Initiation Report| Monday, 19 September 2022

Sarawak Plantation Berhad

(5135 | SPLB MK) Plantation | Plantation

***Initiate with* BUY**

Sarawak's secret treasure

***Target Price*: RM2.70**

KEY INVESTMENT HIGHLIGHTS

- **We initiate our coverage on Sarawak Plantation with a BUY recommendation and TP of RM2.70**
- **Approximately 65% of its planted acreage offers lucrative age, giving prospects for profitability to jump higher**
- **We are sanguine on SPB's mid-longer-term outlook as it set to benefit under transformation strategy underpinned by management's leadership**

Company Background.

Initially, SPB was established as the vehicle company for the privatisation of Sarawak Land Development Board's (SLDB) assets. The privatisation of SLDB's assets, comprising oil palm plantations, milling facilities and related assets, was affected in 1997 through the transfer of SLDB's assets to SPB Group (comprising SPB and its subsidiaries). Sarawak Plantation (SPB) was incorporated on 1991 as private limited company and listed on the Main Market of Bursa Malaysia in 2000. SPB has a total land bank of 43,481 hectares (ha) on which about 412 ha is under joint venture (JV) development with a government statutory body. The group operates 20 PO estates with a total plantable area of 35,577 (82%) ha scattered along the coast of Sarawak as at FY21.

Executive Summary.

We initiate our coverage on Sarawak Plantation with a **BUY** call with target price of **RM2.70** by pegging its FY23 EPS of 36.9 sen to PER of 7.3x nearly the group's three-year historical average mean. We think our valuation is justified, promising on a second valuation, that its intrinsic value estimated at RM2.62 based on historical average 3-years P/B of 1.0x and BV/share of RM2.62, on the back of net asset per share of RM2.64.

Central to our investment thesis are appealing valuations combined with higher average CPO prices realized, which enables consistent share price rise, and decent cash generation, hence, paving the path for a sustainable ROE level of 17% over FY22-FY24F.

Investment Thesis.

(i) Riding on elavated CPO price.

(ii) New strategic direction has unleash its true potential.

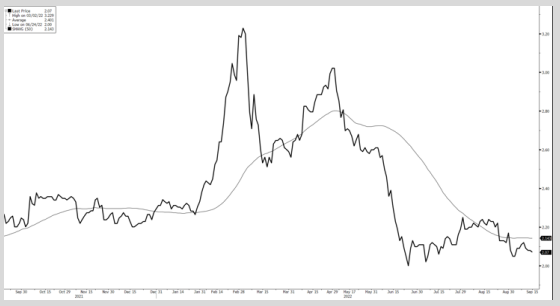
(iii) Appeal valuation

(iv) Positive FCF paving a smooth dividend payout

(v) Sturdy balance sheet would shield any potential downside risk.

RETURN STATISTICS	
Price @ 15th Sept 2022 (RM)	2.07
Expected share price return (%)	+30.43
Expected dividend yield (%)	+9.60
Expected total return (%)	**+40.03**

SHARE PRICE CHART



Share price performance (%)	Absolute	Relative
1 month	-7.2	-3.9
3 months	-1.4	-5.1
12 months	-15.5	-10.4

KEY STATISTICS	
FBM KLCI	1,467.31
Syariah compliant	Yes
Issue shares (m)	340.97
ESG Grading Band (Star rating)	☆☆☆
Estimated free float (%)	19.02
Market Capitalisation (RM'm)	577.60
52-wk price range	RM1.99 - RM3.38
Beta vs FBM KLCI (x)	1.09
Monthly velocity (%)	28.75
Monthly volatility (%)	37.93
3-mth average daily volume (m)	0.15
3-mth average daily value (RM'm)	0.33
Top Shareholders (%)	
Ta Ann Holdings Bhd	29.41
STATE FINANCIAL SECRETARY	25.52
Urusharta Jamaah Sdn Bhd	5.06

MIDF Research
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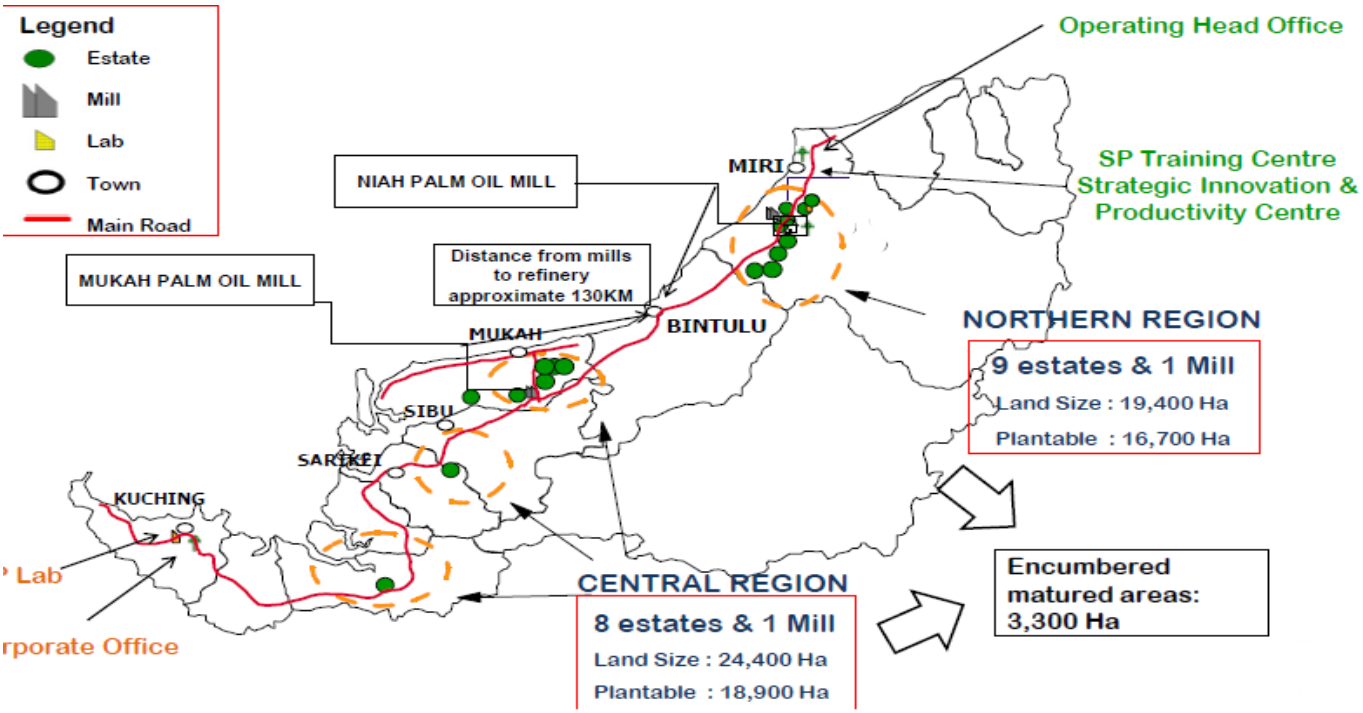
A. BUSINESS OVERVIEW

