

09 May 2014 | Sector Update

Plantation sector

El-Niño likely to arrive, but no immediate impact on CPO production foreseen

Maintain POSITIVE

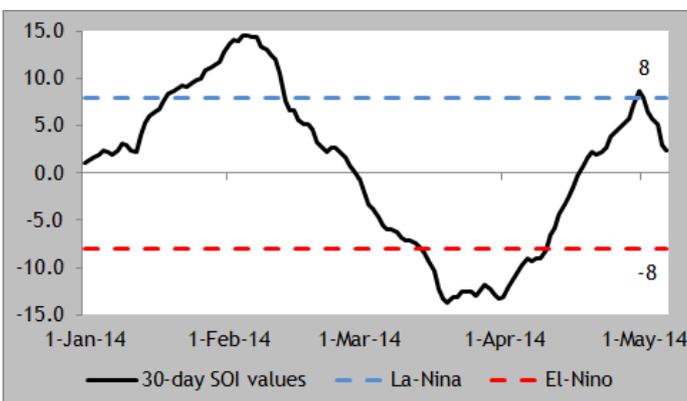
CPO price forecast: RM2,700pmt

HIGHLIGHTS

The Australian Bureau of Meteorology (ABM) in its statement on the 6th May 2014 warned that the chances of El-Niño to develop remain at least 70% and this has triggered El-Niño alert. El-Niño, which is characterized by unusual warm temperature in the Equatorial Pacific happens every three to seven years. Based on the model surveyed by the Bureau, the development of El-Niño is possible as early as July. If the event were to occur, the impact on palm production will depend on its intensity and this will be manifested 10-24 months post-event. Since the occurrence has yet to be confirmed, we expect CPO production in 2014 to continue to grow by +3.5%yoy. Therefore, we maintain POSITIVE on the sector.

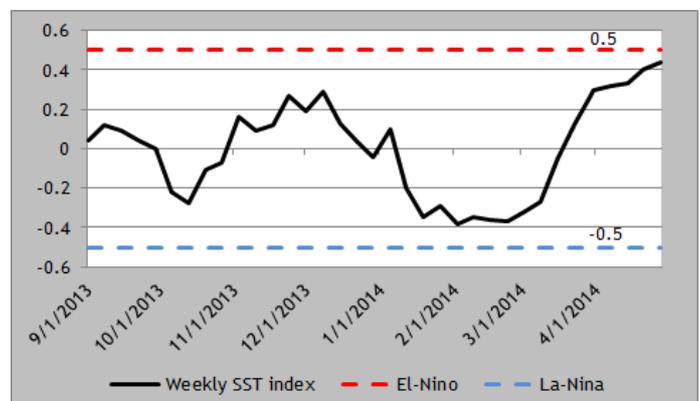
Possibility of El-Niño soonest in July. According to Malaysian Meteorology Department, the current situation of the surface and subsurface oceanic temperature over the Pacific does not yet indicate any condition of a typical development of El Niño (see Fig.1 and 2). However, as the Tropical Pacific continues to warm, the ABM indicates that the chance of El-Niño to occur remain at least 70%. The ABM also suggests that El-Niño development is possible as early as July. If the event is indeed occurring, the impact of El Niño to Malaysia will depend on its intensity. Mild and weak El Niño will not give much impact to the country. However, moderate and strong El-Niño can cause rainfall amount to be lower than normal, particularly over Sabah, the largest palm oil producing state in Malaysia.

Figure 1: 30-day SOI values



Source: Australian Bureau of Meteorology

Figure 2: Weekly sea surface temperatures



The lag effect of El-Niño. Unlike La-Nina (wet weather), the effect of El-Niño on oil palm yield is usually observed 10 to 24 months later as the impact is more on the immature trees rather than the mature ones. During the period to maturity, oil palm needs sufficient water as the sex determination of the flower occurs 24 months before the fruit ripens (see Fig. 3). If palms are subjected to water stress at this critical time, it will affect the sex ratio (higher proportion of the inflorescences become male). Consequently, less fruit bunches are produced.

