Plantation

Weak Output May Reflect Labour Issues

OVERWEIGHT

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Overview

MPOB July 2022 Highlights

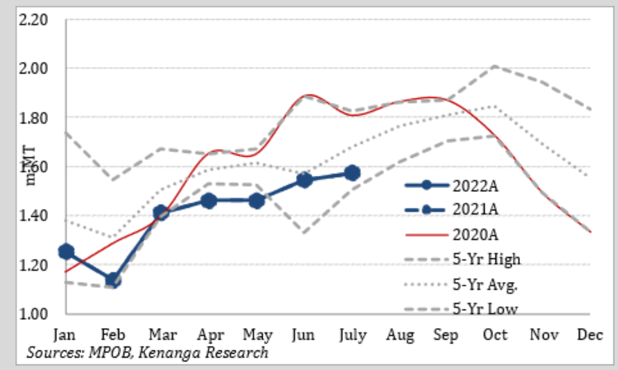
'000 MT	Jul-22	Jun-22	Diff.	MoM %	Jul-21	YoY%
Opening Inventory	**1,655**	**1,522**	**133**	**9%**	**1,614**	**3%**
Production	**1,574**	**1,545**	**28**	**2%**	**1,527**	**3%**
Imports	131	59	71	121%	54	140%
Total Supply	**3,359**	**3,126**	**233**	**7%**	**3,196**	**5%**
Exports	1,322	1,194	128	11%	1,402	-6%
Domestic Usage	265	277	(13)	-5%	296	-11%
Total Demand	**1,586**	**1,471**	**115**	**8%**	**1,698**	**-7%**
Ending Inventory	***1,773***	***1,655***	***118***	***7%***	***1,498***	***18%***
Stock/Usage Ratio	**9.3%**	**9.4%**			**7.4%**	

Source: MPOB, Kenanga

Malaysian July palm oil production came in 6% below Kenanga's estimate but exports were 9% higher in spite of intense competition from Indonesia. Not surprisingly, Malaysia's July inventory ended 6% lower than anticipated but still firmer by 7% MoM and 18% YoY at 1.733m MT. Exports was spurred by CPO prices which corrected from early June till July on aggressive Indonesian selling. However, physical and forward prices have started consolidating around RM4,000/MT levels of late, hence we are keeping our average target price for 2022 CPO at RM4,500/MT and RM4,000/MT for 2023. Moreover, improving edible oils supply is fragile while demand recovery should pick up in 2023. Although CPO prices have likely peaked, earnings and cash flows are resilient. Profit margin and balance sheet are robust. Sector ratings are undemanding and CPO price softness has been largely priced in by the equity market. Altogether, maintain OVERWEIGHT given the sector's defensiveness amidst unclear economic outlook.

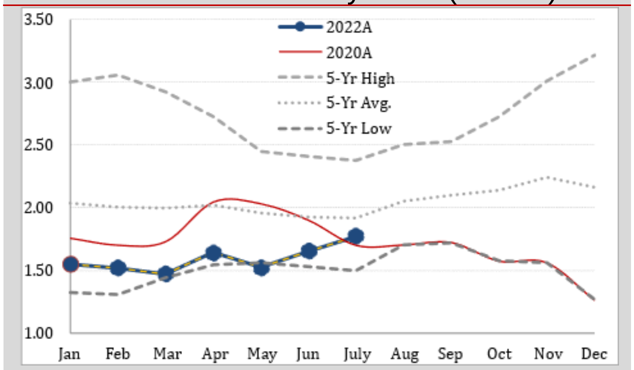
Review: With peak fruiting season approaching, stronger MoM production can be expected; hence, the July production uptick to 1.574m MT (+2% MoM, +3% YoY) is not surprising. As we actually had expected higher July output, the concern here is whether this might portent Malaysia's production challenge due to ongoing labour constraints.

