

26 October 2017 | Sector Update

PLANTATION

*The Ultimate Contrarian Sector Upgrade***Upgrade to POSITIVE**

KEY HIGHLIGHTS

- **KL Plantation Index has declined 5.2% since our sector downgrade**
- **We upgrade the plantation sector to positive due to five reasons**
- **Upgrade 2018 average palm oil price assumption to RM2900/MT from RM2725/MT**
- **Further upside potential if strong La Niña happens by year end**
- **BUY calls are IOICORP (Top Pick), KLK, GENP, TSH, TAANN and FIMACORP**

KL Plantation Index has declined 5.2% since our sector downgrade. KL Plantation Index (KLPLN) has weakened 5.2% to 7748.71 since our sector downgrade on 8-March-2017. Recall that on 8-March-2017, KL Plantation Index was at 8174.14. The decline is mainly caused by the decline in futures palm oil price to the lowest point of RM2398 per MT at 13-June-2017 (from RM2822 per MT as of 8-March-2017) before it rebounding to RM2778 per MT as of 24-October-2017. Our expectation that palm oil price peak should have been reached (at that time) and price is unlikely to surge above RM3000 per MT has generally materialize. Over the same period, KLPLN Index performance of negative 5% has also underperformed FBMKLCI's +0.4%. We believe that the underperformance of KLPLN was justified but it has now reached an end.

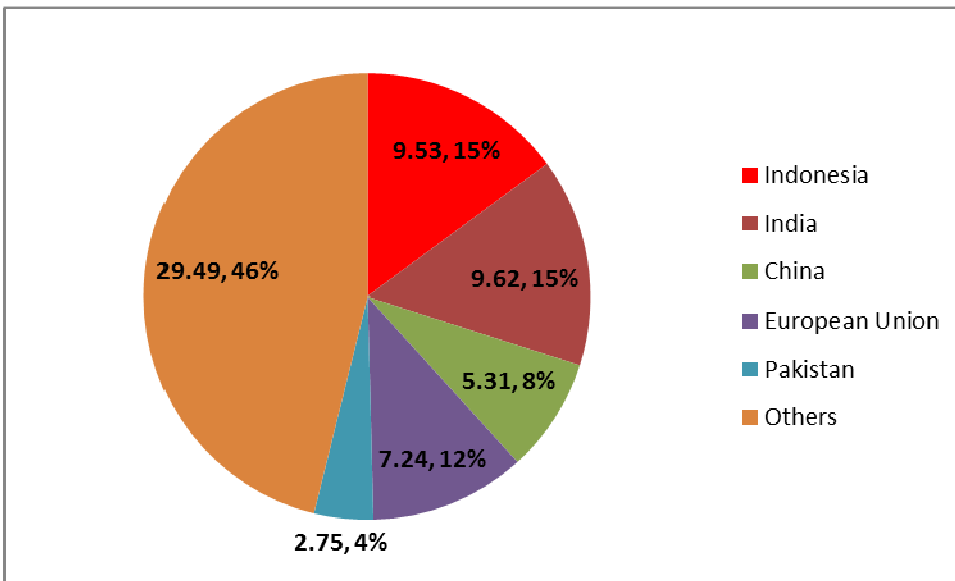
We upgrade the plantation sector to positive due to five reasons:

- 1. Consensus palm oil price forecasts are too pessimistic**
- 2. Demand outlook for palm oil is better in 2018**
- 3. Supply growth for palm oil to weaken in 2018**
- 4. Soybean production should decline for both Brazil and Argentina in 2018**
- 5. Strong set of earnings expected in the upcoming November result season**

Consensus palm oil price forecasts are too pessimistic. Consensus forecasts for average palm oil price in 2017 range between RM2600 to RM2700 per MT. With YTD palm oil price of RM2850 per MT and 3-months futures palm oil price traded at above RM2700 per MT, we believe that consensus forecasts are too pessimistic. For 2018, our contrarian average palm oil price estimate of RM2900 per MT differs from consensus range of RM2400 to RM2600 per MT. We believe that the key difference is our view on demand as we estimate that the demand growth of 4.0% to 66.49m MT in 2018 to exceed 2017 growth of 2.5% yoy to 63.93m MT. For 2017, we have also increased our average CPO price estimate to RM2825/MT (from RM2725/MT).