Sarawak Plantation (SPB) was incorporated on 1991 as private limited company under the name of Sarawak Plantation Sdn. Bhd. and listed on the Main Market of Bursa Malaysia in 2000. Initially, SPB was established as the vehicle company for the privatisation of Sarawak Land Development Board's (SLDB) assets. The privatisation of SLDB's assets, comprising oil palm plantations, milling facilities and related assets, was affected in 1997 through the transfer of SLDB's assets to SPB Group (comprising SPB and its subsidiaries). Since then, SPB emerged one of the pioneer players in the oil palm industry in Sarawak, and involved in the following activities: (i) cultivation and processing of oil palm into crude palm oil and palm kernel (core business), (ii) seed production, (iii) cattle integration, (iv) provision of laboratory and (iiv) management services and property investment.

Oil Palm Plantation and Mill Operation (Core Business)

SPB has a total land bank of 43,481 hectares (ha) on which about 412 ha is under joint venture (JV) development with a government statutory body. The group operates 20 PO estates with a total plantable area of 35,577 (82%) ha scattered along the coast as at FY21. Additionally, it also owns and operates 2 PO mills, with a combined operating capacity of 120 mt/hour, located at Niah and Mukah, respectively. Both PO Mills process harvested FFB from its own estates as well as purchased crops from smallholders, FFB traders and other third-party estates. This segment contributed c. 99.9% of total group revenue in FY21.

Figure 1: Location of Operation



Source: Company

Management services income

Since privatisation of SLDB's assets, its property investment arm namely Sarawak Plantation Property Sdn Bhd managed certain office assets and provides stable recurring income albeit it was small amounted RM581,443 (0.1%) to the group FY21's total sales. The management cited that, they have no plan to expand this segment.

B. INVESTMENT THESIS

i. Riding on elavated CPO price.

ii. New strategic direction has unleash its true potential.

iii. Appeal valuation

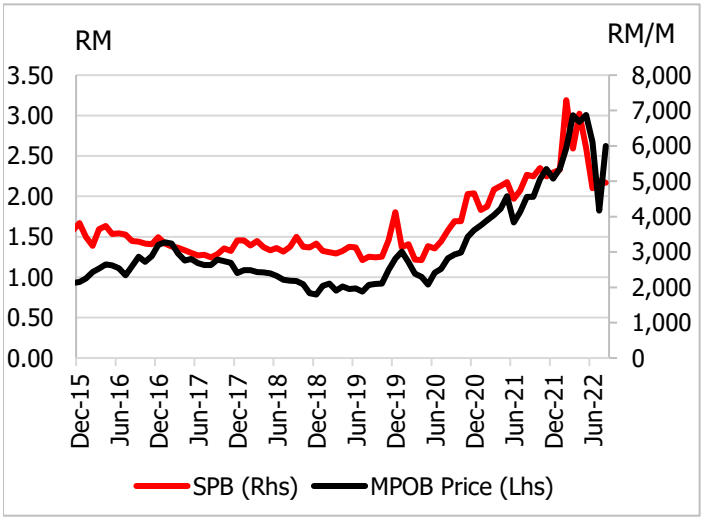
iv. Positive FCF paving a smooth dividend payout

v. Sturdy balance sheet would shield any potential downside risk.

Riding on elevated CPO price. To recall, the CPO ending stock had never closed as low as 1.27m mt in 2020, presenting a firmer platform for prices to rise higher in the face of lockdown circumstances stemming a labour issue. These factors are further aggravated by Russia-Ukraine tensions. Indeed, CPO prices had already fallen to pre-invasion Russia levels by July 22, but prices remain higher than 30 months earlier. Being a pure upstream company with high connectivity of CPO movement c. +0.89 correlation against its share price, SPB's FY21 earnings have risen dramatically to c.RM121.7m (+108% yoy) in parallel with rising CPO prices. The stock returned 10%, a gain of +18% including div. yield during the period (*Chart 1*), outperforming its peers due to a higher selling strategy that derived from 100% spot MPOB pricing.

