

13 November 2017 | Sector Update

PLANTATION

Rise of the biodiesel demand

Maintain POSITIVE

KEY HIGHLIGHTS

- **Export to Europe improved possibly due to demand from the biodiesel industry there**
- **Biodiesel demand in Malaysia and Indonesia is likely to have improved in October**
- **October inventory is within expectation**
- **Production should have peaked in October**
- **Expect November inventory growth to taper down to 5%**
- **Maintain POSITIVE view on the sector with IOICORP as top pick**

Export to Europe improved possibly due to demand from the biodiesel industry there. Export increased 2% mom to 1.55m MT due to better export growth to European Union. Export to EU surged 85% mom to 200,392 MT which we think could be caused by better demand for palm oil from the biodiesel industry as crude oil price increased 7% to USD 61.37 per barrel as of end-October (from USD57.54 per barrel in early-October). Note that palm oil is the second most important feedstock for EU biodiesel industry.

Biodiesel demand in Malaysia and Indonesia is likely to have improved in October. In Malaysia, local usage of palm oil has increased by 35% mom to 303,995 MT in October. As the usage for food usually does not fluctuate much, we believe that the additional demand is likely to be caused by good demand from the biodiesel industry. The import of palm oil from Indonesia has dropped significantly by 67% mom to 13,479 MT. This is an indication that the biodiesel demand is good in Indonesia and hence limits the amount of palm oil to be exported out of the country.

October inventory is within expectation. Malaysia palm oil inventory level of 2.19m MT as of end-October 2017 is close to market expectation of 2.20m MT. However, it is higher than our estimate of 2.09m MT as production came in stronger than expected. Note that October production increased by 13% mom against our expectation of 3% increase. Against last month, inventory level increased by 8% as production growth of 13% exceeded export volume growth of 2%. Against same period last year, inventory is higher by 39% (against September's increase of 31% yoy).

Production should have peaked in October. Palm oil production surged 13% mom and 20% yoy to 2.01m MT in September. Despite the double digit growth in production, we are not overly concerned as it came from a low base in September which has lower working days due to 4 days of public holidays. We also believe that production has peaked in October and expect November production to decline 6% mom.

The data is neutral to palm oil price. Overall, we are neutral on the latest MPOB stats as it falls within market expectation. Strong soybean oil price should continue to support palm oil price.

Expect November inventory growth to taper down to 5%. Although we expect November inventory to increase, the growth is likely to slow down to 5% (from October's 8% increase) as production is expected to decline by 6% mom. We also expect export to decrease 3% mom which is close to the 2.5% decline in the first ten days of November. The seasonal decline in palm oil demand is due to the upcoming winter in Northern Hemisphere. Note that the usage of palm oil tend to be lower during winter as it solidifies in cold temperatures. For production growth we are using seasonal factor to estimate the 6% decline. All said, we expect November inventory of 2.30m MT.


Maintain POSITIVE view on the sector with IOICORP as top pick. We maintain our palm oil price forecast of RM2825 per MT for 2017 and RM2900 per MT for 2018. Reiterate positive view on the sector due to: i) Consensus palm oil price forecasts are too pessimistic, ii) demand outlook for palm oil is better in 2018, iii) supply growth for palm oil to weaken in 2018, iv) South America soybean production should decline in 2018, v) strong set of earnings expected in the upcoming November result season. Top Pick for the sector is IOICORP (BUY with TP of RM5.27) due to: i) overall margin improvement at the Group level after 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). We also have BUY calls on KLK, GENP, TSH, TAANN and FIMACORP. 

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

	Oct-17	Sep-17	Diff.	MoM %	Oct-16	YoY%
Opening Stocks	2,021	1,942	79	4.1%	1,546	30.7%
Production	2,009	1,780	229	12.9%	1,678	19.7%
Imports	13	41	(28)	-67.3%	27	-49.8%
Total Supply	4,043	3,763	280	7.4%	3,251	24.4%
Exports	1,549	1,518	31	2.0%	1,431	8.2%
Dom Disapp	304	225	79	35.4%	246	23.7%
Total Demand	1,853	1,742	110	6.3%	1,677	10.5%
End Stocks	2,190	2,021	170	8.4%	1,574	39.1%
Stock/Usage Ratio	9.9%	9.6%			7.8%	

