

PLANTATION

Maintain POSITIVE***CPO price should exceed RM2500/MT in 1QCY2016***

KEY HIGHLIGHTS

- **The latest US biodiesel targets to boost soybean oil demand.**
- **Soybean crop prospect in Brazil has deteriorated.**
- **CPO price should benefit from SBO price rally.**
- **Low Brent crude oil prices unlikely to affect CPO price.**
- **CPO price to benefit from weak Ringgit.**
- **Expect CPO price to surge above RM2500/MT in 1QCY2016.**
- **Maintain POSITIVE view with top picks IOICORP (TP: RM4.95) and TAANN (RM6.50).**
- **Other BUYs are PPB (TP: RM18.00) and TSH (TP: RM2.33).**

The latest US biodiesel targets to boost soybean oil demand. On 30-Nov-2015, the USEPA (United States Environmental Protection Agency) had announced the final volume requirements for the Renewable Fuel Standard (RFS) programme for 2014, 2015, and 2016. On top of that, the EPA has also finalised the volume requirement for biomass-based diesel for 2017. Note that the mandate for usage of biodiesel was raised to 1.9b gallons for 2016 (against the proposed 1.8b in June) and 2.0b gallons for 2017. We expect incremental SBO demand in US of around 0.45m MT and this is significant as it is equivalent to 5% of US annual SBO consumption of 8.69m MT.

Soybean crop prospect in Brazil has deteriorated. Oil World mentioned that "the Brazilian soybean crop may fall to or below 95m MT (from last year's 96.2m MT) despite an increase in the area planted." We gather that the crop condition is now "critical" on at least one third of the planted area. Specifically, dryness condition has hit central and northern Mato Grosso, Bahia, Maranhao, Piaui, Goias and Minas Gerais. The news is positive to SBO price as Brazil is the second largest soybean producer (accounting for 30% of global production).

CPO price should benefit from SBO price rally. As a result of improved demand prospect and weakened production outlook, SBO price has surged 17% to recent high of 32.08 US cents per pound (or USD707/MT) as of 4-Dec as compared to three weeks ago. For the same period, CPO has gained by only 3% to RM2410/MT (or USD567/MT). We believe that the slower price appreciation of CPO at 3% (against SBO's 17%) is due to ample inventory for CPO at this juncture. However, the supply fundamentals are likely to change in the next three months as lagged impact from El Nino kicks in. Note that palm oil tree usually produce less Fresh Fruit Bunches (FFB) 6 to 9 months after the dry spell.

Low Brent crude oil prices unlikely to affect CPO price as the correlation has disappeared when Brent tumbled below USD80 per barrel. Note that the correlation between CPO price and Brent crude oil has almost disappeared completely at only 0.01 for the period of Dec-2014 to Nov-2015. This is significantly lower than the strong 0.85 correlation for the period of Jan-2000 to Nov-2014. Recall that Nov-2014 was the month when Brent crude oil price dropped below USD80 per barrel. We believe that the correlation has become insignificant when Brent crude oil price tumbled below USD80/barrel due to the negative margin experienced by biodiesel producer if they produce it independent of government subsidy. As a result of the weak correlation, we believe that persistently low Brent crude oil price will no longer affect CPO price as the demand is now supported by the food segment.

CPO price to benefit from weak Ringgit. We expect CPO price to benefit from the weak Ringgit. Although Ringgit has appreciated slightly to the level of 4.30 recently (from 4.40 to 4.50), it is still significantly weaker than last year level of ~3.50. We believe that weak Ringgit should lead to improved CPO competitiveness against other vegetable oil (especially soybean oil).

Expect CPO price to surge above RM2500/MT in 1QCY2016 as CPO-SBO discount shrinks to USD100/MT. We believe that the current CPO-SBO discount of USD153/MT is caused by the high inventory and this should shrink to 12-months average of USD100/MT in 1QCY16 due to reduction in stocks level. We expect strong depletion of stocks level for palm oil in the 1QCY2016 due to significantly reduced supply of palm oil as the lagged impact from El Nino is expected to hit during the seasonal low production period. Hence, CPO price should appreciate towards RM2550/MT (or USD600/MT assuming USDMYR rate of 4.25).

Maintain POSITIVE view on the sector. Top picks are IOICORP (TP: RM4.95) and TAANN (RM6.50). We expect CPO price to improve to average RM2300/MT in 2016 (against expected RM2175/MT in 2015). Our top pick is IOICORP due to: i) the stock is due for rerating after it regained its Shariah funds on 30-Nov, ii) strong earnings growth of +41%yoy to RM338m in 1QFY16 and iii) its earnings profile has the most pure (100%) exposure to palm oil among the big cap index-linked planters. We have removed SIME from our Top Pick due to earnings disappointment from its Industrial division.