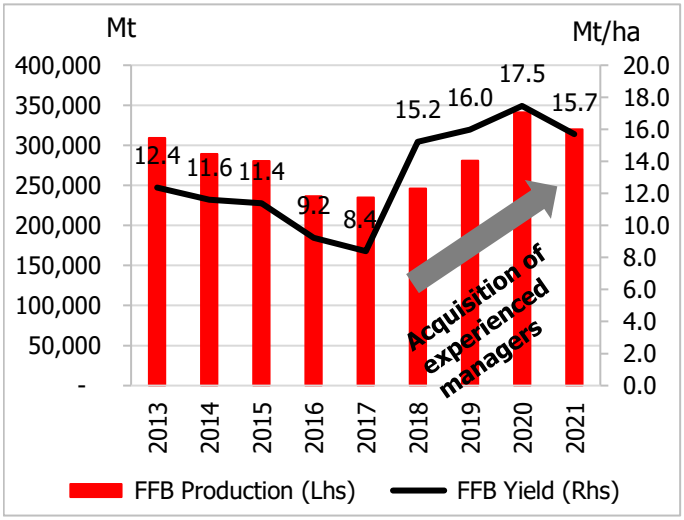
New strategic direction has unleashed its true potential. Even if earnings may be capped by the moderating of lower ASP realized ahead, we think its current share price still has further upside. This will be reinforced by ongoing operational efficiency as the management continues to develop a clear vision for the company by enhancing its estate operation leveraging on experienced estates manager. Previously, the planted area had been poorly managed, but after the arrival of these managers (*Chart 2*), there has been significant transformation plan implemented at management, staff and, most crucially, operating levels. Several strategies that were called including i) reform of human resource (downsizing its employees by 11%), ii) streamlining its organizational structure, and iii) simplifying estate reporting & monitoring processes. As a result, FFB output and yield peaked in FY20 at 341,065 mt and 17.5Mt/ha respectively.

Chart 1: CPO price & SPB share price



Source: Bloomberg, MPOB

Chart 2: FFB production Bfr & Aft Acquisition



Source: Company, MIDFR

Appealing valuation. The stock currently trades at huge discount of 5.6x of FY23 PER to its 3-year historical mean of 12x. Its PER creeping lower to -1SD at 1x due to prevailing higher EPS it will record. However, being overly optimistic on PER conditions is risky in our view, as the CPO price is still elevated as opposed normal times, and the trend is moving downward affected by hawkish stance by US Fed rate to combat the inflationary pressure. However, our positive conviction on the stock is fairly justified, judging from a second valuation we estimate its intrinsic value at RM2.62 based on historical average 3-years P/B of 1.0x and BV/share of RM2.62. In addition, its net asset per share is RM2.64. In

summary, the market seems has slowly start re-rate its cheap valuation propelling its share price to rise +24%/+7%/+10% to RM2.10/RM2.25/RM2.48 from FY19 to FY21.

Table 1: Peer Comparisons within pure Upstream players

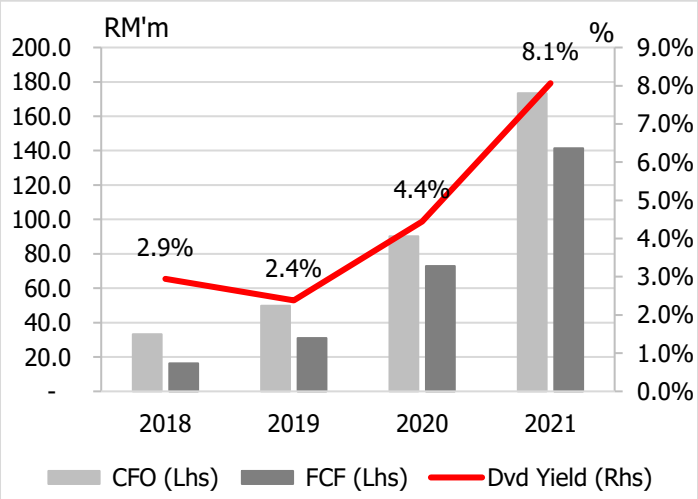
Companies	Price (RM)	Mkt Cap (RM'm)	PER (x)		PB (x)		ROE (%)	EBITDA margin (%)	Net Gearing (%)
			FY20	FY21	FY20	FY21	FY21	FY21	FY21
Sarawak Plantation	**2.07**	**580.4**	**10.2**	**5.4**	**1.3**	**1.3**	**20.4**	**23.9**	**0.10**
TSH Resources	1.01	1,394.0	20.0	8.8	1.1	0.9	10.9	29.9	0.61
HAP Seng Plantations	2.33	1,863.3	15.9	7.0	0.8	0.8	12.5	54.8	0.03
TH Plantation	0.46	402.2	36.1	7.6	0.9	0.8	11.4	38.6	1.54
Ta Ann	3.71	1,634.1	17.2	4.9	0.9	1.0	20.8	26.6	0.22
Sector		**1,174.8**	**19.9**	**6.7**	**1.0**	**1.0**	**15.2**	**34.8**	**0.50**

Source: Bloomberg, MIDFR

Consistent FCF paving a smooth dividend payout. From its consistent cash flow from operations (CFO), the firm generates a substantial amount of free cash flow (FCF) over the FY18-21 (*Chart 3*). Despite not having a dividend policy, the firm was still able to pay out significant dividends to its shareholders thanks to the FCF generated. It has regularly paid an annual dividend of above RM14.0m, or 10-20 sen per share, over the past four years (*Chart 3*), implying an alluring dividend yield of 8.1% (at share price of RM2.48) in FY21. Additionally, a third interim dividend of 5 sen per share was given in FY21. We anticipate that SPB will remain paying at least 20 sen DPS annually for the future, therefore rewarding shareholders while pursuing long-term growth.