In addition, it is important to note that the impact of El-Niño on FFB yield also depends on its severity. If the number of months with low rainfall (<100mm) is less or equal to one month per year, the reduction in FFB yield is expected to be minimal. However, in the event of severe El-Niño like in 1997-1998, the annual yield can drop by approximately 20-30%. If a severe El-Niño were to happen during the second half of this year, the companies with high proportion of immature trees will feel the pain (see Fig. 4).

Update on current weather. Currently Malaysia is experiencing the inter-monsoon season (abundant amount of rainfall, mainly over the inland areas and west coast of Peninsular Malaysia). The season is expected to last by mid of May and be replaced by the southwest monsoon season, which is considered as a dry season for the country. During this season, most states in Malaysia are expected to experience minimum monthly rainfall (typically 100 - 150 mm).

Production expected to continue to grow. We believe this monsoon would not significantly affect FFB and CPO production in the 2Q14 as the ideal rainfall requirement for oil palm is at least 100mm per month. Between January to March 2014, the total CPO production in Malaysia was at 4.28mmt, this in-line with our full year production estimate, accounting for 21.7% of our full year forecast. Therefore, we maintain our CPO production forecast at 19.7mmt for 2014, +3.46%yoy higher. In view of this scenario, we maintain our POSITIVE view on plantation sector with average CPO price forecast of RM2,700pmt.