5-Year Monthly Production Trend ('000MT)



Source: MPOB, Kenanga

5-Year Month End Inventory Trend ('000MT)



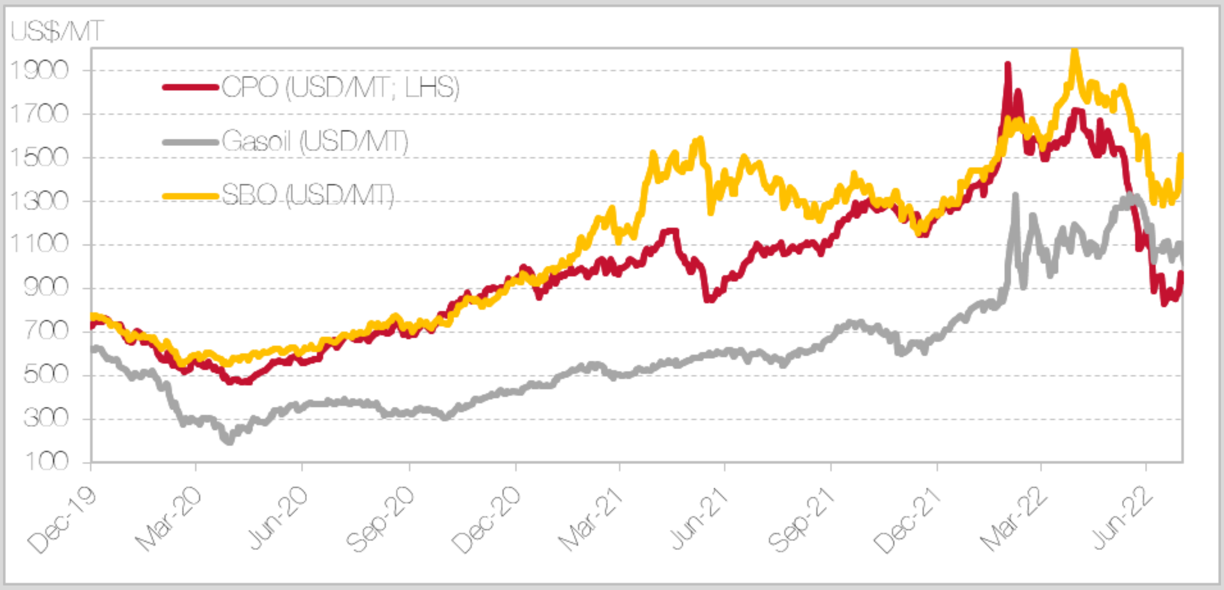
Source: MPOB, Kenanga

Having banned exports for almost a month (28 Apr – 23 May), the lack of storage became an issue in Indonesia. So, since June, it has been trying to boost exports and local usage. Acceleration of exportspermits were announced late May, then export levy was cut on 8 June followed by the removal of exports levy altogether from mid-July. As such, stronger-than-expected July exports of 1.322m MT (+11% MoM, 6% YoY) for Malaysia is surprising, reflecting ready demand once prices reach more attractive levels. Exports to India and Turkiye (Turkey) picked up MoM but China remained disappointingly at the sideline, importing only 55,325 MT (-43% MoM, -67% YoY) from Malaysia in July. End-July inventory levels in India and China were estimated to be >50% and 20-30% below July 2021, respectively. With Deepavali due on 24 Oct, we reckon exports to India will continue to stay buoyant in August and possibly till September.

Although July inventory may have edged up MoM and YoY to 1.773m MT, it still came in 6% below our expectation of 1.876m MT and also below the 5-year average for July, an indication perhaps that while supply is trending up, the overall supply-demand scenario remains tight. Moving forward, demand for palm oil should stay healthy as palm oil prices is now among the most competitive compared to other edible oils while the inventory levels among traditional palm oil buyers such India and China can do with replenishment.

Average CPO price in July was RM4,063/MT (-33% MoM, -2% YoY).