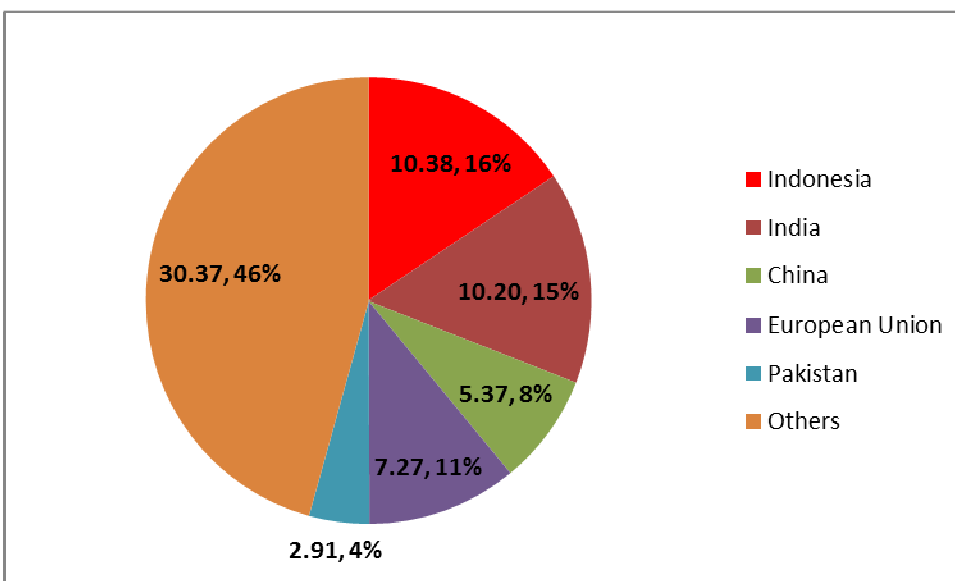
Demand outlook for palm oil is better in 2018. We estimate global palm oil consumption to increase by 4.0% or by +2.56m MT to 66.49m MT. This is expected to surpass the growth of 2.5% or +1.55m MT in 2017 to 63.93m MT. The higher palm oil consumption is in line with better economy condition expected for 2018. Note that World Bank is estimating a better GDP growth in 2018 at +2.9% (against +2.7% in 2017). Indonesia is expected to lead the consumption growth at +9.0% yoy or +0.85m MT to 10.38m MT in view of the supportive biodiesel mandate in the country.

