Market Access

Plantation Sector

(Neutral)

“Possibility of Spill-over Effect from Brewing Storm in Greece on CPO”

Table 1: Plantation Sector Operational Metrics Projection

	2014	2015F
CPO Price (RM/MT)	2,408	2,300
CPO Production (Million Tonnes)	19.7	20.5
Palm Oil Export (Million Tonnes)	17.3	18.5
Ending Stocks (Million Tonnes)	2.0	2.05

Source: M&A Securities

Slow demand ahead? Production, export and import are the key factors that determine the ending level of palm oil stock. If these 3-pronge factors deteriorate in prolong and protracted trend, the risk is that stock level may increase and hence, weighing on palm oil prices. Lower production and/or decrease in import level alone will not benefit CPO price any better if export contracts or demand slows. In the past one month, the 3-month CPO futures price has been hovering around RM2,150/MT – RM2,290/MT, and we expect price could trade within this range in the near term if demand continued to be slow amid cheaper Ringgit and wider discount of palm oil prices against soy oil prices.

Spill-over effect from Greece debt debacle. The global financial market has been gyrating due to the brewing storm from Greece. To recap, Greece has a total of 18 debt schedules to meet in third quarter followed by another 6 in the fourth quarter amounting a total of €26.4 billion altogether. According to our economist, there is a rising possibility that Greece may default in one of its 24 debt schedule repayments in 2H2015, especially when the Greeks are financially fatigue to endure another fiscal consolidation drive. The impact is that Eurozone establishment may be in tatters should Greece opt to be independent. This may cause tremor effect on Eurozone and hence, greater risk to its trading partner i.e. China.

Of note, Eurozone is the biggest trading partner of China and the slowdown in EU’s economy will hurt China exports and hence, may slow down its economy. We are of the view that if the crisis prolong, the contagion effect could hit commodities market sooner or later as China is one of the biggest importer of commodities in the world i.e. palm oil and vegetable oils.

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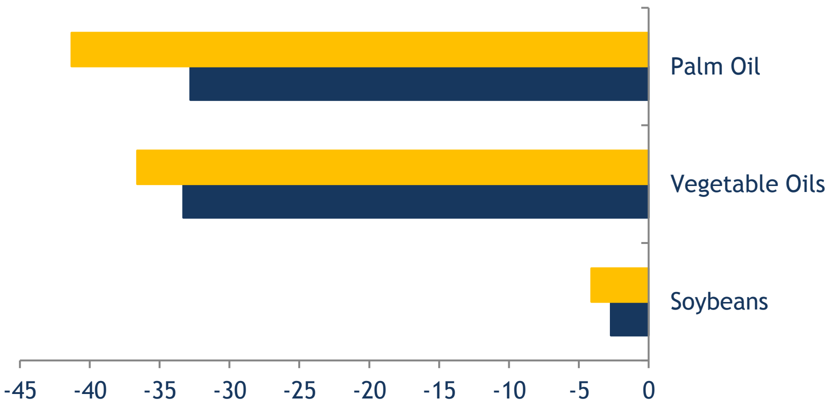
China in focus. The National Bureau of Statistics (NBS) will release China official GDP figures for second quarter today (1Q2015: 7%) and expects growth to slower to 6.9% in the second quarter. According to AFP news, the slowdown in investment and trade may weighed on China's economy. According to data released yesterday by China's General Administration of Customs, 1H2015 two-way trade number fell 6.9% to US$1.88 trillion (RM7.1 trillion) as lower commodities prices has dragged down growth in import value amid sluggish foreign demand. Earlier, China also has given indication that its economy will likely grow at a slower pace this year of 7.0% (2014: 7.4%) and we foresee that if the contraction gets bigger, China will miss the PBOC 7% growth target in 2015. Given that China is one of the biggest importers of commodities in the world, this will put greater downside risk to CPO particularly when China is one of the biggest importers of CPO. Based on the data compiled from Bloomberg (Table 2), China continued to import lower commodities in the month of May after a y-o-y contraction of 4.1% in Soybeans, -36.3% (vegetable oils) and -41.3% (palm oil) in the month of April, justifying the lower export number of palm oil for Malaysia (Table 4).

