

05 April 2021

# Plantation

# NEUTRAL

## Anticipating A CPO Price Correction

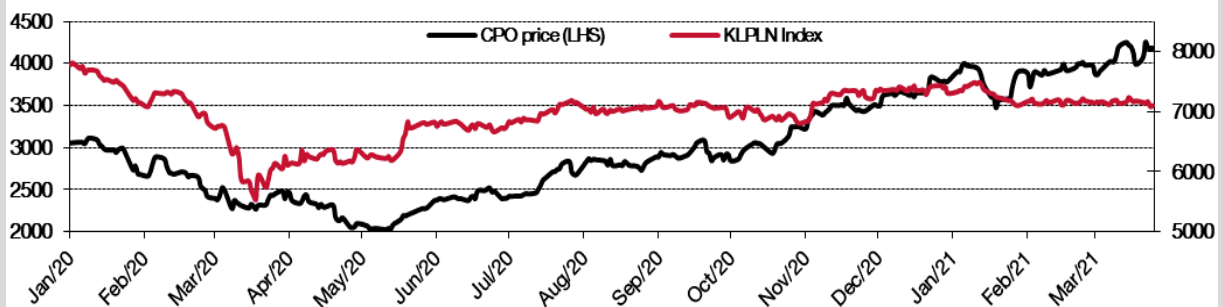


By Adrian Kok / [adrian.kok@kenanga.com.my](mailto:adrian.kok@kenanga.com.my)

While we believe the trajectory for CPO price is heading downwards, we are **turning less bearish**. Our **NEUTRAL call** is justified as (i) post-expected decline, prices are still higher than CY20 level (**Our CY21E CPO price: RM3,000/MT**) and (ii) valuations of planters under our coverage and KLPLN index (both at -1.0SD from mean) seem to have priced in the negatives. We do not expect the KLPLN index to come under severe pressure when CPO prices correct as it has not tracked the gains in CPO prices since the commodity exceeded RM3,500/MT. We continue to believe in our case of CPO prices peaking in 1QCY21 (historical trend). Indonesia's biodiesel policies are to be watched closely. Any changes that will increase the levy (to fund B40) will be bullish for CPO prices but the impact on planters will favour Malaysia upstream planters and Indonesia refiners. Our upstream preferred pick to capitalise on the current strong CPO price and yet able to soften the impact of subsequent price decline due to output growth is **HSPLANT (OP; TP: RM2.15)**. Our integrated pick with defensive overall margin against the CPO price variability is **KLK (OP; RM25.40)**.

**Review of CPO and KLPLN Index.** Crude palm oil (CPO) continued to shine in 1QCY21 (refer to Exhibit 1), climbing (+12%) from around RM3,800/MT to a high of RM4,252/MT in March. However, the same cannot be said about the KLPLN index which actually slipped 3%. The correlation between the KLPLN index and CPO price in 1QCY21 is a negative 21% (vs. positive 88% in 4QCY20 and 75% in CY20). We can think of two reasons – the first being ESG concerns as KLPLN's bellwether SIMEPLT, in late December 2020, was issued a Withhold Release Order by the U.S. Customs and Border Protection, and the second being market participants' view that CPO prices at these elevated levels are unsustainable. As CPO prices exceeded RM3,500/MT, KLPLN index has remained a stubborn laggard suggesting to us that investors could be trying to price in a correction in the commodity price.

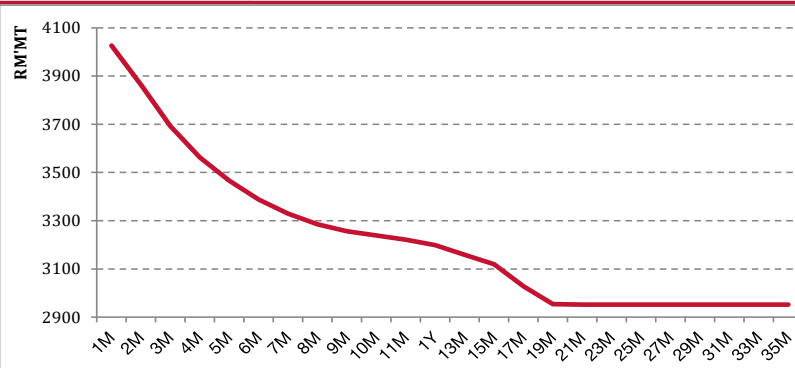
**Exhibit 1: CPO Price vs. KLPLN**



Source: Bloomberg; Kenanga Research

**How low can CPO go?** To answer this, we reference our Virtual POC 2021 Takeaways report (<https://bit.ly/2PAoDab>), where we noted that CPO price forecasts by key speakers were mostly above RM3,000/MT (at an average of c.RM3,400/MT). In other words, most speakers believe that CPO price is unlikely to go below RM3,000/MT, with an exception – Mr. Dorab Mistry who thinks that CPO price (July onwards) will bottom at RM2,700/MT. The CPO forward curve (Exhibit 2), in backwardation suggests downside of c.RM800/MT (-20%) by Dec 2021.