Demand outlook for 2017



Source: MIDF Research estimate

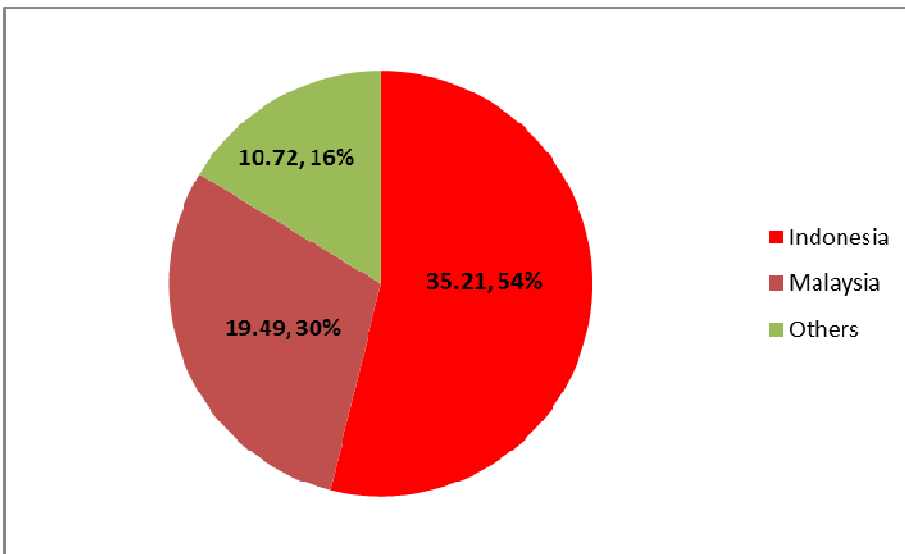
Demand outlook for 2018



Source: MIDF Research estimate

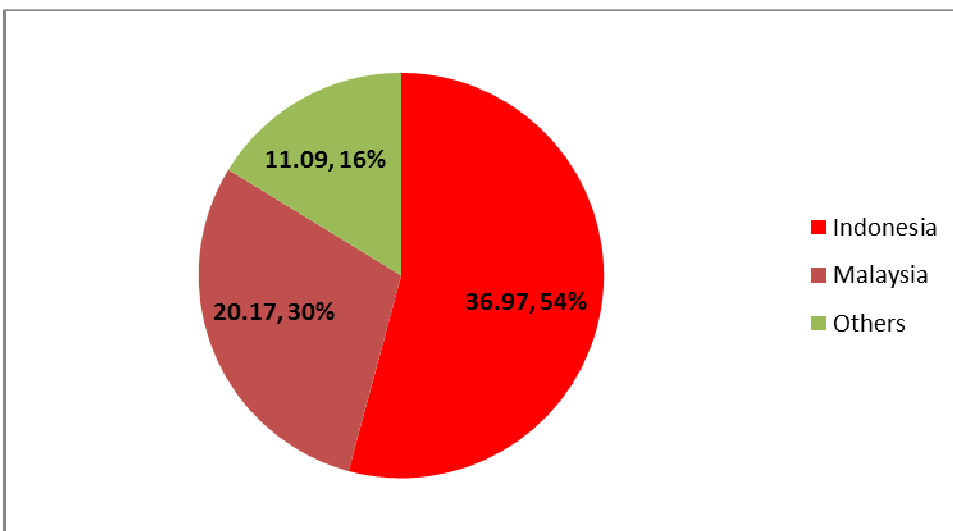
Supply growth for palm oil to weaken in 2018. We expect global palm oil production growth to slow down to +4.3% or +2.82m MT to 68.23m MT in 2018. The minimal growth of +4.3% is likely to be significantly lower than 2017's +12.3% growth yoy or +7.19m MT to 65.41m MT in 2017. Note that 2017 is a production recovery year from the El Nino which has affected production in 2016. In our view, the uptrend for production recovery is coming to an end soon. Note that Malaysia September production of 1.78m MT represents a minimal 3.8% growth against the first 8 months 2017 growth of 13.6% yoy to 12.35m MT.

