

12 April 2016 | Sector Update

PLANTATION

Maintain POSITIVE***"Super El Nino" is dying but its Impact is still young***

KEY HIGHLIGHTS

- **March 2016 inventory level of 1.89m MT is below expectation.**
- **"Super El Nino Impact" has dried up CPO inventory by 35% or 1.02m MT in a short span of 4 months.**
- **"Super El Nino" is dying but its Impact is still young.**
- **Aggressive buying from China and India.**
- **Expect April inventory to decline 9%mom to 1.71m MT.**
- **Maintain POSITIVE view on the sector. Top pick is KLK (TP: RM27.38).**

March 2016 inventory level of 1.89m MT is below expectation as it is 3% lower than consensus forecast of 1.95m MT. It is also 6% lower than our estimate of 2.02m MT. The lower than expected inventory is caused by stronger than expected export of 1.33m MT (against our expectation of 1.20m MT). We believe that the major consumers may have performed stocking activities ahead of the 5% CPO export tax effective 1 April 2016.

"Super El Nino Impact" has dried up CPO inventory by 35% or 1.02m MT in a short span of 4 months. Inventory numbers have so far shown only half the power of what a "Super El Nino Impact" can do. It is worth to take note that the current "Super El Nino Impact" has taken away 1.02m MT of palm oil inventory in a short period of 4 months. Recall that the inventory level was 2.91m MT in Nov-2015 and it has now tumbled by 35% to 1.89m MT. Still, the worse for CPO production is not over as we expect the "Super El Nino Impact" to live on for another 7 months. We maintain our view that CPO price should surge to RM3000/MT by end-June as inventory is expected to drop to the critical level of 1.50m MT.

"Super El Nino" is dying but its Impact is still young. We believe that the market needs to differentiate "Super El Nino" and "Super El Nino Impact" due to the 6 months lagged impact of dry weather on CPO production. In our view, "Super El Nino Impact" has caused Mar-2016 production of 1.22m MT to be 12% below the average of 1.39m MT for March in the past 5 years. Although the current "Super El Nino" is expected to weaken soon by the Australian Bureau of Meteorology, the "Super El Nino Impact" damage is only half way through. In summary, "Super El Nino Impact" has started only from Nov-2015 and is now at its 5th month. As "Super El Nino" lasted about 12 months (from May-2015 to Apr-2016), the current "Super El Nino Impact" is still young and we believe that the tree stress impact is likely to continue until Oct-2016. Recall that Australia Bureau of Meteorology officially announced El Nino condition on 12-May-2015 and the current El Nino is rated as one of the strongest in history.

Aggressive buying from China and India. Total Malaysia export for palm oil surged by 23%mom to 1.33m MT due to higher export to China (+167% to 142k MT) and India (+85% to 328k MT). The significant surge in export to China should be caused by the warmer weather in China. Note that palm oil is used more during warmer weather as stays in liquid form in hot temperature (against solidified form in the cold temperature). As for India, the country may have purchase more Crude Palm Oil to enjoy the zero tax before the start of 5% export tax.

Expect April inventory to decline 9% mom to 1.71m MT. Our key assumptions for April inventory estimate are: i) 3%mom increase in production to 1.26m MT in line with historical production pattern, ii) 5% decline in export to 1.27m MT as the market adjust to the CPO export tax, and iii) local consumption of 237k MT. Note that our estimate is conservative as April demand for palm oil has been strong so far with cargo surveyor data shows that Malaysia palm oil export for the first ten days slipped by only 2% against same period last month.

Maintain POSITIVE view on the sector. Top pick is KLK (TP: RM27.38). Our prediction made on 15-Dec-2015 that CPO price should exceed RM2500/MT in 1Q2016 has been accurate so far. We maintain our bullish view on CPO price and expect it to surge to RM3000/MT by end-June. Our top pick is KLK due to: i) its earnings is expected to benefit from high CPO price due to its high exposure to palm oil business at 88%, ii) good earnings growth of +13%yoy to RM225m in 1QFY16, and iii) it is one of the rare big cap index-linked planters which is Shariah compliant and also an RSPO member. 

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

	Mar-16	Feb-16	Diff.	MoM %	Mar-15	YoY%
Opening Stocks	2,170	2,309	(138)	-6.0%	1,743	24.5%
Production	1,220	1,043	177	16.9%	1,495	-18.4%
Imports	74	68	7	10.2%	42	79.1%
Total Supply	3,464	3,419	45	1.3%	3,280	5.6%
Exports	1,334	1,085	249	22.9%	1,164	14.7%
Dom Disapp	245	163	82	50.0%	250	-2.2%
Total Demand	1,579	1,249	331	26.5%	1,414	11.7%
End Stocks	1,885	2,170	(285)	-13.1%	1,866	1.0%
Stock/Usage Ratio	9.9%	14.5%			11.0%	

