

11 October 2016 | Sector Update

PLANTATION*Small increase in inventory***Maintain POSITIVE****KEY HIGHLIGHTS**

- **September inventory level is within expectation**
- **Temporary slowdown in demand from China and India**
- **Production growth remains flat at 1% mom**
- **Import is at all-time low implying strong biodiesel usage in Indonesia**
- **Expect Oct-2016 inventory to increase by only 2% to 1.57m MT**
- **Maintain POSITIVE view on the sector with BUY call on KLK (TP: RM27.38) and IOICORP (TP: RM5.05)**

September inventory level is within expectation. Malaysia palm oil inventory level of 1.55m MT as of end-September 2016 is the same as our estimate and close to consensus estimate of 1.51m MT. Against last month, inventory level has increased 6% as export declined 20% while production growth remains limited at less than 1%. Having said that, inventory remains significantly lower on-year as it has tumbled 41%yoy.

Temporary slowdown in demand from China and India. Export to India dropped 40%mom to 262,301 MT while export to China declined 34%mom to 197,555 MT. Usage of palm oil may have temporarily declined in China in the absence of stocking activity ahead of major festival. As for India, high price of CPO at near RM3000/MT may have caused the price sensitive consumers to delay their purchase. Note that average CPO price for Sep is RM2862/MT or 10% higher on-month. We expect the low demand situation to be short-lived as CPO price is likely to regain its competitiveness as the discount against soybean oil has widened.

Production growth remains flat at 1%mom. Peninsular Malaysia production growth is the highest at 3%mom to 870,813 MT. Surprisingly, Sarawak production was down 2%mom to 367,147 MT while Sabah production slipped 0.5%mom to 477,165 MT. On a yearly basis, production declined 12%yoy and this suggests that the impact of El Nino is still there.

Import is at all-time low. Import of palm oil (almost all from Indonesia) is very low at 1,792 MT. This is a decline of 77%mom and a drop of 98%yoy. We view this positively as it signals that biodiesel program is running smoothly there.

Expect Oct-2016 inventory to increase by only 2% to 1.57m MT. Our key assumptions are: i) export growth of 7%mom, and ii) production growth of 3%mom. We are expecting an export growth as the recent price decline has made CPO price to be competitive against other edible oils. Cargo surveyors' data shows export increase of 11%mom in the first ten days of October. For production growth, we are using seasonal factor to estimate the 3%mom growth.

Maintain POSITIVE view on the sector – BUY KLK (TP: RM27.38) and IOICORP (TP: RM5.05). We expect CPO price to remain high at the range of RM2500 to RM3000 per MT in the next three months. Our top pick is KLK (BUY; TP RM27.38) due to its high exposure to palm oil business and good earnings growth of +18%yoy to RM747m in 9MFY16. We also like IOICORP (BUY; TP RM5.05) due to its pure exposure to palm oil business both in the upstream and downstream divisions. The Company's profit is also expected to recover in FY17 after the uplift of RSPO suspension.

Table 1: Palm Oil Statistics for September-2016 ('000 MT)

	Sep-16	Aug-16	Diff.	MoM %	Sep-15	YoY%
Opening Stocks	1,464	1,771	(307)	-17.3%	2,492	-41.3%
Production	1,715	1,702	13	0.8%	1,959	-12.5%
Imports	2	8	(6)	-77.0%	76	-97.6%
Total Supply	3,181	3,480	(299)	-8.6%	4,527	-29.7%
Exports	1,451	1,824	(372)	-20.4%	1,678	-13.5%
Dom Disapp	183	193	(10)	-5.1%	221	-17.2%
Total Demand	1,634	2,016	(382)	-19.0%	1,899	-14.0%
End Stocks	1,547	1,464	83	5.7%	2,628	-41.1%
Stock/Usage Ratio	7.9%	6.1%			11.5%	

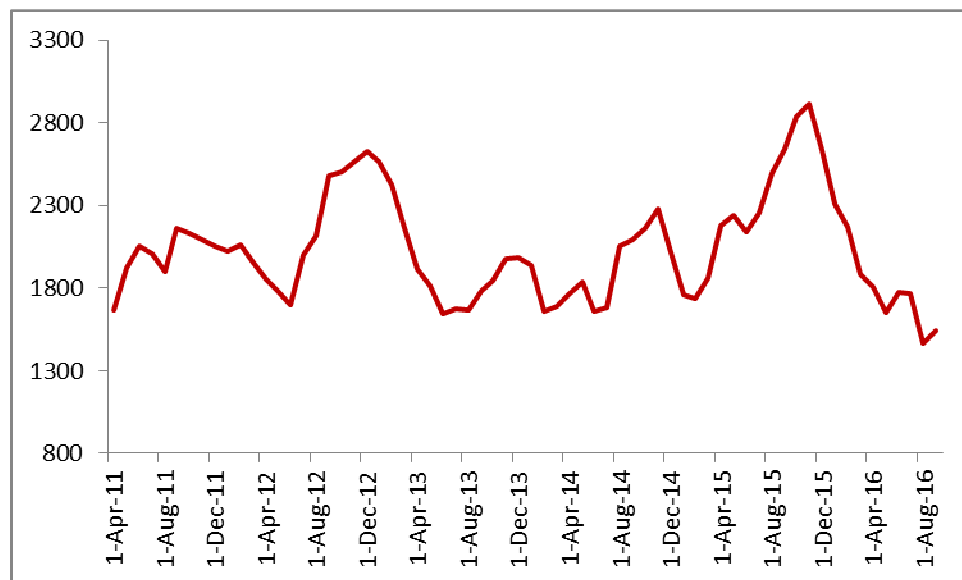
Source: MPOB, MIDF Research

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

Country	Sep-16	Aug-16	Sep-15	MoM%	YoY%	9M16	9M15	YoY%
China	198	299	193	-34%	3%	1,308	1,958	-33%
India	262	440	357	-40%	-27%	2,320	2,519	-8%
EU	172	236	228	-27%	-25%	1,489	1,712	-13%
Pakistan	92	84	58	10%	60%	605	544	11%
US	40	53	50	-24%	-21%	477	507	-6%
Others	687	713	795	-4%	-14%	5,749	5,507	4%
Total	1,451	1,824	1,681	-20%	-14%	11,948	12,746	-6%

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	7.75	NEUTRAL	SOP with plantation sector @ 25.1x FY17E PE. 25.1x is the avg of IOICORP and KLK Target PE.
IOICORP	5.05	BUY	24.7x Fwd. PE on FY16F earnings reflecting +0.5SD valuation.
KLK	27.38	BUY	26.8x Fwd. PE on FY16F earnings reflecting +1.0SD valuation.
PPB	15.00	NEUTRAL	19.5x Fwd. PE on FY16F earnings reflecting mean valuation.
FGV	1.77	NEUTRAL	1.0x Price to Book Value.
GENP	9.72	NEUTRAL	SOP with plantation sector @ 24.7x FY17E PE. 24.7x is the lower valuation between IOICORP and KLK.
IJMP	3.13	NEUTRAL	18.6x Fwd. PE on FY17F earnings reflecting mean valuation.
TSH	2.10	NEUTRAL	22.3x Fwd. PE on FY16F earnings reflecting mean valuation.
TAANN	3.50	NEUTRAL	16.6x Fwd. PE on FY16F 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.