Supply outlook for 2017



Source: MIDF Research estimate

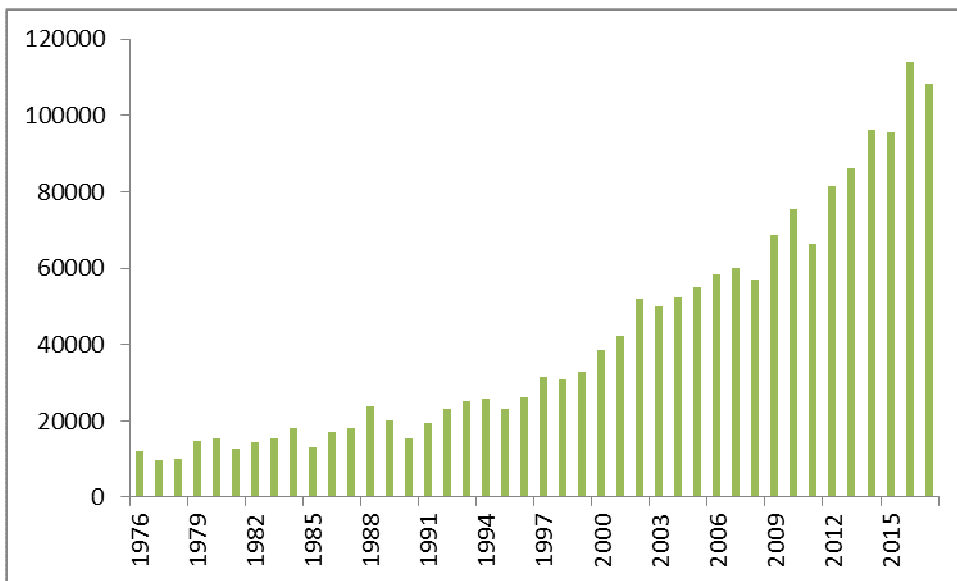
Supply outlook for 2018



Source: MIDF Research estimate

Soybean production should decline for both Brazil and Argentina in 2018. With US soybean harvesting progressing well with 70% harvested as of 22-Oct-2017, the market is shifting the focus to the production prospect in South America. We gather that soybean production is likely to decline in Brazil and Argentina in 2018 due to unfavourable weather. In Brazil, as much as 50% of the areas intended for soybean planting are too dry and the planters have delayed their plantings. The dryness is critical in all key soybean planting states across Brazil and this has prompted CONAB (Companhia Nacional de Abastecimento or Brazil National Company of Supply) to estimate a drop of 5.4% in soybean production to 108.3m MT for 2018.

Soybean supply outlook for Brazil



Source: CONAB

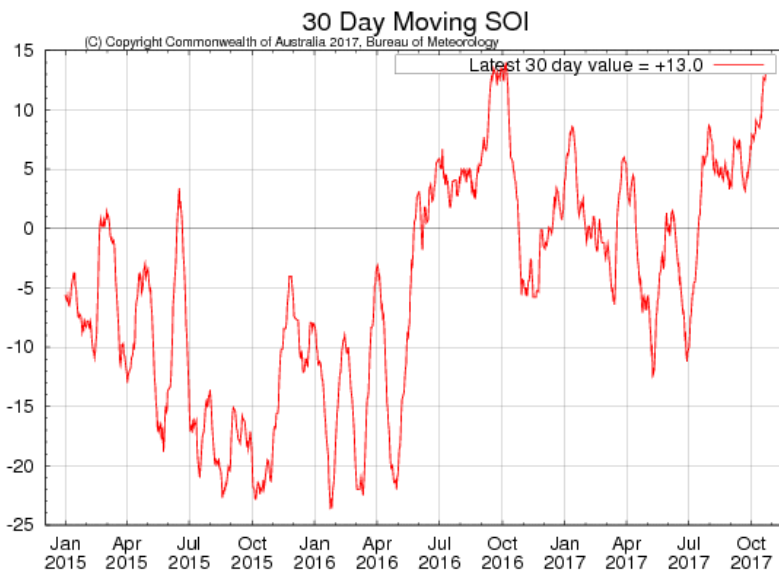
In Argentina, higher than usual rainfall has caused the soybean fields there to be excessively wet hence affecting the soybean production in 2018. Based on Oil World estimate, Argentina production should decline 2.7% yoy to 54.0m MT in 2017/18 planting season. This news is positive to palm oil price as lower soybean supply will eventually lead to lower soybean oil supply. There is a strong correlation between the prices of palm oil and soybean oil with both being substitutes to each other for food and industry use.

Strong set of earnings expected in the upcoming November result season. The upcoming 3QCY2017 result season should be good for planters. We expect stronger earnings yoy due to the increase in palm oil price by 3.3% yoy in 3QCY2017 to RM2681 per MT and better palm oil production by +8.3% yoy. The outlook for sequential earnings growth is also good as the strong production growth of 14.5% should more than offset palm oil price decline of 2.4%.

Upgrade 2018 average palm oil price assumption to RM2900/MT from RM2725/MT. Reasons for the increase in palm oil price assumption are: i) higher soybean oil price assumption, ii) better demand outlook for palm oil in 2018 and iii) weaker supply growth in 2018 after strong recovery in 2017. For 2017, we have also increased our average CPO price estimate to RM2825/MT (from RM2725/MT).

