

ESG

Plantation & Sustainability

By Marie Vaz / msvaz@kenanga.com.my ; Adrian Kok / adrian.kok@kenanga.com.my

Recently, we organised a half-day ESG webinar with sustainability experts from Olam International, IOI Corp and Sime Darby Plantation. We were reassured that palm oil is here to stay – it is the most efficient oil crop, and hence the best environmental option to cater for a growing global population (+14% by 2050). That said, the sector remains bogged down by issues around deforestation and biodiversity loss, labour, open burning, and carbon emission. Some of the ways local players have responded are by: (i) adopting No Deforestation, No Peat, No Exploitation (NDPE) policy, (ii) zero burning policy, (iii) protecting High Conservation Value (HCV) areas, (iv) prioritising labour and human rights, (v) GHG emission targets, and (vi) sustainable certifications (RSPO, MSPO, and ISPO). In order for the carrot and stick approach to work, there needs to be greater demand for sustainable palm oil. Only an estimated 2-3% of China and India’s palm oil imports (China & India accounted for 53% of Malaysia’s 2020 palm oil exports) are RSPO certified. Lastly, while our target prices and recommendations are under review pending results release, we offer a preview to embedding ESG into planters’ valuations.



We recently organised a half-day Plantation and Sustainability webinar led by experts in the Sustainability scene from major plantation companies; Audrey Lee (Sustainability General Manager, Olam International Limited), Dr. Surina Ismail (Group Head of Sustainability, IOI Corporation Bhd) and Rasyid Redza (Head of Group Sustainability, Sime Darby Plantation Bhd). These are our key takeaways for the sector and outlook for our plantation coverage.

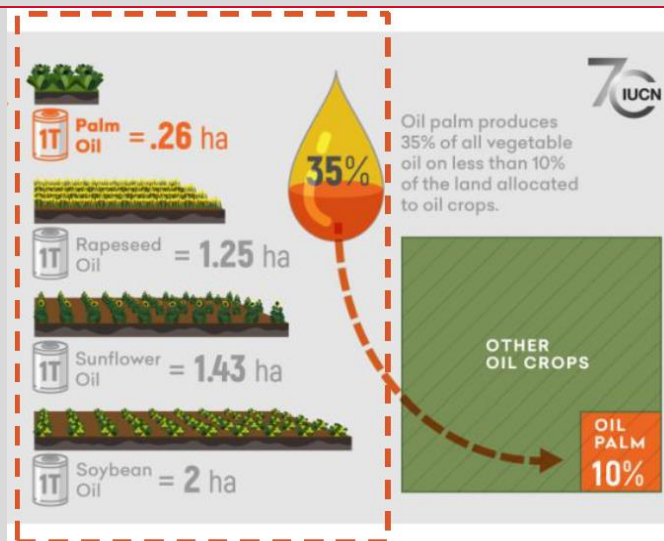
Most efficient crop vs. rival oils. Contrary to its stigma, palm oil is the most efficient crop in terms of oil yield to land use (refer to Land Use to Yield Chart). To produce 1 tonne of oil, palm only requires 0.26 ha of land, whilst its biggest competitor soy would require 7.7 times that amount at 2.0 ha of land. According to IUCN, palm oil accounts for 35% of global vegetable oil

production on only 10% of global land use, proportionately less land usage than its peers. Meanwhile, it is estimated that soybean oil accounts for 26% of global vegetable oil production on 40% of global land use, based on data compiled by Our World in Data from UN Food and Agriculture Organization (FAO) 2017.

