Sector Update | Monday, 04 July 2022

PLANTATION

Maintain POSITIVE

A short-lived downwards trend

KEY INVESTMENT HIGHLIGHTS

- **Supply tightness over edible oils to be remain on the back lower area planted for USA Soybean, unresolved Russia-Ukraine war, tight Malaysia FFB output.**
- **Widening premium/discount SBO-PO.**
- **Maintain POSITIVE stance on the sector with CPO TP of RM5,500/mt for CY22**

CPO prices rally are being halted? From a technical point of view, it does seem that the CPO price rally is waning seemingly in correction mode given the weak numbers seen to-date of RM4,766/tonne, but we believe there are signs that this soft pace is short-lived, and price will stay elevated. To recap, CPO price (local delivery) started on a solid foundation at RM5,214/tonne in early Jan 2022, while in March saw active accelerations to RM8,077/tonne before easing to RM5,105/tonne (-2.09%Ytd) in June. A few factors disconcerting this sharp declined were; i) Indonesia lifting its export ban and cut its maximum PO export tax and levy to $488/tonne resulting in Malaysia's CPO being less attractive due to the price discount, ii) we are entering the higher PO production cycle seasons (2-3Q), and iii) sentiment concerns on demand, as inflationary fears grasp in.

We think this contraction is justified at the moment, as if we compare to 2021's Ytd performance (-1.60%), it faced quite the same strained position during the period (*Chart 1*). We believe the prices grew at a too fast pace as opposed to subsequent year and seemingly has peaked as market assessed Russian-Ukraine war and inflation impact. Gong onward, we anticipate that CPO price to rest above at 5,000 level in 2H22 given on longer outlook, whereby supply tightness over the edible oils is still present due to; i) subdued soybean production due to drought in South America amidst lower planted US soybean area, ii) supply concerns amid Russia – Ukraine prolongs war (disrupted sunflower supply) and iii) lower than expected on Malaysian palm oil production. The following highlights the basis for our view:

- We are on a view that La-Nina is back for the third year, and US Climate Prediction Center (CPC) warns that this disruptive global weather would bring drought and dry conditions and could hinder the crop's yield development for soybean in Brazil and Argentina later in 2HCY22.
- Meanwhile, planted soybean area in US is expected to be lower this year. According to *USDA NASS* June report, it forecasts planted area at 88.325m (-3.0%) acres versus 90.446m acres. Roughly 17 states recorded negative and only 5 states posted positive growth in similar acres (*Chart 2*), charting softer output in 2022/23.

COMPANY IN FOCUS

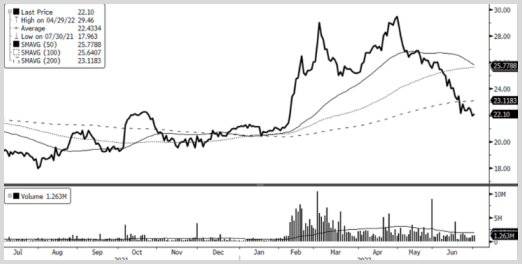
Kuala Lumpur Kepong

Maintain BUY | Revised target price: **RM31.50**

Price @ 1st July 2022: RM22.10

- Its nitrile latex business is expected to improve on the back of better sales
- Replanting programme is expected to improve its production level in the longer term.
- Manufacturing segment is expected to continue recording steady increase in profit

Share price chart



TSH Resources Bhd

Maintain BUY | Revised target price: **RM1.90**

Price @ 1ST July 2022: RM1.06

- Earnings to be amplified by favourable CPO price
- Going ahead, healthy FFB production and favourable CPO
- Moving forwards, production to be bolstered by young age profile of its Indonesian oil palm estates.