Further upside potential if strong La Niña happens by year end. Australia Bureau of Meteorology has activated its La Niña Watch yesterday with 50% chance of La Niña forming in late 2017. If La Niña is confirmed, we expect excessive rains in Malaysia and Indonesia which usually cause flood. The production in flood prone states may be affected. Overall, the news is slightly positive to palm oil price but the magnitude of impact will depend on the whether La Niña eventually materializes and its strength. Coupled with labour shortage problem which is still affecting the industry, we expect palm oil price to surge to RM3500 per tonne if a strong La Niña materialize.

Chart 1: Southern Oscillation Index



Source: Australia Bureau of Meteorology


Top pick is IOICORP (BUY; TP: RM5.50). Top Pick for the sector is IOICORP due to: i) overall margin improvement at the Group level after sale of 70% stake in Lodders Croklaan (Lodders), 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. Refer Table 1 for the Recommendations and Target Price for stocks under our coverage. 

Table 1: New 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

Table 2: Previous Target Price and Recommendations

Company	TP	Call	Valuation Basis
SIME	9.05	NEUTRAL	SOP with plantation sector @ 26.8x FY18F PE. 26.8x is the higher of IOICORP and KLK Target PE.
IOICORP	5.27	BUY	26.3x Fwd. PE on FY18F earnings reflecting +1.0SD 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	12.06	BUY	SOP with plantation sector @ 24.7x FY17F PE. 24.7x is the lower valuation between IOICORP and KLK.
IJMP	3.00	NEUTRAL	18.6x Fwd. PE on FY18F 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.
FIMACORP	2.50	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

Table 3: SIME Earnings Forecast

FYE Jun	FY15A	FY16A	FY17A	FY18F	FY19F
Revenue	43,729	43,963	48,045	49,333	50,738
EBIT	3,542	3,067	3,562	3,782	3,829
PBT	3,003	2,816	2,655	3,363	3,382
Net Income	2,313	2,409	2,438	2,819	2,833
Core Net Income	2,071	1,877	2,216	2,467	2,481
EPS (sen)	37.68	38.60	36.70	41.45	41.66
Core EPS (sen)	33.74	29.67	33.40	36.27	36.49
Net DPS (sen)	25.0	27.0	23.0	24.9	25.0
Net Dvd Yield	2.8%	3.0%	2.5%	2.7%	2.8%
Core PER	26.9	30.6	27.2	25.0	24.9
NTA/share (RM)	4.29	4.45	5.24	5.41	5.58
P/NTA	2.11	2.04	1.73	1.68	1.63
ROE	7.6%	7.4%	6.5%	7.3%	7.2%
ROA	3.8%	3.8%	3.6%	4.9%	4.7%

Source: Company, MIDF Research

Table 4: IOICORP Earnings Forecast

FYE Jun	FY15A	FY16A	FY17A	FY18F	FY19F
Revenue	11,542	11,739	14,127	14,850	15,231
EBIT	1,142	1,355	1,560	1,757	1,776
PBT	316	966	1,087	1,674	1,699
Net Income	52	630	733	1,315	3,841
Core Net Income	1,134	1,176	1,007	1,315	1,309
EPS (sen)	0.82	9.99	11.65	20.92	61.10
Core EPS (sen)	17.83	18.66	16.00	20.92	20.82
Net DPS (sen)	9.00	8.00	9.50	23.46	10.41
Net Dvd Yield	2.0%	1.8%	2.1%	5.3%	2.3%
Core PER	25.0	23.9	27.9	21.3	21.4
NTA/share (RM)	1.04	1.05	1.10	1.27	1.77
P/NTA	4.29	4.25	4.04	3.52	2.52
ROE	0.7%	8.8%	9.8%	15.5%	33.0%
ROA	0.3%	3.6%	4.1%	7.8%	22.5%