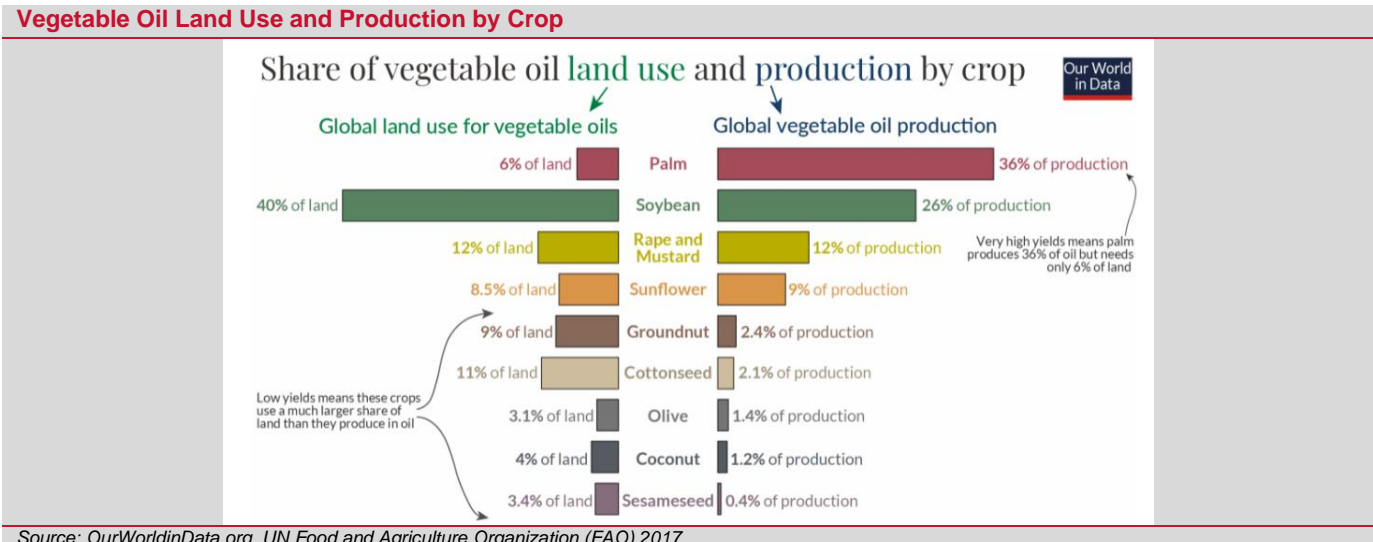
The misconception portrayed by international organisations vilifying palm oil over rival oils has been damning to the industry reputation, while brands that highlight the exclusion of palm oil in their products and attempt to substitute palm oil with other less efficient oils are either greenwashing or are sorely misinformed.

Since rival oils have lower yields vs. palm oil, **replacing palm oil is not a solution at this point. However, ensuring that palm oil is produced sustainably will be the best way forward for the industry and the planet.**