Figure 3: Oil palm growth stages to maturity

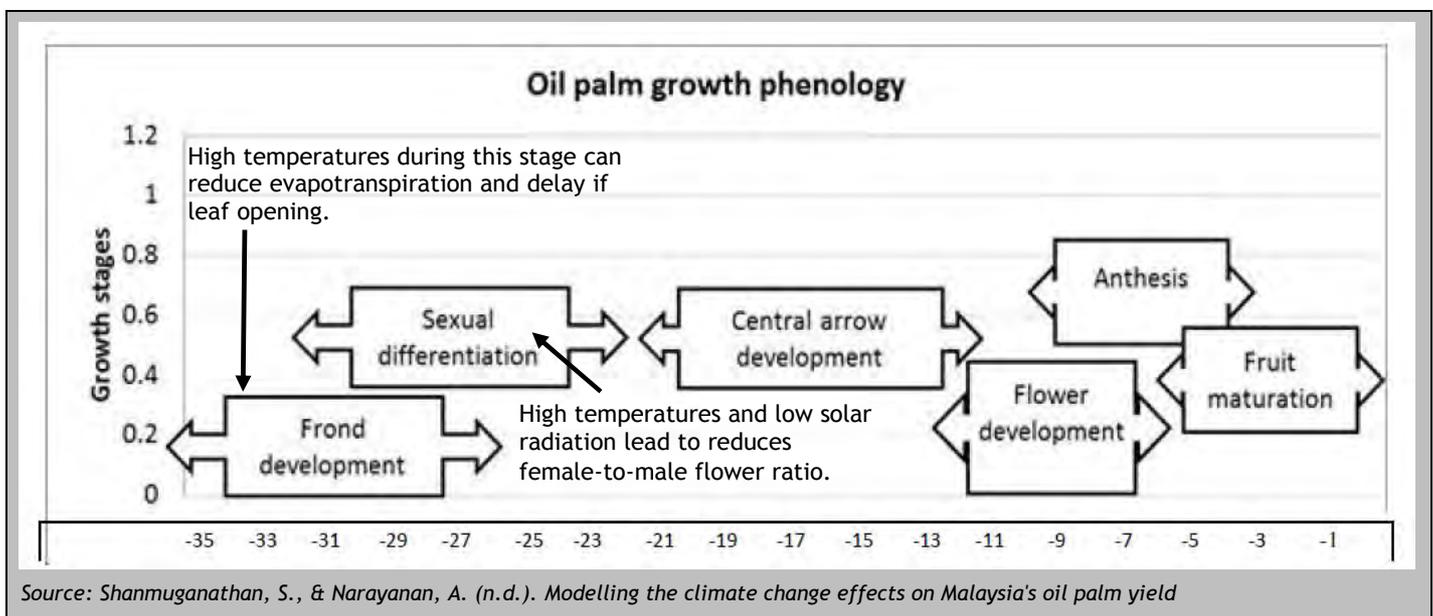


Figure 4: Percentage of immature area to total planted area

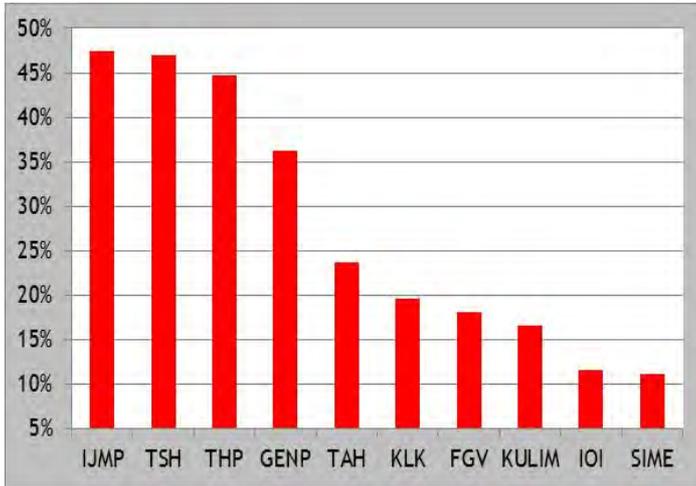
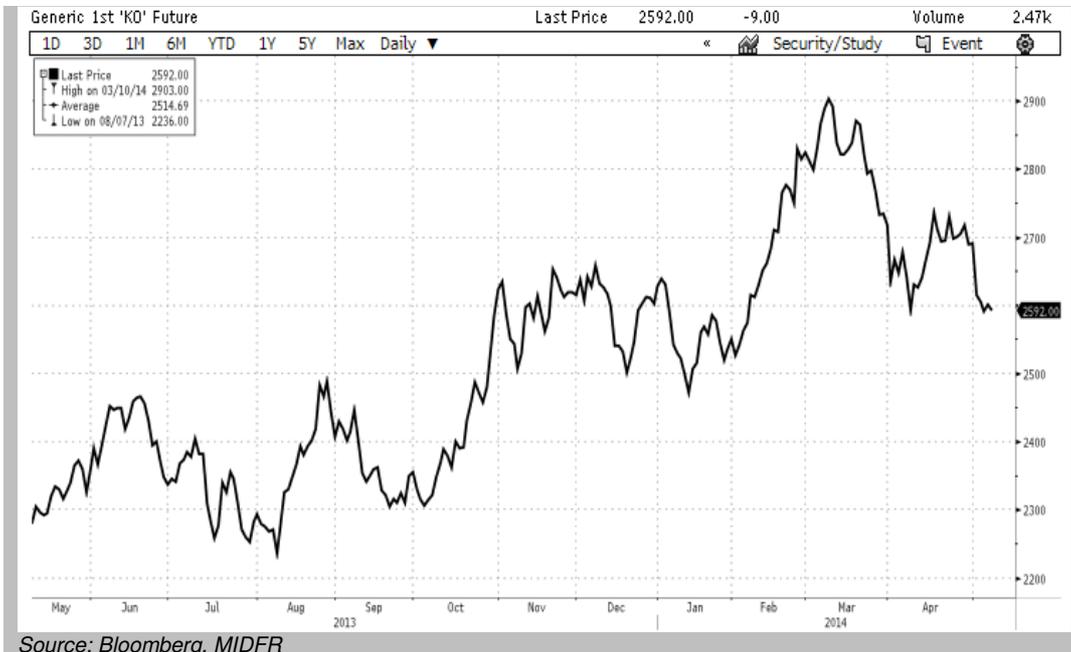


Table 1: Sensitivity analysis between CPO production and earnings

1% drop in CPO production, earnings will drop by;	
IJM Plant	-1.6%
Genting Plant	-1.1%
TSH Resources	-1.0%
TH Plant	-0.9%
FGV	-0.9%
KL Kepong	-0.4%
Kulim	-0.3%
Ta Ann Holdings	-0.3%
Sime Darby	-0.1%
IOI Corp	-0.1%

DAILY PRICE CHART



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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.