

11 March 2016 | Sector Update

PLANTATION

Maintain POSITIVE

Inventory downtrend continues

KEY HIGHLIGHTS

- **February 2016 inventory level of 2.17m MT is above expectation due to weaker than expected local consumption.**
- **The slowdown in local consumption should be temporary as Brent crude oil has improved to USD40/barrel hence higher biodiesel production going forward.**
- **Inventory downtrend continues in Feb-2016 as it declines 6% mom.**
- **Tree stress impact continues as Feb-2016 production is the lowest in 9 years.**
- **Lower export is not a major concern as it was partly caused by lower production.**
- **Expect March inventory to decline 7%mom to 2.02m MT.**
- **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).**

February 2016 inventory level of 2.17m MT is above expectation as it is 3% higher than consensus forecast of 2.10m MT. It is also 5% higher than our estimate of 2.07m MT. The higher than expected inventory is caused by weaker than expected local consumption of 165k MT (against a 12-month average of 239k MT). We believe that the local biodiesel production may have slowed down temporarily in Feb-2016. Note that the premium of CPO against Brent crude oil surged to an estimated USD335/MT in Feb-2016 (from USD 285/MT in Jan-2016) as CPO price increased while Brent crude oil stayed low at average of USD33.53/barrel. Nevertheless, we think that the local consumption should improve to above 200k MT in March as Brent crude oil price has improved to around USD40/barrel.

Inventory downtrend continues in Feb-2016 mom as it declines 6% mom. Total demand (export + local consumption) of 1.25m MT exceeds total production (import + local production) of 1.11m MT. Overall, the data is neutral to CPO price as the higher than expected inventory news is neutralised by the high export growth of 31%mom in the first 10 days of March.

Tree stress impact continues as Feb-2016 production is the lowest in 9 years. Note that Feb-2016 production of 1.04m MT is the lowest since Mar-2007. The previous record low was on Feb-2007 in which production tumbled to 0.99m MT due to the previous El Nino 2007/2008 episode. We believe that the tree stress impact is likely to continue with more severe impact than 2007/2008 episode as the current El Nino is the strongest since 1997/1998. Recall that Australia Bureau of Meteorology officially announced El Nino condition on 12-May-2015 and consequently the current situation of extremely low production.

Lower export is not a major concern as it was partly caused by lower production. Total Malaysia export for palm oil declined by 15%mom to 0.97m MT due to lower export to China (-49% to 53k MT) and India (-33% to 178k MT). The lower export to China likely be caused by the winter which peaked in February. As palm oil tends to solidify in cold weather, it is used less during cold temperature. As for India, the country may be clearing its relatively high inventory hence purchased less in Feb-2016.

Expect March inventory to decline 7% mom to 2.02m MT. Our key assumptions for March inventory estimate are: i) 12%mom increase in production in line with historical production pattern, and ii) 11% improvement in export as the winter period in the Northern Hemisphere has ended. As the weather gets hotter, CPO is used more as it stays in liquid form in hot temperature (against solidified form in cold temperature).

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. The impact of El Nino is still lingering and we are only at the 3rd month of the lagged impact of a super El Nino. Hence, we expect CPO production to be significantly lower than what it used to be in March and 2Q2016. As a result, the CPO discount against soybean oil (SBO) should diminish and we expect CPO to trade on par with SBO. Such rare phenomenon occurred before in Feb-2011 in which CPO price surged to RM3800/MT as inventory dropped to 1.48m MT. Our key assumptions are SBO price to improve slightly to USD725/MT and USD/MYR rate of 4.15.


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 due for rerating after it regained its Shariah status on 30-Nov, ii) strong earnings growth of +22%yoy to RM778m in 1HFY16, iii) its earnings profile has the most pure (100%) exposure to palm oil among the big cap index-linked planters, and iv) the recent purchase of 4.14m shares by the major shareholder which will likely bode well for investors' confidence in the company. 

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

	Feb-16	Jan-16	Diff.	MoM %	Feb-15	YoY%
Opening Stocks	2,309	2,634	(325)	-12.4%	1,770	30.4%
Production	1,043	1,130	(87)	-7.7%	1,122	-7.0%
Imports	68	37	31	84.4%	64	6.4%
Total Supply	3,419	3,800	(381)	-10.0%	2,955	15.7%
Exports	1,085	1,279	(194)	-15.2%	973	11.6%
Dom Disapp	165	213	(48)	-22.5%	239	-31.1%
Total Demand	1,250	1,492	(242)	-16.2%	1,212	3.2%
End Stocks	2,169	2,309	(140)	-6.1%	1,743	24.4%
Stock/Usage Ratio	14.5%	12.9%			12.0%	

Source: MPOB, MIDF Research

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

Country	Feb-16	Jan-16	Feb-15	MoM%	YoY%	2M16	2M15	YoY%
China	53	105	65	-49%	-18%	158	281	-44%
India	178	263	222	-33%	-20%	441	382	15%
EU	209	185	137	13%	53%	394	309	28%
Pakistan	21	65	33	-67%	-36%	86	89	-3%
US	50	58	33	-14%	50%	108	98	10%
Others	574	604	483	-5%	19%	1,178	1,006	17%
Total	1,085	1,279	973	-15%	12%	2,364	2,164	9%

Source: MPOB, MIDF Research

Table 1: Basis of valuation

Company	TP	Call	Valuation Basis
SIME	8.20	NEUTRAL	SOP with plantation sector @ 23.2x FY16E PE. 23.2x is the avg of IOICORP and KLK Target PE.
IOICORP	4.95	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	18.00	BUY	21.6x Fwd. PE on FY16F earnings reflecting +0.5SD valuation.
FGV	1.30	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	3.65	NEUTRAL	18.6x Fwd. PE on FY16F earnings reflecting mean valuation.
TSH	2.33	BUY	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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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.