

11 December 2015 | Sector Update

**PLANTATION****Maintain POSITIVE*****Tree stress impact may have started*****KEY HIGHLIGHTS**

- **November 2015 inventory level of 2.91m MT is within expectation.**
- **Record high inventory and Stock/Usage ratio should have been mostly priced in.**
- **Tree stress impact may have started as production plunged 19%mom.**
- **Inventory should have peaked; expect Dec inventory to ease 3% to 2.83m 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).**

**November 2015 inventory level of 2.91m MT is within expectation** as it is close to our estimate of 2.90m MT and only 2% above consensus estimate of 2.85m MT. Against October level of 2.84m MT, inventory is up 2%mom as production of 1.65m MT still exceed export value of 1.50m MT.

**Record high inventory and Stock/Usage ratio should have been mostly priced in.** Palm oil inventory reached another new record high level of 2.91m MT. Accordingly, Stock/Usage ratio has also reached new record of 14.2% (against previous record of 13.4% recorded in Feb-2013). Note that Stock/Usage ratio compares inventory against total yearly demand instead of looking at the absolute number of inventory alone. While this news is admittedly negative to the market, we think most of the impact should have been mostly priced in. Note that in Nov-2015, average CPO discount against Soybean Oil (SBO) has widened 16% to USD107/MT (from USD92/MT in Oct-2015).


**Tree stress impact may have started as production plunged 19%mom.** Sarawak production declined the most (-23%mom to 324k MT) followed by Peninsular Malaysia (-21%mom to 813k MT) and Sabah (-13%mom to 516k MT). The decline rate of 19%mom is also much higher than past 5-year average decline of 8%mom between October and November from the year 2010 to 2014. Additionally, production has declined 6%yoy and this is the first occurrence after seven months of on-year production growth. Hence, we believe that the tree stress impact has started to kick in as a result of El Nino.

**Export declined 12%mom.** Total Malaysia export for palm oil declined by 12%mom to 1.50m MT due to lower export to India (-12% to 390k MT). Lower demand for palm oil from India may be caused by the normalization of demand after the stock up activity ahead of Deepavali celebration on 10-Nov.

**Inventory should have peaked; expect Dec inventory to ease 3% to 2.83m MT.** Our key assumptions for December inventory estimate are: (i) 13%mom decline in production in line with historical production pattern, and (ii) 3% drop in export as demand usually decline during winter in the Northern Hemisphere. As palm oil tends to solidify in cold weather, it is used less during cold temperature months. Stock/Usage ratio is expected to be lower at 14.1%.

**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 RM2,300/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 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 USD/MYR as the division's product (Export Log and Plywood) prices are quoted in US Dollar.

**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 US Dollar. 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 Nov-2015 ('000 MT)**

	Nov-15	Oct-15	Diff.	MoM %	Nov-14	YoY%
<b>Opening Stocks</b>	<b>2,836</b>	<b>2,642</b>	<b>194</b>	<b>7.3%</b>	<b>2,090</b>	<b>35.7%</b>
<b>Production</b>	<b>1,653</b>	<b>2,037</b>	<b>(384)</b>	<b>-18.9%</b>	<b>1,893</b>	<b>-12.7%</b>
Imports	122	73	48	65.9%	83	46.8%
<b>Total Supply</b>	<b>4,610</b>	<b>4,752</b>	<b>(142)</b>	<b>-3.0%</b>	<b>4,066</b>	<b>13.4%</b>
Exports	1,499	1,712	(213)	-12.4%	1,605	-6.6%
Dom Disapp	203	205	(2)	-1.0%	294	-31.0%
<b>Total Demand</b>	<b>1,702</b>	<b>1,917</b>	<b>(215)</b>	<b>-11.2%</b>	<b>1,900</b>	<b>-10.4%</b>
<b>End Stocks</b>	<b>2,908</b>	<b>2,836</b>	<b>73</b>	<b>2.6%</b>	<b>2,166</b>	<b>34.3%</b>
<b>Stock/Usage Ratio</b>	<b>14.2%</b>	<b>12.3%</b>			<b>9.5%</b>	

