

12 November 2015 | Sector Update

PLANTATION**Maintain POSITIVE*****Still reasonable Stock/Usage ratio amidst record high inventory*****KEY HIGHLIGHTS**

- **October 2015 inventory level of 2.83m MT was higher than expected**
- **CPO price is unlikely to tumble despite record high inventory due to reasonable Stock/Usage ratio**
- **Export improved 2%mom**
- **Expect inventory to increase slightly in November by 2% to 2.90m MT**
- **Maintain POSITIVE with 2015 and 2016 average CPO prices of RM2,175/MT and RM2,300/MT respectively**
- **SIME (BUY; TP: RM9.10) is our top pick**
- **Other BUYs are PPB (TP: RM18.00), TSH (TP: RM2.33) and TAANN (TP: RM4.50).**

October 2015 inventory level of 2.83m MT was higher than expected as it came 4% above consensus estimate of 2.72m MT and 8% higher than our forecast of 2.62m MT. Note that Malaysia's palm oil production unexpectedly increased 4%mom to 2.04m MT due to strong 11%mom surge seen in Sabah. We believe that Sabah production pattern has changed slightly this year with its peak shifting to October instead of the usual August/September seen historically. This could be caused by a change in tree behaviour in Sabah after going through moisture stress period in 1QCY15. Nevertheless, overall production in October of 2.04m MT was still below August's 2.05m MT hence we maintain our view that seasonal production has started and is likely to decline in November.

CPO price is unlikely to tumble despite record high inventory due to reasonable Stock/Usage ratio.

Although inventory is currently at record high level of 2.83m MT, we wish to highlight that Stock/Usage ratio is only at 12.3%. This is still lower than record high Stock/Usage ratio of 13.4% recorded in Feb-2013. We believe that the Stock/Usage ratio is a better indication as it compares inventory against total yearly demand instead of looking at the absolute number of inventory alone. Additionally, we expect CPO to be supported by weak Ringgit as its competitiveness should increase relative to soybean oil.

Export improved 2%mom. Total Malaysia's export for palm oil increased by 2%mom to 1.71m MT due to higher export to India (+23% to 441k MT). Better demand for palm oil from India may be caused by the stock up activity ahead of Deepavali celebration on 10-Nov. However, export to China declined 13%mom to 167k MT which consequently dragged the overall Malaysia's export growth.

Expect inventory to increase slightly in November by 2% to 2.90m MT. Our key assumptions for November inventory estimate are: (i) 6%mom decline in production in line with historical production pattern, and (ii) flattish export at 1.71m MT as demand normalizes after Deepavali festival in India. Furthermore, Stock/Usage ratio is expected to increase to 12.6% (but still below the record high of 13.4%).

Maintain POSITIVE with 2015 and 2016 average CPO prices of RM2,175/MT and RM2,300/MT respectively; SIME (BUY; TP: RM9.10) is our top pick. All considered, we are neutral on the news of October inventory as the negative sentiment from record high inventory on CPO price should be neutralized by the impact of weak Ringgit. Our top pick is SIME as its FY16 FFB growth estimate of 9.0%yoy for FY16 is the highest (against IOICORP's 2.5% and KLK's 4.7%). Valuation wise, SIME's forward PER is the lowest at 20.2x (against IOICORP's 23.3x and KLK's 23.5x). Its dividend yield of 3.2% is also decent (against IOICORP's 3.6% and KLK's 2.5%).


Other BUYs are PPB (TP: RM18.00), TSH (TP: RM2.33) and TAANN (TP: RM4.50). We like PPB as Wilmar is poised to benefit from biodiesel mandate in Indonesia and higher USD/MYR rate as Wilmar earnings is reported in US Dollar. We also like TSH as its estimated FY16 FFB growth of 12% means that the Company is poised to enjoy superior earnings growth against other mid-cap peers. Its young age tree profile estimated at 7.3 years old means that its FFB production is more resilient to El Nino impact. For TAANN, we expect its timber division to benefit from higher USD/MYR as the division's product (Export Log and Plywood) prices are quoted in US Dollar. Hence, TAANN is poised to enjoy earnings growth from both its plantation and timber divisions. 

Table 1: Palm Oil Statistics for Oct-2015 ('000 MT)

	Oct-15	Sep-15	Diff.	MoM %	Oct-14	YoY%
Opening Stocks	2,642	2,492	149	6.0%	2,090	26.4%
Production	2,037	1,959	78	4.0%	1,893	7.6%
Imports	73	76	(3)	-3.4%	83	-11.5%
Total Supply	4,752	4,527	225	5.0%	4,066	16.9%
Exports	1,712	1,681	31	1.9%	1,605	6.6%
Dom Disapp	207	205	1	0.7%	294	-29.8%
Total Demand	1,918	1,886	33	1.7%	1,900	1.0%
End Stocks	2,834	2,642	192	7.3%	2,166	30.8%
Stock/Usage Ratio	12.3%	11.7%			9.5%	

