Sector Update | Friday, 11 October 2019

PLANTATION

Maintain NEGATIVE

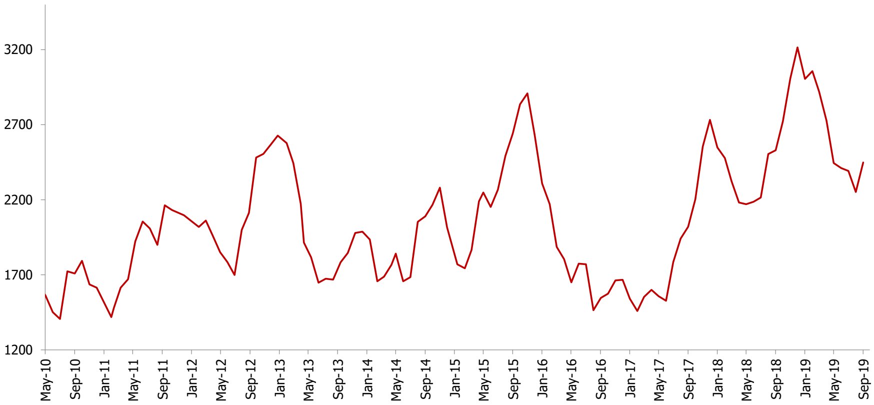
Palm oil inventory level rebound

KEY INVESTMENT HIGHLIGHTS

- **September 2019 inventory rebounded to 2.4m metric tonnes (mt) which remained elevated -3.7% below on a year-over-year basis**
- **The export demand in September 2019 fell by -12.9%yoy, mainly attributable to the slower demand growth from India and China and larger decline from EU (-38.9%yoy) and other markets (-34.6%yoy)**
- **We expect stockpiles to continue to trend upwards in view of the lower export demand and higher production cycle in 4QCY19 which could provide some resistance in the recovery of CPO price**
- **Maintain NEGATIVE stance on the sector with an unchanged CPO target price of RM2,090/mt**

Stockpiles escalates. Malaysian palm oil inventory in September 2019 increased to 2.4m mt, breaking the consecutive eight months of decrease since December 2018. This was mainly attributable to the decrease in export demand by -12.9%yoy amidst the seasonal higher production period. The inventory level came in within Bloomberg and Reuters expectations with a variance of -0.1% and -2.8% respectively. Meanwhile, we opine that the export demand to trend lower in coming months due to India's imposition of additional 5.0% tariff on Malaysian refined palm oil. Coupled with the higher production cycle, we believe this could possibly cause the inventory level to trend upwards and provide some resistance to the recovery in CPO price.

Chart 1: Malaysia Palm Oil Inventory ('000 MT)



Source: Malaysia Palm Oil Board (MPOB), MIDFR

Export demand declined precipitously... On a year-over-year basis, September 2019 export plunged by -12.9%yoy to circa 1.4m mt. This came in within expectation of Bloomberg and Reuters consensus with a variance of -2.8% and +0.9% respectively. The lower export demand was primarily due to weakening demand growth from India as the Indian government raised additional tariff rate of 5.0% on Malaysian refined palm oil on 4th September 2019 to 50.0%. This is predicated on the fact that the purchases might be shifted towards Indonesian palm oil which has a cheaper pricing than Malaysian palm oil as both producers incur the same tariff rate. This was manifested through a sharp decline of -45.1%mom of export to India. In addition, the export demand from EU and other markets fell by -38.9%yoy and -34.6%yoy respectively. The latter includes major decliners like Turkey (-78.0%yoy), Iran (-66.4%yoy), South Africa (-92.2%yoy) and Nigeria (-85.1%yoy).

COMPANY IN FOCUS

Sime Darby Plantation Bhd
Maintain **SELL** | Unchanged Target price: RM4.08
Price @ 10th October 2019: RM4.60

- Low CPO price continues to negatively impact the group's upstream operations
- Cost management efforts is insufficient to provide meaningful buffer
- We expect dividend payout to be unattractive leading to dividend yield of less than one percent

Share price chart

Kuala Lumpur Kepong Bhd
Maintain **SELL** | Unchanged Target price: RM18.78
Price @ 10th October 2019: RM21.44

- Low CPO price continues to negatively impact the group's plantation division
- We are concerned on the thinning margin from its European operation
- Property segment's profit has improved considerably but minimal profit contribution