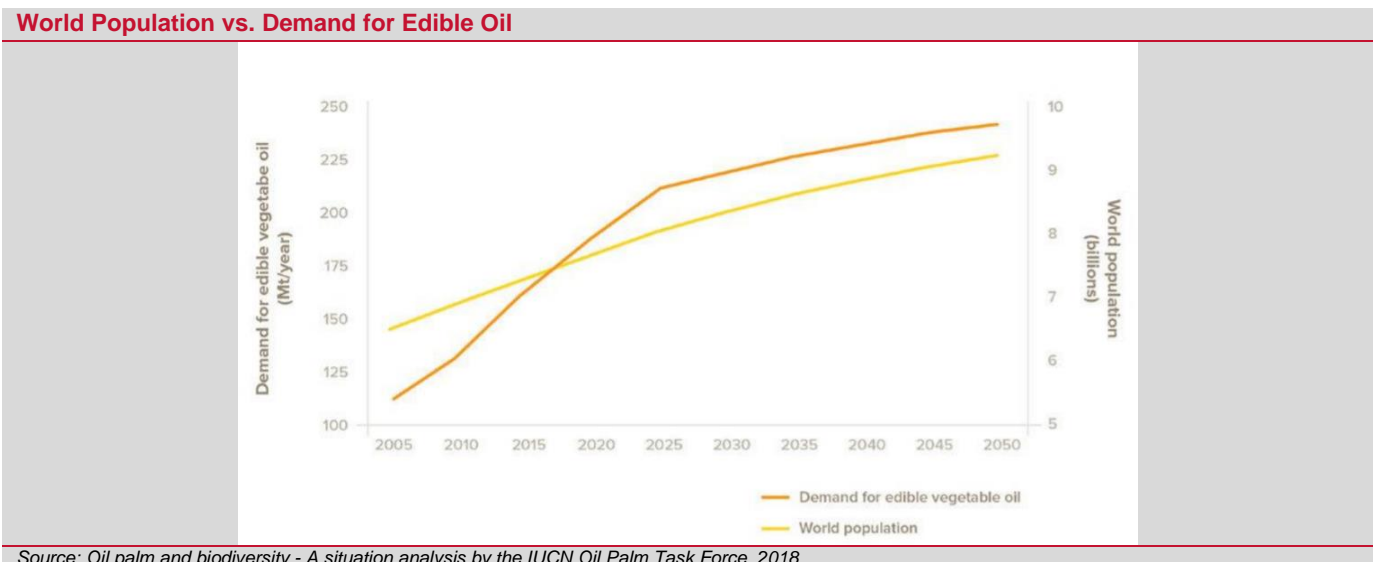
Land Use to Yield



Source: IUCN.org



Palm oil is the best option to cater to a growing global population, which is set to increase to over 9b by 2050 (vs. c.7.9b currently). In order to limit the environmental impact, palm oil would be the most efficient means to meet the growing global demand for edible vegetable oil. Fewer resources would be required by mitigating excessive land use or deforestation, especially at a time when the planet requires its carbon sinks and biodiversity maintained.



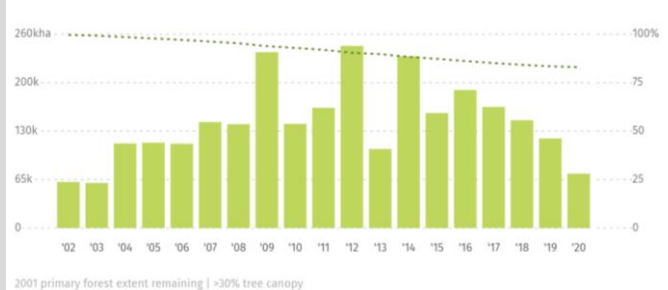
Tackling deforestation and biodiversity loss. Deforestation is particularly harmful to the environment as a third of global carbon emissions are stored in tropical rainforest, but when trees are burned or removed, this carbon is released back into the atmosphere, increasing global temperatures. From 2002 to 2020, Malaysia lost 2.70m ha of humid primary forest (-17%) while Indonesia lost 9.75m ha of humid primary forest (-10%), making up 34% and 36% respectively of their total tree cover loss. Globally, palm oil ranks 3rd among crops that cause deforestation, behind maize and soy, but the main culprit for deforestation is in fact livestock.

On a national level, Malaysia and Indonesia that make up 85% of the world palm oil supply have taken active measure to minimise the rate of deforestation. Malaysia’s Plantation Industries and Commodities Ministry Secretary General Ravi Muthayah has recently (in 2021) reiterated the countries’ commitment to limit total oil palm cultivated area at 6.5m ha (vs. c.5.9m ha as at December 2020), with no encroachment to forest areas by banning conversion of permanent forest reserved area for oil palm cultivation and no new planting allowed in peatland areas. Indonesia saw a 75% drop in deforestation between 2019 to 2020, according to the Ministry of Environment and Forestry, a steady decline since 2015 which is a result of multiple policies aimed at protecting the country’s forests which include permanent ban on issuing new permits to clear primary forests and peatlands, a moratorium on new oil palm plantation licenses, and increased enforcement against environmental violations. Even though deforestation rates are declining, it is important to note that it is still ongoing.

On a corporate level, SIMEPLT and IOICORP both have a No Deforestation, No Peat, No Exploitation (NDPE) policy. Additionally, IOICORP is committed to reforestation, and the protection of High Conservation Value (HCV) of 3,655 ha, High Carbon Stock areas and other conservation land set aside of 11,509 ha. As for SIMEPLT, they have a total of 46,435 ha identified for HCV and Conservation Set Asides (CSA) land across its global operations. When it comes to new development for SIMEPLT, a thorough assessment is required to avoid deforestation; this include considering 6 HCVs, and if any of the six criteria are met, SIMEPLT will not proceed with the development (refer to table, SIMEPLT’s HCV Considerations).

On top of that, SIMEPLT is going the extra mile pioneering R&D to **improve crop yields for sustainability**. This palm biotechnology **will essentially** optimise agricultural land use, limiting the need for further land clearing to meet increased global demand of palm oil. SIMEPLT's breakthrough innovation, Genome Select™ planting material is expected to give up to 20% more yield on existing land. As of June 2020, SIMEPLT have made its genome research publicly available. The genome sequence shared is 80% more detailed than previously available findings as the Group wants other researchers to accelerate their ability to increase oil palm yield.

