

15 January 2016 | Sector Update

PLANTATION

Maintain POSITIVE***The diminishing correlation between crude oil and CPO price***

KEY HIGHLIGHTS

- **December 2015 inventory level of 2.63m MT is below expectation.**
- **Tree stress impact continues as production plunged 15%mom.**
- **Steady export volume at 1.48m MT.**
- **Expect Jan inventory to decline 9%mom to 2.40m MT.**
- **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).**

Tumbling crude oil to hit biodiesel plans in Indonesia and Malaysia? Reuters reported that "Indonesia and Malaysia may have to curb plans to channel more of the commodity into biodiesel as tumbling crude oil prices render the edible oil twice as expensive as its fossil fuel alternative. Indonesia expects to raise the minimum bio content of gas oil in the country by a quarter to 20% in 2016, while Malaysia has said it plans a 10% blend, up from the 7% targeted in 2015."

Malaysia biodiesel plan has improved local consumption in 2015. Based on MPOB data, local disappearance (in which we interpret as consumption) of palm oil for 2015 has increased 4%yoy to 2.96m MT. We believe that the significant increase is likely caused by higher biodiesel usage despite the lower crude oil price observed in 2015. However, Indonesia usage of biodiesel is likely to have fallen short of their target.

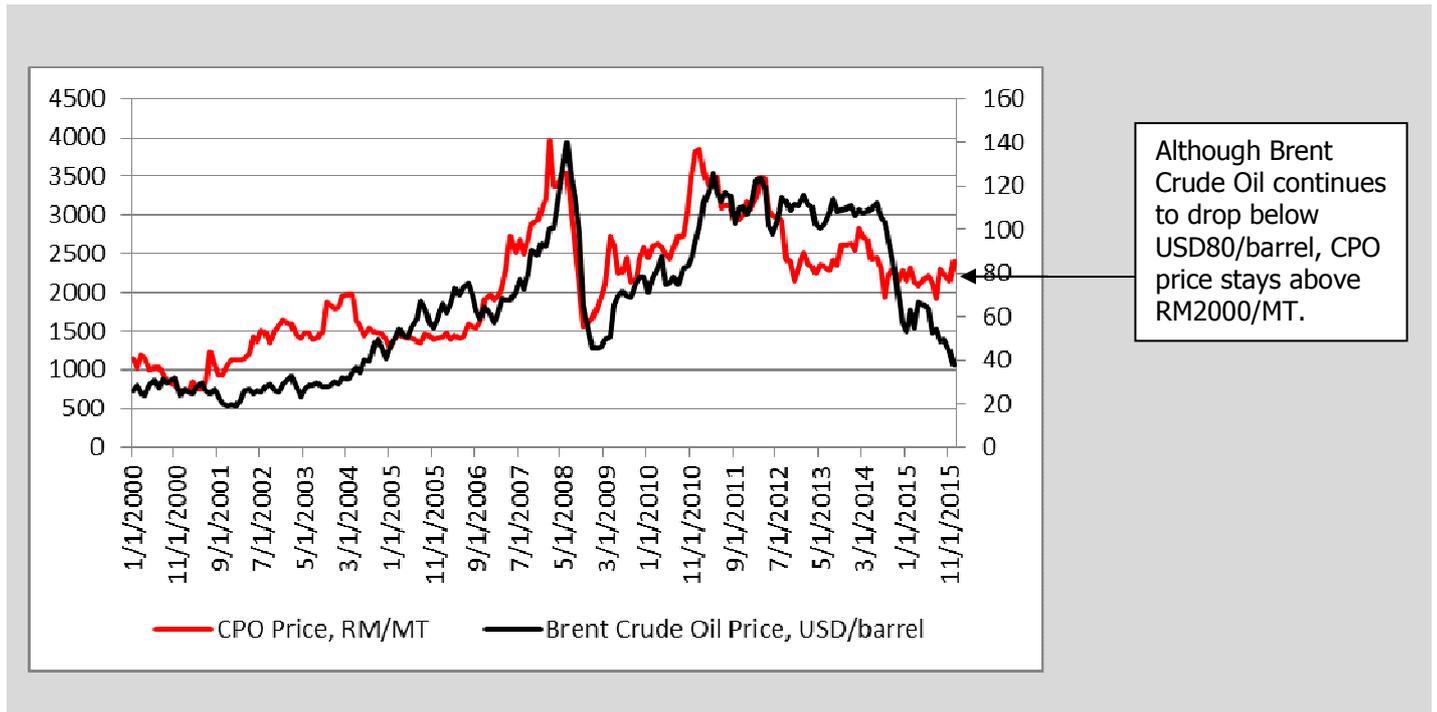
But Indonesia biodiesel plan has likely fell short of their target. Assuming that high usage of biodiesel in Indonesia should cause Malaysia's import of palm oil to decline, we believe that the measurement of Indonesia biodiesel usage can be gauged from MPOB statistic on Malaysia palm oil import. As Malaysia palm oil import has surged 112%yoy to 1.03m MT in 2015, in which almost all of the imports came from Indonesia, we believe that this is a sign that the biodiesel implementation in Indonesia has been lacking.