We also like TAANN due to: i) strong earnings growth of +38%yoy to RM115m in 9MFY15 and ii) its timber division should benefit from higher USDMYR as the division's product (Export Log and Plywood) prices are quoted in USD.

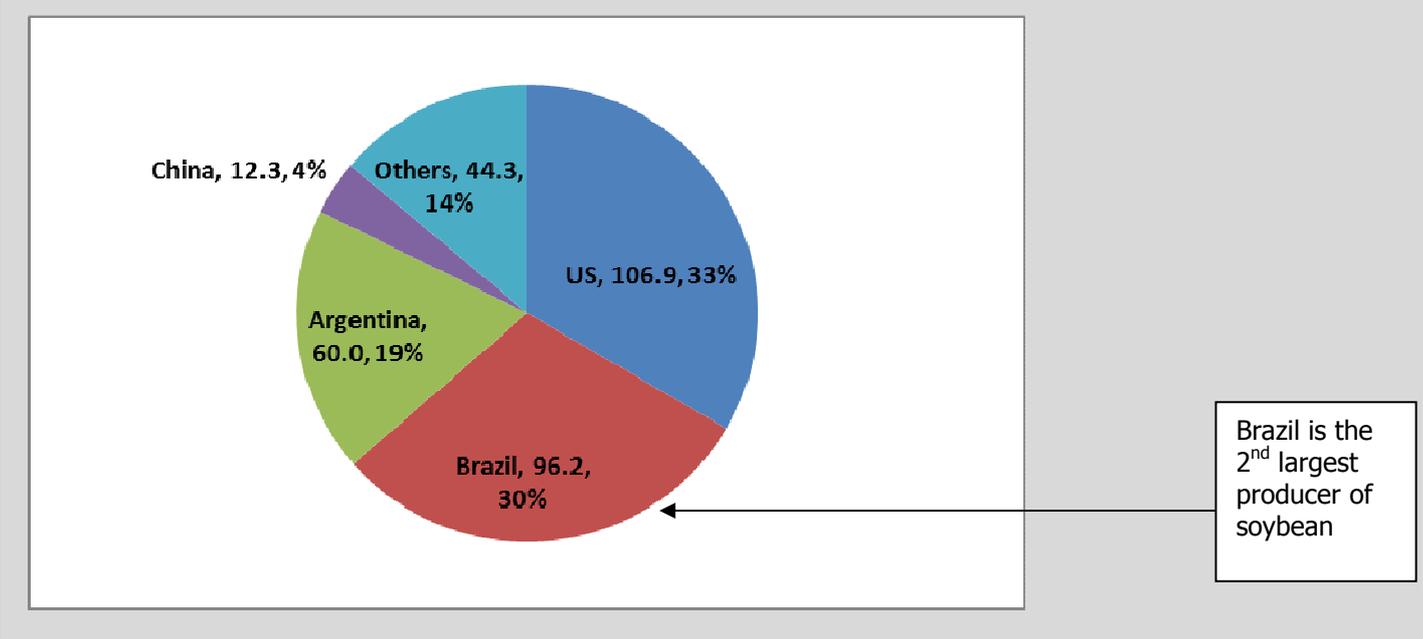
Other BUYs are PPB (TP: RM18.00) and TSH (TP: RM2.33). We like PPB due to: i) good 9MFY15 earnings growth of +12%yoy to RM710m; and ii) it is expected to benefit from higher USDMYR rate as Wilmar earnings is reported in USD. For TSH, we like the stock as: i) its FFB growth expected at 12% in FY16 is higher than other mid-cap peers average of 7%; ii) its young age profile estimated at 7.3 years old means that its FFB production is more resilient to El Nino.