Share price chart

ANALYST
Martin Foo Chuan Loong
martin.foo@midf.com.my
03 -2173 8354

…export to China might be tapering off as well. Chinese buyers have been ramping up purchases of U.S. soybeans with approximately 1.5m mt in the last week of September 2019 ahead of the US-China trade talk. The shipment of those purchased soybeans is said to be throughout the 4QCY19 period. It is worth noting that an increase in soybean purchases by China would normally translate into lower purchases of palm oil since the two commodities are close substitutes. As such, we have observed a fall in China's September 2019 import of palm oil by -27.9%mom. Nonetheless, the 9MCY19 export demand growth remains robust at +14.4%yoy, underpinned mainly by India due to previous preferential tariff trade agreement. Moving forward, we are of the view that export demand to trend lower in coming months in view of the expected further weakening demand from India and China subsequent to major festival like Diwali coming to an end in October 2019 and resumption of U.S. soybeans purchases by China respectively as well as the winter season in 4QCY19.

Table 1: September 2019 Export Performance ('000 MT)

Market	Sep-19	Aug-19	Sep-18	MoM%	YoY%	9M19	9M18	Ytd%
China	222.5	308.5	110.0	-27.9	102.3	1,618.1	1,214.1	33.3
India	310.6	566.2	228.1	-45.1	36.2	3,908.2	1,940.2	101.4
EU	139.6	147.1	228.4	-5.1	-38.9	1,569.7	1,509.5	4.0
Pakistan	119.3	106.7	105.0	11.8	13.6	821.6	881.8	-6.8
US	31.0	47.3	49.5	-34.5	-37.3	466.2	399.5	16.7
Others	586.8	557.0	897.8	5.4	-34.6	5,639.5	6,312.7	-10.7
Total	**1,409.9**	**1,732.9**	**1,618.7**	**-18.6**	**-12.9**	**14,023.3**	**12,257.8**	**14.4**

Source: MPOB, MIDFR

Production to remain elevated. September 2019 production level came in at 1.8m mt which was about the same level as in August 2019. Although this represented a marginal decrease of -0.6%yoy, the output level still remained elevated as the palm oil industry is experiencing the high production cycle. It was worth noting that this was the first decline after consecutive eight months increase in production level on a year-over-year basis. The higher output was mainly attributable to higher production from the state of Kelantan (+2.9%yoy), Pahang (+8.5%yoy), Terengganu (+4.8%yoy), Sarawak (+3.6%yoy) and Negeri Sembilan (+10.7%yoy). Meanwhile, this came in lower than the Bloomberg and Reuters consensus by -3.0% and -3.4% respectively. On a year-to-date comparison, 9MCY19 CPO production also remained elevated (+9.3%ytd) due to higher output primarily from the state of Kelantan (+29.3%ytd), Terengganu (+25.1%ytd), Pahang (+21.7%ytd) and Negeri Sembilan (+15.6ytd). Moving forward, we expect production level to remain elevated in the beginning of 4QCY19 before tapering off as the quarter comes to end. This is premised on the absence of supply disruption event and seasonally higher output cycle.