**Exhibit 2: CPO Forward Curve as of 5-January-21**



Source: Bloomberg; Kenanga Research

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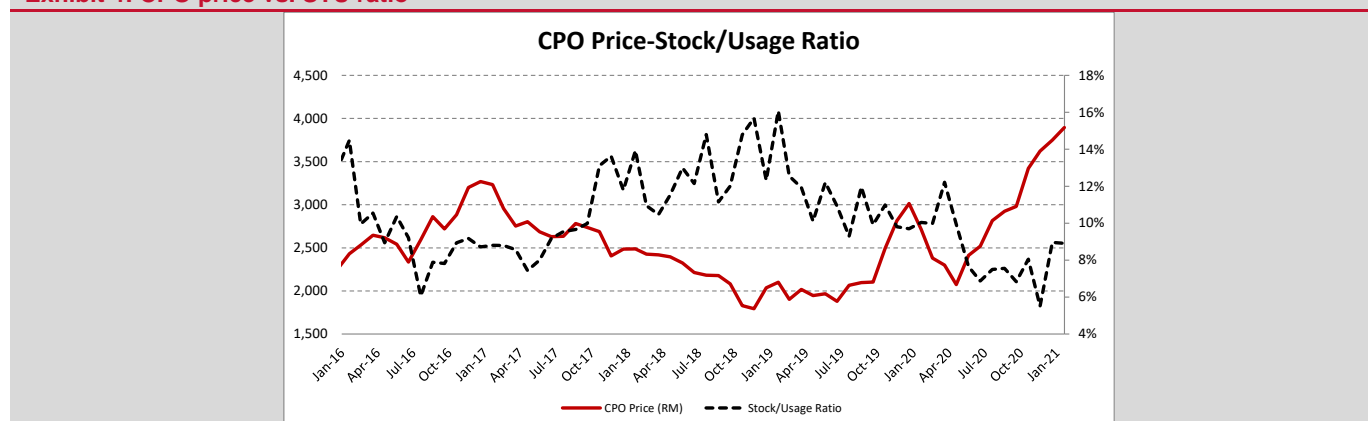
**The case for CPO price peak in 1QCY21.** During the Virtual POC 2021, Mr. Thomas Mielke (Oil World) stated that he believes we have seen the peak, and if not, it will happen in the next four weeks. This is aligned with our view which is built upon our peak-to-trough CPO price study. From this (*Exhibit 3*), we observed that the peak of major CPO price rallies all occurred in 1QCY and we believe that the same historical trend could happen this time as well.

**Exhibit 3: CPO price Peak-to-Trough Study**

Peak Qr	Trough Qr	Duration (mths)	Peak Price (RM)	Trough Price (RM)	Chg (%)	Other Notable Events
1Q98	3Q99	18	2,604	984	-62%	East Asian Financial Crisis (1997-1998)
1Q08	4Q08	8	4,203	1,404	-67%	The Great Recession (2007-2009)
1Q11	3Q11	8	3,927	2,787	-29%	The European Crisis (2009-2011)
1Q17	3Q17	5	3,348	2,577	-23%	
1Q20	2Q20	4	3,114	2,023	-35%	COVID-19 Pandemic

Source: Bloomberg; Kenanga Research

**Inventory is set to be on an upward trajectory.** As of February 2021, Peninsular Malaysia's production downtrend has reversed while we believe East Malaysia could see its production beginning to recover as early as March 2021, which will drive inventory higher and pressure CPO prices. As of February 2021, inventory level is at 1.30m MT, while stock-to-usage (STU) ratio was at 9% (*Exhibit 4*). We expect an average STU ratio of 9% in 2021. Based on *Exhibit 5*, the implied CPO price is RM2,924/MT, close to our CY21 forecast of RM3,000/MT.

**Exhibit 4: CPO price vs. STU ratio**

Source: MPOB; Kenanga Research

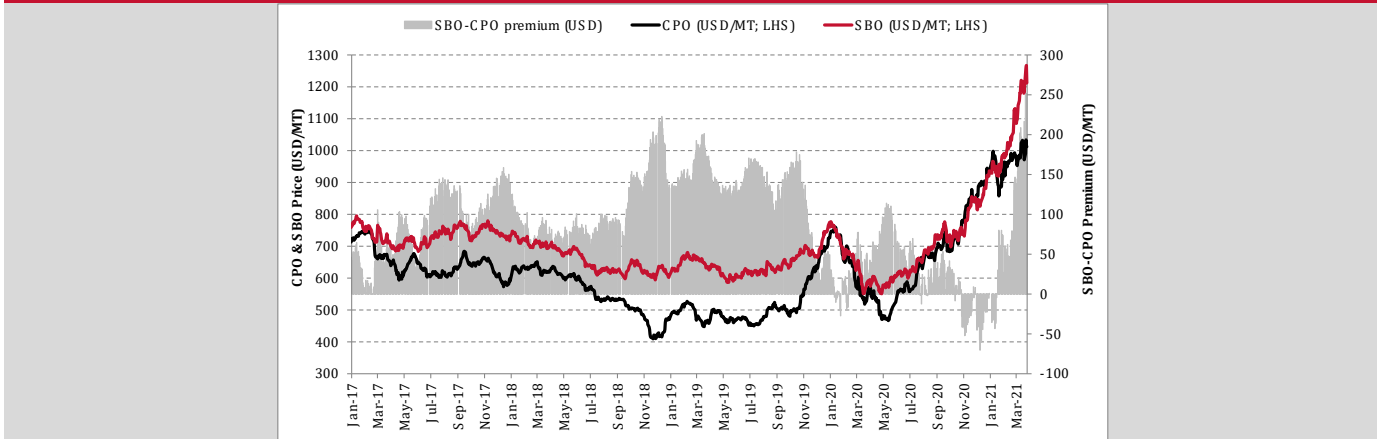
**Exhibit 5: STU ratio – Implied CPO price**

STU ratio	Average CPO Price (RM/MT)		Implied CPO Price (Avg of 5 & 10 Yr Range)
	5-Year Range	10-Year Range	
6%	3,106	3,106	3,106
7%	2,767	2,767	2,767
8%	2,834	2,642	2,738
9%	2,966	2,882	2,924
10%	2,515	2,567	2,541
11%	2,325	2,513	2,419
12%	2,178	2,254	2,216
13%	2,306	2,286	2,296
14%	2,448	2,362	2,405
15%	2,007	2,007	2,007

Source: MPOB; Kenanga Research

**Don't look to soybean oil (SBO) for support.** In light of record soybean prices, U.S. farmers are more incentivized to increase soybean planting area. In its February Outlook Forum, USDA estimated soybean planting area to increase (+8.3% YoY) to 90m acres in 2021-22 (Sep-Aug) period. Coupled with improving weather in South America (especially in Argentina) this should weigh on soybean oil price. Considering the high SBO-CPO premium (*Exhibit 6*) of c.USD200/MT (vs. 3-year average of c.USD90/MT), SBO price is unlikely to provide support for CPO prices.