Lower palm oil exports to China. YTD June 2015, palm oil export volume slid 3.7% to 7.83 million tonnes against 8.13 million tonnes in the same period in 2014. During the period, we note that export volume to India has picked up with off-takes totalling 1.55 million tonnes (19.7% of the total palm oil import) while China and EU have contracted by 14.3% and 9.2% respectively with China off-takes totalling 1.28 million tonnes (16.3% of the total palm oil import) and EU with 1.04 million tonnes (13.2% of the total palm oil import) respectively. Of note, from the data that we gathered and analyzed from Bloomberg, we noticed that China has gradually reduced its palm oil import from Malaysia since 2008, cutting their importation from 67% in 2008 to only 54% in 2014 (YTD May'15: 48%). On the flipside, it has increased their palm oil import from Indonesia, from 32% of their need in 2008 to 46% in 2014 (YTD May'15: 51%).

Table 2: China Imports - YTD YOY%
(Real Volume)



	Soybeans	Vegetable Oils	Palm Oil
Apr-15	-4.1	-36.6	-41.3
May-15	-2.7	-33.3	-32.8

Source: Bloomberg, M&A Securities

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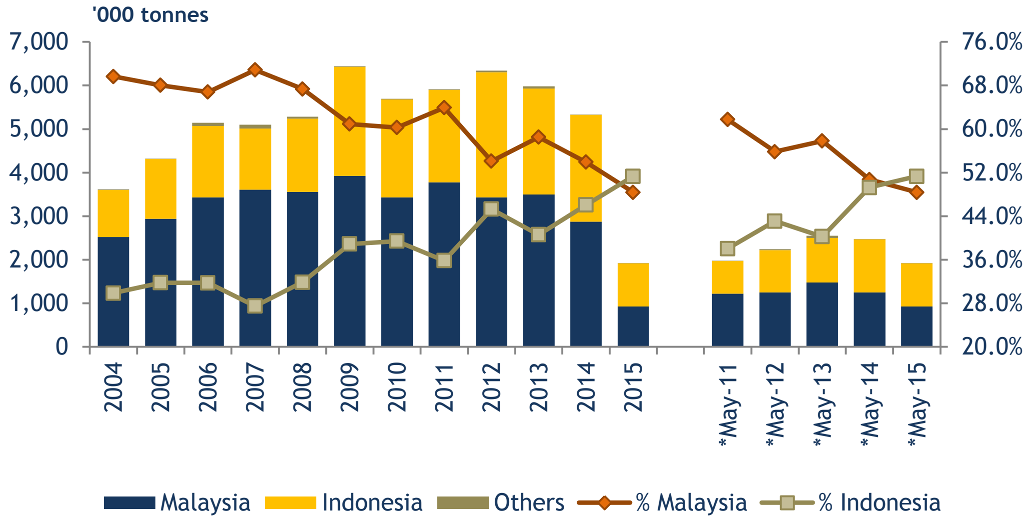
Table 3: China Palm Oil Import Volume (2004 - YTD May 2015)



Source: Bloomberg, M&A Securities

Table 4: YTD (June 2015) Major Export Destinations

	YTD'14	YTD'15	Changes	
	('000 tonnes)	('000 tonnes)	('000 tonnes)	%
Total	***8,133.97***	***7,832.16***	***-301.8***	***-3.71%***
China	1,493.25	1,280.04	-213.21	-14.28%
India	1,156.31	1,545.96	389.66	33.70%
EU	1,141.07	1,036.16	-104.91	-9.19%

Source: MPOB, M&A Securities

Our view. At this stage we maintain our **NEUTRAL** call on plantation sector, but if the landscapes change, we may review our call on the sector. At this junction, our CPO price target of RM2,300/MT stays. However, we have done some analysis if the CPO price contract further by 5% or 10% from our target. We have done a sensitivity analysis on the stocks under our coverage and found out that for every 5% change in our CPO price target, net profit of 1) IOI Corp and IJM Plants will change by 6%; 2) KLK, Genting Plants and TSH by 5%; 3) TH Plant by 12%; and 4) SIME will change by 2%; vice versa respectively. The percentage will go even bigger when the change is in the bigger quantum of 10% (see table 5). At this stage, unless and until the landscape change for the worse or better, we are cautiously optimistic that CPO price may reach our targeted level.

