12 February 2019 | Sector Update

PLANTATION

***Maintain* NEUTRAL**

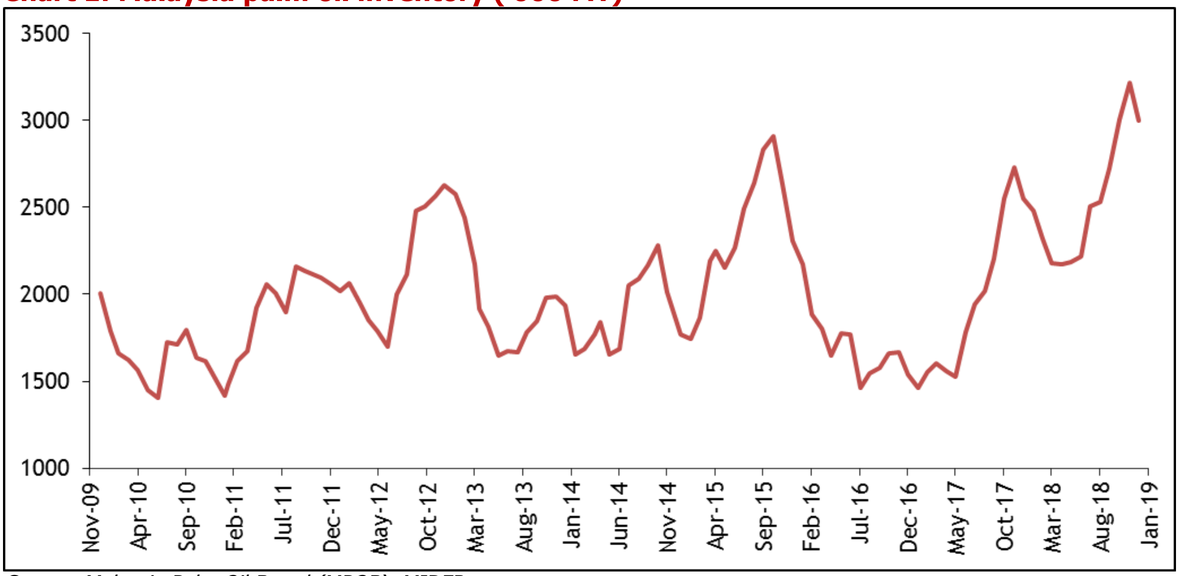
Higher export keep inventory level at bay

KEY HIGHLIGHTS

- **Inventory fell by -6.7%mom to 3.0m tonnes but still remained at elevated level**
- **Both production and export demand was higher than expected, with the growth of export demand outpaced of that production**
- **Export growth mainly to be premised on rising demand from EU, China and India as well as other burgeoning export destinations**
- **The oversupply phenomenon of Malaysian palm oil, negative sentiments from EU, price competitiveness of competing oils continue to be a bane to the CPO price**
- **Biodiesel mandates in both Malaysia and Indonesia is viewed as a positive development to boost domestic consumption and act as a diversification strategy**
- **Maintain NEUTRAL on the sector**

Inventory declined but remained elevated. Malaysia palm oil inventory for the month of January 2019 experienced its first decline after a seven-month gains to about 3.0m tonnes. This translated into a -6.7% decrease moms. This was below both the Bloomberg and Reuters consensus by approximately -1.0% and -2.2% respectively. However, the inventory level remained elevated in view of higher than expected output level. Fortunately, this was partially mitigated by higher than expected export demand, mainly from the European Union countries and other export markets. On a year-over-year basis, January 2019 inventory increased by +17.8%yoy primarily due to record high stockpiles as at end Dec 2018. We opine stockpiles to continue to decline from its record high (albeit at a moderating pace) in-line with the historically low seasonal production period and rising export demand. This will also lend additional support to the CPO price which has seen recovery (+13.5%mom) after a record low in Dec 2018 to RM2,037/mt in Jan 2019.

