midf RESEARCH

07 September 2017 | Sector Update

PLANTATION

***Maintain* NEUTRAL**

High palm oil stockpile to be neutralised by strong soybean oil price

KEY HIGHLIGHTS

- **United States soybean production outlook has improved slightly**
- **Expect August inventory to be above 2.0m MT but strong soybean oil price should limit palm oil price downside**
- **Normal weather outlook until end of 2017**
- **Unexciting 2QCY17 earnings performance with 3 below and 6 within expectations**
- **Maintain NEUTRAL view on the sector with BUY calls on KLK, GENP, TSH and TAANN**

United States soybean production outlook has improved slightly. Soybean crop condition in the United States has improved throughout August due to timely rains in the Midwest. As of 3-September, the percentage of United States soybean field which were rated either "fair", "poor" or "very poor" have declined to 39% (against 41% as of 31-July). However, this is still much higher than 27% registered during the same period last year. We gather that the most affected areas are northern US, parts of the Midwest and Mississippi. Refer Page 2 for the details. In view of better weather in US, we have temporary abandoned the possibility of palm oil price to surge above RM3000 per MT by end-December. For South America, soybean planting is expected to start soon for Brazil but the weather has been dry in central part of the country. However, Argentina (planting to start in October) has received excessive rains in Buenos Aires and Entre Rios. The ongoing concern on soybean production has kept soybean oil price strong at above 35.0 US cents per pound (or USD 772 per MT) in the CBOT market and this is supportive to palm oil price.

Expect August inventory to be above 2.0m MT but strong soybean oil price should limit palm oil price downside. We expect inventory to increase 18% mom to 2.10m MT as of end-August and hence palm oil discount against soybean oil should widen. Having said that, the strong soybean oil price (which has surged above 35 US cents per pound) should limit the impact of higher inventory to palm oil price. Key assumptions for inventory are: i) production increase of 4% mom and ii) export increase of 2% mom. We believe that palm oil demand should be supported by good export growth to China as the pre stocking activity should continue in August. For production growth we are using seasonal factor to estimate the 4% increase.

Normal weather outlook until end of 2017. As of 29-August, Australia Bureau of Meteorology (ABM) has maintained its ENSO Outlook as INACTIVE. It further explains that "International climate models surveyed by the Bureau suggest the tropical Pacific Ocean is likely to persist at ENSO-neutral levels until at least late 2017." Note that the El Nino WATCH status has been cancelled on 20-June by ABM and the outlook has been INACTIVE since then. Our average CPO price forecast of RM2725 per MT for both 2017 and 2018 is based on normal weather assumption hence we maintain our forecast.

Unexciting 2QCY17 earnings performance with 3 below and 6 within expectations. Most plantation companies reported earnings which met ours and consensus expectation. However, three companies reported earnings which missed expectations. The underperformers are IOICORP (lower than expected margin in the resource based manufacturing division), FGV (lower than expected FFB production) and IJMPLNT (higher than expected cost incurred from its Indonesian operations). Planters which met earnings estimate are SIME, KLK, PPB, GENP, TAANN and TSH.

Maintain NEUTRAL view on the sector. Our NEUTRAL view on the sector is maintained with average CPO price of RM2750 per MT for both 2017 and 2018. We believe that there is little downside risk to our estimate as YTD CPO price is RM2865 per MT and we expect CPO price to be well supported at above RM2700 per MT throughout 4Q2017. Top Pick for the sector is KLK (BUY with TP of RM29.25) for the Company earnings resiliency and its good FFB production growth estimated at 10% (highest among index-linked plantation stocks). We also like GENP (TP: RM12.06) due to strong 1HFY17 earnings surge of 157%yoy to RM150.9m and robust FY17 FFB growth expected at 13%.