Source: MPOB, MIDF Research

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

Country	Mar-16	Feb-16	Mar-15	MoM%	YoY%	3M16	3M15	YoY%
China	142	53	65	167%	119%	300	414	-28%
India	328	178	222	85%	47%	768	680	13%
EU	127	209	137	-39%	-7%	521	403	29%
Pakistan	45	21	33	110%	35%	131	149	-12%
US	61	50	33	21%	82%	168	158	6%
Others	632	574	483	10%	31%	1,810	1,542	17%
Total	1,334	1,085	973	23%	37%	3,699	3,347	11%

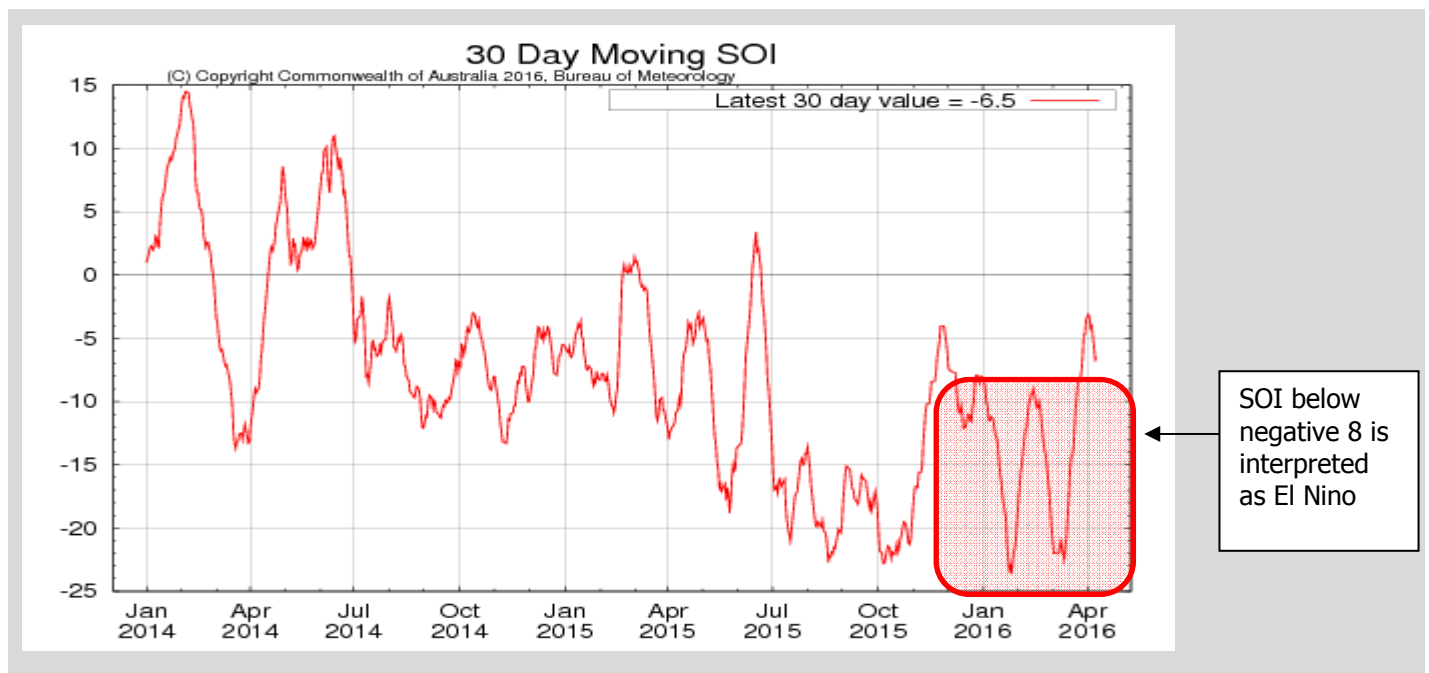
Source: MPOB, MIDF Research

Table 3: Basis of valuation

Company	TP	Call	Valuation Basis
SIME	8.05	NEUTRAL	SOP with plantation sector @ 25.1x FY17E PE. 25.1x is the avg of IOICORP and KLK Target PE.
IOICORP	4.82	NEUTRAL	23.1x Fwd. PE on FY16F earnings reflecting mean valuation.
KLK	27.38	BUY	26.8x Fwd. PE on FY16F earnings reflecting +1.0SD valuation.
PPB	18.60	NEUTRAL	21.6x Fwd. PE on FY16F earnings reflecting +0.5SD valuation.
FGV	1.33	NEUTRAL	1.0x Price to Net Tangible Asset (P/NTA).
GENP	10.66	NEUTRAL	SOP with plantation sector @ 23.5x FY16E PE. 23.5x is the lower valuation between IOICORP and KLK.
IJMP	3.57	NEUTRAL	18.6x Fwd. PE on FY16F earnings reflecting mean valuation.
TSH	2.28	NEUTRAL	22.3x Fwd. PE on FY16F earnings reflecting mean valuation.
TAANN	6.80	BUY	16.6x Fwd. PE on FY16F earnings reflecting mean valuation.

Source: MIDF Research Estimate

Chart 1: El Nino has weakened but its impact on CPO production is only half way through



Source: Australia Bureau of Meteorology, MIDF Research

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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.