Exhibit 6: SBO vs. CPO Price and Historical Premiums



Source: Bloomberg; Kenanga Research

**Biodiesel mandates uncertainty remains.** During the previous POTS Digital 2021 in Jan 2021 (<https://bit.ly/3d9igmc>), Mr. Togar Sitanggang (Vice-Chairman of GAPKI) made a remark that if CPO price remains at c.RM4,000/MT or higher, there may be a need to re-evaluate biodiesel levy structures. However, during the Virtual POC 2021, he mentioned that based on the current situation and levy structure, the biodiesel fund is able to support the Indonesian B30 mandate until the end of 2021. That said, based on our Biodiesel Fund Simulation, we believe that the current biodiesel levy and export tax structure may not be enough to fully support Indonesia’s B40 ambition should price moderate to <RM3,700/MT (refer to Exhibit 8). Considering Indonesia’s determined stance to push forward with B40, the risk of changes to its biodiesel policies remains. Any changes that will increase the levy (to fund B40) will be a bullish factor for CPO price. Zooming in to the planters, it is likely to be detrimental to Indonesian upstream planters but beneficial to Indonesian refineries. Indonesian upstream planters will see realised CPO prices capped further and this will add to the Malaysian upstream planters’ advantage. The key winners of Indonesia’s current biodiesel levy structure and any increase in the levy structure are pure Malaysian upstream planters like **HSPLANT (OP; RM2.15)**, and **TAANN (MP; RM3.00)** that are able to enjoy the full benefits of the rise in CPO prices.

**Nothing to shout about for 1QCY21 earnings cycle.** After a good 4QCY20 results season, investors should not be too excited about 1QCY21. We believe improvement in CPO prices will likely be muted by the seasonal decline in output. Based on MPOB’s data, 1QCY21 average CPO price rose (+16% QoQ) to RM3,919/MT (vs. RM3,366/MT in 4QCY20), while we expect a c.25% decline for Malaysia’s 1QCY21 production.

**Stay NEUTRAL on the plantation sector.** While CPO price is expected to trend downwards, we are turning less bearish as post-expected decline, prices are still above CY20 level (our CY21E CPO price: RM3,000/MT) and as valuations of planters under our coverage and KLPLN index (both at -1.0SD from mean) seem to have somewhat priced in the negatives. Also, considering how the KLPLN index has not tracked the gains in CPO price since the commodity exceeded RM3,500/MT, we think that the index is unlikely to come under severe pressure when CPO price corrects. Our upstream preferred pick to capitalise on higher CPO price is **HSPLANT (OP; TP: RM2.15)**, while our integrated pick to weather through the expected CPO price decline is **KLK (OP; RM25.40)**.

