

14 June 2017 | Sector Update

PLANTATION

Maintain **NEUTRAL**

May inventory is lower than expected

KEY HIGHLIGHTS

- **May inventory is lower than expected**
- **Production uptrend continues for the sixth month**
- **Good export growth due to strong demand from India and Pakistan**
- **Expect June-2017 inventory to ease 2% mom to 1.52m MT**
- **Stay NEUTRAL with BUY calls on KLK (TP: RM29.25), TSH (TP: RM2.15) and TAANN (TP: RM4.30)**

May inventory is lower than expected. Malaysia palm oil inventory level of 1.56m MT as of end-May 2017 is lower than our estimate of 1.60m MT and consensus estimate of 1.61m MT. The surprise factor is the stronger than expected export growth at 17% mom to 1.51m MT. This could be caused by the exceptionally high demand for palm oil from India and Pakistan due to restocking activity ahead of Ramadhan. Against last month, inventory level declined by 3% as export growth of 17% exceeded production growth of 7%. Against same period last year, inventory remains lower yoy by 5 % but the decline rate has is lower against April's 11% decline yoy.

Production uptrend continues for the sixth month. CPO production has shown a strong recovery with 7% increase mom and 21% yoy to 1.65m MT. Sarawak CPO production leads the recovery (+9% mom to 327,777 MT) and this is followed by Sabah (+8% to 461,650 MT) and Peninsular Malaysia (+5% mom to 865,067 MT). May production increase of 21% yoy suggests that the palm trees have fully recovered from the impact of severe El Nino and the uptrend of strong production should continue into 3Q2017.

Good export growth due to strong demand from India and Pakistan. Export to India surged 70% mom to 273,699 MT. Besides India, export to Pakistan has also jumped (+90% to 108,185 MT). We believe that the pre-stocking activity ahead of Ramadhan in these countries has boosted palm oil consumption.

Expect June-2017 inventory to ease 2% mom to 1.52m MT. Key assumptions are: i) production increase of 2% mom and ii) export growth of 3% mom. We are expecting better export of palm oil as we expect more usage in the Northern Hemisphere as the Summer Solstice should start soon on 21 June. Note that palm oil is used more during warm weather as it tends to stay in liquid form and does not solidify. Our export estimate is deemed conservative as cargo surveyors reported 6% increase in the first ten days of May. For production growth we are using seasonal factor to estimate the 2% increase.

Stay NEUTRAL with BUY calls 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 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 5.9% trailed KL Plantation Index +2.4%. 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 12.7% trailed KL Plantation Index +2.4%.

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

	May-17	Apr-17	Diff.	MoM %	May-16	YoY%
Opening Stocks	1,600	1,553	47	3.0%	1,804	-11.3%
Production	1,654	1,548	106	6.9%	1,365	21.2%
Imports	47	54	(7)	-12.9%	20	137.0%
Total Supply	3,302	3,156	146	4.6%	3,189	3.6%
Exports	1,506	1,284	222	17.3%	1,282	17.4%
Dom Disapp	238	272	(34)	-12.4%	261	-8.5%
Total Demand	1,744	1,556	189	12.1%	1,543	13.0%
End Stocks	1,558	1,600	(42)	-2.6%	1,646	-5.3%
Stock/Usage Ratio	7.4%	8.6%			8.9%	

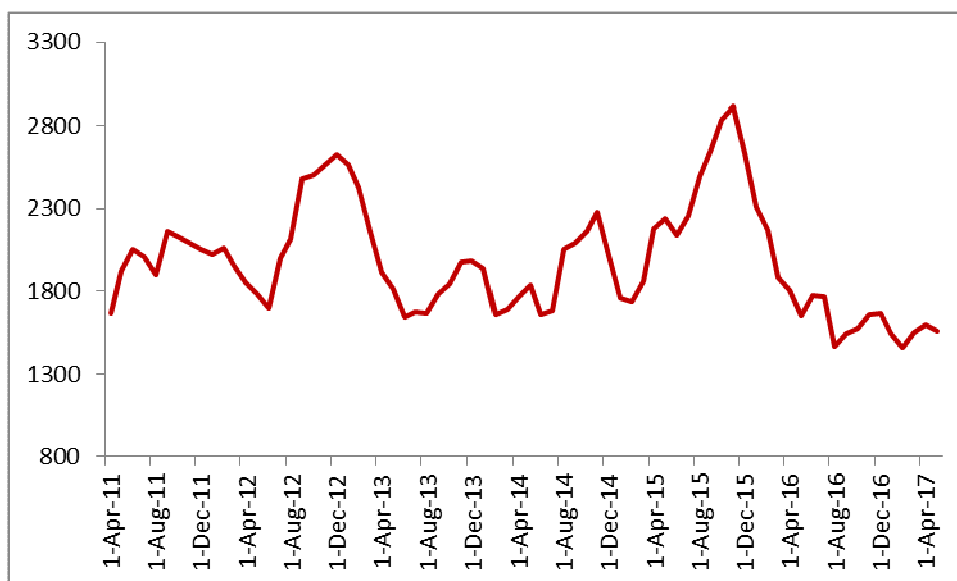
Source: MPOB, MIDF Research

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

Country	May-17	Apr-17	May-16	MoM%	YoY%	5M17	5M16	YoY%
China	113	137	106	-18%	7%	625	500	25%
India	274	161	310	70%	-12%	879	1,259	-30%
EU	169	164	117	4%	44%	758	740	2%
Pakistan	108	55	77	97%	41%	314	280	12%
US	39	51	59	-25%	-35%	205	278	-26%
Others	803	715	613	12%	31%	3,658	3,090	18%
Total	1,506	1,284	1,282	17%	17%	6,439	6,147	5%

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.