Neutral on the news as crude oil price is no longer a determinant of CPO price. We are neutral on the news. Our observation shows that the correlation between Brent Crude Oil price and CPO price has weakened when the former fell below USD80/barrel in Nov-2014. Since then, CPO price has declined merely-14% to USD545/MT while Brent Crude Oil tumbled -47% to USD37.28/barrel as of end-2015. Statistically, the correlation between Brent Crude Oil and CPO price has weakened to +0.57 between Nov-2014 and Dec-2015. To conclude, we believe that the correlation will regain its significance when Brent Crude Oil surged above USD80/barrel as this is the point in which the demand for palm oil by independent biodiesel producer will re-emerge as their margin is expected to become positive again.

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 an average of RM2500/MT in 1Q2016. Our top pick is IOICORP due to: (i) the stock is due for rerating 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 (100%) 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 should benefit from higher USD/MYR as the division's product (Export Log and Plywood) prices are quoted in USD.

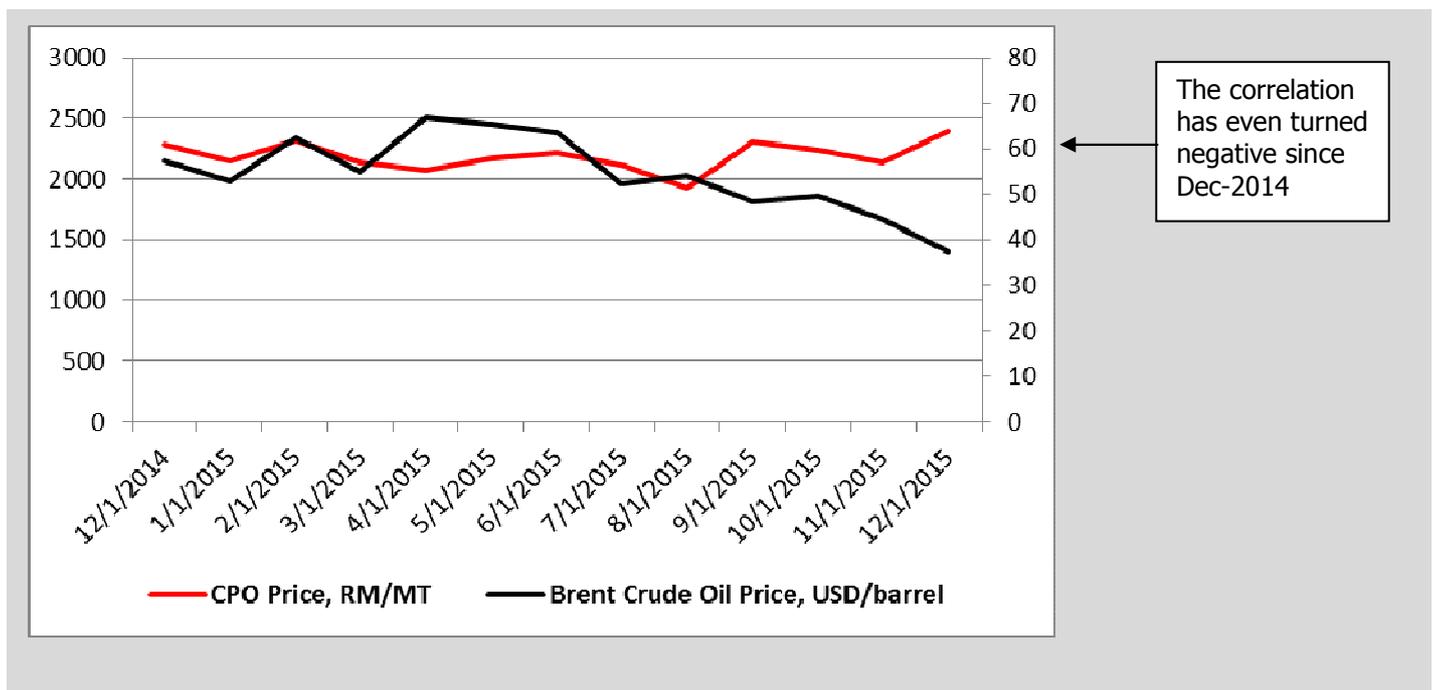
Other BUYs are PPB (TP: RM18.00) and TSH (TP: RM2.33). We like PPB due to: (i) good 9MFY15 earnings growth of +12%yoy to RM710m, and (ii) it is expected to benefit from higher USD/MYR rate as Wilmar earnings is reported in USD. For TSH, we like the stock as: (i) its FFB growth expected at 12% in FY16 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 the impact of El Nino. 

Chart 1: CPO and Brent Crude Oil price movement



Source: Bloomberg, MIDF Research

Chart 2: Diminishing correlation between CPO and Brent Crude Oil price since Dec-2014



Source: Bloomberg, MIDF Research

Table 3: 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.