

13 June 2016 | Sector Update

**PLANTATION***Inventory level at 5-year low***Maintain POSITIVE****KEY HIGHLIGHTS**

- **May 2016 inventory level of 1.65m MT is within expectation.**
- **Lowest inventory level in the past five years.**
- **Tree stress impact continues as May-2016 production is down 25%yoy.**
- **Expect Jun inventory to remain flat at 1.65m MT.**
- **Our earlier estimate of 1.50m MT inventory forecast by end-June is unlikely to materialize due to slower than expected demand from China.**
- **We remain bullish on CPO price with lower range estimate of RM2500/MT to RM2800/MT.**
- **Maintain POSITIVE view on the sector. Top pick is KLK (TP: RM27.38).**

**May 2016 inventory level of 1.65m MT is within expectation** as it is close to the consensus forecast range from 1.64m MT to 1.66m MT. However, it was lower than our expectation of 1.70m MT as production came in weaker than expected with 5% mom growth (against our estimate of 7% growth) as El Nino impact continues to limit the seasonal production increase. Local consumption remains high at 261k MT (+3% mom and 9% yoy) and this suggests growing biodiesel usage. Import of palm oil from Indonesia has also tumbled 50% mom to 20k MT.

**Lowest inventory level in the past five years.** Inventory downtrend continues in May-2016 mom as it declines 9% mom to 1.65m MT. Total demand (export + local consumption) of 1.54m MT exceeds total supply (import + local production) of 1.39m MT. Overall, the data is positive to CPO price as the continuous decline in inventory suggest that demand has outpaced supply.

**Strong Brent crude oil price has improved biodiesel consumption in Malaysia and Indonesia.** Average Brent crude oil price has increased 9% MoM to USD47.31/barrel in May and we believe that this has improved local consumption in Malaysia (via higher biodiesel consumption). The significantly lower MoM imports of palm oil from Indonesia should be caused by the high usage of biodiesel in Indonesia hence limiting supply from there.


**Tree stress impact continues as May-2016 production is down 25%yoy.** Although palm oil production increased by 5% mom, we wish to highlight that it has tumbled 25%yoy. As a result, we believe that the tree stress impact caused by Super El Nino is still there and is likely to continue throughout 2Q2016 and 3Q2016.

**Export improved 9% mom in May due to Ramadhan demand.** Total Malaysia export for palm oil increased by 9% MoM to 1.28m MT as all major palm oil consumers (India, China, European Union, Pakistan and United States) purchased more palm oil from Malaysia. The highest mom jump is from India (+73% to 310k MT) and this is likely due stocking up activity ahead of Ramadhan.

**Expect Jun inventory to remain flat at 1.65m MT.** Our key assumptions are: i) 0% MoM increase in production in line with historical production pattern and ii) 2% decline in export due stocking up activity due to Ramadhan demand should have ended. The decline in export should not be high as we expect "summer demand" from Northern Hemisphere countries to cushion the drop in demand.

**Our earlier estimate of 1.50m MT inventory forecast by end-June is unlikely to materialize** due to slower than expected demand from China. Note that in the first 5 months, export to China has declined by 51%yoy to 510k MT. We believe that China has increased the usage of soybean oil (at the expense of palm oil) due to high crushing of soybean imported into the country. Hence, CPO price is unlikely to surge to RM3000/MT by end-June. Having said that, we believe that China is expected to import more palm oil in the near term as the stocks of palm oil at major cargo have drop below the historical average level. • We remain bullish on CPO price with CPO price forecast in the range of RM2500/MT to RM2800/MT.

**Maintain POSITIVE view on the sector. Top pick is KLK (TP: RM27.38).** Our top pick is KLK due to: i) its earnings is expected to benefit from high CPO price due to its high exposure to palm oil business, ii) good earnings growth of +41%yoy to RM536m in 1HFY16, and iii) it is one of the rare big cap index-linked planters which is Shariah compliant and also an RSPO member.

**TAANN Target Price has been adjusted to RM3.50 (from RM4.20).** This is to reflect the stock's 1-for-5 bonus issue which has been completed with the listing of 74.1m bonus shares on 10-Jun-2016. The valuation method is unchanged by using mean valuation of 16.6x Forward PER on FY16 EPS. 

