

11 August 2017 | Sector Update

PLANTATION

Maintain NEUTRAL

July inventory is higher than expected

KEY HIGHLIGHTS

- **July inventory is higher than expected**
- **Production surge in July is mainly due to low based effect in June**
- **Export to China surged but India demand weakened**
- **The data is short term negative to CPO price but watch out for US dry weather condition**
- **Expect August-2017 inventory to increase 18% mom to 2.10m MT**
- **Maintain NEUTRAL with BUY on KLK (TP: RM29.25), TSH (TP: RM2.15) and TAANN (TP: RM4.30)**

July inventory is higher than expected. Malaysia palm oil inventory level of 1.78m MT as of end-July 2017 is higher than ours (1.65m MT) and consensus (1.63m MT) estimate. Against last month, inventory level increased by 17% as production surge of 21% exceeded export rise of 1%. Against same period last year, inventory is higher by 1% (against June's decline of 14% yoy).

Production surge in July is mainly due to low based effect in June. CPO production surged by 21% mom and 15% yoy to 1.83m MT. Peninsular Malaysia palm production leads the recovery by increasing 30% mom to 986,796 MT and this is followed by Sarawak (+8% to 462,153 MT) and Sabah (+16% mom to 378,159 MT). The quantum of July production surge is higher than expected but it could be partly caused by the low base of production in June. Note that June was the festival period as harvesters took leave to go back to Indonesia for Hari Raya. And as a result, production increased significantly in July as harvesting activity resumed.

Export to China surged but India demand weakened. Export to China jumped by 175% mom to 188,738 MT as pre stocking activity for Mid-Autumn Festivals may have started. However, export to India dropped 34% mom to 157,458 MT in the absence of major festival there in July.

The data is short term negative to CPO price but watch out for US dry weather condition. Overall, we are slightly negative on the latest MPOB stats as strong production is expected to cap CPO price upside. Having said that, we believe that the market should monitor the dry weather condition in the US as it could drive soybean oil price higher (and hence CPO as well).

Expect August-2017 inventory to increase 18% mom to 2.10m MT. Key assumptions are: i) production increase of 4% mom and ii) export increase of 2% mom. We believe that palm oil demand should be supported by good export growth to China as the pre stocking activity should continue in August. Although cargo surveyors data shows decline of 1% in export for the first ten days of July, we believe that export should improve in the remaining of the months due to better demand seen from China. For production growth we are using seasonal factor to estimate the 4% increase.

Maintain NEUTRAL with BUY on KLK (TP: RM29.25), TSH (TP: RM2.15) and TAANN (TP: RM4.30).

Our NEUTRAL view on the sector is maintained as we expect strong production in 2H2017 to cap CPO price upside. We like KLK for the Company earnings resiliency and its good FFB production growth estimated at 8% (highest among index-linked plantation stocks). We also like TSH due to: i) its strong 1QFY17 Core Net Profit which has grown 71% yoy, ii) attractive valuation at close to its -0.5SD level and iii) its young age profile of ~7.3 years old which should allow them to register better FFB growth in the long run. Lastly, we have BUY call on TAANN as: i) its plantation division earnings growth should remain strong due to high FFB volume expected at 10% and ii) timber division is expected to remain profitable due to the support from high export logs price.

Table 1: Palm Oil Statistics for July-2017 ('000 MT)

	Jul-17	Jun-17	Diff.	MoM %	Jul-16	YoY%
Opening Stocks	1,527	1,557	(30)	-1.9%	1,775	-14.0%
Production	1,827	1,514	313	20.7%	1,586	15.2%
Imports	53	46	7	15.6%	13	313.0%
Total Supply	3,407	3,117	290	9.3%	3,373	1.0%
Exports	1,398	1,380	18	1.3%	1,384	1.0%
Dom Disapp	225	210	15	7.1%	218	3.1%
Total Demand	1,623	1,590	33	2.1%	1,603	1.3%
End Stocks	1,784	1,527	257	16.8%	1,771	0.8%
Stock/Usage Ratio	9.2%	8.0%			9.2%	

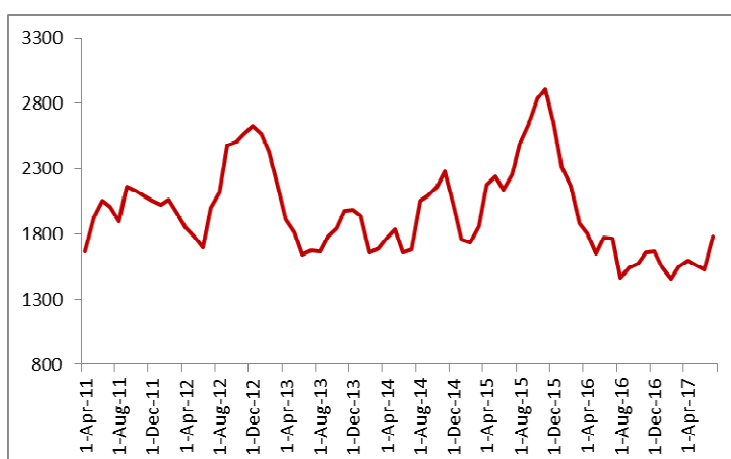
Source: MPOB, MIDF Research

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

Country	Jul-17	Jun-17	Jul-16	MoM%	YoY%	7M17	7M16	YoY%
China	189	69	211	175%	-10%	882	812	9%
India	157	238	189	-34%	-17%	1,275	1,618	-21%
EU	213	169	190	26%	12%	1,140	1,081	5%
Pakistan	78	124	61	-37%	28%	516	429	20%
US	51	48	77	5%	-34%	304	385	-21%
Others	710	732	657	-3%	8%	5,100	4,349	17%
Total	1,398	1,379	1,384	1%	1%	9,216	8,673	6%

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	9.00	NEUTRAL	SOP with plantation sector @ 26.8x FY17E PE. 26.8x is the higher of IOICORP and KLK Target PE.
IOICORP	5.00	NEUTRAL	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	17.69	NEUTRAL	1.0x Price to Book Value
FGV	1.59	NEUTRAL	1.0x Price to Book Value
GENP	11.55	NEUTRAL	SOP with plantation sector @ 24.7x FY17E PE. 24.7x is the lower valuation between IOICORP and KLK.
IJMP	3.53	NEUTRAL	18.6x Fwd. PE on FY17F earnings reflecting mean valuation.
TSH	2.15	BUY	22.3x Fwd. PE on FY17F earnings reflecting mean valuation.
TAANN	4.30	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.