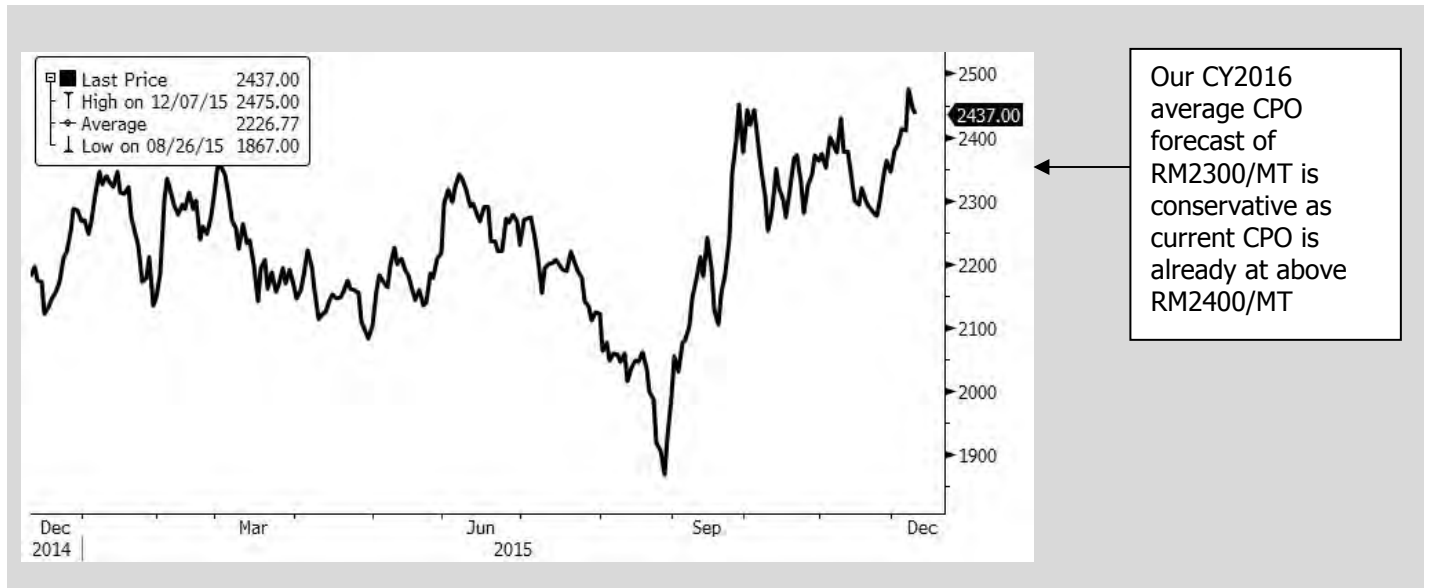
Source: MPOB, MIDF Research

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

Country	Nov-15	Oct-15	Nov-14	MoM%	YoY%	11M15	11M14	YoY%
China	160	167	341	-4%	-53%	2,286	2,582	-11%
India	390	441	285	-12%	37%	3,350	2,865	17%
EU	215	222	207	-3%	4%	2,149	2,171	-1%
Pakistan	57	58	50	-2%	13%	658	748	-12%
US	42	75	43	-43%	-2%	624	707	-12%
Others	635	749	588	-15%	8%	7,383	6,711	10%
<b>Total</b>	<b>1,499</b>	<b>1,712</b>	<b>1,514</b>	<b>-12%</b>	<b>-1%</b>	<b>16,449</b>	<b>15,784</b>	<b>4%</b>

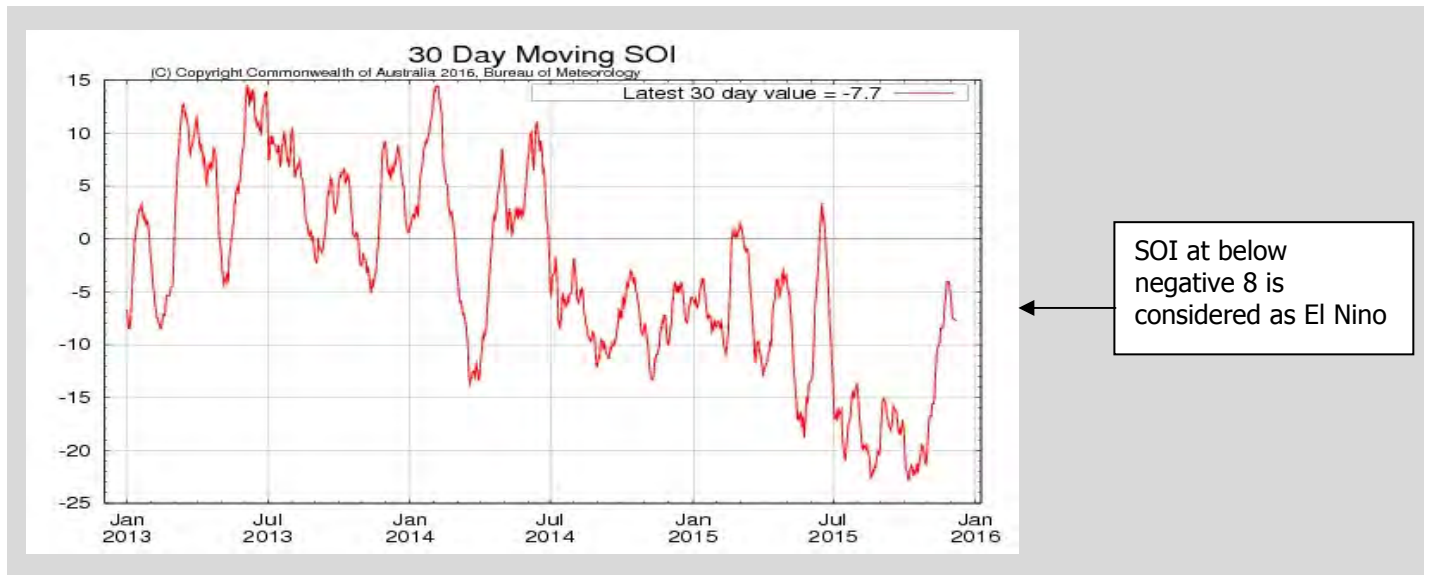
Source: MPOB, MIDF Research

**Chart 1: CPO price movement**



Source: Bloomberg, MIDF Research

**Chart 2: SOI Index has stayed in the El Nino zone persistently**



Source: Bloomberg, MIDF Research

**Table 3: Basis of valuation**

<b>Company</b>	<b>TP</b>	<b>Call</b>	<b>Valuation Basis</b>
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.