Share price chart



MIDF RESEARCH
research@midf.com.my

- As for sunflower oil, we understand that its spring planting season (April-May) has been disrupted as 50% of sunflower seeds are produced from regions being contested in the Ukraine-Russia conflict. Since Russia has taken over the Black Sea ports, major logistical issues are also inevitable, even if farmers managed to plant and harvest this year.
- While CPO production enters its peak cycle season in 2Q-3Q aided with more foreign labour boots in 2HCY22, the majority of planters confirmed that 2022 FFB production would continue slow, impacted by lower fertilizer application due to labour (manuring and upkeeping) shortage in the previous year.

On the demand front, based on MPOB data, we saw most major importing countries intake of Malaysia's palm oil has slowed down by -7.9% to 2.6m tonnes from 2.8m tonnes. These were led by US (-60.1% ytd), followed by Pakistan (-24.7% ytd), China (-10.8% ytd) and India (-6.2% ytd). While EU (+7.9% ytd) imported more, this was mainly due to inaccessibility of sunflower oil. In light of growing recession fears, we anticipate export numbers to remain flattish due to inflationary pressure worldwide.

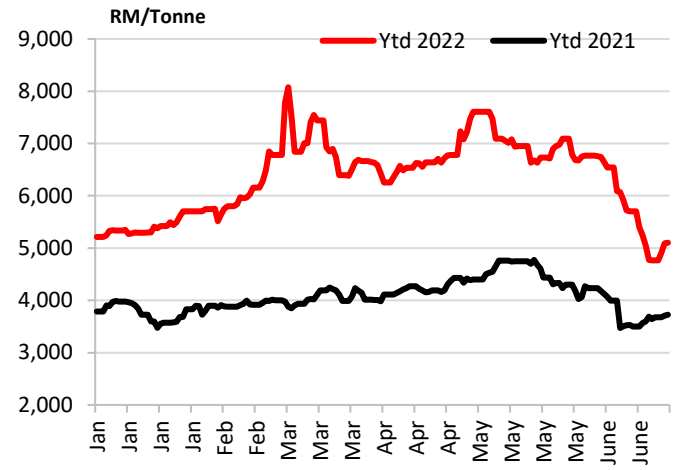
We also estimate intake from Pakistan and India to be slower, due to the high CPO prices traded. We opine that any further increase in CPO prices could further diminish demand from these two countries. As for China, economic activity is supposed to restart on 1 June 2022, after two-month of lockdown in major cities. Hence, we could see normalize demand in the near-term. Nevertheless, due to price competition between Malaysia and Indonesia in which normally Indonesia CPO prices trades at discount to Malaysia due to lower export and duty, this has made Indonesia's CPO more attractive resulting higher market share of palm oil export to China.

Widening PO and SBO spread. Apart from that, we noticed the widening discount of PO and SBO price differential (*Chart 4*) remained higher in Apr-May, major soybean exporter such as US, Brazil and Argentina current discount parity were at USD224/MT, USD100/MT and USD107/MT versus 3-years average discount of USD114/MT, USD96/MT and USD89/MT respectively. This indicates the widening discount could paving a hope for PO price to turn a corner from its recent slowdown, as price wise, now it's more attractive against SBO. Hence, we are seeing the total PO importing countries on to-date basis still recorded growth of 5.8% (2021Ytd: -7.1%), based on MPOB data.

Is it still investable for the sector? Valuation wise, KLPLN Index is currently trade at PER of 25.4x, which nearly the 4y-avg historical mean of 25.8x (*Chart 6*). At current level, we view the sector PE as attractive and should be trade higher tracking commodity upcycle cemented by supply tightness. Following on that, we think current PE for companies under our coverage has not fully priced-in the higher ASP CPO to be realised by the planters going into 2HCY22. This sharp correction is due to market pessimism of inflation, concerns on demand as well as Indonesia's move to lower export duty and levy. Additionally, we also opine current KLPN Index of 6,900.83 pts (*Chart 5*) to reversed higher following our earnings optimism.