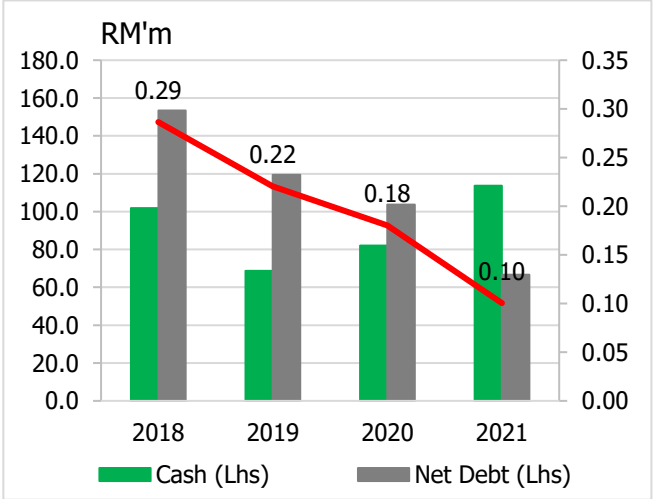
Healthy balance sheet to shield any potential risk on CPO volatility. While CPO price gradually losing its steam and transitioning to a possible downcycle position, we view the SPB's plans to improve its net gearing as applaudable. With strong balance sheet circa only 4% of net gearing registered as to-date, the company now on stronger footing and liquidity to pursue landbank expansion following the normalization of estates market price ahead. Note that, SPB's net gearing continued improving from FY18-21 (*Chart 4*) and expected turn to net cash in FY21 following the term settlement in 4QFY22.

Chart 3: FCF & Dividend Yield FY18-21



Source: Company, MIDFR

Chart 4: Gearing & Cash FY18-21



Source: Company, MIDFR

C. KEY CATALYSTS

Age Profile. Since SPB is a pure planter and extremely subject to the strength and weakness of CPO prices, maintaining appropriate mature age profile is crucial plan to ensure that it can continue to harvest high yielding age brackets. As of Dec 2021, the average oil palm age profile is about 11.2 years, with 21% immature, 16% young mature (4-6 years), 49% of prime mature (7-20 years) and 14% elderly profile (>20 years). The company's young and mature areas now account for 65% of harvestable areas, indicating the increased output is on the way. We anticipate that the new replanting methodology by management from experienced estates manager, will further enhance its age profile (*Chart 5*).

Mechanization. In the past, SPB had few machineries, and outsourced much of it upkeeping & manuring activities to external contractors. After new management came in, they streamlined the activities by adding extra machinery and performing the task by themselves. Subsequently, the management acquired better control over operational costs while simultaneously improving it activities efficiency. Based on 2018 & 2020 AR, SPB has invested circa RM17.4m and RM4.7m to purchase new heavy equipment such as excavators, bulldozers, prime movers and others, resulting an increase of +39%/+5.7% in FFB production/oil yield to 341,065 Mt and 3.09 yield/ha respectively. We expect the mechanization process will continue and increase, paving the way for better mills productivity and higher OER in the future (*Chart 6*).

Chart 5: SPB's oil palm age profile

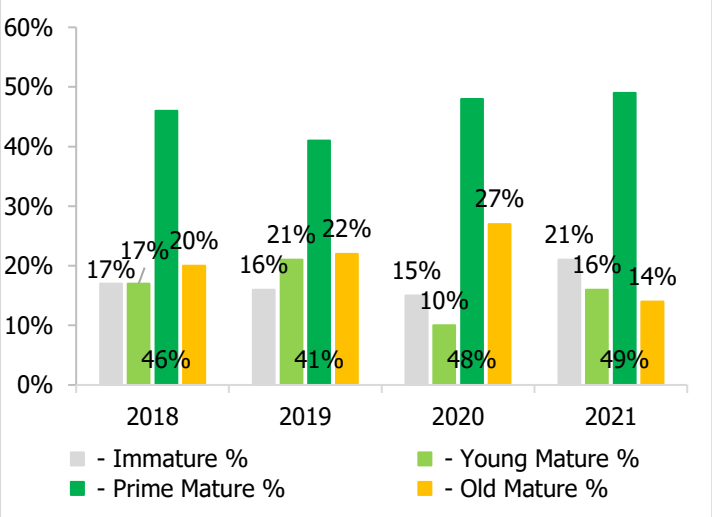
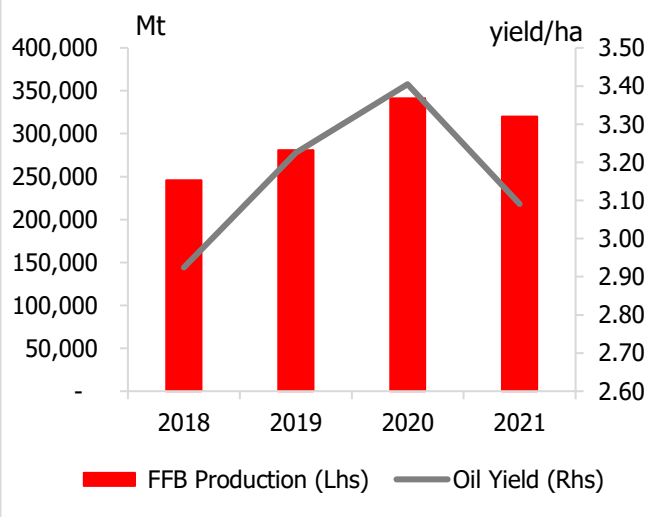


Chart 6: SPB's FFB production vs oil yield



Source: Company, MIDFR

Table 2: SWOT Analysis

Strengths	Weaknesses
▪ Acquired new management & experienced estates manager. ▪ Mechanization operations in place. ▪ Net cash position to mitigate potential downside risk of volatility of CPO prices.	▪ The Group's businesses do not have downstream division that could cushion any significant drop of CPO prices. ▪ Opex was vulnerable to an increase of fertilizer prices.
Opportunities	**Threats**
▪ Net cash position allowed SPB to pursue landbank acquisition in the future.	▪ Unexpected wet season ▪ Labour shortage. ▪ Volatility of CPO prices & fertilizer costs.

