06 July 2015 | Sector Update

PLANTATION

***Maintain* NEUTRAL**

2015 CPO price average forecast reduced to RM2,175/MT

KEY HIGHLIGHTS

- **Expecting 2015 and 2016 average CPO price of RM2175 and RM2100 respectively.**
- **Global soybean oil inventory is expected to increase.**
- **Rising US Dollar Index trend to limit CPO price upside.**
- **Low crude oil prices to affect demand for CPO from biodiesel segment.**
- **The strength of El Niño is still uncertain.**
- **Downgrade SIME (New TP: RM8.80), GENP (New TP: RM9.06) and TAANN (New TP: RM4.00) to NEUTRAL. Upgrade PPB to BUY (New TP: RM17.80).**
- **Maintain NEUTRAL on plantation sector.**

Expecting 2015 and 2016 average CPO price of RM2175 and RM2100 respectively. We have reduced our 2015 CPO price by 9% to RM2175/MT (from RM2400/MT) due to higher global soybean oil inventory, rising US Dollar Index and low Brent crude oil prices currently. Additionally, we have also introduced 2016 average CPO price of RM2100/MT. We reckon that consensus CPO price forecast for 2015 at average RM2300/MT is still too bullish as 1H2015 average is only at RM2228/MT. Historically, CPO supply in 2nd half of the year is higher than 1st half and this should keep CPO price upside limited.

Global soybean oil inventory is expected to increase. According to United States Department of Agriculture (USDA), global soybean oil inventory is expected to increase to 3.41m MT in 2014/2015 (from 3.39m MT in 2013/2014. Looking ahead, this is expected to increase further to 3.60m MT in 2015/2016. Key reasons for the increasing inventory trend is due to additional soybean supply from three global producers in the world namely United States, Brazil and Argentina. As soybean oil and CPO are commonly used as substitute to each other for food and industry use, we believe that increasing inventory for soybean oil means limited upside for CPO price

Rising US Dollar Index trend to limit CPO price upside. Historically, US Dollar Index has strong negative correlation with CPO price. In the past 10 years, the correlation between these two is at negative 0.71. This trend could be caused by the shift of liquidity between cash (denominated in US Dollar) and commodity by global fund managers. For example, when US Dollar provides low interest, global fund managers may believe that it is better to keep less cash and invest the money in commodity (CPO is part of the commodity asset class) and this caused the lower US Dollar Index and higher CPO price. The vice versa applies. In the current global economy trend in which we think that US Dollar Index is unlikely to decline in the next 12 months, it is hard for CPO price to surge significantly.

Low crude oil prices to affect demand for CPO from biodiesel segment. Our estimate shows that discretionary demand for biodiesel is likely to have stopped completely. This is due to the negative margin expected assuming CPO price of RM2200/MT and Brent crude oil price of USD70/barrel. Our calculation shows that biodiesel production is only economically feasible in one of these scenario: i) Brent crude oil price to increase above USD82/barrel and CPO stays at RM2200/MT or ii) CPO price to decline below RM1900/MT (and Brent crude oil stays at USD70/barrel. Hence, we think that the demand for biodiesel will only be limited to countries in which mandatory admixture is imposed. Overall, this should lead to weak demand for CPO from the biodiesel segment.

The strength of El Niño is still uncertain. We are aware of the threat that El Nino may cause significant production decline for CPO and hence possibly caused CPO price to surge. However, we wish to highlight that the magnitude of production decline will still depend on the severity of the El Nino. Based on the latest information by Australia Bureau Of Meteorology, it was mentioned that "It is not possible at this stage to determine how strong this El Niño will be." In our model, we have assumed weak El Nino as we have assumed Malaysia palm oil inventory to decline to 1.68m MT by end-2015. Despite declining inventory, the three other factors (high soybean oil inventory, strengthening US Dollar Index and low crude oil prices) are keeping CPO price upside limited.