Hence, maintain **HOLD** on SIME Darby (TP: RM9.00), Genting Plant (TP: RM10.77), KLK (TP: RM21.50), TSH Resources (TP: RM2.38), TH Plant (TP: RM1.47), IJM Plant (TP: RM3.46) and IOI Corp (TP: RM4.04). We continue to favor TSH (Hold: RM2.38) and Genting Plant (Hold: RM10.77) given their bright outlook underpinned by 1) better FFB yield moving forwards as more young trees

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will reach its prime age; 2) high percentage of immature to young matured land over planted area which provides visible revenue and earnings growth catalyst; and 3) operational efficiencies and promising long-term earnings growth potential.

Table 5: Impact of CPO Price Movement

Company	Category	(+/-) 5% Change to NP	(+/-) 10% Change to NP
IOI Corporation	Upstream + Downstream	6%	13%
Kuala Lumpur Kepong	Upstream + Downstream + Others	5%	9%
Genting Plantations	Upstream + Downstream + Others	5%	10%
IJM Plantations	Upstream	6%	11%
TH Plantations	Pure Upstream	12%	23%
TSH Resources	Upstream + Downstream	5%	10%
SIME Darby	Conglomerate	2%	5%

Source: M&A Securities, Bloomberg

Table 6: Peers Comparison - Stocks under Coverage

Company	Mkt. Cap (RM m)	Price (RM)	EPS (sen)		P/E (X)		P/B (X)		ROE	Div. Yield	TP	Call
			FY1	FY2	FY1	FY2	FY1	FY2				
IOI CORP	26,857.4	4.24	15.6	22.9	27.2	18.5	3.2	3.1	7.8	2.4	4.04	HOLD
KLK	24,132.1	22.66	99.5	110.9	22.8	20.4	2.8	2.6	10.0	2.6	21.50	HOLD
GENPLANTS	7,897.5	10.20	47.7	53.1	21.4	19.2	1.9	1.7	8.7	0.9	10.77	HOLD
IJM PLANTS	3,090.8	3.51	16.0	19.6	21.9	17.9	2.0	1.9	6.0	2.3	3.46	HOLD
TH PLANTS	1,370.0	1.55	2.9	7.4	53.4	20.9	1.1	1.1	4.1	0.6	1.47	HOLD
TSH RESOURCES	3,036.9	2.24	10.1	11.9	22.2	18.8	2.3	2.1	6.8	1.1	2.38	HOLD
SIME Darby	53,043.3	8.54	33.9	43.2	25.2	19.8	1.8	1.8	8.9	3.3	9.00	HOLD
Average					**27.7**	**19.4**	**2.2**	**2.0**	**7.5**	**1.9**		

Notes: FY1 is the current FY estimate

Source: Bloomberg, M&A Securities

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STOCK RECOMMENDATIONS

BUY *Share price is expected to be ≥+10% over the next 12 months.*
TRADING BUY *Share price is expected to be ≥+10% within 3-months due to positive news flow.*
HOLD *Share price is expected to be between -10% and +10% over the next 12 months.*
SELL *Share price is expected to be ≥-10% over the next 12 months.*

SECTOR RECOMMENDATIONS

OVERWEIGHT *The sector is expected to outperform the FBM KLCI over the next 12 months.*
NEUTRAL *The sector is expected to perform in line with the FBM KLCI over the next 12 months.*
UNDERWEIGHT *The sector is expected to underperform the FBM KLCI over the next 12 months.*

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