Source: MIDFR

D. OUTLOOK

CPO Prices on roller coaster ride. With the stabilisation of CPO prices in 3QCY22, the CPO price is likely to trade sideways between RM3,000/mt and RM4,500/mt in CY23-24, supported by the price disparity between CPO and SBO, which is presently around USD531 in July according to USDA data. We expect decent ASP CPO to be realized should be more than enough to offset any large fall in FFB sales volume if wet weather to persist in coming years. However, we also recognized its downside risk on fragile demand outlook on the back inflationary pressure coupled with tight household spending on high base interest rate locally and globally.

Efficiencies are essential when operational costs rise. As European energy prices soar amidst on going Russia-Ukraine conflicts, this explains reasonably well the increase in NPK and other fertiliser prices. We expect that SPB will continue to incur high operational costs on the back of high fertilizer costs, but can be weather by prudent control over its fertiliser application and sourced it from alternate supplier.

E. RISKS RELATED TO THE BUSINESS AND INDUSTRY

Dependency on the CPO prices. Being an upstream player exposed SPB's top-line of any significant drop from CPO prices volatility due to low average selling price realized and no forward sales strategy in plan.

Dependency on the climate condition and foreign labour. A significant shift in climate condition and labour shortage might have an impact its harvesting, upkeeping and manuring activities, FFB production as well as oil yield.

Volatility of fertilizer cost. An increase in fertilizer prices possibly minimized the potential gain realized from average CPO price, due to higher production cost coupled with increased in minimum wage salary.

F. FINANCIALS

Snapshot of 1HFY22 results. SPB reported a higher Operating profit before tax of RM91.8m, up +75.9%yoy, due to greater contributions from the oil palm operations, which offset high distribution expenses, as well as high cost of sales, which marginally up 1.2%yoy to -RM263.1m. Additionally, PBT was also improved in-line with increase in operating profit, supported by increase in finance income of RM1.3m. As a result, profit margin expanded by 5.35 ppts to 18.9 ppts in 6M22 (6M21:13.6 ppts).

Operational wise, SPB reported FFB and CPO production of 140,850 Mt (-3.8%ytd) and 50,167 Mt (-23.8%ytd) respectively in 6MY22 dragged by wet weather impacts coupled with labour shortage. Nonetheless, ASP CPO and PK realized during the period significantly higher to RM6,225/Mt (+54.3%) and RM3,849/Mt (+57.9%) in-line with local avg CPO prices of RM6,302/Mt. On a quarter-on-quarter basis, FFB, CPO, PK production were higher due to the abovementioned reason.

Table 3: SPB's 1HFY22 Operational Statistics

	2Q22	1Q22	2Q21	YOY (%)	QoQ (%)	6M22	6M21	YoY (%)
FFB Production Mt	78,789	62,061	77,753	1.3	27.0	140,850	146,389	-3.8
CPO Production Mt	25,729	24,438	35,719	-28.0	5.3	50,167	65,834	-23.8
PK Production Mt	5,636	5,185	7,706	-26.9	8.7	10,821	13,999	-22.7
ASP – CPO (RM/Mt)	6,496	5,938	4,221	53.9	9.4	6,225	4,035	54.3
ASP – PK (RM/Mt)	3,359	2,489	4,375	-23.2	35.0	3,849	2,438	57.9

Source: Company, MIDFR

Forecast. We expect SPB's earnings to stay consistent at RM121.0-RM120.7m over FY22-24F, despite supernormal profits being chipped down to normal profit backed by further production output from encumbered area coming on stream. Our underlying earnings assumptions are detailed in *Table 4* below:

Table 4: Earnings Outlook for FY22-24F

(All in RM'm unless stated otherwise)	FY2020A	FY2021A	FY2022E	FY2023F	FY2024F
Revenue	**465.7**	**790.5**	**827.8**	**642.4**	**665.2**
GP	110.7	211.6	206.7	168.3	185.8
EBITDA	98.5	188.9	167.3	144.0	161.2
EBIT	67.2	147.7	153.2	130.3	147.8
PBT	83.1	168.4	158.8	137.4	156.7
PATAMI	61.4	127.8	121.0	103.1	120.7
Core PATAMI	**61.4**	**127.8**	**121.0**	**103.1**	**120.7**

Source: Company, MIDFR

Table 5: Revenue driver for FY22-24F

(All in RM'm unless stated otherwise)	FY2020A	FY2021A	FY2022E	FY2023F	FY2024F
FFB Production Mt	341,065	319,999	307,199	313,343	319,610
CPO Production Mt	141,000	142,652	114,644	121,580	147,411
PK Production Mt	29,978	31,279	25,346	26,880	32,591
ASP realised of CPO (RM/Mt)	2,704	4,388	5,445	3,960	3,465
ASP realised of PK (RM/ Mt)	1,521	2,729	3,267	2,376	2,079