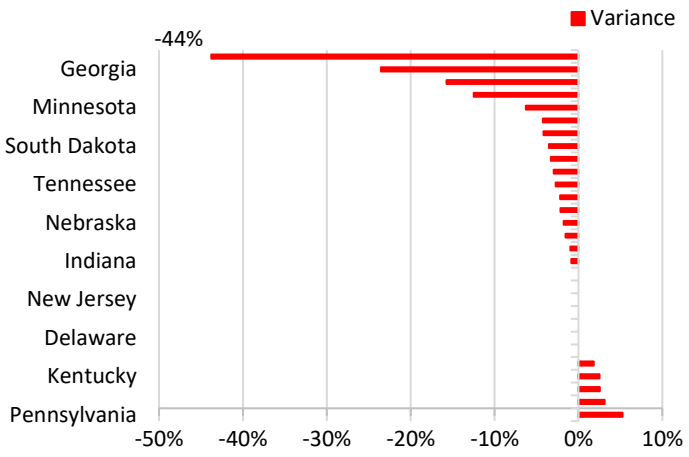
Maintain POSITIVE with unchanged CY22 CPO price of RM5,500/mt. We anticipate that the CPO price will remain elevated in 2HCY22 as the price level will be supported by; i) higher price of edibles oil on the back of supply concerns amid Russia – Ukraine prolongs war (disrupted sunflower supply), ii) subdued production outlook for soybean in 2022/23 due return in La-Nina in third year in a row in South America such Brazil and Argentina compounded by lower planted area in USA, and iii) improved demand outlook on improved economic activities. Despite our positive view on the sector, we do expect the CPO price will ease in 2HCY22 but at a gradual pace on concern of inflationary pressure globally after achieving higher-than-expected CPO price in 1HCY22. As such, we maintained our CY22 CPO price forecast of **RM5,500/mt** at this juncture. In line with this, we reaffirm our **POSITIVE stance** on plantation sector. Key risks to CPO prices are i) unprecedented new variants appear which resulting another lockdown worldwide, ii) above expectation stockpiles and supply of soybean and soybean oil and iii) changing policy in importing countries. Our top picks for the sector are **KLK (BUY, TP: RM31.50)** and **TSH (BUY, TP: RM1.90).**

Chart 1: Local CPO Price Delivery



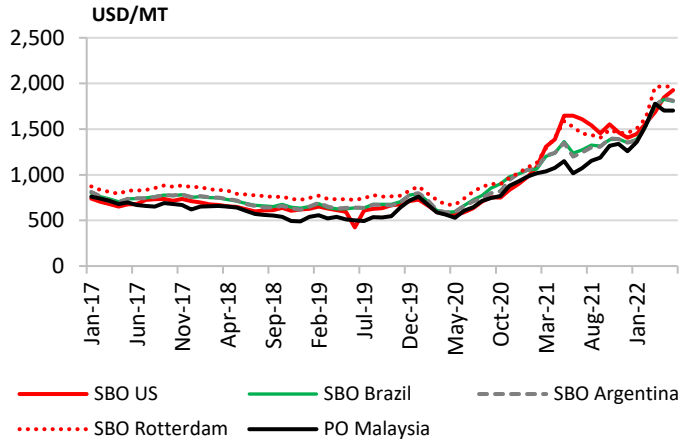
Source: MPOB, MIDFR

Chart 2: U.S. Soybean Plantings 2022 (March-June)



