

11 February 2016 | Sector Update

PLANTATION**Maintain POSITIVE*****Expect inventory to decline below 2.00m MT soon*****KEY HIGHLIGHTS**

- **January 2016 inventory level of 2.31m MT is below expectation.**
- **Tree stress impact continues as production plunged 19%mom.**
- **Lower export is not a major concern as it was partly caused by lower production.**
- **Expect Feb inventory to decline 11%mom to 2.07m MT. Inventory level likely decline below the "comfortable" 2.00m MT soon in March-2016 and get close to the "critical" 1.50m MT in 2QCY2016.**
- **Maintain POSITIVE view on the sector.**
- **Top picks are IOICORP (TP: RM4.95) and TAANN (RM6.50).**
- **Other BUYS are PPB (TP: RM18.00) and TSH (TP: RM2.33).**

January 2016 inventory level of 2.31m MT is below expectation as it is 3% lower than consensus forecast of 2.39m MT. It is also 4% below our estimate of 2.40m MT. Against December level of 2.63m MT, inventory was depleted significantly by 12%mom as production decline rate of 19%mom is way higher than export decline rate of 14%mom. Overall, the data is positive to CPO price as strong depletion in stocks suggest that demand has outpaced supply significantly in Jan-2016.

Tree stress impact continues as production plunged 19%mom. Sabah production declined the most (-22%mom to 338k MT) followed by Sarawak (-21%mom to 234k MT) and Peninsular Malaysia (-17%mom to 113k MT). The decline rate of 19%mom is higher than past 5-year average decline of 13%mom between December to January from the year 2011 to 2015. The data has validated our belief that the tree stress impact has started as a result of lagged effect from El Nino six to nine months ago. Recall that Australia Bureau of Meteorology officially announced El Nino condition on 12-May-2015.

Lower export is not a major concern as it was partly caused by lower production. Total Malaysia export for palm oil declined by 14%mom to 1.28m MT due to lower export to European Union (-30% to 185k MT), India (-21% to 263k MT) and United States (-20% to 65k MT). However, this is neutralised by stronger export to Pakistan (+35% to 56k MT) and China (+11% to 105k MT). We are not overly concerned about the decline in exports as we think it could be partly caused by the decline in production by 19%mom as highlighted above.

Expect Feb inventory to decline 11%mom to 2.07m MT. Our key assumptions for February inventory estimate are: i) 7%mom decline in production in line with historical production pattern, and ii) 14% drop in export as demand is usually lower during winter period in the Northern Hemisphere. As palm oil tends to solidify in cold weather, it is used less during winter season. Beyond February, **inventory level should decline below 2.0m MT soon in March-2016 and get close to 1.50m MT in 2QCY2016.** The impact of El Nino is now established and we believe that production will be significantly lower than what it used to be in 1HCY2016. Note that 2.0m MT is the level in which the market perceived the stock situation as "comfortable" and we think that this situation is likely to end soon. As we move into 2QCY2016, it is entirely possible that inventory may drop to the "critical" level as it gets closer to 1.50m MT.

Maintain POSITIVE view on the sector. Top picks are IOICORP (TP: RM4.95) and TAANN (RM6.50). We expect CPO price to improve to range between RM2400/MT to RM2600/MT with average of RM2500/MT in 1Q2016. Our top pick is IOICORP due to: i) rerating catalyst after it regained its Shariah status on 30-Nov, ii) strong earnings growth of +41%yoy to RM338m in 1QFY16, and iii) its earnings profile has the most pure exposure to palm oil among the big cap index-linked planters. We also like TAANN due to: i) strong earnings

growth of +38%yoy to RM115m in 9MFY15, and ii) its timber division FY16 earnings should benefit from higher average USD/MYR 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 average USD/MYR 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%, and ii) its young age profile estimated at 7.3 years old means that its FFB production is more resilient to El Nino. 

Table 1: Palm Oil Statistics for Jan-2016 ('000 MT)

	Jan-16	Dec-15	Diff.	MoM %	Jan-15	YoY%
Opening Stocks	2,634	2,909	-275	-9.5%	2,016	30.7%
Production	1,130	1,399	-270	-19.3%	1,161	-2.7%
Imports	37	83	-47	-56.1%	90	-59.2%
Total Supply	3,800	4,392	-591	-13.5%	3,266	16.3%
Exports	1,279	1,484	-205	-13.8%	1,191	7.4%
Dom Disapp	214	274	-60	-22.0%	305	-30.0%
Total Demand	1,493	1,758	-265	-15.1%	1,496	-0.3%
End Stocks	2,308	2,634	-326	-12.4%	1,770	30.4%
Stock/Usage Ratio	12.9%	14.2%			9.9%	

Source: MPOB, MIDF Research

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

Country	Jan-16	Dec-15	Jan-15	MoM%	YoY%	1M16	1M15	YoY%
China	105	95	216	11%	-52%	105	216	-52%
India	263	333	160	-21%	64%	263	160	64%
EU	185	266	172	-30%	7%	185	172	7%
Pakistan	65	48	56	35%	17%	65	56	17%
US	58	72	65	-20%	-11%	58	65	-11%
Others	604	670	523	-10%	15%	604	523	15%
Total	1,279	1,483	1,192	-14%	7%	1,279	1,192	7%

Source: MPOB, MIDF Research

Table 1: Basis of valuation

Company	TP	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.

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.