**Table 1: Palm Oil Statistics for May-2016 ('000 MT)**

	May-16	Apr-16	Diff.	MoM %	May-15	YoY%
<b>Opening Stocks</b>	<b>1,804</b>	<b>1,886</b>	<b>(82)</b>	<b>-4.3%</b>	<b>2,189</b>	<b>-17.6%</b>
<b>Production</b>	<b>1,365</b>	<b>1,301</b>	<b>63</b>	<b>4.9%</b>	<b>1,811</b>	<b>-24.6%</b>
Imports	20	42	(22)	-52.1%	101	-80.2%
<b>Total Supply</b>	<b>3,189</b>	<b>3,229</b>	<b>(40)</b>	<b>-1.2%</b>	<b>4,101</b>	<b>-22.3%</b>
Exports	1,282	1,173	109	9.3%	1,614	-20.5%
Dom Disapp	261	252	9	3.4%	239	8.9%
<b>Total Demand</b>	<b>1,543</b>	<b>1,425</b>	<b>118</b>	<b>8.3%</b>	<b>1,853</b>	<b>-16.7%</b>
<b>End Stocks</b>	<b>1,646</b>	<b>1,804</b>	<b>(158)</b>	<b>-8.8%</b>	<b>2,249</b>	<b>-26.8%</b>
<b>Stock/Usage Ratio</b>	<b>8.9%</b>	<b>10.6%</b>			<b>10.1%</b>	

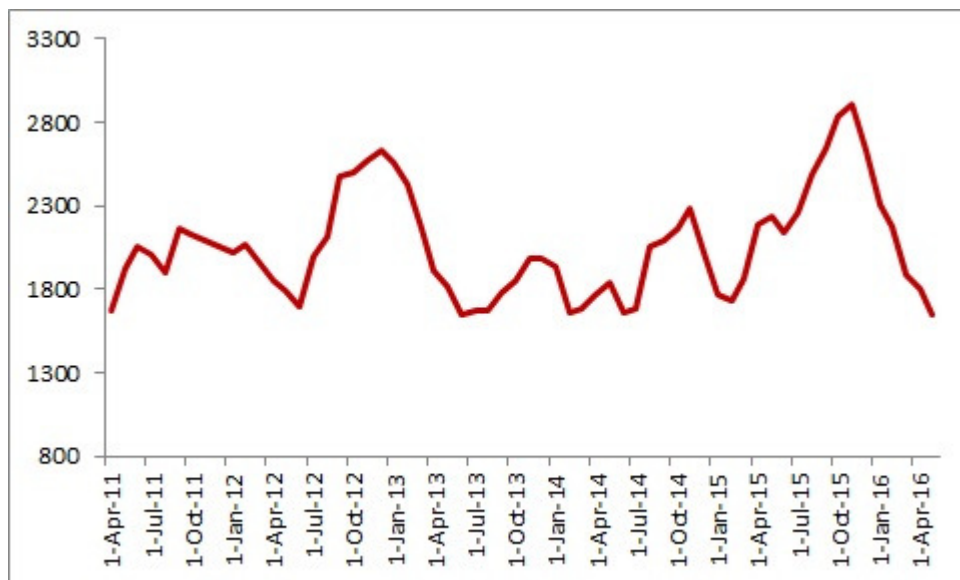
Source: MPOB, MIDF Research

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

Country	May-16	Apr-16	May-15	MoM%	YoY%	5M16	5M15	YoY%
China	106	105	360	1%	-71%	510	1,036	-51%
India	310	180	343	73%	-9%	1,259	1,110	13%
EU	117	101	267	17%	-56%	740	801	-8%
Pakistan	77	72	58	6%	31%	280	272	3%
US	59	50	58	18%	1%	278	281	-1%
Others	613	665	539	-8%	14%	3,092	2,649	17%
<b>Total</b>	<b>1,282</b>	<b>1,173</b>	<b>1,626</b>	<b>9%</b>	<b>-21%</b>	<b>6,159</b>	<b>6,150</b>	<b>0%</b>

Source: MPOB, MIDF Research

**Chart 1: Malaysia palm oil inventory ('000 MT)**



Source: Malaysia Palm Oil Board (MPOB)

**Table 3: Basis of valuation**

Company	TP	Call	Valuation Basis
SIME	7.85	NEUTRAL	SOP with plantation sector @ 25.1x FY17E PE. 25.1x is the avg of IOICORP and KLK Target PE.
IOICORP	4.82	BUY	23.1x Fwd. PE on FY16F earnings reflecting mean valuation.
KLK	27.38	BUY	26.8x Fwd. PE on FY16F earnings reflecting +1.0SD valuation.
PPB	18.60	BUY	21.6x Fwd. PE on FY16F earnings reflecting +0.5SD valuation.
FGV	1.33	NEUTRAL	1.0x Price to Net Tangible Asset (P/NTA).
GENP	9.85	NEUTRAL	SOP with plantation sector @ 23.5x FY16E PE. 23.5x is the lower valuation between IOICORP and KLK.
IJMP	3.13	NEUTRAL	18.6x Fwd. PE on FY16F earnings reflecting mean valuation.
TSH	2.10	NEUTRAL	22.3x Fwd. PE on FY16F earnings reflecting mean valuation.
TAANN	3.50	NEUTRAL	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.