Exhibit 7: KLPLN Index Fwd. PER Band



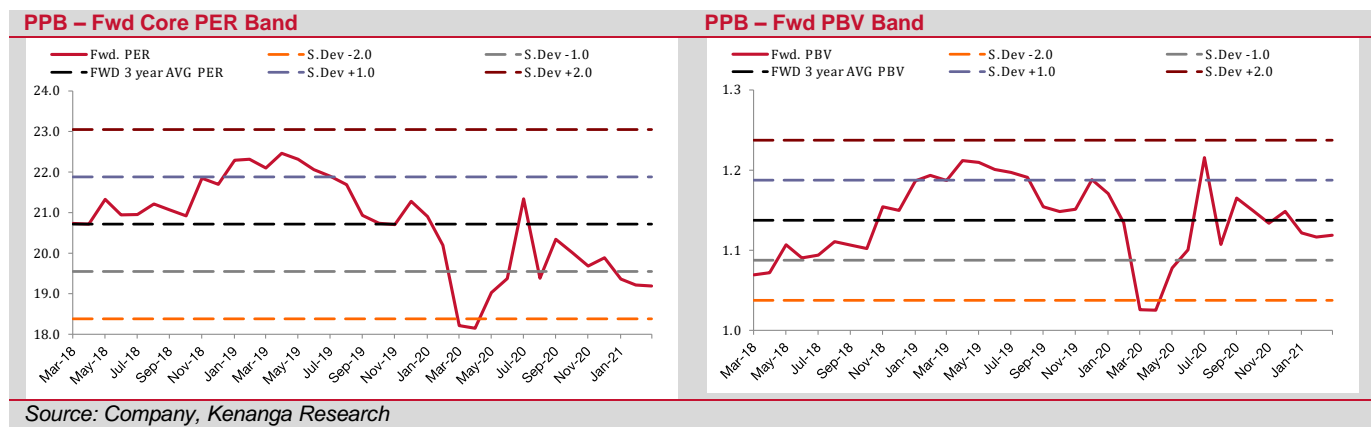
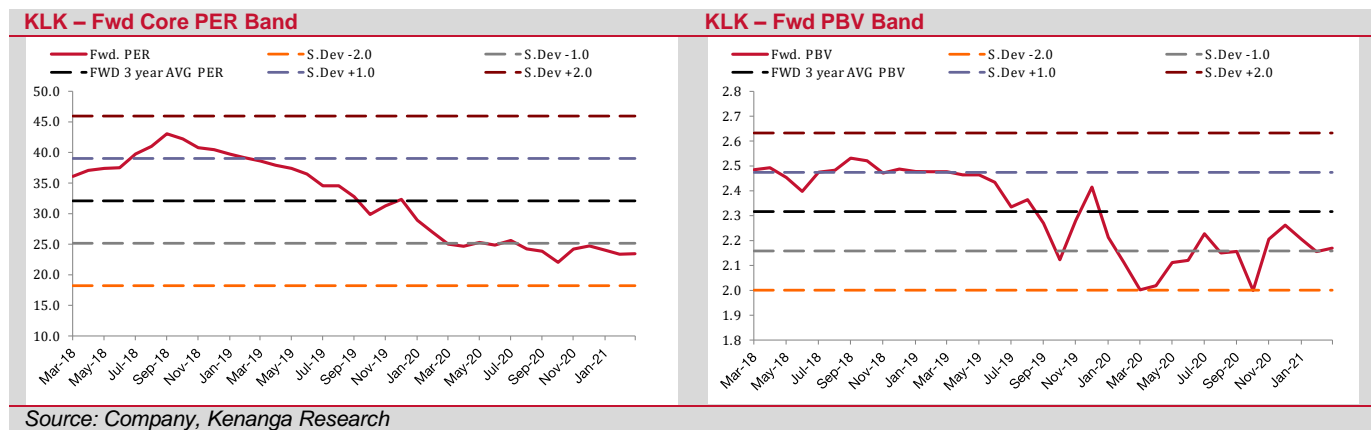
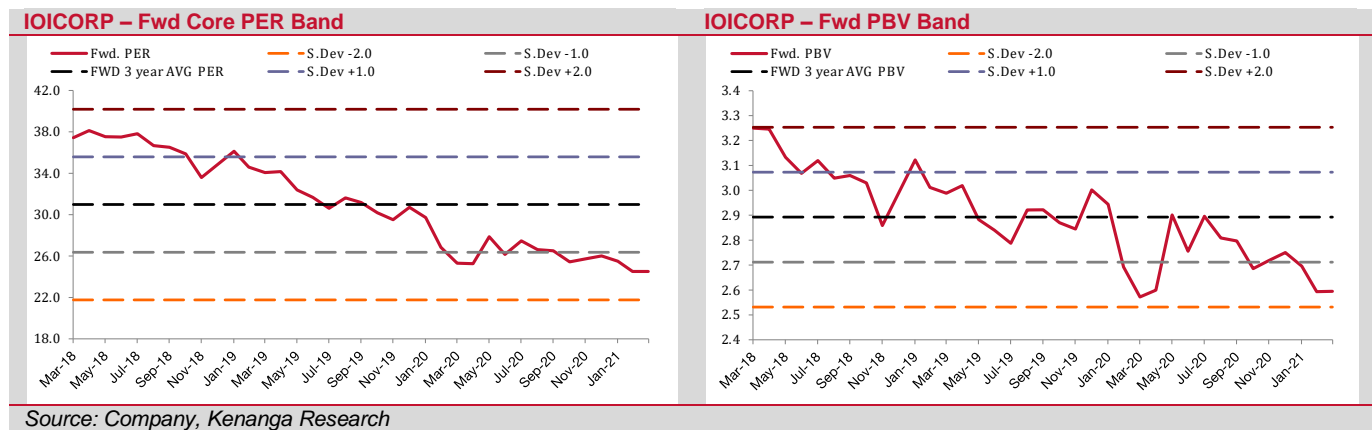
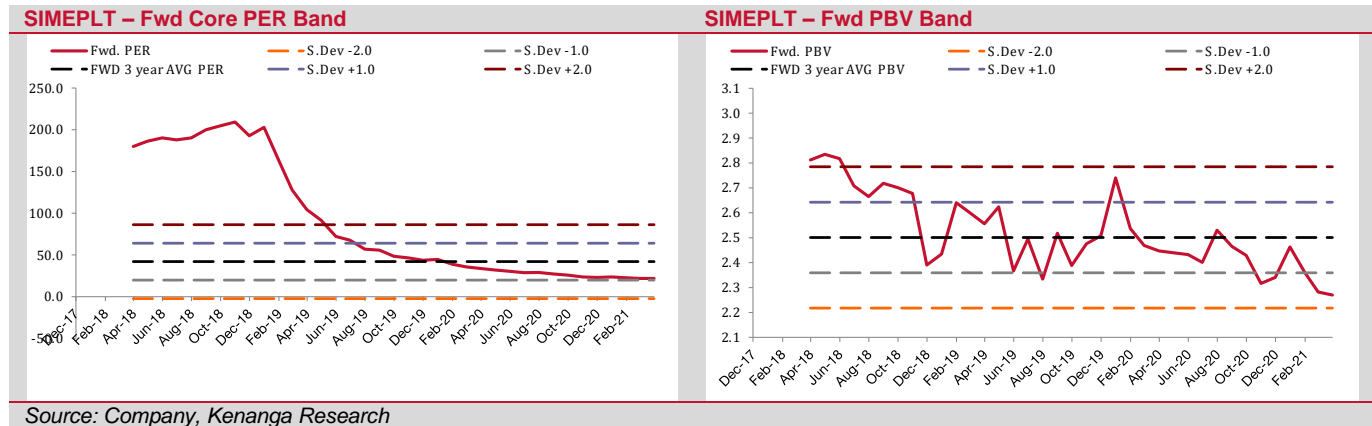
Source: Bloomberg

