

25 October 2017 | Sector Update


**PLANTATION***La Niña by year end?***Maintain NEUTRAL****KEY HIGHLIGHTS**

- **La Niña to happen soon?**
- **Significant impact to production if it is a strong La Niña**
- **Maintain October inventory estimate of 2.09m MT**
- **Maintain NEUTRAL view on the sector but may review our palm oil price assumption soon**
- **Top pick is IOICORP (BUY; TP: RM5.27)**

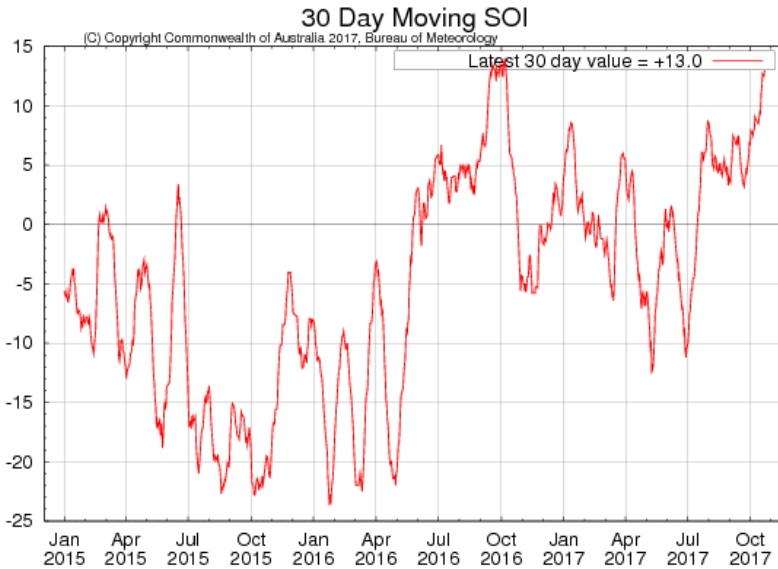
**La Niña to happen soon?** Australia Bureau of Meteorology has activated its La Niña Watch yesterday with 50% chance of La Niña forming in late 2017. According to ABM, "models suggest the tropical Pacific Ocean will continue to cool, making the chance of a La Niña forming in late 2017 at least 50%; around double the normal likelihood. While this means the Bureau's ENSO Outlook has shifted to La Niña WATCH, rainfall outlooks remain neutral due to competing climate drivers... Seven of the eight international climate models surveyed by the Bureau suggest that sea surface temperatures will reach or exceed La Niña thresholds by November 2017. However, indicators need to remain at La Niña levels for at least three months to be considered an event."

**Significant impact to palm oil production if it is a strong La Niña.** If La Niña is confirmed, we expect excessive rains in Malaysia and Indonesia which usually cause flood. The production in flood prone states may be affected. Overall, the news is slightly positive to palm oil price but the magnitude of impact will depend on the whether La Niña eventually materializes and its strength. Coupled with labour shortage problem which is still affecting the industry, we expect palm oil price to surge to RM3500 per tonne if a strong La Niña materialize.

**Maintain October inventory estimate of 2.09m MT.** We expect October inventory to rise 4%mom to 2.09m MT. Key assumptions are: i) production increase of 3%mom, and ii) export increase of 6%mom. We believe that palm oil demand should be supported by good export growth to India as the pre stocking activity should continue. Our export assumption is deemed conservative as cargo surveyors' data shows growth of 18% in export for the first ten days of October. For production growth we are using seasonal factor to estimate the 3% increase.

