

11 August 2016 | Sector Update

PLANTATION

*The return of China demand***Maintain POSITIVE**

KEY HIGHLIGHTS

- **July 2016 inventory level of 1.77m MT is lower than expected**
- **China demand has returned as anticipated but the 109%mom surge is a positive surprise**
- **El Nino impact is still lingering as production increase by only 3%mom to 1.59m MT**
- **Biodiesel consumption in Indonesia is still strong**
- **Expect Aug-2016 inventory to ease 1% to 1.76m MT**
- **Maintain POSITIVE view on the sector with KLK (TP: RM27.38) as our top pick**

July 2016 inventory level of 1.77m MT is lower than expected. Malaysia palm oil inventory level of 1.77m MT as of end-July 2016 is 3% below consensus estimate of 1.83m MT. It is also 3% below our estimate of 1.96m MT. Inventory has eased -0.2%mom (the first decline in three months) and declined -22%yoy. Separately, exports for the first 10 days have improved 18% based on cargo surveyors' data.

China demand has returned as anticipated but the 109%mom surge is a positive surprise. We have stated in our report on 13-July-2016 that "demand from China should pick up due to stocking activity ahead of the Mid-Autumn Festival which will fall on 15-Sep this year". Nevertheless, the 109%mom surge in export to China to 210,781 MT is a positive surprise as we did not anticipate such a rapid recovery. We gather that July-2016 export to China is also the highest in 12 months. Demand has also improved for India (+12%mom to 189,358 MT), United States (+156%mom to 76,786 MT) and European Union (+26%mom to 189,735 MT).

El Nino impact is still lingering as production increase by only 3%mom to 1.59m MT. Note that this is below the seasonal pattern of 8% growth seen historically. Sarawak production growth is the highest at 11% to 344,585 MT followed by Sabah (+3% to 475,506 MT) and Peninsular Malaysia (+1% to 765,791 MT). On a yearly basis, production declined 13% and this suggests that the impact of El Nino is still there.

Biodiesel consumption in Indonesia is still strong. Import from Indonesia is very low at 12,823 MT. This is a decline of -35%mom and -91%yoy. We view this positively as it signals that biodiesel program is running smoothly there. As more palm oil is channelled for biodiesel sector, the supply from Indonesia will be limited.

Expect Aug-2016 inventory to ease 1% to 1.76m MT. Key assumptions are: i) export growth of 9%, and ii) production growth of 7%. Our export growth is considered conservative as cargo surveyors data shows export growth of 18%mom in the first ten days of August. For production growth, we are using seasonal factor to estimate the 7% growth.


Maintain POSITIVE view on the sector. We maintain our average CPO price assumption of RM2,450/MT (YTD: RM2,506/MT) for the year 2016 which is 14% higher than 2015 average of RM2,153.50/MT. We believe that China demand is likely to continue in August as the inventory has fall down to below average level in major ports. 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, ii) good earnings growth of +41%yoy to RM536m in 1HFY16, 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 July-2016 ('000 MT)

	Jul-16	Jun-16	Diff.	MoM %	Jul-15	YoY%
Opening Stocks	1,775	1,650	125	7.6%	2,152	-17.5%
Production	1,586	1,533	53	3.5%	1,816	-12.7%
Imports	13	20	(7)	-34.7%	143	-91.0%
Total Supply	3,373	3,202	171	5.3%	4,110	-17.9%
Exports	1,384	1,142	243	21.2%	1,613	-14.2%
Dom Disapp	218	286	(67)	-23.6%	230	-5.1%
Total Demand	1,603	1,427	175	12.3%	1,843	-13.0%
End Stocks	1,771	1,775	(4)	-0.2%	2,267	-21.9%
Stock/Usage Ratio	9.2%	10.4%			10.3%	

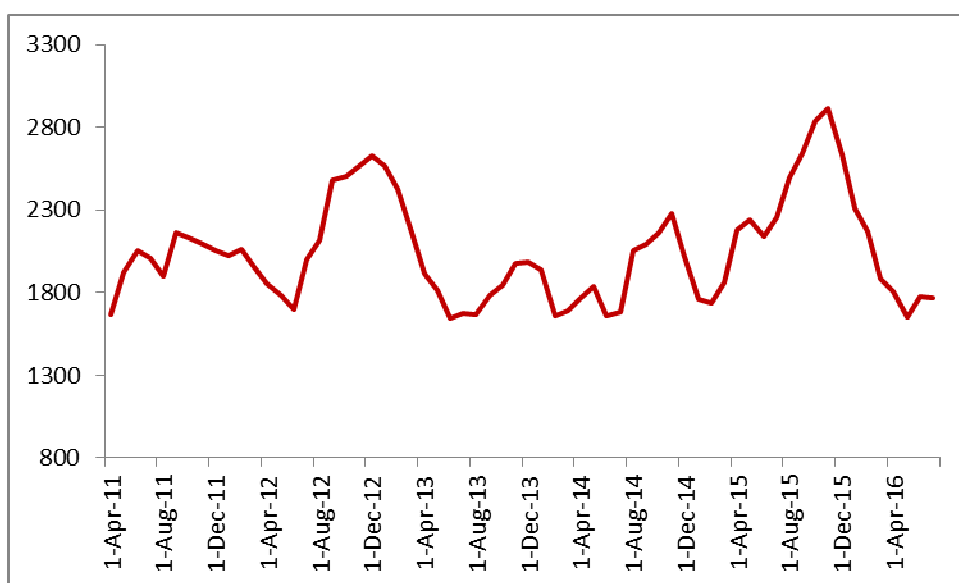
Source: MPOB, MIDF Research

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

Country	Jul-16	Jun-16	Jul-15	MoM%	YoY%	7M16	7M15	YoY%
China	211	101	290	109%	-27%	812	1,570	-48%
India	189	169	352	12%	-46%	1,617	1,897	-15%
EU	190	151	212	26%	-10%	1,081	1,229	-12%
Pakistan	61	88	40	-31%	50%	429	384	12%
US	77	30	74	154%	4%	385	399	-4%
Others	657	602	643	9%	2%	4,350	3,977	9%
Total	1,384	1,142	1,610	21%	-14%	8,673	9,457	-8%

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	7.85	NEUTRAL	SOP with plantation sector @ 25.1x FY17E PE. 25.1x is the avg of IOICORP and KLK Target PE.
IOICORP	5.15	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	1.33	NEUTRAL	1.0x Price to Net Tangible Asset (P/NTA).
GENP	9.85	NEUTRAL	SOP with plantation sector @ 23.5x FY16E PE. 23.5x is the lower valuation between IOICORP and KLK.
IJMP	3.13	NEUTRAL	18.6x Fwd. PE on FY16F 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.