Primary Forest Loss in Malaysia



Source: Global Forest Watch

Global Cause of Deforestation

Total Forest Loss, 1990-2008 (mha)

■ = 1 million ha

Livestock

Beef and other ruminant products



Pigs and poultry



Crops

Soy



Maize



Palm Oil



Wood Products



Rice



Sugar Cane



Rubber



Source: Union of Concerned Scientists; Climate Focus calculations based on European Commission, 2013

SIMEPLT HCV Considerations

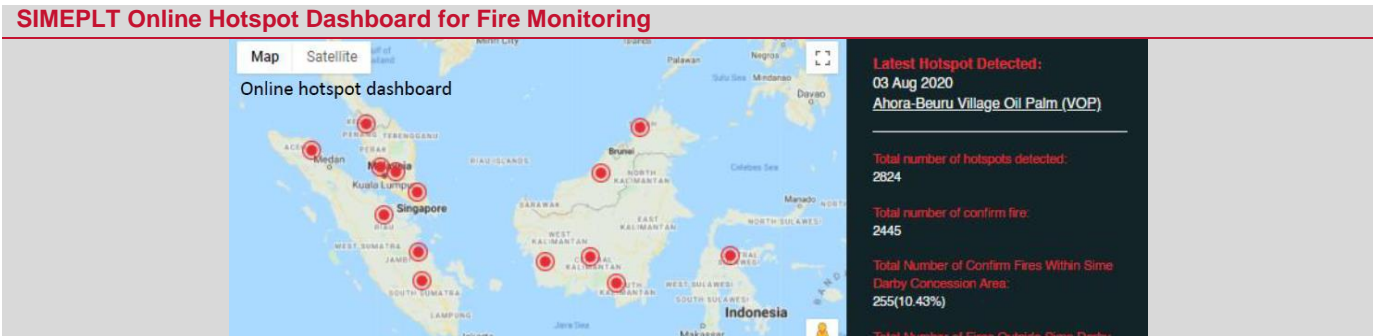
High Conservation Value (HCV) Areas

HCV1	• Significant biodiversity value	HCV4	• Critical ecosystem services
HCV2	• Natural habitat landscapes	HCV5	• Community livelihoods
HCV3	• Rare, threatened or endangered ecosystems	HCV6	• Community culture and tradition

Source: Sime Darby Plantation Berhad

Fire management to curb transboundary haze. In the past, fires at plantations have been linked to slash and burn activities by farmers, smallholders, and oil palm companies. If left unchecked, open burning activities during extreme droughts can easily spread from sparks carried by wind or peat fire that can travel underground, exacerbating the fires. The latest major incidents in South East Asia were in 2019 and 2015 after the major incident back in 1997.

To address this, most local palm oil players implement a zero burning policy and no peat to mitigate the harm caused by fire during the dry season that can result in a transboundary haze. Since the slash and burn method is a far cheaper way of land clearing for local farmers and smallholders, the oil palm giants have established ongoing collaboration efforts with neighbouring communities, government bodies, civil societies and industry associations. SIMEPLT has a near real-time online hotspot dashboard to monitor beyond a 5km radius of their concession areas via satellite systems. CY2020 did not see a transboundary haze situation in the South East Asia likely on slower clearing efforts due to Covid-19. The effectiveness of ongoing fire prevention efforts has yet to be seen, but we concur that active and transparent monitoring facilities are a step in the right direction.