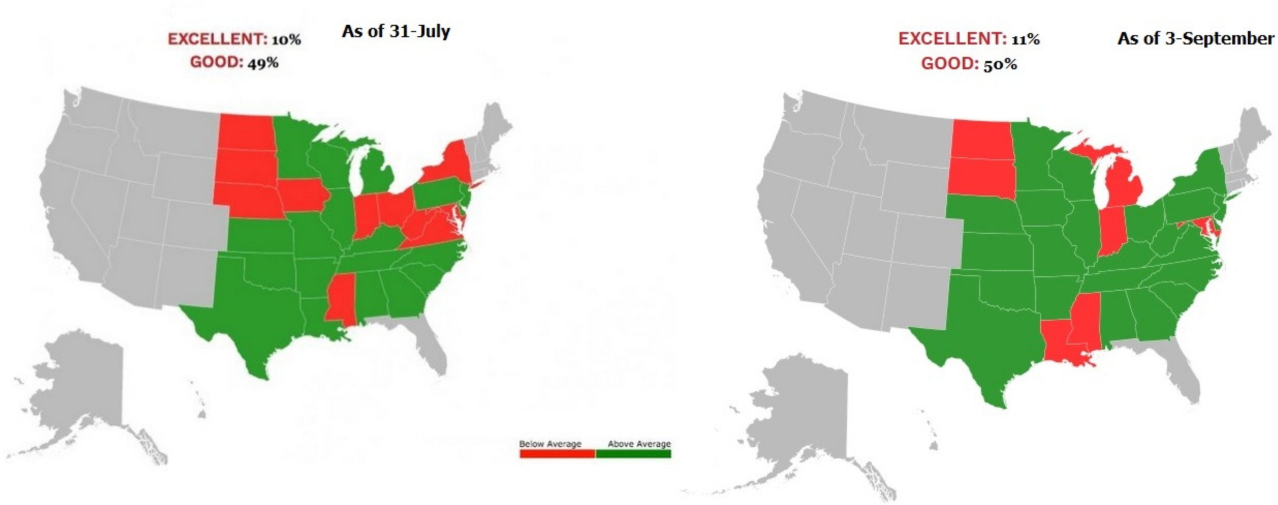
For mid cap planters, we like TSH (TP: RM2.15) due to: i) its strong 1HFY17 CNI which has grown 30% yoy, ii) attractive valuation at close to its -0.5SD level and iii) solid FY17 FFB growth expected at 16%. Lastly, we have BUY call on TAANN (TP:RM4.30) as i) its plantation division earnings growth should remain strong due to high FFB growth expected at 10% and ii) timber division outlook is challenging but remains profitable.

Table 1: Summary of 2QCY17 result for planters under our coverage

No	Stock	Period Under Review	Cumulative Qtr CNI (RM m)	CNI % of our estimate	Against Expectation	Comment
1	SIME	12MFY17	2216	99%	Within	
2	IOICORP	12MFY17	1007	87%	Below	Weaker than expected margin in the resource based manufacturing (RBM) division. We gather that RBM refining sub-segment margin has declined yoy in which we believe is caused by the challenging operating environment for the refining industry in Malaysia
3	KLK	9MFY17	847	73%	Within	
4	PPB	6MFY17	448	47%	Within	
5	GENP	6MFY17	151	45%	Within	
6	FGV	6MFY17	-35	NA	Below	Lower than expected FFB production
7	IJMPLNT	1QFY18	18	11%	Below	Higher-than-expected cost incurred from its Indonesian operations
8	TSH	6MFY17	51	39%	Within	Although it made up 39% of our full year earnings estimate, we are expecting seasonally stronger FFB production in 2HFY17.
9	TAANN	6MFY17	69	60%	Within	Although it made up 60% of our full year earnings estimate, we are expecting weaker performance from timber segment in 2HFY17.

Source: Company, MIDF Research

Figure 1: Soybean Crop Condition in United States has improved slightly



Source: United States Department of Agriculture (USDA)

Table 2: Basis of valuation

Company	TP	Call	Valuation Basis
SIME	9.05	NEUTRAL	SOP with plantation sector @ 26.8x FY18E PE. 26.8x is the higher of IOICORP and KLK Target PE.
IOICORP	4.95	NEUTRAL	24.7x Fwd. PE on FY18F earnings reflecting +0.5SD valuation.
KLK	29.25	BUY	26.8x Fwd. PE on FY17F earnings reflecting +1.0SD valuation.
PPB	17.69	NEUTRAL	1.0x Price to Book Value
FGV	1.59	NEUTRAL	1.0x Price to Book Value
GENP	12.06	BUY	SOP with plantation sector @ 24.7x FY17E PE. 24.7x is the lower valuation between IOICORP and KLK.
IJMP	3.00	NEUTRAL	18.6x Fwd. PE on FY18F earnings reflecting mean valuation.
TSH	2.15	BUY	22.3x Fwd. PE on FY17F earnings reflecting mean valuation.
TAANN	4.30	BUY	16.6x Fwd. PE on FY17F 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 *rise* 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 *fall* 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.