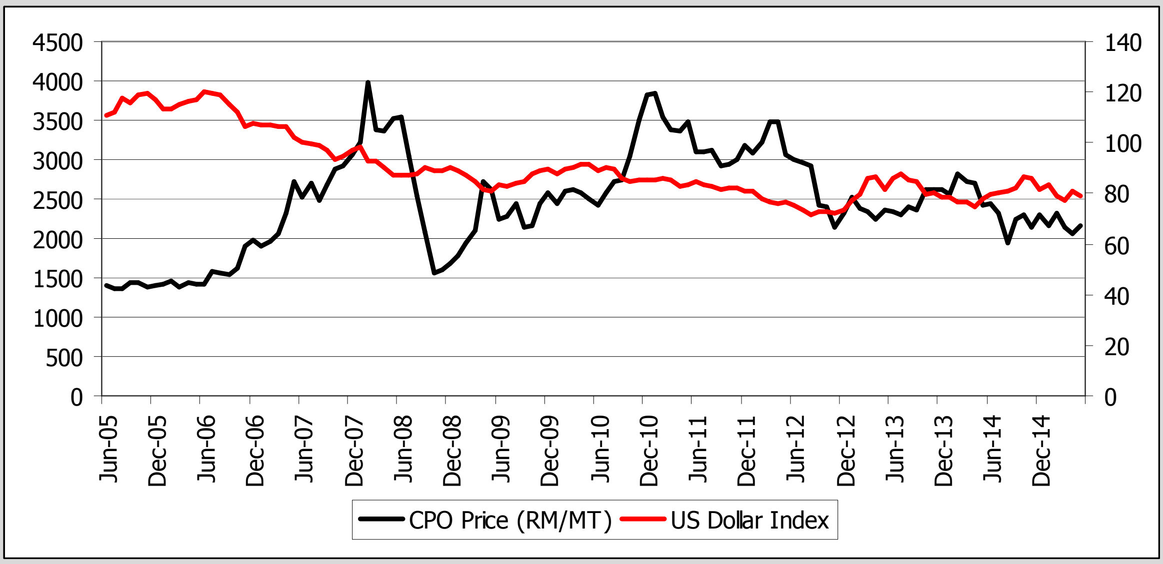
Downgrade SIME (New TP: RM8.80), GENP (New TP: RM9.06) and TAANN (New TP: RM4.00) to NEUTRAL. Upgrade PPB to BUY (New TP: RM17.80). In line with lower CPO price assumption, we have downgraded SIME, GENP and TAANN to NEUTRAL. SIME is previously a TRADING BUY while GENP and TAANN are previously rated BUY. However, we have upgraded PPB to BUY (from NEUTRAL) with new TP of RM17.80. We believe that PPB is a net beneficiary of low CPO price as Wilmar's Consumer Products segment margin is likely to expand in view of lower palm olein prices. Recall that Wilmar contribution to PPB's Profit Before Tax is 68% although PPB holds only 18.3% stake in Wilmar. PPB's 1Q15 earnings growth at +61%yoy is also the strongest among index-linked planters which registered on average earnings decline of 48%yoy. Lastly, PPB earnings is poised to benefit from stronger USDMYR as Wilmar earnings is reported in USD.

Table 1: Global soybean oil demand and supply forecast

In metric tonne (mt)	2013/14*	2014/15F	2015/16F
Inventory (Begin)	3.76	3.39	3.41
Production	45.00	47.84	49.95
Import	9.35	9.54	10.18
TOTAL SUPPLY	**58.11**	**60.77**	**63.54**
Export	9.37	10.01	10.78
Domestic	45.36	47.34	49.17
TOTAL DEMAND	**54.73**	**57.35**	**59.95**
Inventory (End)	**3.39**	**3.41**	**3.60**

Source: United States Department Of Agriculture (USDA)
**Marketing year for soybean begins on 1-Oct and ends on 30-Sep*