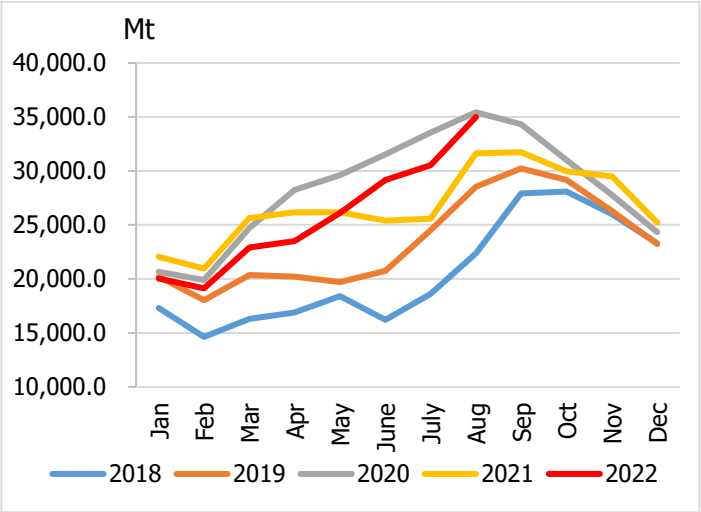
Source: Company, MIDFR

Our key assumptions are discussed as follow:

- **Revenue.** As aforementioned, we foresee revenue to slow by -22% in FY22-23F. The biggest factor for our projection is the normalization of CPO prices (FY23: RM4,000, FY24: RM3,500) which was exacerbated by the difficulties of FFB evacuation process owing to inconsistent weather pattern that had already damaged 1H22 production. On the other side, we anticipate that FFB output will catch-up and improve by +2% to 319,610mt in FY23-24Ft, aided by further boots on the ground and mechanisation initiative in place. We expect that the company's top-line will continue to expand organically only until the CPO price is normalized in FY24 ahead.
- **COGS.** We understand most of the planters operates in higher production cost environments, mainly due to increase in fertilizer cost amidst ceiling wage bar were raised. In contrast, SPB has consistently own GP margins above 17-27% over FY18-21. In FY22, SPB also enjoys low fertilizer cost that being carried forward due to unfulfilled contracts last year based on existing price year price. Going forward, we expect cost to be stabilize as management pursuing prudent fertilizer management control.

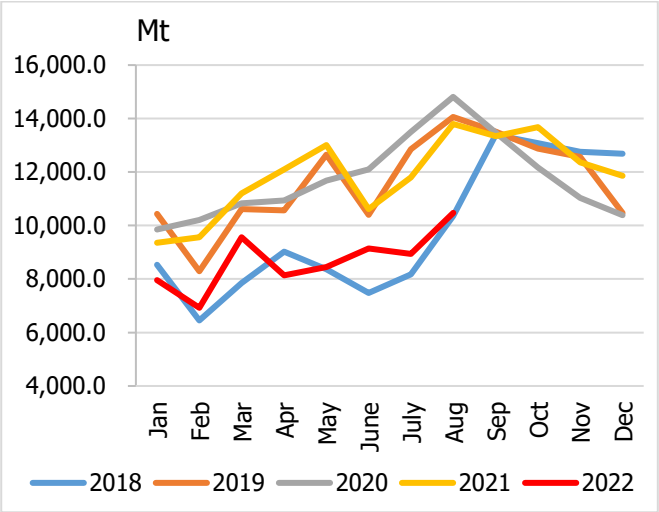
  Hence, we estimate EBITDA margin to stable at 20-24% in FY22-24 backed by 1) centralized mills which helps shorter FFB logistical delivery 2) lower seedling cost since SPB owns seedling innovation hub and 3) prudent fertilizer application based on the availability of window to apply 4) cost rationalization by the new management. Nonetheless, EBITDA margin could still be squeezed if its ASP CPO realized below the production cost which c. RM2,500.
- **Earnings.** We forecast NP margin to range at 15-18% during FY22-24F supported by normalize FFB sales volume combined with high FFB yield. Margin could be pressured by higher OPEX but would be mitigated by the better sales volume, FFB yiel,. following more mature area coming in especially the Southern region. SPB pays out dividend of up to 20% of its PAT. Based on that, we expect the dividend yields to range between 9.6%-9.7% in FY22E-FY24F.