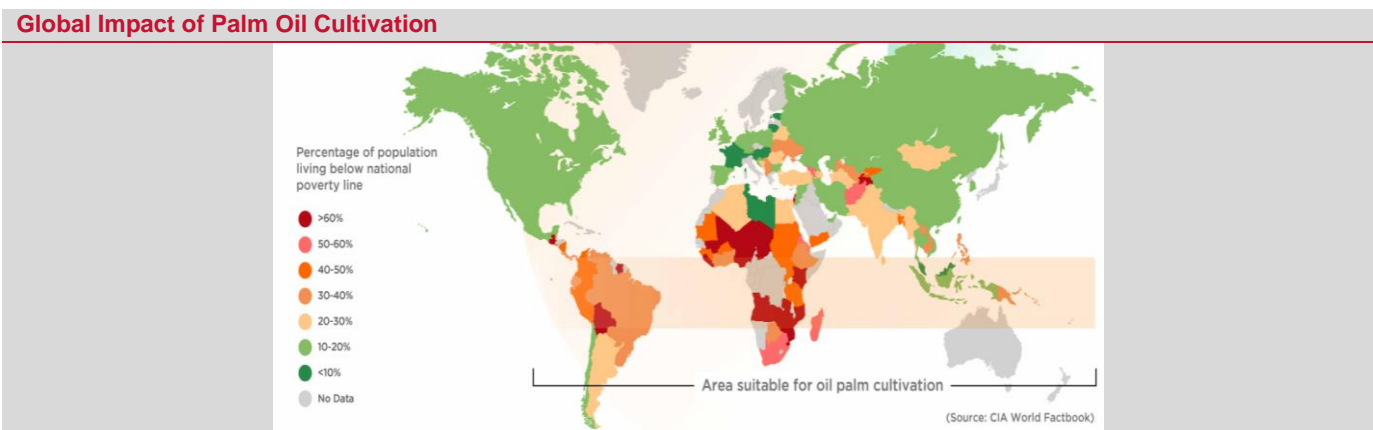
Source: Sime Darby Plantation Berhad

Labour issues in the forefront. Mounting scrutiny of labour rights issues at plantations, ranging from forced labour, exploitative and dangerous working practices have rattled the sector in recent years. From primarily focussing on environmental concerns, the plantation sector is increasingly prioritising labour and human rights. The bigger players are already addressing these concerns head on, and it is important to note that with RSPO or MSPO certification (which the palm oil majors tend to have) most social and labour issues are prioritised and audited by third parties.



Source: RSPO

To address labour and human rights concerns, IOICORP conducts internal as well as external monitoring with audit certifications, labour specialist such as BSR and NGO's such as Finnwatch and Tenaganita. It is also important to note that IOICORP does not engage in recruitment fees (or runners) for pre-employment of workers, which has been a key issue behind the scandal, abuse and mismanagement of foreign workers. Olam's efforts in Gabon appear widely positive as they have taken large strides to uplift the local community. Palm oil has done a lot for poverty-stricken countries in the tropics as it not only provides food security, but has also lifted millions out of poverty through job security. By setting up base in Gabon, Olam has created jobs for over 4,000 people representing USD2m in wages per month injected back into the local economy. Additionally, Olam also actively engages in long term social commitments by investing in water and energy, education and healthcare for the locals.