Source: Company, MIDF Research

Table 5: KLK Earnings Forecast

FYE Sep	FY14A	FY15A	FY16A	FY17F	FY18F
Revenue	11,130	13,650	16,506	16,729	17,567
EBIT	1,395	1,134	1,865	1,692	1,874
PBT	1,318	1,135	1,712	1,615	1,796
Net Income	992	870	1,592	1,178	1,316
Core Net Income	1,032	789	1,052	1,178	1,316
EPS (sen)	93.1	81.7	149.5	110.6	123.6
Core EPS (sen)	96.9	74.1	98.8	110.6	123.6
Net DPS (sen)	55.0	45.0	50.0	65.4	73.0
Net Dvd Yield	2.2%	1.8%	2.0%	2.7%	3.0%
Core PER	25.3	33.1	24.8	22.1	19.8
NTA/share (RM)	7.26	7.81	9.79	9.17	9.68
P/NTA	3.37	3.13	2.50	2.67	2.53
ROE	12.8%	10.4%	15.2%	12.0%	12.8%
ROA	7.7%	6.6%	8.7%	8.0%	8.5%

Source: Company, MIDF Research

Table 6: PPB Earnings Forecast

FYE Dec	FY14A	FY15A	FY16A	FY17F	FY18F
Revenue	3,701	4,048	4,186	4,135	4,349
EBIT	313	399	401	371	391
PBT	1,028	1,181	1,211	1,074	1,114
Net Income	917	1,051	1,045	954	988
Core Net Income	917	1,051	1,045	954	988
EPS (sen)	77.3	88.7	88.1	80.4	83.4
Core EPS (sen)	77.3	88.7	88.1	80.4	83.4
Net DPS (sen)	23.0	25.0	25.0	24.1	25.0
Net Dvd Yield	1.4%	1.5%	1.5%	1.4%	1.5%
Core PER	21.6	18.8	18.9	20.7	20.0
NTA/share (RM)	14.12	16.74	17.63	15.51	16.10
P/NTA	1.18	1.00	0.95	1.08	1.04
ROE	5.5%	5.3%	5.0%	5.2%	5.2%
ROA	4.9%	4.8%	4.6%	4.9%	4.9%

Source: Company, MIDF Research

Table 7: FGV Earnings Forecast

FYE Dec	FY14A	FY15A	FY16A	FY17F	FY18F
Revenue	15,258	15,670	17,283	19,238	20,070
EBIT	1,111	682	463	454	557
PBT	971	384	266	304	366
Net Income	325	117	30	54	70
Core Net Income	121	(106)	(157)	54	70
EPS (sen)	8.92	3.21	0.81	1.47	1.91
Core EPS (sen)	3.32	(2.91)	(4.30)	1.47	1.91
Net DPS (sen)	10.0	4.0	0.0	0.0	0.0
Net Dvd Yield	5.5%	2.2%	0.0%	0.0%	0.0%
Core PER	54.9	(62.6)	(42.3)	123.6	95.5
NTA/share (RM)	1.15	1.19	1.17	1.18	1.20
P/NTA	1.59	1.53	1.56	1.54	1.52
ROE	5.7%	2.0%	0.5%	0.9%	1.2%
ROA	1.6%	0.6%	0.1%	0.2%	0.3%

Source: Company, MIDF Research

Table 8: GEPN Earnings Forecast

FYE Dec	FY14A	FY15A	FY16A	FY17F	FY18F
Revenue	1,643	1,375	1,480	1,618	1,779
EBIT	513	276	536	465	506
PBT	520	247	501	460	524
Net Income	377	190	367	337	385
Core Net Income	382	210	300	337	385
EPS (sen)	49.3	24.8	46.3	42.4	48.5
Core EPS (sen)	50.0	27.5	37.9	42.4	48.5
Net DPS (sen)	10.0	5.5	21.0	10.6	12.1
Net Dvd Yield	0.9%	0.5%	2.0%	1.0%	1.1%
Core PER	21.2	38.6	28.0	25.0	21.9
NTA/share (RM)	4.89	5.31	5.85	5.48	5.84
P/NTA	2.17	2.00	1.81	1.94	1.82
ROE	9.7%	4.5%	7.9%	7.7%	8.2%
ROA	6.7%	3.7%	4.7%	6.0%	6.5%