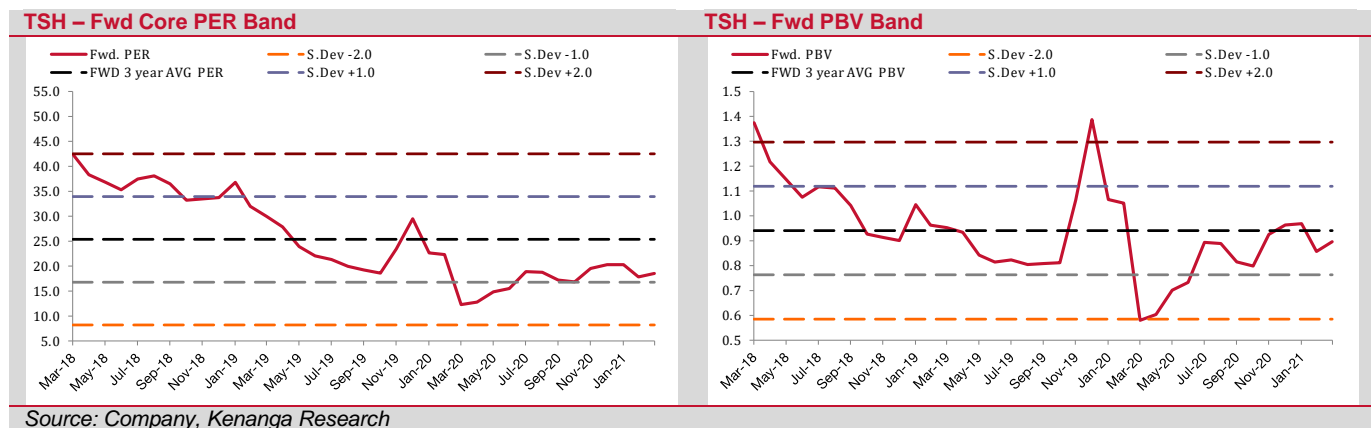
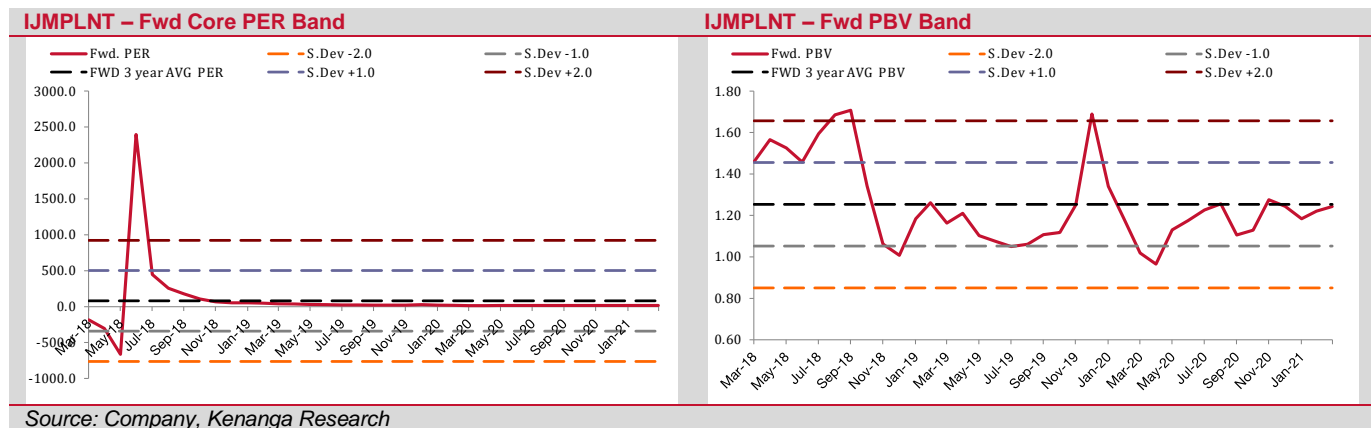
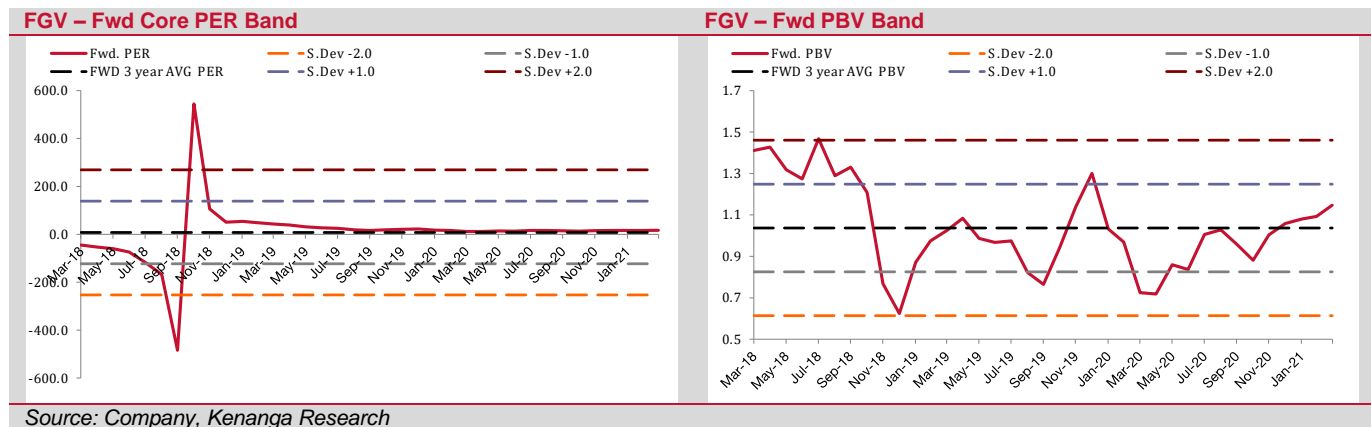
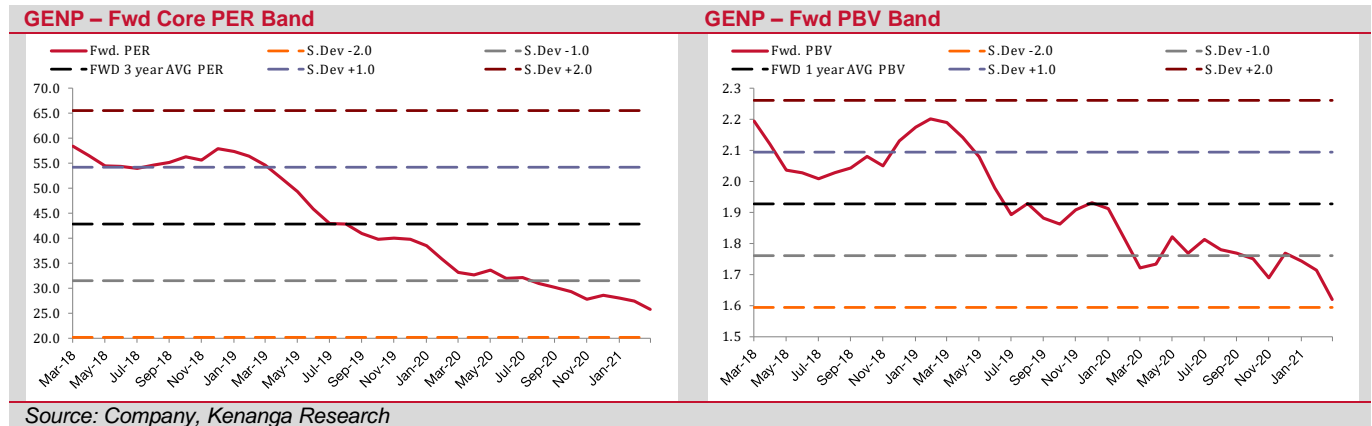
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## Exhibit 8: Indonesia Biodiesel Fund Simulation