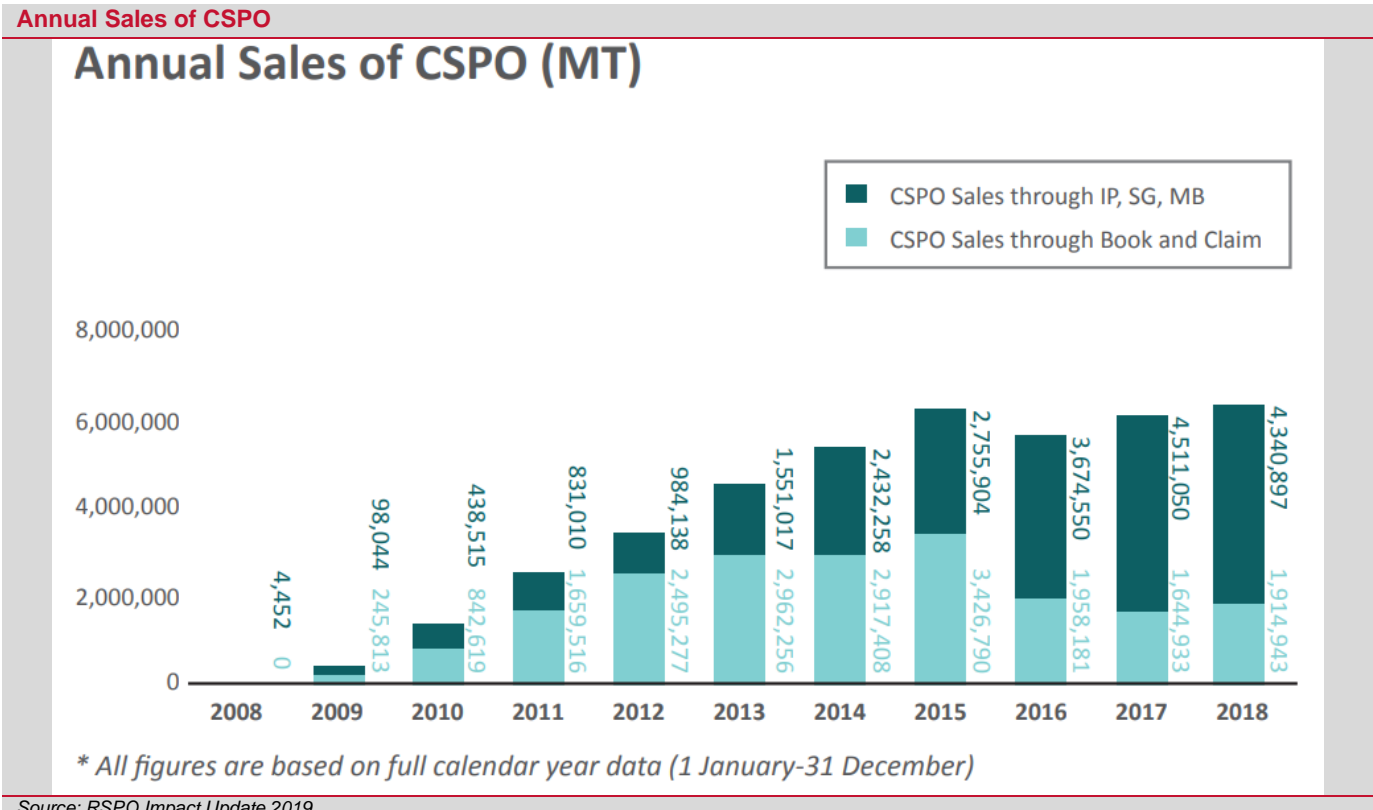


Source: RSPO

Sime Darby Plantation U.S. CBP WRO updates. Since the Withhold Release Order (WRO) issued by U.S. Customs and Border Protection (CBP) in December 2020, SIMEPLT has had multiple engagements with U.S. CBP and has appointed a credible third party (Impactt) to conduct a thorough assessment of the group's operations around the 11 Indicators of Forced Labour (ILO). The assessment includes interviews with c.30k workers, review of documents, and unannounced site visits. From what we understand, prior to the Raya holidays, Impactt has completed most of the interviews. After completing the assessments, Impactt will produce a report (targeting by June 2021) with its findings, which will be made publicly available. SIMEPLT will then develop a correction action plan to address any gaps found. Meanwhile, we gathered that there is constant engagement between SIMEPLT and its customers, with supportive/neutral feedback. Most of its customers are providing SIMEPLT and Impactt time to conduct the assessment.

There needs to be greater demand for sustainable palm oil. The demand for certified palm oil is increasing globally (*refer below*), which is a step in the right direction, but this comes at a higher cost to palm oil producers. Currently, the demand for sustainable palm oil is mostly driven by Europe and America with corporate giants such as Nestle and Unilever committed to using 100% responsibly-sourced palm oil by 2020. However, Malaysia's main export countries are China and India which are less demanding of sustainable palm oil, preferring cheaper alternatives. It is estimated that only 2% of China's and 3% of India's palm oil imports are RSPO certified, compared to certification rates in EU of 80-90%. Globally, it is estimated that environmentally certified palm oil accounts for only 19% of global production, of which 42% comes from Malaysia and 51% from Indonesia. Clearly more work needs to be done to push for sustainable palm oil demand, but palm oil majors have already bit the bullet by concentrating on sustainable palm oil supply ahead of demand requirements.

Singapore-listed Olam has 100% RSPO certification for its plantations in Gabon. SIMEPLT's global operations are certified to multiple sustainability standards, with 100% RSPO, MSPO and ISPO certification. IOICORP has 170,384.4 ha of RSPO-certified and 174,653.5 ha of MSPO-certified areas, of its 178,068 ha of total planted area. Additionally, both companies actively engage smallholders to increase traceability and ensure smallholders in their supply chain grow their crop responsibly.