Table 1: Recommendation and basis of valuation

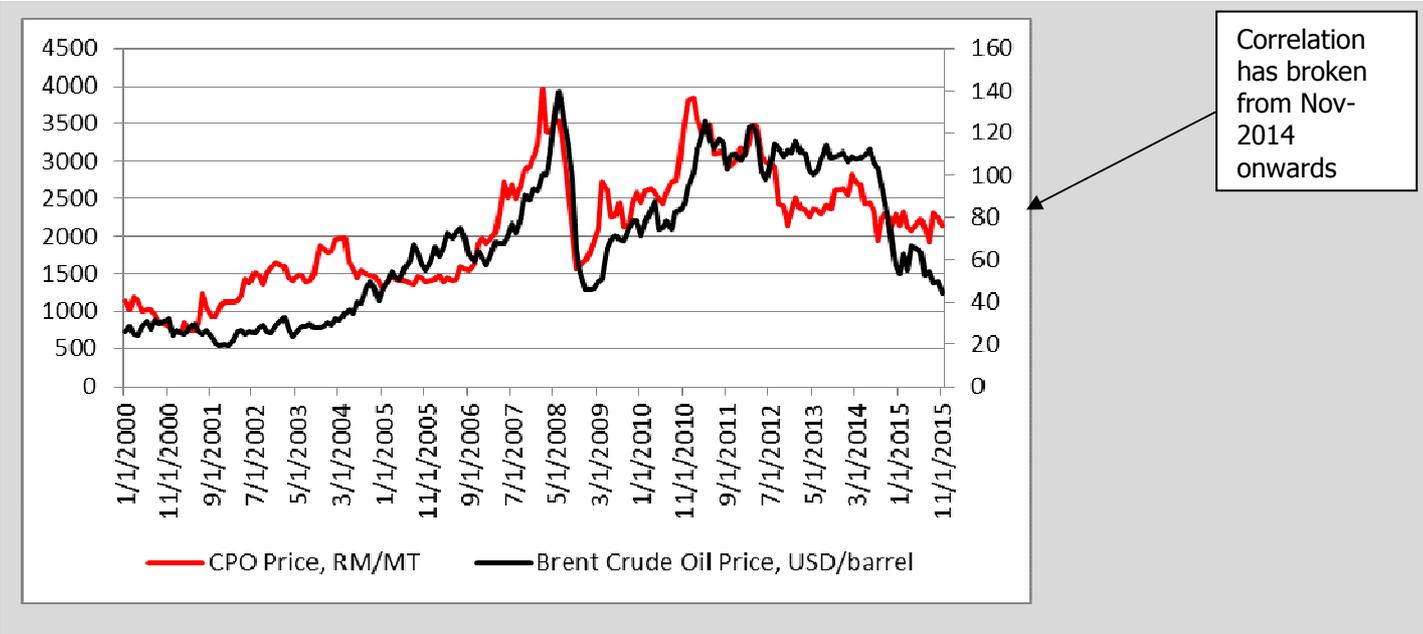
Company	Target Price	Call	Valuation Basis
SIME	8.20	NEUTRAL	SOP with plantation sector @ 23.2x FY16E PE. 23.2x is the avg of IOICORP and KLK Target PE.
IOICORP	4.95	BUY	26.6x Fwd. PE on FY16F earnings reflecting +0.5SD valuation.
KLK	22.50	NEUTRAL	23.5x Fwd. PE on FY16F earnings reflecting mean valuation.
PPB	18.00	BUY	21.6x Fwd. PE on FY16F earnings reflecting +0.5SD valuation.
FGV	1.30	SELL	1.0x Price to Net Tangible Asset (P/NTA).
GENP	9.53	NEUTRAL	SOP with plantation sector @ 23.1x FY16E PE. 23.1x is the lower valuation between IOICORP and KLK.
IJMP	3.65	NEUTRAL	18.6x Fwd. PE on FY16F earnings reflecting mean valuation.
TSH	2.33	BUY	22.3x Fwd. PE on FY16F earnings reflecting mean valuation.
TAANN	6.50	BUY	16.6x Fwd. PE on FY16F earnings reflecting mean valuation.

Chart 1: Major soybean producer in the world (m MT)