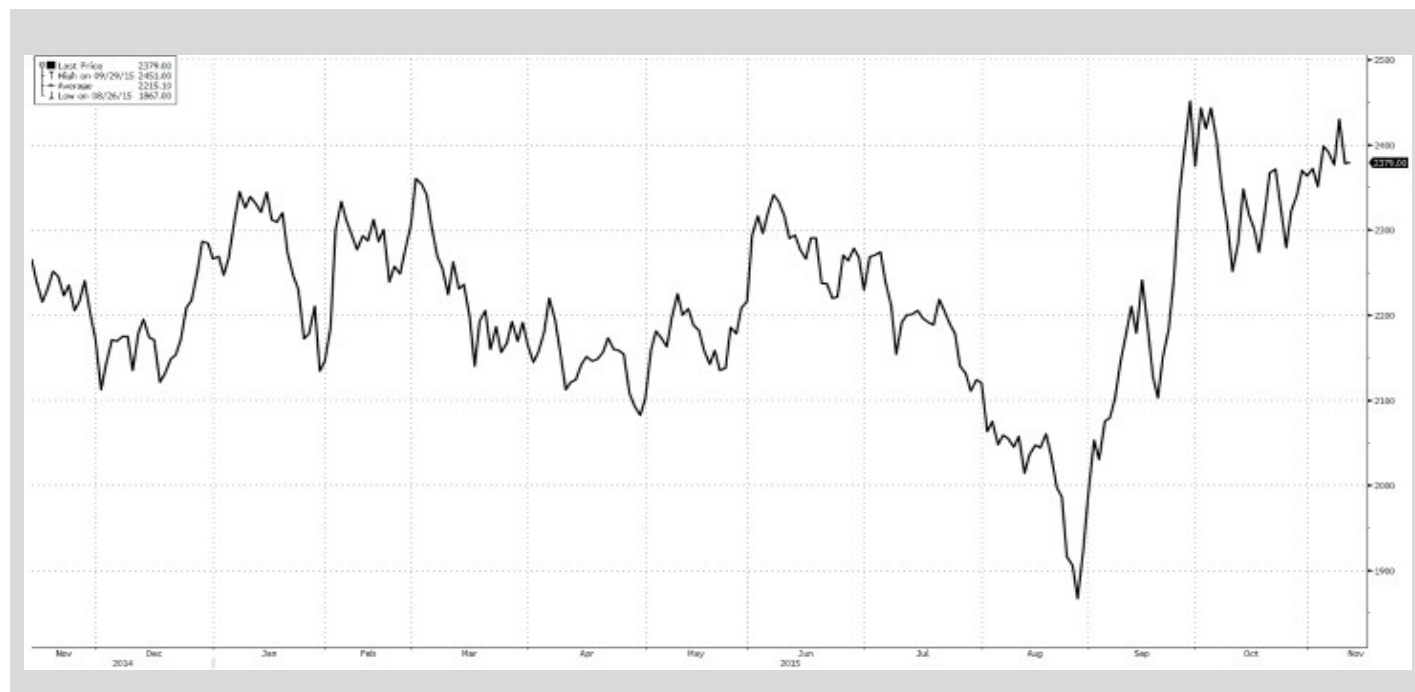
Source: MPOB, MIDF Research

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

Country	Oct-15	Sep-15	Oct-14	MoM%	YoY%	10M15	10M14	YoY%
China	167	193	234	-13%	-28%	2,125	2,241	-5%
India	441	357	278	23%	59%	2,960	2,580	15%
EU	222	228	257	-3%	-14%	1,934	1,963	-2%
Pakistan	58	58	86	0%	-33%	602	698	-14%
US	75	50	72	48%	4%	581	664	-12%
Others	749	795	684	-6%	10%	6,748	6,123	10%
Total	1,712	1,681	1,611	2%	6%	14,950	14,270	5%

Source: MPOB, MIDF Research

Chart 1: CPO price movement



Source: Bloomberg, MIDF Research

Table 3: Basis of valuation

Company	TP	Call	Valuation Basis
SIME	9.10	BUY	SOP with plantation sector @ 23.2x FY16E PE. 23.2x is the avg of IOICORP and KLK Target PE.
IOICORP	4.30	NEUTRAL	23.1x Fwd. PE on FY16F earnings reflecting mean valuation.
KLK	23.40	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	NEUTRAL	1.0x Price to Net Tangible Asset (P/NTA).
GENP	10.20	NEUTRAL	SOP with plantation sector @ 23.1x FY16E PE. 23.1x is the lower valuation between IOICORP and KLK.
IJMP	3.50	NEUTRAL	18.6x Fwd. PE on FY17F earnings reflecting mean valuation.
TSH	2.33	BUY	22.3x Fwd. PE on FY16F earnings reflecting mean valuation.
TAANN	4.50	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.