

08 March 2017 | Sector Update

PLANTATION*Time to take a breather***Downgrade to NEUTRAL****KEY HIGHLIGHTS**

- **KL Plantation Index has gained 12% since our upgrade on 2-Oct-2015**
- **Expect Neutral-to-Negative view on CPO price from POC 2017**
- **CPO price should be supported in the near term**
- **But CPO price peak is now behind us; the best earnings quarter is already registered in 4QCY16**
- **Rising soybean production in South America**
- **Risk to our downgrade is the El Nino return**
- **Downgrade the sector to NEUTRAL (from POSITIVE) after the recent share price increase for most planters. Downgrade IOICORP to NEUTRAL with unchanged TP of RM5.30**

KL Plantation Index has gained 12% since our upgrade on 2-Oct-2015. Currently, the KL Plantation Index is at 8174.14 and it has gained 12% since our sector upgrade on 2-Oct-2015. Recall that on 2-Oct-2015, KL Plantation Index was at 7307.17. The strong gain is mainly caused by appreciation in spot CPO price by 30% over the same period to RM2996 per MT (from RM2302 per MT as of 2-Oct-2015). Our expectation that CPO price will benefit from Strong El Nino, strong Dollar environment and decline in inventory has generally materialized.

Expect Neutral-to-Negative view on CPO price from POC 2017. Palm and Lauric Oils Price Outlook Conference & Exhibition (POC2017) starts yesterday on 7-March-2017. We gather that three world renowned speakers (Mr. Dorab Mistry, Mr. Thomas Mielke and Dr. James Fry) will be sharing their view on CPO price during the event. We expect the three speakers' view on CPO price to be neutral or negative on CPO price due to rising production of palm oil. Recall that in Jan-2017, Malaysia palm oil production has increased yoy by 13% and this is the second consecutive yoy increase. Going forward, we think that the yoy increase trend should continue through 2Q2017 and 3Q2017 as palm trees have started to recover from the impact of severe El Nino.

CPO price should be supported in the near term. We expect CPO price to stay at between RM2600 to RM2900 per MT up to end-June as inventory is expected to stay well below 2.0m MT. Although production should recover from its seasonal low in February, the demand should also recover as well. As the Northern Hemisphere gets warmer, palm oil can be used in more countries. From April onwards, we expect higher demand from India and Pakistan due to stocking activity ahead of Ramadan which will begin in end-May.

But CPO price peak is now behind us; the best earnings quarter is already registered in 4QCY16. Despite the good CPO price expected for the next three months, the peak of CPO price should have been reached and we think that CPO price is unlikely to surge above RM3000 per MT from now onwards until the end of 2017. As a result, planters' earnings should have peaked in 4QCY16 in line with high average CPO price achieved. Looking ahead, we expect 1QCY17 earnings to be lower qoq as the expected 6% increase in CPO price is not enough to compensate the expected lower CPO production by 25%.

Rising soybean production in South America. Oil World estimated that South America soybean production in early 2017 is likely to increase by 9m to 10m MT yoy. It has also increased its crop estimate for Brazil to 105.0m MT. As higher soybean production should eventually lead to higher soybean oil supply, high soybean production should limit CPO price upside.

Risk to our downgrade is the El Nino return. Recently, Australia Bureau of Meteorology has upgraded its ENSO Outlook status to El Nino WATCH (likelihood of ~50%). It further explains that “recent changes in both the tropical Pacific Ocean and atmosphere, and climate model outlooks surveyed by the Bureau, suggest the likelihood of El Niño forming in 2017 has risen.” Our average CPO price forecast of RM2725 per MT has not factor in the El Nino return.


Downgrade the sector to NEUTRAL (from POSITIVE) after the recent share price increase for most planters. Downgrade IOICORP to NEUTRAL with unchanged TP of RM5.30. Our sector downgrade is premised on valuation as the recent increase in share price of most planters has made the upside limited. We maintain our average CPO price of RM2725 per MT for 2017. As a result, all the Target Price for the planters remains unchanged. However, we downgrade our recommendation for IOICORP to NEUTRAL as the recent share price increase has lowered the total return prospect to less than 15%. Our Top Pick for the sector is KLK (BUY with TP of RM29.25) as the Company’s 1QCY17 result should fare better against other planters as it has locked in forward sales when the CPO price is high. The Company’s earnings are also resilient and matched consensus expectation most of the time. 

Table 1: Basis of valuation

Company	TP	Call	Valuation Basis
SIME	9.00	NEUTRAL	SOP with plantation sector @ 26.8x FY17F PE. 26.8x is the higher between IOICORP and KLK Target PE.
IOICORP	5.30	NEUTRAL	24.7x Fwd. PE on FY17F earnings reflecting +0.5SD 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	1.77	NEUTRAL	1.0x Price to Book Value
GENP	11.55	NEUTRAL	SOP with plantation sector @ 24.7x FY17E PE. 24.7x is the lower valuation between IOICORP and KLK
IJMP	3.53	NEUTRAL	18.6x Fwd. PE on FY18F earnings reflecting mean valuation
TSH	2.15	NEUTRAL	22.3x Fwd. PE on FY17F earnings reflecting mean valuation
TAANN	4.25	NEUTRAL	16.6x Fwd. PE on FY17F earnings reflecting mean valuation

Source: MIDF Research Estimate

Alan Lim, CFA
alan.lim@midf.com.my
 03-21738464

MIDF RESEARCH is part of MIDF Amanah Investment Bank Berhad (23878 - X).
 (Bank Pelaburan)
 (A Participating Organisation of Bursa Malaysia Securities Berhad)

DISCLOSURES AND DISCLAIMER

This report has been prepared by MIDF AMANAH INVESTMENT BANK BERHAD (23878-X). It is for distribution only under such circumstances as may be permitted by applicable law.

Readers should be fully aware that this report is for information purposes only. The opinions contained in this report are based on information obtained or derived from sources that we believe are reliable. MIDF AMANAH INVESTMENT BANK BERHAD makes no representation or warranty, expressed or implied, as to the accuracy, completeness or reliability of the information contained therein and it should not be relied upon as such.

This report is not, and should not be construed as, an offer to buy or sell any securities or other financial instruments. The analysis contained herein is based on numerous assumptions. Different assumptions could result in materially different results. All opinions and estimates are subject to change without notice. The research analysts will initiate, update and cease coverage solely at the discretion of MIDF AMANAH INVESTMENT BANK BERHAD.

The directors, employees and representatives of MIDF AMANAH INVESTMENT BANK BERHAD may have interest in any of the securities mentioned and may benefit from the information herein. Members of the MIDF Group and their affiliates may provide services to any company and affiliates of such companies whose securities are mentioned herein. This document may not be reproduced, distributed or published in any form or for any purpose.

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.