05 June 2017 | Sector Update

PLANTATION

Lacklustre 1QCY17 report card for planters

***Maintain* NEUTRAL**

KEY HIGHLIGHTS

- **Lacklustre 1QCY17 earnings performance with 1 above; 2 below and 6 within expectations**
- **CPO price should be supported at above RM2500 per MT**
- **Expect May-2017 inventory to stay flat mom at 1.60m MT**
- **Ample supply of soybean globally**
- **Risk to our downgrade is the El Nino return**
- **Maintain NEUTRAL view on the sector with BUY calls on KLK, TSH and TAANN**

Lacklustre 1QCY17 earnings performance with 1 above; 2 below and 6 within expectations. Most plantation companies reported earnings which met ours and consensus expectation. Only one company registered better than expected earnings as TAANN plantation division 1QCY17 FFB production growth came in stronger than expected at 20% yoy to 148,715 MT. The underperformers are IOICORP (lower than expected PBT in the resource based manufacturing division) and FGV (unexpected loss in the sugar division).

CPO price should be supported at above RM2500 per MT. We expect CPO price (spot) to weaken slightly to around RM2500 per MT in the 3Q2017 (from above RM2700 per MT currently). Due to the seasonal impact and the recovery of El Nino, we expect 3Q2017 production to be higher than average and hence limit the upside of CPO price. The outlook demand is lacklustre throughout most of 3Q2017 in the absence of major festivals. Having said that, the pre-stocking activity ahead of Mid-Autumn Festival should boost demand for palm oil from China but this should only occur from September onwards.

Expect May-2017 inventory to stay flat mom at 1.60m MT. We are revising down our end-May inventory estimate by 6% to 1.60m MT due to stronger than expected export of palm oil. Note that cargo surveyors have reported export growth of 15% to 16% and this is higher than our initial assumption of 7% growth. Production growth is maintained at 7% mom. We believe that the strong export of palm oil was caused by restocking activity ahead of Ramadhan in key consumers such as India and Pakistan.

Ample supply of soybean globally. Oil World estimated that global soybean stocks should approach 100m MT by the end of 2016/2017 season (ending September). It further explains that "larger than expected yields have created a surplus in soybeans with large stocks accumulating. Biggest year-on-year increases in soybean stocks in August 2017 will be in the USA, Brazil and Argentina." We believe that the ample supply of soybean should eventually lead to higher soybean oil supply, hence limiting CPO price upside.

May upgrade the sector if El Nino returns. As of 12-May-2017, Australia Bureau of Meteorology has maintained its ENSO Outlook status at El Nino WATCH (likelihood of ~50%). It further explains that "Five of eight international climate models suggest the tropical Pacific Ocean is likely to warm above El Niño thresholds during the second half of 2017. However virtually all models now suggest less warming is likely to occur compared to their previous outlooks, indicating any event may be weak." We are watching the situation closely and may upgrade our sector only if El Nino materialize. At this juncture, we maintain our average 2017 CPO price forecast of RM2725 per MT assuming ENSO neutral weather.

Maintain NEUTRAL view on the sector. Top Pick for the sector is KLK (BUY with TP of RM29.25) 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 18.5x PE which is close to its -0.5SD level of 18.1x and iii) it is a key laggard among plantation stocks as its YTD share price decline of 5.4% trailed KL Plantation Index +2.7%. 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%, ii) timber division is expected to remain profitable due to the support from high export logs price and iii) it is a key laggard among plantation stocks as its YTD share price decline of 10.4% trailed KL Plantation Index +2.7%.

Table 1: Summary of 1QCY17 result for planters under our coverage

No	Stock	Period Under Review	Cumulative Qtr CNI (RM m)	CNI % of our estimate	Against Expectation	Comment
1	SIME	9MFY17	1599.9	71%	Within	
2	IOICORP	9MFY17	824.8	61%	Below	Lower than expected PBT of RM285m (-57% yoy) in the resource based manufacturing (RBM) division. RBM sub-segments of oleochemical and refining have registered weaker sales volume and lower margin.
3	KLK	6MFY17	666.9	55%	Within	
4	PPB	3MFY17	358.3	38%	Within	Although the Core Net Profit makes up 38% of our estimate and 33% of consensus, we deem the result as within expectation. We are expecting Wilmar result to moderate in the coming quarters due to lower CPO price estimated in the remaining quarte
5	GENP	1QFY17	82.2	24%	Within	
6	FGV	3MFY17	0.5	1%	Below	Unexpected loss in the sugar division.
7	IJMPLNT	4QFY17	119.1	95%	Within	
8	TSH	3MFY17	28.7	22%	Within	
9	TAANN	3MFY17	36.8	37%	Above	Stellar performance from the plantation division as 1QFY17 FFB production growth came in stronger than expected at 20% yoy to 148,715 MT.

Source: Company, MIDF Research

Table 2: 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 *rise* 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 *fall* 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.