Chart 7: Monthly FFB Production



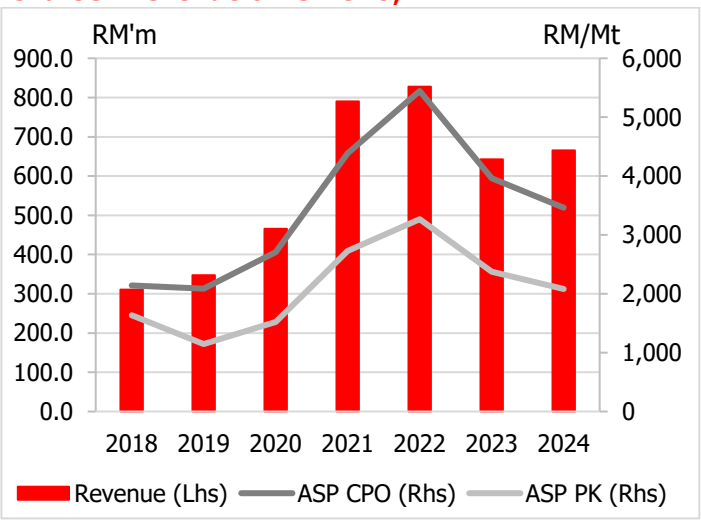
Source: Bursa Malaysia, MIDFR

Chart 8: Monthly CPO Production



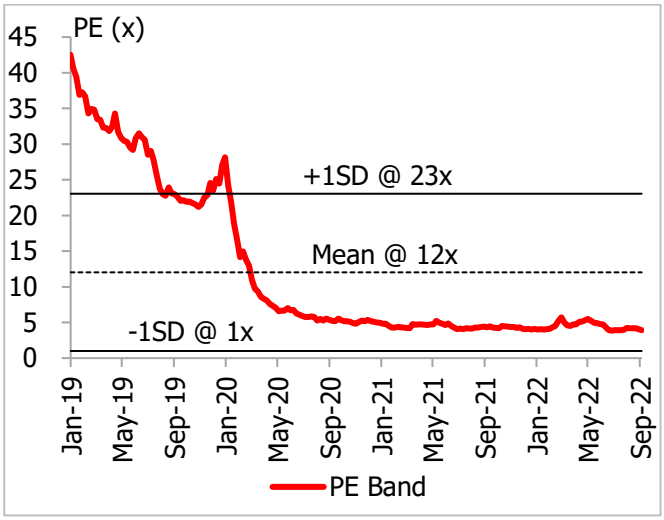
Source: Bursa Malaysia, MIDFR

Chart 9: Revenue & ASP CPO, PK



Source: Company, MIDFR

Chart 10: SPB's historical forward PE band



Source: Bloomberg, MIDFR

G. VALUATION

We initiate our coverage on Sarawak Plantation with a **BUY** call with target price of **RM2.70** by pegging its FY23 EPS of 36.9 sen to PER of 7.3x nearly the group's three-year historical average mean (*Chart 10*). We think the stock deserves a re-rating following a successful transformation plan that they achieved in achieving higher FFB output, Oil yield aided by mechanization in place. Our positive conviction is further stated as below:

- On a second valuation, company poses intrinsic value estimated at RM2.62 based on historical average 3-years P/B of 1.0x and BV/share of RM2.62. In addition, the back of net asset per share of RM2.64.
- The company has enough headroom to pursue for landbank acquisition given its balance sheet now turn to net cash position in FY22. The SPB effort on monetize asset efficiency is a right timing since sector are heading to downcycle position, and liquidity can be leverage once the opportunity appears after estates market price consolidate.

INCOME STATEMENT

Financial year ending 31st Dec (in RM'm, unless otherwise stated)	FY20A	FY21A	FY22E	FY23F	FY24F
Revenue	465.7	790.5	827.8	642.4	665.2
Gross profit	110.7	211.6	206.7	168.3	185.8
EBITDA	98.5	188.9	167.3	144.0	161.2
EBIT	67.2	147.7	153.2	130.3	147.8
PBT	83.1	168.4	158.8	137.1	155.8
PATAMI	61.4	127.8	121.0	102.8	120.0
Core PATAMI	61.4	127.8	121.0	102.8	120.0
Core EPS (sen)	22.0	45.8	43.4	36.9	43.0
PER (x)	9.3x	5.0x	4.8x	5.6x	4.8x
EBITDA Margin (%)	21.1	23.9	20.2	22.4	24.2
EBIT Margin (%)	14.4	18.7	18.5	20.3	22.0
PBT Margin (%)	17.8	21.3	19.2	21.3	23.4
Normalized PATAMI Margin (%)	13.2	16.2	14.6	16.0	18
DPS (RM)	0.1	0.2	0.2	0.2	0.2
Dividend yield (%)	4.4	8.1	9.6	9.7	9.7

Source: MIDFR

BALANCE SHEET

Balance Sheet (RM'm)	FY20A	FY21A	FY22E	FY23F	FY24F
Total non-current assets	704.9	695.0	688.2	681.9	676.7
Total current assets	173.1	279.6	358.4	393.1	463.1
Total assets	**878.0**	**974.7**	**1,046.6**	**1,075.0**	**1,139.8**
Non-current liabilities	172.7	130.2	130.2	130.2	130.2
Current liabilities	130.2	179.9	186.7	168.0	168.7
Total Equity	575.1	664.6	729.7	776.8	841.0
Total Equity & liabilities	**878.0**	**974.7**	**1,046.6**	**1,075.0**	**1,139.8**