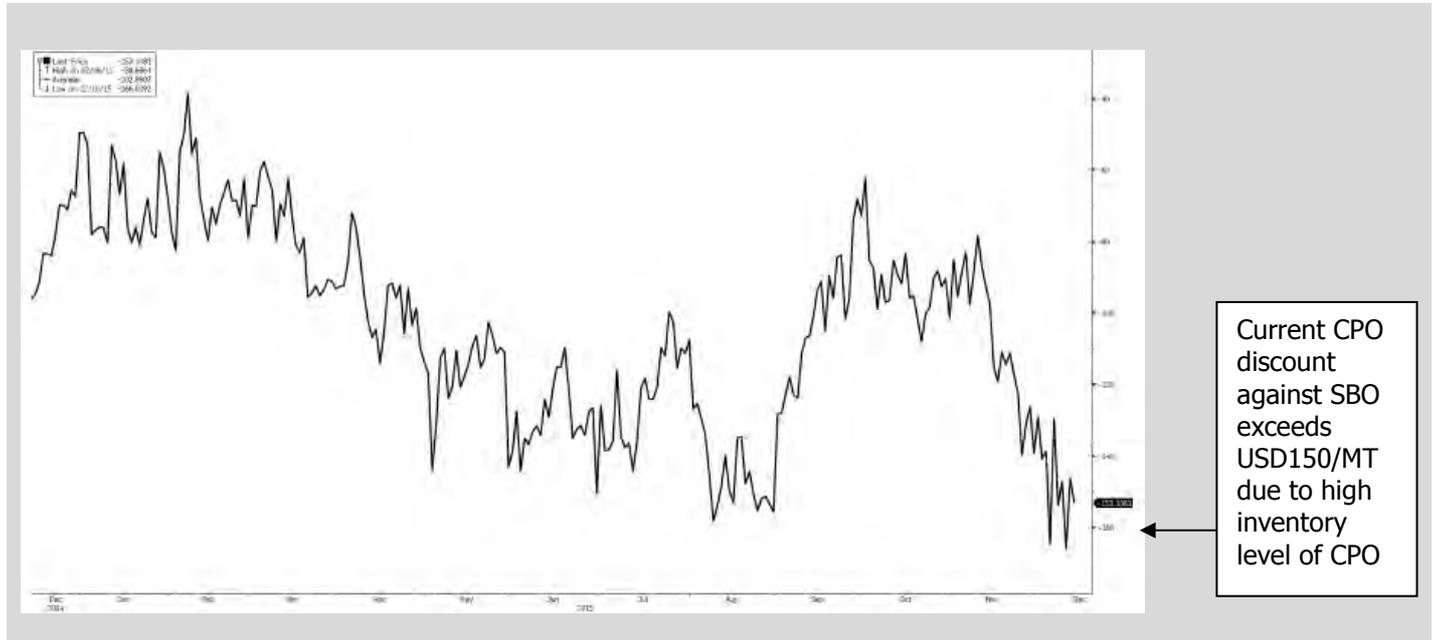
Source: Oil World, MIDF Research

Chart 2: The correlation between Brent crude oil and CPO



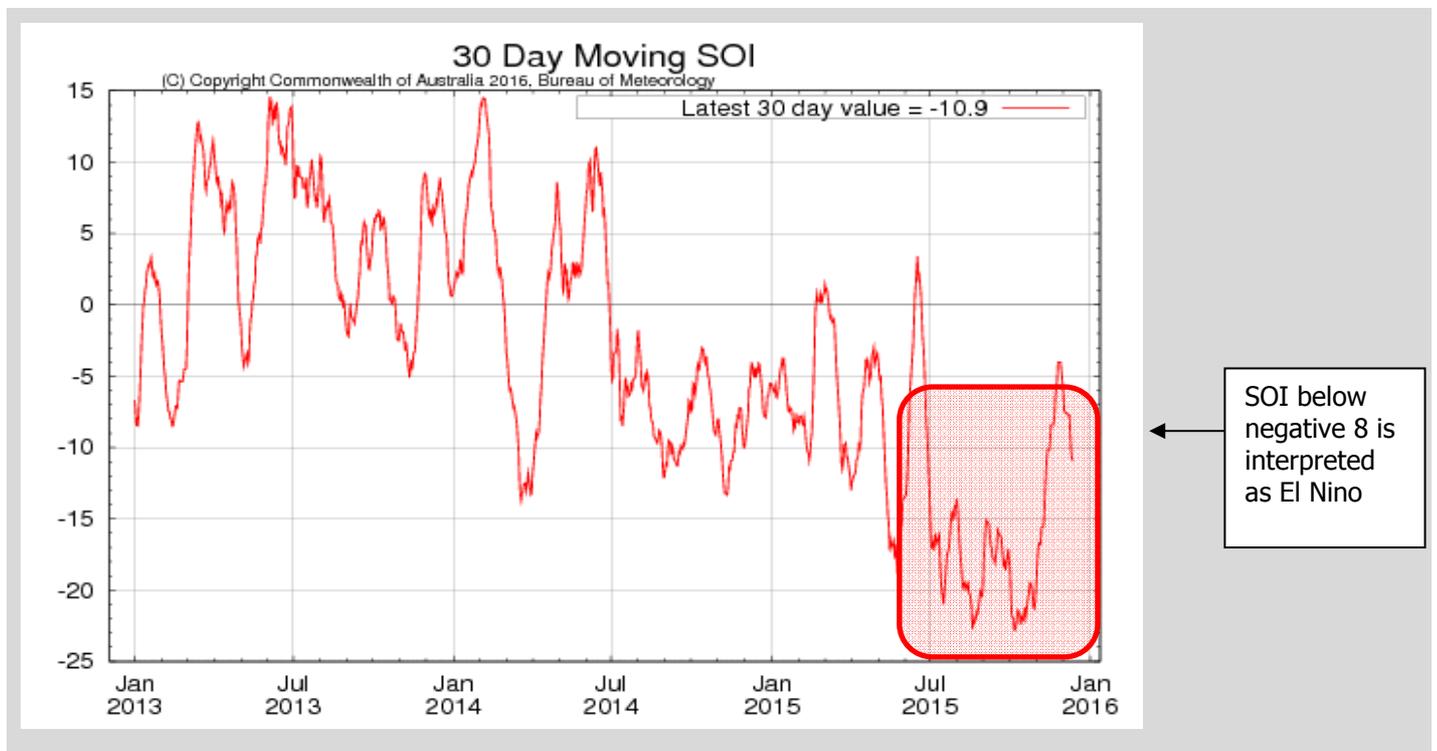
Source: Bloomberg, MIDF Research

Chart 3: CPO discount against SBO (USD/MT)



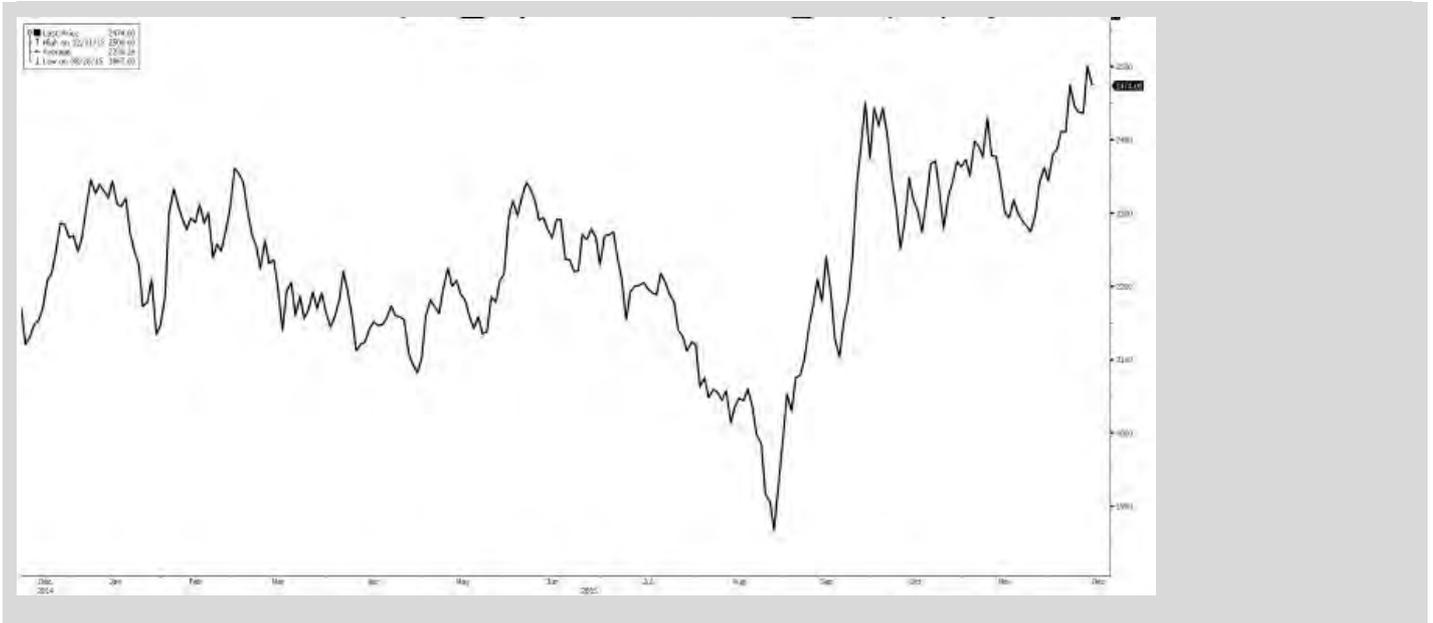
Source: Australia Bureau of Meteorology, MIDF Research

Chart 4: SOI Index is still in the El Nino zone



Source: Australia Bureau of Meteorology, MIDF Research

Chart 5: CPO price movement



Source: Bloomberg, MIDF Research

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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.