Source: Company, MIDF Research

Table 9: IJMP Earnings Forecast

FYE Mar	FY15A	FY16A	FY17A	FY18F	FY19F
Revenue	668	558	754	652	704
EBIT	141	72	192	178	221
PBT	89	50	169	170	213
Net Income	90	24	115	136	168
Core Net Income	142	25	119	136	168
EPS (sen)	10.7	2.9	13.1	16.1	20.0
Core EPS (sen)	16.8	3.0	13.5	16.1	20.0
Net DPS (sen)	6.0	5.0	7.0	6.0	9.0
Net Dvd Yield	2.1%	1.8%	2.5%	2.1%	3.2%
Core PER	16.9	95.9	21.1	17.6	14.3
NTA/share (RM)	1.91	1.92	2.12	2.08	2.19
P/NTA	1.49	1.48	1.34	1.37	1.30
ROE	5.6%	1.5%	6.4%	7.8%	9.1%
ROA	3.5%	0.9%	4.4%	5.0%	6.0%

Source: Company, MIDF Research

Table 10: TSH Earnings Forecast

FYE Dec	FY14A	FY15A	FY16A	FY17F	FY18F
Revenue	1,071	800	873	1,141	1,199
EBIT	185	113	133	221	256
PBT	187	(86)	113	197	218
Net Income	139	(106)	57	135	152
Core Net Income	160	87	79	135	152
EPS (sen)	10.31	(7.85)	4.20	10.07	11.27
Core EPS (sen)	11.90	6.48	5.89	10.07	11.27
Net DPS (sen)	2.50	2.00	2.00	2.52	2.82
Net Dvd Yield	1.5%	1.2%	1.2%	1.5%	1.7%
Core PER	13.9	25.5	28.0	16.4	14.6
NTA/share (RM)	0.97	1.07	1.19	1.28	1.37
P/NTA	1.70	1.54	1.38	1.29	1.20
ROE	11.1%	-7.8%	3.8%	8.4%	8.8%
ROA	5.2%	-3.3%	1.6%	5.6%	6.2%

Source: Company, MIDF Research

Table 11: TAANN Earnings Forecast

FYE Dec	FY14A	FY15A	FY16A	FY17F	FY18F
Revenue	1,012	1,047	1,147	1,120	1,149
EBIT	166	255	196	177	196
PBT	168	234	176	163	182
Net Income	124	188	122	121	135
Core Net Income	126	170	112	121	135
EPS (sen)	27.81	42.34	27.36	27.11	30.34
Core EPS (sen)	28.39	38.21	25.23	27.11	30.34
Net DPS (sen)	20.00	20.00	10.00	13.91	15.57
Net Dvd Yield	5.4%	5.4%	2.7%	3.8%	4.2%
Core PER	13.0	9.6	14.6	13.6	12.1
NTA/share (RM)	2.39	2.62	2.82	2.98	3.13
P/NTA	1.54	1.40	1.30	1.23	1.18
ROE	11.2%	15.9%	9.6%	9.0%	9.6%
ROA	6.6%	9.5%	5.9%	6.0%	6.4%

*Source: Company, MIDF Research***Table 12: FIMACORP Earnings Forecast**

FYE Mar	FY15A	FY16A	FY17A	FY18F	FY19F
Revenue	378.0	375.2	372.1	343.7	363.4
EBIT	84.5	75.8	58.7	76.0	85.2
PBT	87.8	77.3	61.3	79.0	88.2
Net Income	55.8	51.3	37.7	56.9	63.5
Core Net Income	55.9	49.6	71.5	56.9	63.5
EPS (sen)	23.17	20.55	29.64	23.58	26.33
Core EPS (sen)	23.17	20.55	29.64	23.58	26.33
Net DPS (sen)	12.50	12.50	17.50	12.50	12.50
Net Dvd Yield	5.8%	5.8%	8.2%	5.8%	5.8%
Core PER	9.2	10.4	7.2	9.1	8.1
NTA/share (RM)	2.20	2.29	2.33	2.44	2.58
P/NTA	0.97	0.93	0.92	0.88	0.83
ROE	10.5%	9.3%	6.7%	9.7%	10.2%
ROA	7.8%	7.5%	5.3%	7.7%	8.2%

Source: Company, MIDF Research

Alan Lim, CFA
alan.lim@midf.com.my

Jessica Low

03-21738464

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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.