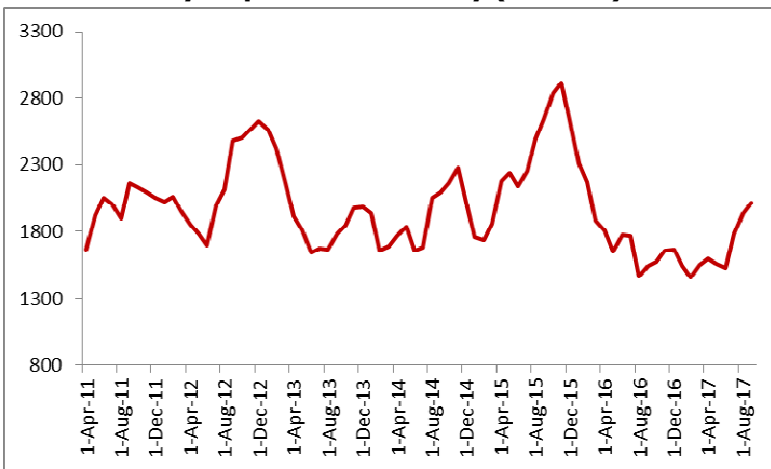
**Maintain NEUTRAL view on the sector but may review our palm oil price assumption soon.** Our NEUTRAL view on the sector is maintained with near term expectation of palm price to trade at between RM2700 to RM2950 per MT. The floor of RM2700 per MT is due to our assumption that soybean oil should stay strong at 33 US cents per pound (~USD 725 per MT) in view of the dry weather in Brazil. For the ceiling of RM2950 per MT, we believe that most palm oil producers will sell forward in a significant way when price gets closer to RM3000 per MT and hence the upside is limited at RM2950 per MT. Our Top Pick for the sector is IOICORP (BUY with TP of RM5.27) due to: i) overall margin improvement at Group level after the sale of 70% stake in Loders Croklaan (Loders), ii) special dividend of 13.0 sen, and iii) net gearing is expected to decline significantly to 0.25x (from 0.78x). 

**Chart 1: Southern Oscillation Index**



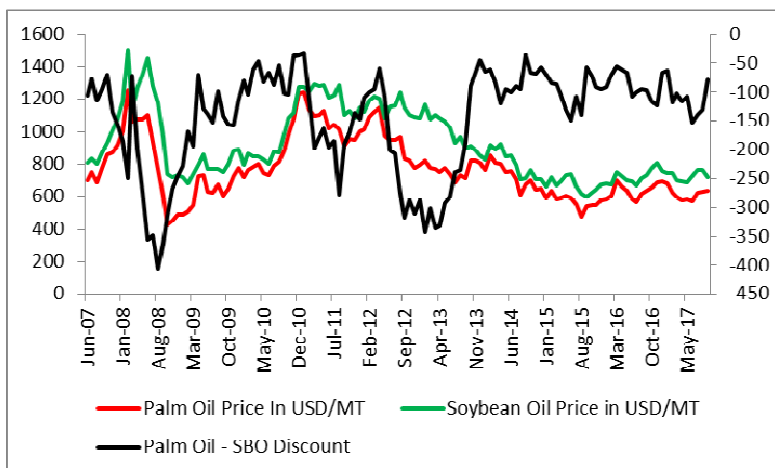
Source: Australia Bureau of Meteorology

**Chart 1: Malaysia palm oil inventory ('000 MT)**



Source: Malaysia Palm Oil Board (MPOB)

**Chart 2: Discount between palm oil and soybean oil**



Source: Bloomberg

**Table 1: Basis of valuation**

Company	TP	Call	Valuation Basis
SIME	9.05	NEUTRAL	SOP with plantation sector @ 26.8x FY18F PE. 26.8x is the higher of IOICORP and KLK Target PE.
IOICORP	5.27	BUY	26.3x Fwd. PE on FY18F earnings reflecting +1.0SD 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	12.06	BUY	SOP with plantation sector @ 24.7x FY17F PE. 24.7x is the lower valuation between IOICORP and KLK.
IJMP	3.00	NEUTRAL	18.6x Fwd. PE on FY18F 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.
FIMACOR	2.50	BUY	SOP with plantation sector @ 11.5x FY18F PE. 11.5x is based on 40% discount to average Target PE for mid cap planters.

Source: MIDF Research Estimate

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#### 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.