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



Source: Malaysia Palm Oil Board (MPOB), MIDFR

Higher than expected production. Despite a -3.9%mom decline in January 2019 production to 1.7m, we observed that it has exceeded both Bloomberg and Reuters consensus by +6.6% and +7.9% respectively. This indicated that output might be still at the tail-end of its peak period and it is declining at a moderating pace. The fall was mainly resulted from lower production at the state of Sabah (-8.0%mom) and Sarawak (-9.5%mom). On a year-over-year comparison, production growth increased by +9.5%yoy as a result of higher production mostly from the state of Perak (+26.0%yoy), Pahang (+19.3%yoy) and Johor (+8.5%yoy).

Export demand trended higher. On a sequential basis, January 2019 export rose by +21.0%mom to approximately 1.7m tonnes. Note that the export demand come in above both Bloomberg and Reuters consensus by +7.5%. To recall, similar level of export figures was last seen in Jan 2013. This was mainly premised on the rising demand from key destinations like European Unions (EU) (+161.0%mom), China (+18.0%mom) and India (+12.0%mom). We view that demand from China was mainly boosted by the festive purchase and lower demand of soybean due to the African swine fever phenomenon. Meanwhile, India's demand improved subsequent to the implementation of lower import duties for palm oil related products and preferential trade agreement with Malaysia. We also opine that demand from EU was predominantly attributed to the rise of biodiesel usage as majority of palm oil (51%) imported into the EUis currently subsidised to make 'green fuel'. Apart from these key export markets, export was also driven by another destinations such as Mozambique (>+100%mom), Turkey (+80.0%mom), South Africa (>+100%mom), and South Korea (+90.5%mom).

Maintain NEUTRAL on the sector. Stockpiles remained elevated at 3.0m tonnes despite a slight drop in production and lower imports. The figure might be even higher if it was not for the higher-than-expected export level. This could also indicate that Malaysian palm oil is still in an oversupply sphere at this period of time, if export demand could not be sustained. The palm oil industry continues to be faced with strong negative sentiment from the environmentally-sensitive countries, particularly the EU, which is the second largest export destination of Malaysian palm oil. The French and Norwegian governments passed an amendment to exclude palm oil as biodiesel feedstock starting from 2020 onwards. Coupled with the recent trade truce which bring optimism in soybean oil demand than palm oil, we view that the seemingly oversupply might still be a drag on CPO price at this current juncture. On a positive note, we are optimistic of the biodiesel mandates in both Malaysia and Indonesia as a diversification strategy to boost domestic palm oil consumption. Hence, we are maintaining our **CPO price target of RM2,280/mt** for 2019.

Table 1: Palm Oil Statistics for January 2019 ('000 MT)

	Jan-19	Dec-18	Diff.	MoM (%)	Jan-18	YoY%()
Opening Stocks	**3,215**	**3,007**	**208**	**6.9**	**2,732**	**17.7**
Production	**1,737**	**1,808**	**-71**	**-3.9**	**1,587**	**9.5**
Imports	81	109	-28	-25.4	35	132.8
Total Supply	**5,034**	**4,924**	**110**	**2.2**	**4,354**	**15.6**
Exports	1,676	1,383	293	21.2	1,514	10.7
Dom Disapp	356	325	31	9.4	291	22.5
Total Demand	**2,032**	**1,709**	**324**	**19.0**	**1,805**	**12.6**
End Stocks	**3,001**	**3,215**	**-214**	**-6.7**	**2,549**	**17.8**
Stock/Usage Ratio (%)	**12.3%**	**15.7%**			**11.8**	

Source: MPOB, MIDFR

Table 2: Export performance for January-2019 ('000 MT)

	Jan-19	Dec-18	Jan-18	MoM(%)	YoY(%)	1M19	1M18	YoY(%)
China	317	269	157	18	102	317	157	102
India	318	284	202	12	58	318	202	58
EU	243	93	182	161	34	243	182	34
Pakistan	81	104	86	-23	-7	81	86	-7
US	62	58	48	6	27	62	48	27
Others	655	575	798	14	-18	655	798	-18
Total	**1,677**	**1,384**	**1,473**	**21**	**14**	**1,677**	**1,473**	**13.8**

Source: MPOB, MIDFR

Figure 1: CPO Futures Price Trend (KO3)

Source: Bloomberg, MIDFR

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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 *rise* 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 *fall* 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.