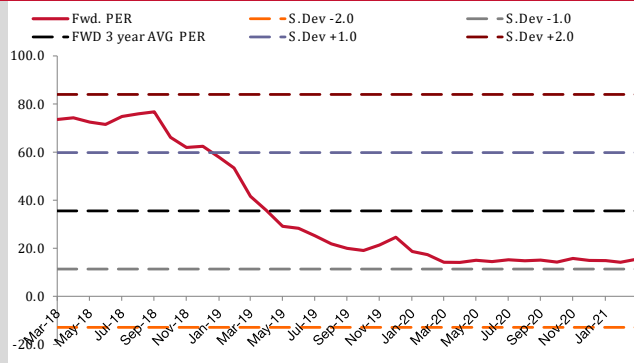
<b>Indonesia Biodiesel fund</b>						
<b>CPO price (RM/MT)</b>	<b>3,300</b>	<b>3,500</b>	<b>3,700</b>	<b>3,900</b>	<b>4,100</b>	<b>4,300</b>
Biodiesel export tax levy for CPO (USD/MT)	135	165	195	225	255	255
Biodiesel export tax levy for refined oil (USD/MT)	93	117.5	142.5	167.5	192.5	192.5
Export tax structure for CPO (USD/MT)	18	33	52	74	93	116
Export tax structure for Refined - using RBD Olein (USD/MT)	0	2	12	26	40	56
<b>Estimated Indonesia palm oil exports ('m MT)</b>	<b>30</b>	<b>30</b>	<b>30</b>	<b>30</b>	<b>30</b>	<b>30</b>
CPO (25% of exports)	8	8	8	8	8	8
Refined oil (75% of exports)	23	23	23	23	23	23
<b>Potential revenue from biodiesel export levy (USD'm)</b>	<b>3,094</b>	<b>3,881</b>	<b>4,669</b>	<b>5,456</b>	<b>6,244</b>	<b>6,244</b>
CPO (25% of exports)	1,013	1,238	1,463	1,688	1,913	1,913
Refined oil (75% of exports)	2,081	2,644	3,206	3,769	4,331	4,331
<b>Potential revenue from export tax (USD'm)</b>	<b>135</b>	<b>293</b>	<b>660</b>	<b>1,140</b>	<b>1,598</b>	<b>2,130</b>
CPO (25% of exports)	135	248	390	555	698	870
Refined - using RBD Olein (75% of exports)	0	45	270	585	900	1,260
<b>Total potential biodiesel fund for 2021 (USD'm)</b>	<b>3,229</b>	<b>4,174</b>	<b>5,329</b>	<b>6,596</b>	<b>7,841</b>	<b>8,374</b>
<b>B30 implementation</b>						
Crude oil price (USD/barrel)	55	55	55	55	55	55
USD/MYR	4.05	4.05	4.05	4.05	4.05	4.05
Crude oil price (RM/MT)	1,633	1,633	1,633	1,633	1,633	1,633
Diesel refining cost (USD/MT)	151	151	151	151	151	151
Diesel refining cost (RM/MT)	612	612	612	612	612	612
<b>Diesel cost (RM/MT)</b>	<b>2,244</b>	<b>2,244</b>	<b>2,244</b>	<b>2,244</b>	<b>2,244</b>	<b>2,244</b>
CPO price (RM/MT)	3,300	3,500	3,700	3,900	4,100	4,300
Biodiesel refining cost (USD/MT)	181	181	181	181	181	181
Biodiesel refining cost (RM/MT)	734	734	734	734	734	734
<b>Biodiesel cost (RM/MT)</b>	<b>4,034</b>	<b>4,234</b>	<b>4,434</b>	<b>4,634</b>	<b>4,834</b>	<b>5,034</b>
Deficit for biodiesel usage (RM/MT)	1,790	1,990	2,190	2,390	2,590	2,790
Deficit for biodiesel usage (USD/MT)	442	491	541	590	639	689
Targeted CPO consumption for B30 ('m MT)	8.0	8.0	8.0	8.0	8.0	8.0
<b>Biodiesel-Diesel deficit (USD'm)</b>	<b>3,535</b>	<b>3,931</b>	<b>4,326</b>	<b>4,721</b>	<b>5,116</b>	<b>5,511</b>
<b>Deficit after biodiesel fund (USD'm)</b>	<b>-307</b>	<b>243</b>	<b>1,003</b>	<b>1,876</b>	<b>2,726</b>	<b>2,863</b>
Max breakeven CPO consumption after biodiesel fund (MT)	7.3	8.5	9.9	11.2	12.3	12.2
Potential (shofffall)/surplus (MT)	(0.7)	0.5	1.9	3.2	4.3	4.2