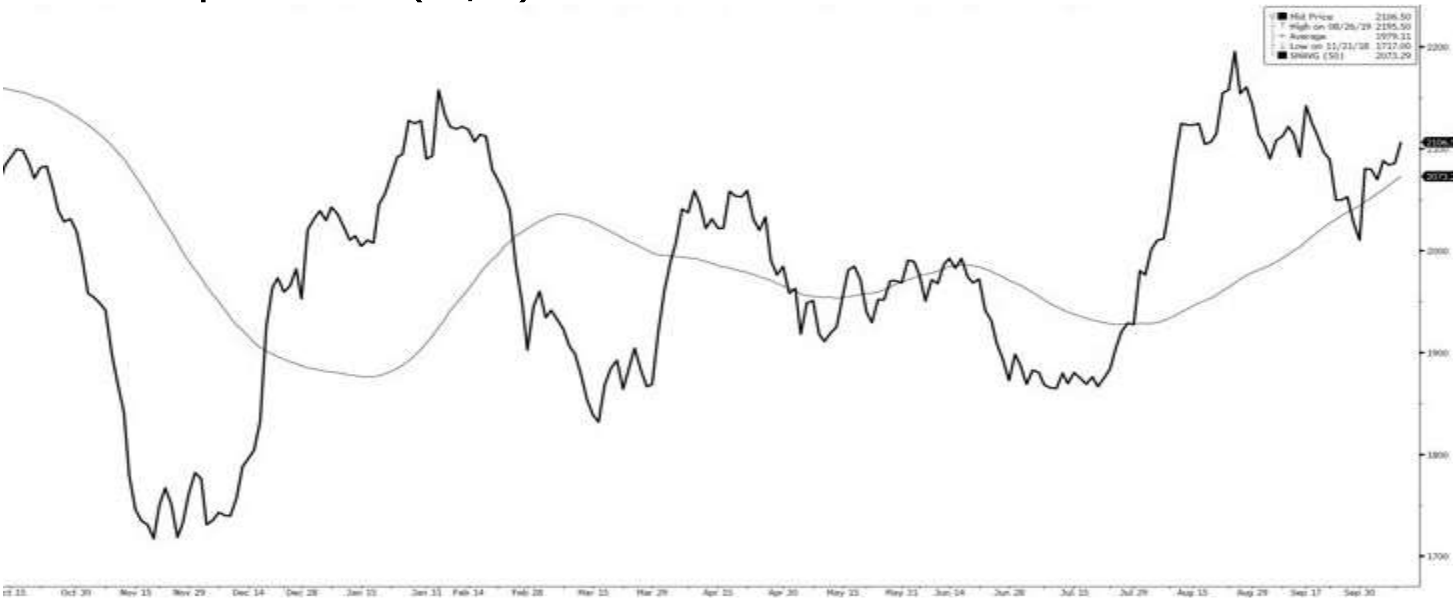
Table 2: Palm Oil Statistics for September 2019 ('000 MT)

	Sep-19	Aug-19	Sep-18	YoY %	MoM %	9MCY19	9MCY18	Ytd%
Opening Stocks	**2,251.8**	**2,391.7**	**2,504.9**	**-10.1**	**-5.8**	**3215.05**	**2,732.1**	**17.7**
Production	**1,842.4**	**1,821.5**	**1,853.6**	**-0.6**	**1.1**	**15187.76**	**13,897.3**	**-86.7**
Imports	71.1	51.1	61.6	15.4	39.3	690.59	481.2	-85.2
Total Supply	**4,165.4**	**4,264.3**	**4,420.1**	**-5.8**	**-2.3**	**19,093.4**	**17,110.6**	**-75.7**
Exports	1,409.9	1,732.9	1,618.7	-12.9	-18.6	14003.60	12,259.4	-88.5
Dom Disapp	307.2	279.6	260.2	18.0	9.9	2641.53	2,321.7	-86.8
Total Demand	**1,717.1**	**2,012.4**	**1,878.9**	**-8.6**	**-14.7**	**16,645.1**	**14,581.1**	**-88.2**
End Stocks	**2,448.3**	**2,251.8**	**2,541.2**	**-3.7**	**8.7**	**2,448.3**	**2,529.4**	**-3.2**
Stock/Usage Ratio (%)	**11.9%**	**9.3%**	**11.3%**			**1.2%**	**1.4%**	

Source: MPOB, MIDFR

Average CPO price hovering about RM2,000/mt level. While the average CPO price has been gradually creeping upwards, it is expected to be met with resistance in coming months. This is premised on the expectation that inventory will continue to trend upwards amidst weaker export demand and higher production cycle. Thus, this would exert downward pressure on the recovery of the CPO price. Nonetheless, the 9MCY19 average CPO price of about RM2,000/mt remains lacklustre, representing a discount of -15%yoy. This is still within our 2019 average CPO price assumption of RM2,090/mt, bearing a variance of -4.5%. We opine that the expected lower export demand from major importers like India, China and EU to continue to partially impede on the recovery of CPO price. In addition, the strengthening of the soybean price on the optimism arising from China's resumption in soybean purchases provides slight comfort to the CPO price. This is to take note of the positively-interrelated price trend between palm oil and soybean oil.

