1,660.1	117.7
EU	147.1	144.5	80.1	1.8	83.7	1,418.3	1,273.4	11.4
Pakistan	106.7	81.1	56.5	31.6	88.9	700.2	762.0	-8.1
US	47.3	40.5	47.4	17.1	-0.1	435.2	350.1	24.3
Others	557.0	672.6	665.2	-17.2	-16.3	5,026.2	5,395.7	-6.8
<b>Total</b>	<b>1,732.9</b>	<b>1,485.2</b>	<b>1,099.9</b>	<b>16.7</b>	<b>57.6</b>	<b>12,600.3</b>	<b>10,530.6</b>	<b>19.7</b>

Source: MPOB, MIDFR

**Higher-than-expected production.** August 2019 production level came in at 1.8m mt, representing an increase of +12.4%yoy and rebounded to the level last seen in November 2018. The higher output was mainly attributable to higher production from the state of Kelantan (+33.6%yoy), Pahang (+32.3%yoy), Terengganu (+33.0%yoy), and Negeri Sembilan (+30.3%yoy). The higher output represented the eighth month of year-over-year increase. This also came in higher than the Bloomberg and Reuters consensus by +4.7% and +2.9% respectively. On a year-to-date comparison, 8MCY19 CPO production remained elevated (+10.8%ytd) due to higher output primarily from the state of Kelantan (+33.7%ytd), Terengganu (+28.7%ytd), and Pahang (+23.6%ytd). In addition, we do not expect any potential disruption to the palm oil supply. According to the Australia Bureau of Meteorology, the chances of a El-Nino have reduced to less than 50% as the indicator changed from a 'WATCH' state to 'NEUTRAL' state. This signals a lower chance of drought conditions appearing in the region.

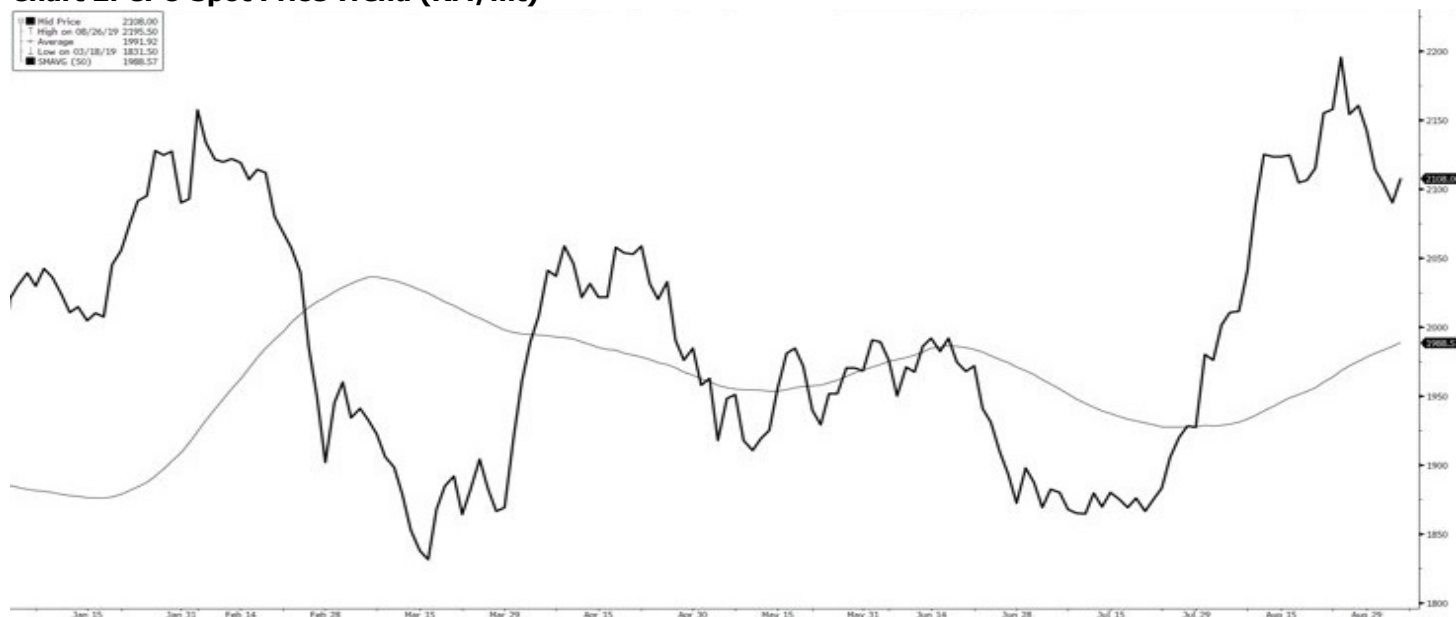
**Table 2: Palm Oil Statistics for August 2019 ('000 MT)**