Chart 1: US Dollar Index has strong negative correlation with CPO price



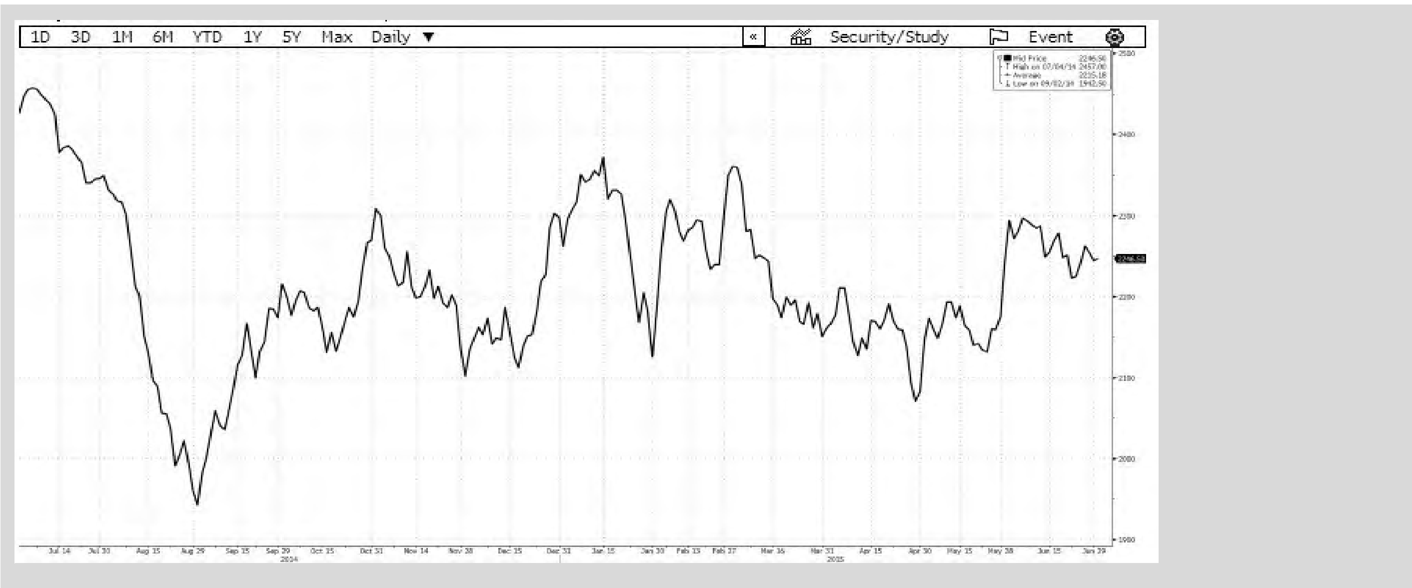
Source: Bloomberg, MIDF Research

Table 2: Change in calls and target prices

Company	Last Price (RM) @ 2-July-15	Upside/(Downside)	Net Dvd Yield (%)	Expected Total Return (%)	New TP (RM)	New Call	Previous TP (RM)	Previous Call
SIME	8.66	1.6%	4.2%	5.8%	8.80	NEUTRAL	10.15	TRADING BUY
IOICORP	4.22	5.5%	4.0%	9.5%	4.45	NEUTRAL	3.53	NEUTRAL
KLK	22.30	-5.8%	3.0%	-2.8%	21.00	NEUTRAL	20.04	NEUTRAL
PPB	15.24	16.8%	1.3%	18.1%	17.80	BUY	15.30	NEUTRAL
FGVH	1.66	-3.6%	4.0%	0.4%	1.60	NEUTRAL	2.94	NEUTRAL
GENP	10.22	-11.4%	1.0%	-10.4%	9.06	NEUTRAL	12.65	BUY
IJMP	3.53	-0.8%	2.4%	1.6%	3.50	NEUTRAL	3.78	NEUTRAL
TSH	2.26	3.1%	1.1%	4.2%	2.33	NEUTRAL	2.16	NEUTRAL
TAANN	3.86	3.6%	1.3%	4.9%	4.00	NEUTRAL	5.35	BUY

Source: MIDF Research Estimate

Chart 2: CPO price movement



Source: Bloomberg, MIDF Research

Table 3: Basis of valuation

Company	Valuation Basis
SIME	SOP with plantation sector @ 23.2x FY16E PE. 23.2x is the avg of IOICORP and KLK Target PE.
IOICORP	23.1x Fwd. PE on FY16F earnings reflecting mean valuation. Target price is higher despite lower CPO price as we have rollover to FY16F.
KLK	23.5x Fwd. PE on FY16F earnings reflecting mean valuation. Target price is higher despite lower CPO price as we have rollover to FY16F.
PPB	21.6x Fwd. PE on FY16F earnings reflecting +0.5SD valuation.
FGVH	20.8x Fwd. PE on FY16F earnings reflecting -2.0SD valuation.
GENP	SOP with plantation sector @ 23.1x FY16E PE. 23.1x is the lower valuation between IOICORP and KLK.
IJMP	18.6x Fwd. PE on FY16F earnings reflecting mean valuation.
TSH	22.3x Fwd. PE on FY16F earnings reflecting mean valuation.
TAANN	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 *rise* 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 *fall* 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.