Chart 2: CPO Spot Price Trend (RM/mt)



Source: Bloomberg, MIDFR

Maintain NEGATIVE. We are of the view that the relatively high CPO output to continue its momentum throughout the historical seasonal higher production period which typically fall between July and October. Coupled with the lower export demand trend from major importers of Malaysian palm oil, we are likely to see a continued upward trend in the inventory level. This will continue to exert resistance to the gradual recovery of CPO price. The expected weakening demand is mainly predicated on factors such as (1) India's 5.0% tariff hike resulting in removal of Malaysian palm oil preferential treatment across ASEAN region (2) Chinese buyers resume loading up soybean (3) Winter season (i.e. November to February) where palm oil might not be the most suitable oil to be consumed as it tends to turn semi-solid or thick. All in, with the expected downward trend in export and higher stockpiles level, we are maintaining our **NEGATIVE** stance on the sector with an unchanged 2019 CPO price target of **RM2,090/mt**.

PEER COMPARISON TABLE

Stock	FYE	Rec.	Price @ 10-Oct-19	Tgt Price (RM)	Core EPS (sen)		CORE PE (x)		Net DPS (sen)		Net Dvd Yield (%)	
					CY19F	CY20F	CY19F	CY20F	CY19F	CY20F	CY19F	CY20F
Genting Plantation	Dec	SELL	10.08	8.40	20.6	30.1	48.9	33.5	10.9	12.1	1.1	1.2
IOI Corporation	Jun	SELL	4.22	3.48	12.6	14.0	33.5	30.3	9.3	11.0	2.2	2.6
IJM Plantation	Mar	SELL	1.50	1.16	3.9	4.5	38.5	33.0	2.0	3.0	1.3	2.0
Kuala Lumpur Kepong	Sep	SELL	21.44	18.78	67.3	75.6	31.8	28.4	45.0	45.0	2.1	2.1
Sime Darby Plantation	Dec	SELL	4.90	4.08	2.1	6.3	233.3	77.8	1.1	3.8	0.2	0.8
PPB Group	Dec	NEUTRAL	17.90	17.43	64.6	72.1	27.7	24.8	19.4	21.6	1.1	1.2
Ta Ann Holdings	Dec	NEUTRAL	2.31	2.18	8.5	18.2	27.1	12.7	10.0	10.0	4.3	4.3
TSH Resources	Dec	NEUTRAL	0.90	0.89	3.6	4.6	24.8	19.5	1.0	1.2	1.1	1.3
FGV Holdings	Dec	NEUTRAL	1.02	0.96	-3.0	-2.1	-33.7	-49.5	N/A	N/A	N/A	N/A

Source: Company, MIDFR

MIDF RESEARCH is part of MIDF Amanah Investment Bank Berhad (23878 - X).
(Bank Pelaburan)
(A Participating Organisation of Bursa Malaysia Securities Berhad)

DISCLOSURES AND DISCLAIMER

This report has been prepared by MIDF AMANAH INVESTMENT BANK BERHAD (23878-X). It is for distribution only under such circumstances as may be permitted by applicable law.
Readers should be fully aware that this report is for information purposes only. The opinions contained in this report are based on information obtained or derived from sources that we believe are reliable. MIDF AMANAH INVESTMENT BANK BERHAD makes no representation or warranty, expressed or implied, as to the accuracy, completeness or reliability of the information contained therein and it should not be relied upon as such.
This report is not, and should not be construed as, an offer to buy or sell any securities or other financial instruments. The analysis contained herein is based on numerous assumptions. Different assumptions could result in materially different results. All opinions and estimates are subject to change without notice. The research analysts will initiate, update and cease coverage solely at the discretion of MIDF AMANAH INVESTMENT BANK BERHAD.
The directors, employees and representatives of MIDF AMANAH INVESTMENT BANK BERHAD may have interest in any of the securities mentioned and may benefit from the information herein. Members of the MIDF Group and their affiliates may provide services to any company and affiliates of such companies whose securities are mentioned herein This document may not be reproduced, distributed or published in any form or for any purpose.

MIDF AMANAH INVESTMENT BANK : GUIDE TO RECOMMENDATIONS	
STOCK RECOMMENDATIONS	
BUY	Total return is expected to be >10% over the next 12 months.
TRADING BUY	Stock price is expected to *rise* by >10% within 3-months after a Trading Buy rating has been assigned due to positive newsflow.
NEUTRAL	Total return is expected to be between -10% and +10% over the next 12 months.
SELL	Total return is expected to be <10% over the next 12 months.
TRADING SELL	Stock price is expected to *fall* by >10% 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.