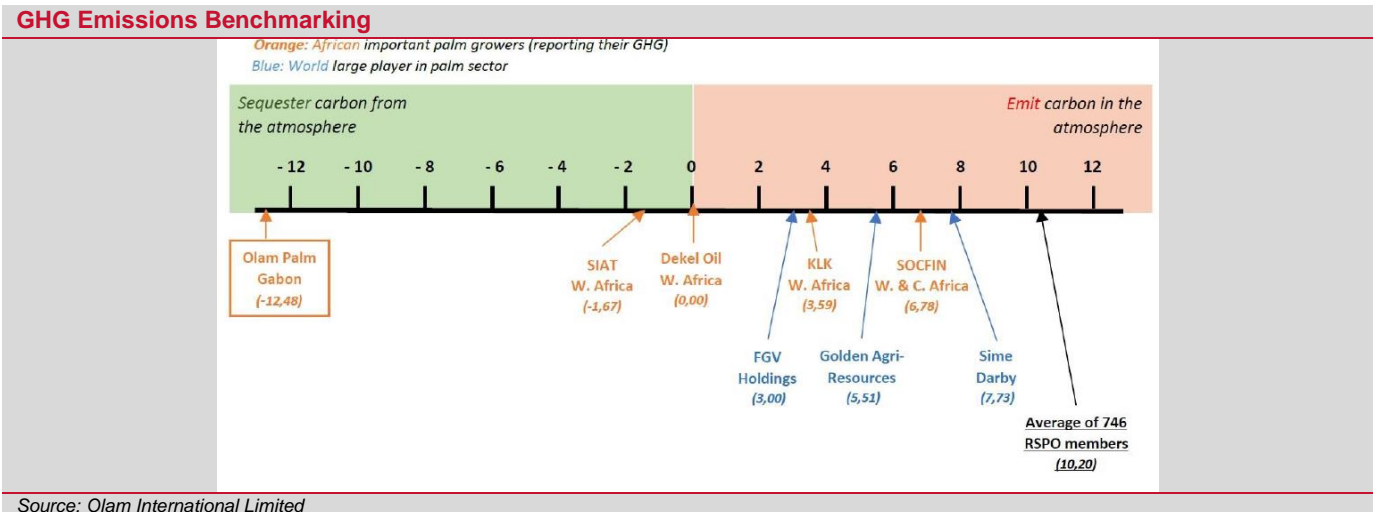


Export of palm oil to major countries for Malaysia in 2020

2020 ('000)	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
China	177	157	148	199	226	351	289	295	250	190	301	148
India	47	21	11	17	55	246	455	330	375	424	204	548
EU	183	152	195	208	152	127	172	159	156	120	181	138
Pakistan	171	47	67	62	97	132	116	60	59	79	67	48
Turkey	37	57	59	56	42	72	83	25	44	48	11	79
US	53	59	50	42	44	46	51	42	47	58	3	46
Mozambique	15	30	22	8	14	31	26	52	31	19	41	14
Egypt	1	16	11	0	47	10	9	4	17	21	12	9
Others	530	544	622	643	693	691	583	611	634	716	485	595
Total	1,214	1,082	1,185	1,236	1,369	1,707	1,783	1,578	1,612	1,674	1,303	1,625

Source: MPOB, Kenanga Research

Investors should be eyeing palm oil neutrality. Olam has successfully set a high benchmark by achieving palm oil neutrality or carbon neutrality in Gabon by actively planting trees able to sequester carbon from the atmosphere unlike most of its peers. Knowing that carbon neutrality is possible should serve as an incentive for local palm oil players to push the agenda to the forefront. At present, IOICORP is planning on reducing GHG emissions by 41% by 2025 and hopes to achieve carbon neutrality by 2030, while SIMEPLT is targeting to reduce emissions by 40% by 2030 with 80% of their operations utilising renewable energy.



Preview to embedding ESG into our valuations. In Kenanga’s recent Market Strategy – Sustainability Series report (<https://bit.ly/3yic6Ki>), we attempted to embed ESG into valuations. Building on the same methodology for the plantation sector, we include our ESG score and expand the ESG discount to all planters under our coverage. Our target prices and recommendations are under review. The official changes in target prices and calls will be reflected in our coming individual company reports during the results season.

Preview – Embedding ESG into Valuations

	ESG Score	% Planted land which is peat	Original target price (RM)	Theoretical ESG adjusted target price (RM)	ESG Discount	Previous S.D. Level - PER	New S.D. Level - PER
FGV	74%	7%	1.30	1.25	4%	n.a.	n.a.
GENP	77%	5%*	8.95	8.65	3%	-1.0	-1.0
HSPLANT	73%	0%	2.15	2.15	0%	-0.5	-0.5
IJMLNT	74%	4%*	1.80	1.75	3%	n.a.	n.a.
IOI	81%	2%	4.55	4.20	8%	-0.5	-1.0
KLK	78%	10%*	25.40	24.00	6%	-0.5	-1.0
PPB	82%	3%	20.70	19.20	7%	Mean	-0.5
SIMEPLT	78%	5%	5.50	5.40	2%	-0.75	-0.75
TAANN	42%	10%*	3.00	2.80	7%	Mean	-0.5
TSH	71%	5%*	1.00	0.97	3%	-1.0	-1.0
UMCCA	55%	3%*	5.30	5.00	6%	n.a.	n.a.