	Aug-19	Jul-19	Diff.	MoM %	Aug-18	YoY%
<b>Opening Stocks</b>	2,391.7	2,410.7	<b>(19.1)</b>	<b>-0.8</b>	2,214.7	<b>8.0</b>
<b>Production</b>	1,821.5	1,738.4	<b>83.2</b>	<b>4.8</b>	1,620.6	<b>12.4</b>
Imports	51.1	36.7	14.4	39.3	80.2	-36.3
<b>Total Supply</b>	<b>4,264.3</b>	<b>4,185.8</b>	<b>78.5</b>	<b>1.9</b>	<b>3,915.5</b>	<b>8.9</b>
Exports	1,732.9	1,485.2	247.7	16.7	1,099.8	57.6
Dom Disapp	279.6	308.9	(29.3)	-9.5	310.8	-10.1
<b>Total Demand</b>	<b>2,012.4</b>	<b>1,794.1</b>	<b>218.4</b>	<b>12.2</b>	<b>1,410.6</b>	<b>42.7</b>
<b>End Stocks</b>	<b>2,251.8</b>	<b>2,391.7</b>	<b>(139.8)</b>	<b>-5.8</b>	<b>2,504.9</b>	<b>-10.1</b>
<b>Stock/Usage Ratio (%)</b>	<b>9.3%</b>	<b>11.1%</b>			<b>14.8%</b>	

Source: MPOB, MIDFR

**Gradual improvement in CPO price to be met with resistance.** We believe the recent declining trend of inventory level since February 2019 and the higher export demand has provided some comforts to the CPO price, rising to an average CPO price of RM2,142/mt in August 2019 from a record low of RM1,869/mt in March 2019. However, the August 2019 average CPO price still posted a marginal decline of -1.7%yoy on a year-over-year basis and the year-to-date average CPO price from January 2019 to August 2019 was RM1,970/mt (-16.0%yoy). Note that it was still below our CPO target price of RM2,090/mt. While we expect some recovery in the CPO price, we opine it would not be significant in view of the expected lower export demand and higher production in third quarter. In addition, we view that the subdued U.S. soybean price due to an elevated soybean inventory level and weaker outlook resulting from the heightened U.S.-China trade dispute and African swine fever to continue adding downward pressure on the CPO price.

**Chart 2: CPO Spot Price Trend (RM/mt)**



Source: Bloomberg, MIDFR

**Maintain NEGATIVE.** We are of the view that the higher CPO output would continue to be seen throughout the historical seasonal higher production period which typically fall between July and October. This would continue to hinder the Malaysian CPO inventory drawdown amidst the weaker demand prospects in second half of the year. We also do not discount the possibility that stockpiles level to rebound to above 2.2m mt level toward the end of third quarter given that India's import duty hike on Malaysian refined palm oil commencing on 4<sup>th</sup> September. This resulted in Malaysia and Indonesia are competing again on a level-playing field with the same total tariff imposed on their respective palm oil products exporting to India. Coupled with the increasing supplies of cheaper Indonesian palm oil, we posit that this would be weakening the export demand of Malaysian palm oil. Nonetheless, the potential increase in export demand from China and the progressive biodiesel mandate in Malaysia would partially assuage the expected lower export demand. 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.**

## PEER COMPARISON TABLE

Stock	FYE	Rec.	Price @	Tgt Price	Core EPS (sen)		CORE PE (x)		Net DPS (sen)		Net Dvd Yield (%)	
			10-Sep-19	(RM)	FY19F	FY20F	FY19F	FY20F	FY19F	FY20F	FY19F	FY20F
Genting Plantation	Dec	SELL	9.99	8.40	20.6	30.1	48.5	33.2	10.9	12.1	1.1	1.2
IOI Corporation	Jun	SELL	4.41	3.48	11.4	13.9	38.7	31.7	9.0	10.5	2.0	2.4
IJM Plantation	Mar	SELL	1.50	1.16	-1.3	3.2	-115.4	46.9	2.0	3.0	1.3	2.0
Kuala Lumpur Kepong	Sep	SELL	23.66	18.78	62.7	78.2	37.7	30.3	45.0	45.0	1.9	1.9
Sime Darby Plantation	Dec	SELL	4.89	4.08	2.1	6.3	232.9	77.6	1.1	3.8	0.2	0.8
PPB Group	Dec	NEUTRAL	18.48	17.43	64.6	72.1	28.6	25.6	19.4	21.6	1.0	1.2
Ta Ann Holdings	Dec	NEUTRAL	2.23	2.18	8.5	18.2	26.2	12.3	10.0	10.0	4.5	4.5
TSH Resources	Dec	NEUTRAL	0.87	0.89	3.6	4.6	24.0	18.9	1.0	1.2	1.1	1.4
FGV Holdings	Dec	NEUTRAL	0.94	0.96	-3.0	-2.1	-31.0	-45.6	N/A	N/A	N/A	N/A

Source: Company, MIDFR

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#### STOCK RECOMMENDATIONS

<b>BUY</b>	Total return is expected to be >10% over the next 12 months.
<b>TRADING BUY</b>	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.
<b>NEUTRAL</b>	Total return is expected to be between -10% and +10% over the next 12 months.
<b>SELL</b>	Total return is expected to be <10% over the next 12 months.
<b>TRADING SELL</b>	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

<b>POSITIVE</b>	The sector is expected to outperform the overall market over the next 12 months.
<b>NEUTRAL</b>	The sector is to perform in line with the overall market over the next 12 months.
<b>NEGATIVE</b>	The sector is expected to underperform the overall market over the next 12 months.