Source: Indonesian Ministry of Finance; Bloomberg; Kenanga Research

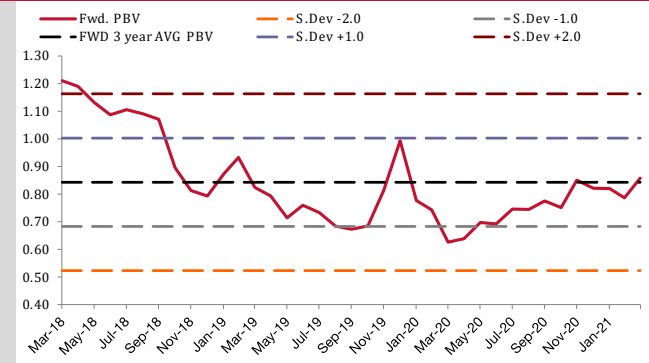




**HSPLANT – Fwd Core PER Band**

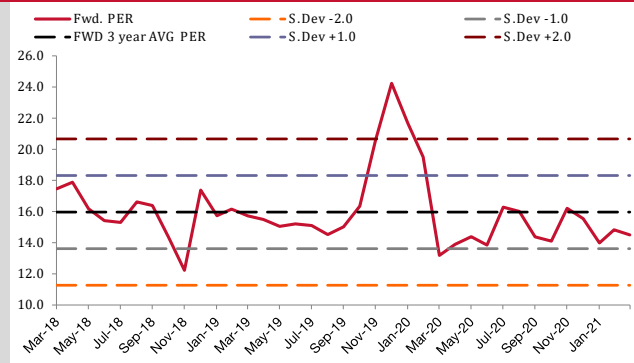


**HSPLANT – Fwd PBV Band**

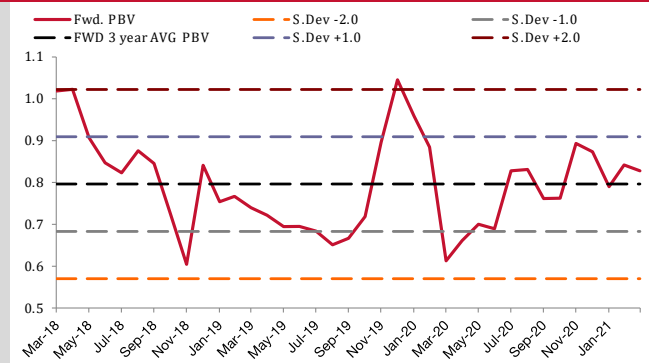


Source: Company, Kenanga Research

**TAANN – Fwd Core PER Band**

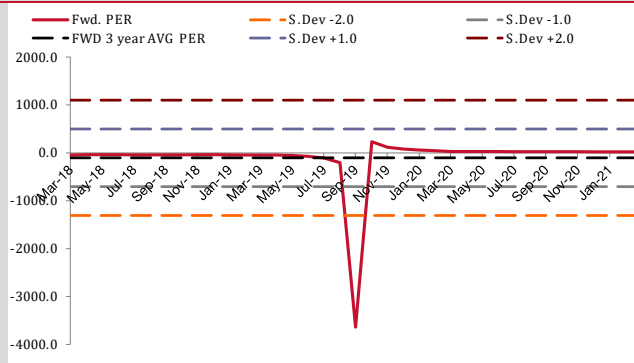


**TAANN – Fwd PBV Band**

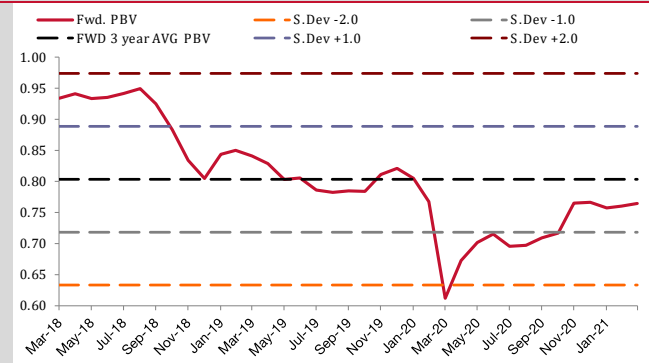


Source: Company, Kenanga Research

**UMCCA – Fwd PER Band**



**UMCCA – Fwd PBV Band**



Source: Company, Kenanga Research

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Exhibit 10: Valuation & Justification For Calls: Pt.1

Company	Last Price (RM) @ 19-Mar-21	Action	New Call	Previous Call (RM)	New TP (RM)	Previous TP (RM)	Valuation basis (New)	Valuation basis (Old)	FY20/21E Earnings (RM m) - New	FY21/22E Earnings (RM m) - New	FY20/21E Earnings (RM m) - Old	FY21/22E Earnings (RM m) - Old	FY20E Earnings Changes (%)	FY21E Earnings Changes (%)
FGV	1.40	n.a.	MP	Accept Offer	1.30	1.30	16x PER on FY21E earnings	Takeover Offer Price	292.2	327.9	292.2	327.9	0%	0%
GENP	9.20	Lower TP	MP	MP	8.95	9.50	SOP with Plantation segment @ 25x FY21E PER, Downstream @ 24x FY21E PER, Property division at 20% to RNAV, and Premium Outlets @ 25.0x FY21E PER (average retail sub-sector)	SOP with Plantation segment @ 27x FY21E PER, Downstream @ 24x FY21E PER, Property division at 20% to RNAV, and Premium Outlets @ 25.0x FY21E PER (average retail sub-sector)	312.8	341.2	312.8	341.2	0%	0%
HSPLANT	1.89	Unchanged	OP	OP	2.15	2.15	18x PER on FY21E earnings, reflecting below -0.5SD	18x PER on FY21E earnings, reflecting below -0.5SD	96.4	102.6	96.4	102.6	0%	0%
IJMLNT	1.84	Unchanged	MP	MP	1.95	1.95	18x PER on CY21E earnings (SD level unavailable - previously loss-making)	18x PER on CY21E earnings (SD level unavailable - previously loss-making)	89.0	97.0	89.0	97.0	0%	0%
IOICORP	4.24	Downgrade Call and lower TP	MP	OP	4.55	4.95	26x PER on FY22E earnings, reflecting -1.0SD from mean.	27x PER on FY22E earnings, reflecting -0.5SD from mean.	1043.2	1101.9	1,079.5	1,153.4	-3%	-4%