Source: Annual Reports; Kenanga Research
*Our assumptions

19 May 2021

Peer Comparison – TPs & Calls Under Review Pending Results Update

Name	Last Price	Market Cap	Shariah Compliant	Current FYE	Revenue Growth		Core Earnings Growth		PER (x) - Core Earnings			PBV (x)		ROE (%)	Net Div. Yld. (%)	Target Price (RM)	Rating
	(RM)	(RM'm)			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.	1-Yr. Fwd.	(UNDER REVIEW)	
STOCKS UNDER COVERAGE																	
FGV HOLDINGS BHD	1.38	5,034.4	Y	12/2021	5.5%	1.7%	18.3%	12.2%	97.7	24.9	19.7	1.2	1.2	6.7%	1.4%	1.30	MP
GENTING PLANTATIONS BHD	8.60	7,715.9	Y	12/2021	-1.7%	5.5%	31.2%	9.1%	32.4	24.7	22.6	1.6	1.5	6.3%	2.2%	8.95	MP
HAP SENG PLANTATIONS HLDGS	1.98	1,583.4	Y	12/2021	8.4%	4.2%	39.2%	6.5%	22.9	16.4	15.4	0.9	0.9	5.6%	3.5%	2.15	OP
IJM PLANTATIONS BHD	2.07	1,822.8	N	03/2021	24.9%	3.0%	155.9%	-0.2%	52.3	20.5	20.5	1.5	1.5	7.3%	1.9%	1.80	MP
IOI CORP BHD	4.09	25,596.1	Y	06/2021	24.2%	6.2%	23.8%	5.6%	33.8	30.5	23.3	2.7	2.6	10.8%	2.1%	4.55	MP
KUALA LUMPUR KEPONG BHD	22.02	23,749.8	Y	09/2021	11.5%	4.4%	35.6%	9.7%	31.3	23.0	21.0	2.2	2.1	9.2%	2.5%	25.40	OP
PPB GROUP BERHAD	18.70	26,602.6	Y	12/2021	18.4%	11.1%	3.3%	7.9%	20.3	19.7	18.2	1.2	1.1	6.0%	2.1%	20.70	OP
SIME DARBY PLANTATION BHD	4.47	30,774.1	Y	12/2021	14.1%	5.0%	80.5%	5.2%	36.7	20.3	19.3	2.3	2.1	10.8%	2.2%	5.50	OP
TA ANN HOLDINGS BERHAD	2.95	1,299.4	Y	12/2021	6.2%	3.2%	35.0%	10.5%	20.4	15.1	13.7	0.9	0.9	5.8%	3.4%	3.00	MP
TSH RESOURCES BHD	1.23	1,697.6	Y	12/2021	19.8%	1.4%	7.5%	11.3%	23.6	21.9	19.7	1.1	1.0	7.8%	2.0%	1.00	UP
UNITED MALACCA BHD	5.22	1,095.0	Y	04/2021	38.8%	9.1%	72.9%	60.6%	N.A.	32.2	20.1	0.8	0.8	2.6%	1.7%	5.30	MP
Simple Average					15.5%	5.0%	45.7%	12.6%	37.1	22.7	19.4	1.5	1.4	7.2%	2.3%		

Source: Bloomberg, Kenanga Research

19 May 2021

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.**

This document has been prepared for general circulation based on information obtained from sources believed to be reliable but we do not make any representations as to its accuracy or completeness. Any recommendation contained in this document does not have regard to the specific investment objectives, financial situation and the particular needs of any specific person who may read this document. This document is for the information of addressees only and is not to be taken in substitution for the exercise of judgement by addressees. Kenanga Investment Bank Berhad accepts no liability whatsoever for any direct or consequential loss arising from any use of this document or any solicitations of an offer to buy or sell any securities. Kenanga Investment Bank Berhad and its associates, their directors, and/or employees may have positions in, and may effect transactions in securities mentioned herein from time to time in the open market or otherwise, and may receive brokerage fees or act as principal or agent in dealings with respect to these companies.

Published and printed by:

KENANGA INVESTMENT BANK BERHAD (15678-H)

Level 17, Kenanga Tower, 237, Jalan Tun Razak, 50400 Kuala Lumpur, Malaysia
Telephone: (603) 2172 0880 Website: www.kenanga.com.my E-mail: research@kenanga.com.my