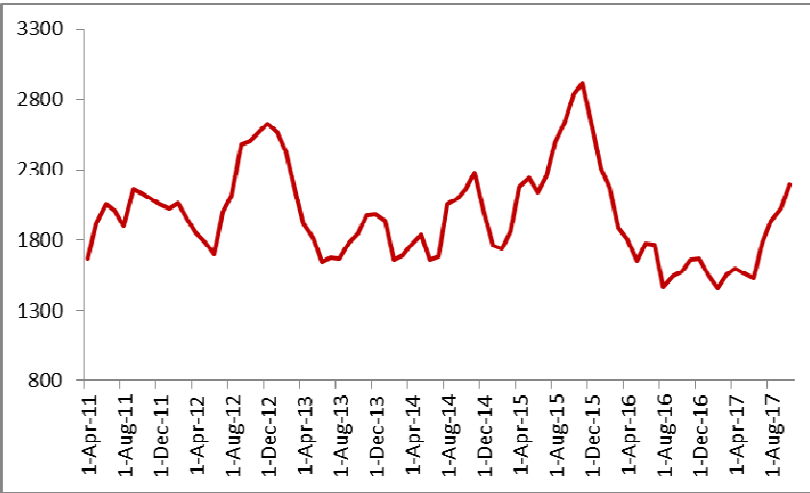
Source: MPOB, MIDF Research

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

Country	Oct-17	Sep-17	Oct-16	MoM%	YoY%	10M17	10M16	YoY%
China	194	268	187	-27%	4%	1,538	1,495	3%
India	166	189	204	-12%	-18%	1,818	2,523	-28%
EU	200	109	226	85%	-11%	1,626	1,714	-5%
Pakistan	137	128	89	7%	54%	849	694	22%
US	41	47	36	-13%	15%	436	513	-15%
Others	810	775	690	5%	17%	7,502	6,439	17%
Total	1,549	1,515	1,431	2%	8%	13,768	13,379	3%

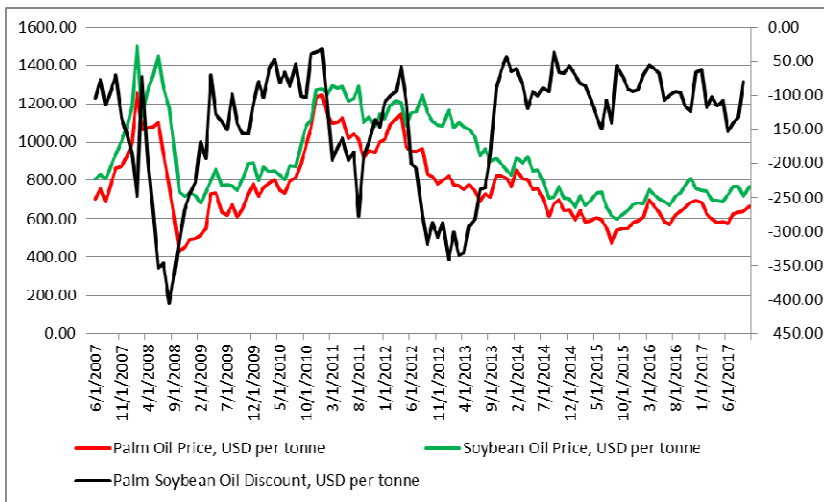
Source: MPOB, MIDF Research

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: Target Price and Recommendations

Company	TP	Call	Valuation Basis
SIME	9.25	NEUTRAL	SOP with plantation sector @ 26.8x FY18F PE. 26.8x is the higher of IOICORP and KLK Target PE.
IOICORP	5.50	BUY	26.3x Fwd. PE on FY18F earnings reflecting +1.0SD valuation.
KLK	29.65	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	12.60	BUY	SOP with plantation sector @ 24.7x FY17F PE. 24.7x is the lower valuation between IOICORP and KLK.
IJMP	3.15	NEUTRAL	18.6x Fwd. PE on FY18F earnings reflecting mean valuation.
TSH	2.25	BUY	22.3x Fwd. PE on FY17F earnings reflecting mean valuation.
TAANN	4.50	BUY	16.6x Fwd. PE on FY17F earnings reflecting mean valuation.
FIMACORP	2.60	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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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.