Source: Kenanga Research



Exhibit 11: Valuation & Justification For Calls: Pt.2

Company	Last Price (RM) @ 19-Mar-21	Action	New Call	Previous Call (RM)	New TP (RM)	Previous TP (RM)	Valuation basis (New)	Valuation basis (Old)	FY20/21E Earnings (RM m) - New	FY21/22E Earnings (RM m) - New	FY20/21E Earnings (RM m) - Old	FY21/22E Earnings (RM m) - Old	FY20E Earnings Changes (%)	FY21E Earnings Changes (%)
KLK	23.48	Lower TP	OP	OP	25.40	26.80	26x PER on CY21E earnings, reflecting below -0.5SD from mean.	28x PER on FY21E earnings, reflecting -0.5SD from mean.	1017.7	1116.1	1,017.7	1,116.1	0%	0%
PPB*	18.60	Unchanged	OP	OP	20.70	20.70	SOP with PPB (ex-Wilmar) @ 21x FY21E PER, Wilmar (ex-YKA) @ 16x FY21E PER, and YKA @ 30x FY21E PER	SOP with PPB (ex-Wilmar) @ 21x FY21E PER, Wilmar (ex-YKA) @ 16x FY21E PER, and YKA @ 30x FY21E PER	1352.0	1459.2	1,352.0	1,459.2	0%	0%
SIMEPLT	4.85	Unchanged	OP	OP	5.50	5.50	25x PER on FY21E earnings	25x PER on FY21E earnings	1514.4	1593.3	1,514.4	1,593.3	0%	0%
TAANN	2.90	Unchanged	MP	MP	3.00	3.00	SOP with Plantation segment @ 15x FY21E PER, and Timber @ 0.6x FY21E PBV	SOP with Plantation segment @ 15x FY21E PER, and Timber @ 0.6x FY21E PBV	85.8	94.8	85.8	94.8	0%	0%
TSH	1.070	Downgrade Call and lower TP	UP	MP	1.00	1.10	18x PER on FY21E earnings, reflecting below -0.5SD from mean.	20x PER on FY21E earnings, reflecting -0.5SD from mean.	77.6	86.3	77.6	86.3	0%	0%
UMCCA	5.12	Unchanged	MP	MP	5.30	5.30	0.80x PBV on CY21E book value, reflecting mean	0.80x PBV on CY21E book value, reflecting mean	33.9	54.4	33.9	54.4	0%	0%

Source: Kenanga Research

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## Peer Comparison

Name	Last Price (19/03/21) (RM)	Market Cap (RM'm)	Shariah Compliant	Current FYE	Revenue Growth		Core Earnings Growth		PER (x) - Core Earnings			PBV (x)		ROE (%)	Net Div. Yld. (%)	Target Price (RM)	Rating
					1-Yr. Fwd.	2-Yr. Fwd.	1-Yr. Fwd.	2-Yr. Fwd.	Hist.	1-Yr. Fwd.	2-Yr. Fwd.	Hist.	1-Yr. Fwd.	1-Yr. Fwd.			
<b>STOCKS UNDER COVERAGE</b>																	
FGV HOLDINGS BHD	1.40	5,107.4	Y	12/2021	5.5%	1.7%	18.3%	12.2%	99.1	25.3	19.9	1.2	1.2	6.7%	1.4%	1.30	MP
GENTING PLANTATIONS BHD	9.20	8,254.2	Y	12/2021	-1.7%	5.5%	31.2%	9.1%	34.6	26.4	24.2	1.7	1.6	6.3%	2.1%	8.95	MP
HAP SENG PLANTATIONS HLDGS	1.89	1,511.4	Y	12/2021	8.4%	4.2%	39.2%	6.5%	21.8	15.7	14.7	0.9	0.9	5.6%	3.7%	2.15	OP
IJM PLANTATIONS BHD	1.84	1,620.3	N	03/2021	12.3%	5.5%	155.5%	9.0%	46.5	18.2	16.7	1.4	1.3	7.3%	2.1%	1.95	MP
IOI CORP BHD	4.24	26,558.0	Y	06/2021	24.2%	6.2%	23.8%	5.6%	35.0	31.6	24.2	2.8	2.7	10.8%	2.0%	4.55	MP
KUALA LUMPUR KEPONG BHD	23.48	25,324.4	Y	09/2021	11.5%	4.4%	35.6%	9.7%	33.3	24.6	22.4	2.3	2.2	9.2%	2.3%	25.40	OP
PPB GROUP BERHAD	18.60	26,460.4	Y	12/2021	18.4%	11.1%	3.3%	7.9%	20.2	19.6	18.1	1.2	1.1	6.0%	2.2%	20.70	OP
SIME DARBY PLANTATION BHD	4.85	33,390.2	Y	12/2021	14.1%	5.0%	80.5%	5.2%	39.8	22.0	21.0	2.4	2.3	10.8%	2.1%	5.50	OP
TA ANN HOLDINGS BERHAD	2.90	1,277.3	Y	12/2021	6.2%	3.2%	35.0%	10.5%	20.1	14.9	13.5	0.9	0.8	5.8%	3.4%	3.00	MP
TSH RESOURCES BHD	1.07	1,476.8	Y	12/2021	19.8%	1.4%	7.5%	11.3%	20.5	19.1	17.1	1.0	0.9	7.8%	2.3%	1.00	UP
UNITED MALACCA BHD	5.12	1,074.0	Y	04/2021	38.8%	9.1%	72.9%	60.6%	N.A.	31.6	19.7	0.8	0.8	2.6%	1.8%	5.30	MP
<b>Simple Average</b>					<b>14.3%</b>	<b>5.2%</b>	<b>45.7%</b>	<b>13.4%</b>	<b>37.1</b>	<b>22.6</b>	<b>19.2</b>	<b>1.5</b>	<b>1.4</b>	<b>7.2%</b>	<b>2.3%</b>		

Source: Bloomberg, Kenanga Research

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**Stock Ratings are defined as follows:****Stock Recommendations**

OUTPERFORM	: A particular stock's Expected Total Return is MORE than 10%
MARKET PERFORM	: A particular stock's Expected Total Return is WITHIN the range of -5% to 10%
UNDERPERFORM	: A particular stock's Expected Total Return is LESS than -5%

**Sector Recommendations\*\*\***

OVERWEIGHT	: A particular sector's Expected Total Return is MORE than 10%
NEUTRAL	: A particular sector's Expected Total Return is WITHIN the range of -5% to 10%
UNDERWEIGHT	: A particular sector's Expected Total Return is LESS than -5%

**\*\*\*Sector recommendations are defined based on market capitalisation weighted average expected total return for stocks under our coverage.**

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Published and printed by:

**KENANGA INVESTMENT BANK BERHAD (15678-H)**

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