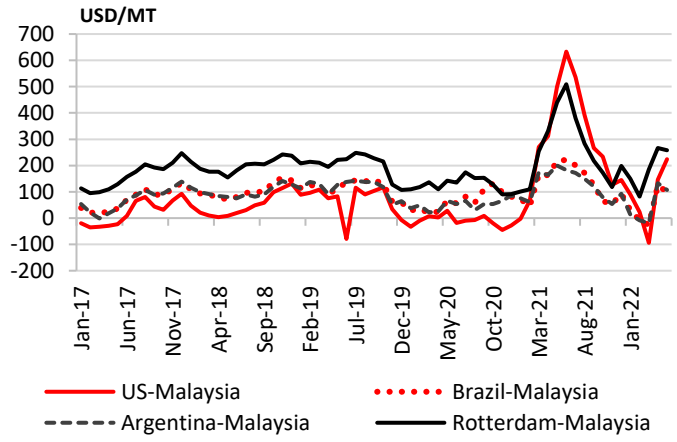
Source: USDA NASS, MIDFR

Chart 3: SBO price (US, Brz & Arg) & PO price Msia



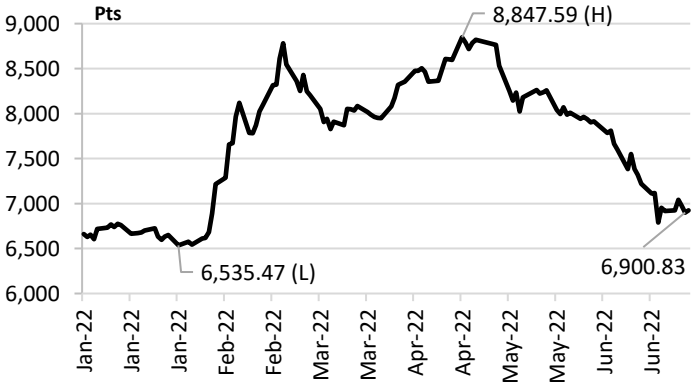
Source: USDA, MIDFR

Chart 4: Premium/Discount between SBO vs. PO



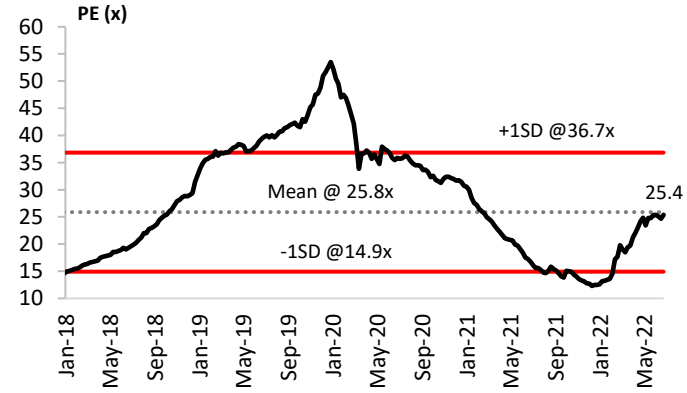
Source: USDA, MIDFR

Chart 5: KLPLN Index 6-mth performance



Source: Bloomberg, MIDFR

Chart 6: KLPLN Index Trailing-12 PE Band



Source: Bloomberg, MIDFR

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MIDF AMANAH INVESTMENT BANK : GUIDE TO RECOMMENDATIONS	
STOCK RECOMMENDATIONS	
BUY	Total return is expected to be >10% over the next 12 months.
TRADING BUY	Stock price is expected to *rise* by >10% within 3-months after a Trading Buy rating has been assigned due to positive newsflow.
NEUTRAL	Total return is expected to be between -10% and +10% over the next 12 months.
SELL	Total return is expected to be <-10% over the next 12 months.
TRADING SELL	Stock price is expected to *fall* by >10% 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.
ESG RECOMMENDATIONS* - source Bursa Malaysia and FTSE Russell	
☆☆☆☆	Top 25% by ESG Ratings amongst PLCs in FBM EMAS that have been assessed by FTSE Russell
☆☆☆	Top 26-50% by ESG Ratings amongst PLCs in FBM EMAS that have been assessed by FTSE Russell
☆☆	Top 51%- 75% by ESG Ratings amongst PLCs in FBM EMAS that have been assessed by FTSE Russell
☆	Bottom 25% by ESG Ratings amongst PLCs in FBM EMAS that have been assessed by FTSE Russell

* ESG Ratings of PLCs in FBM EMAS that have been assessed by FTSE Russell in accordance with FTSE Russell ESG Ratings Methodology