Source: MIDFR

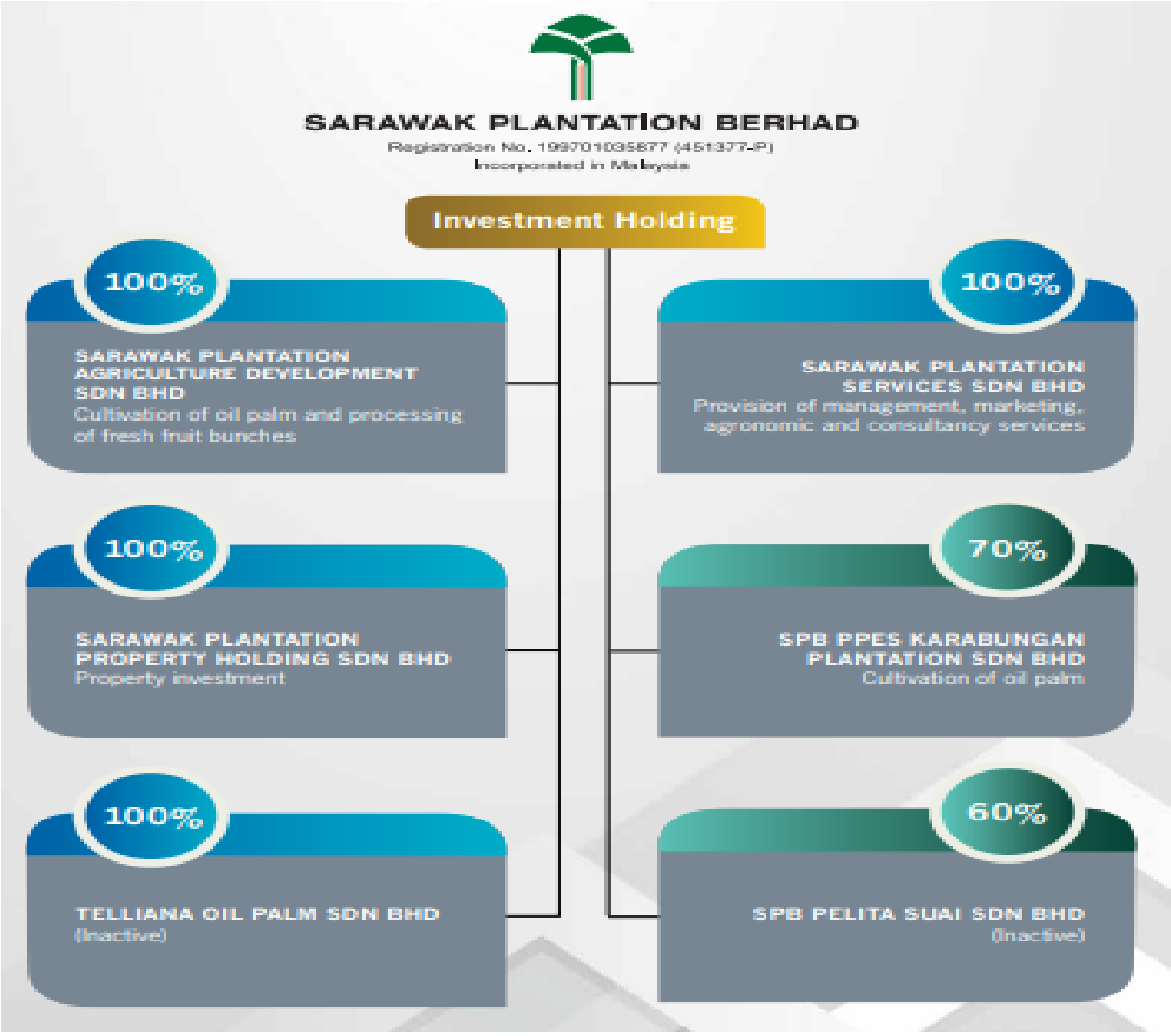
CASH FLOW

Cash Flow (RM'm)	FY20A	FY21A	FY22E	FY23F	FY24F
Cash flow from operating activities CFO	90.29	173.36	139.31	106.36	133.49
Cash flow from investing activities (CFI)	(43.98)	(75.76)	(7.26)	(7.43)	(8.23)
Cash flow from financing activities (CFF)	(32.92)	(66.02)	(55.81)	(55.81)	(55.81)
Net change in cash & cash equivalent	13.4	31.6	76.2	43.1	69.5

Source: MIDFR

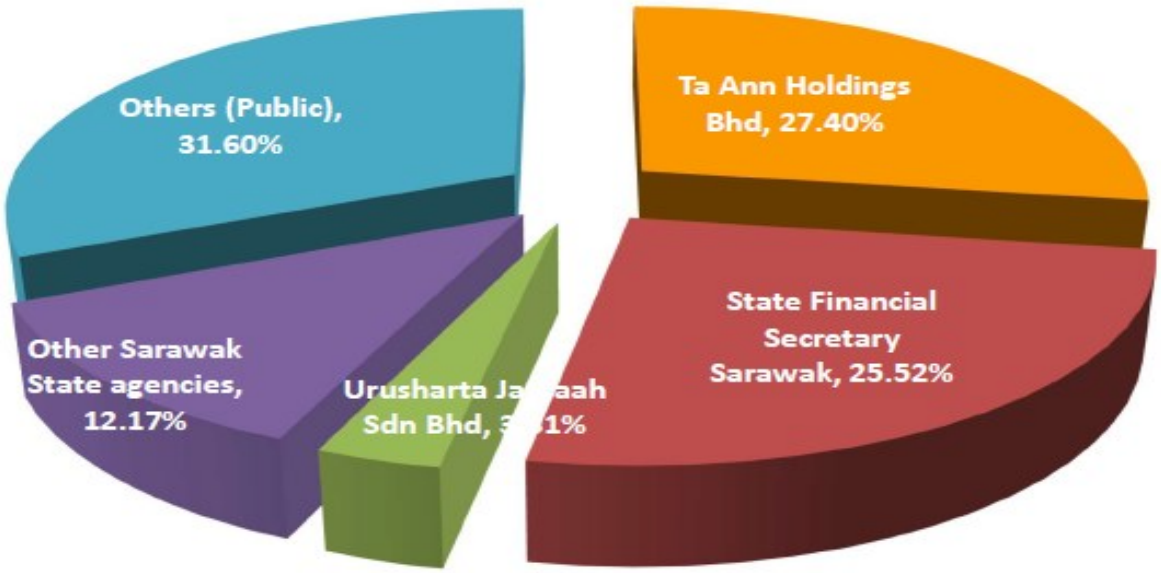
APPENDIX

A. Corporate Structure



Source: Company

B. Shareholding analysis



Source: Company

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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