Palm Oil vs Soyabean Oil vs Gasoil Prices (US$/MT)



Source: Bloomberg

MPOB July 2022 Exports Destination Highlights

('000 MT)	Jul-22	Jun-22	MoM%	Jul-21	YoY%	7M22	7M21	YoY%
China	55	96	-43%	166	-67%	621	908	-32%
India	259	171	51%	234	11%	1,656	1,810	-8%
EU	72	124	-42%	213	-66%	851	969	-12%
Pakistan	36	57	-37%	52	-31%	273	357	-23%
Turkiye	104	77	35%	81	29%	541	381	42%
US	28	25	12%	32	-12%	100	163	-39%
Mozambique	20	16	27%	30	-32%	119	158	-25%
Egypt	22	54	-58%	28	-19%	236	86	175%
Others	724	573	26%	567	28%	4,106	3,646	13%
Total	**1,322**	**1,194**	**11%**	**1,402**	**-6%**	**8,503**	**8,477.82**	**0%**

Source: MPOB, Kenanga

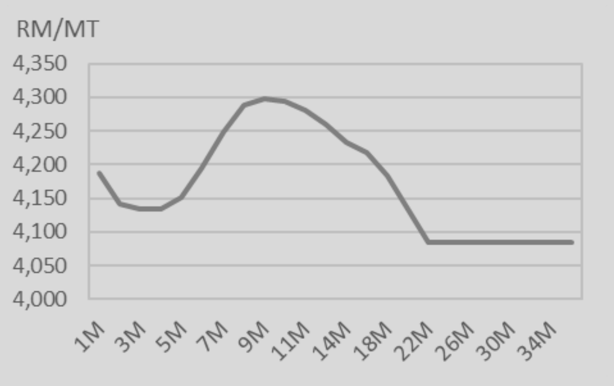
Outlook: Some weaknesses in edible oils price during the 2H is not unusual due to seasonally higher production of two major oil crops - palm and soya. While this seasonal pattern is holding for 2022, this year's 2H output is not likely to be able to fully address the overstretched supply situation. As such, CPO prices should stay firm supported by the following factors:

a) **A good 2023 is needed for supply to fully recover.** Current edible oils tightness began in 2020 when production failed to meet demand. Inventory continued slipping into 2021 but a good 2H 2022 harvest may lift end-2022 inventory. However, to fully address the current supply tightness, a favourable 2023 season is needed.

b) **Demand should recover more strongly in 2023. Ris**ing population and affluence have led to annual demand growth of 3.6% over the past 30 years. However, since 2022, the Covid-19 impact has tempered growth to about 1% but we suspect growth will revert towards 3% come 2023 unless a severe recession takes hold.

c) **Supportive biofuel demand**. Elevated fossil fuel price is supportive of edible oil demand as about 20% of edible oils are processed into biofuel. Indonesia has resumed efforts to blend up to 40% palm (B40) into its biodiesel after halting work earlier due to high palm oil prices. Its current blend is B30.

36-Month Forward Palm Oil Price Curve



Source: Bloomberg, Kenanga

Our thoughts on the sector

Another good set of plantation results can be expected for the coming April–June or 2Q 2022 season. Thereafter, easier earnings are likely but still resilient on expected CPO price of RM4,500 per MT for 2022 and RM4,000 per MT for 2023. With production cost of between RM2,000 to 2,500 per MT, margins for the sector are still healthy.
With CPO prices probably having peaked, the appeal of the plantation sector is more about resilience and defensiveness at this juncture **especially as the economic outlook is unclear and the sector is among the beneficiary of food and energy inflation.**

Forecast for August 2022

'000 MT	Aug-22	MoM	YoY
Opening Inventory	**1,655.1**	**10%**	**110%**
Production	**1,683.7**	**9%**	**98%**
Imports	58.0	-2%	63%
Total Supply	**3,396.8**	**9%**	**103%**
Exports	1,229.7	3%	105%
Domestic Usage	259.3	-6%	102%
Total Demand	**1,489.0**	**-6%**	**5%**
Closing Inventory	***1,907.8***	***8%***	***2%***
Stock/Usage Ratio	10.7%		

Source: MPOB, Kenanga

For investors benchmarked against the Shariah Index, the sector is also unavoidable as the plantation sector accounts for 9.6% by weight in the FBM Shariah Index (and 9.4% in the FBMKLCI). For these reasons, we suggest keeping an OVERWEIGHT on the sector.

A believer and promoter of responsible ESG investing, Kenanga is nevertheless optimistic that palm oil has a bright future. First and foremost, it is impossible to replace palm oil entirely given how pervasive it is in our food chain. It is also very competitive with multiple uses - from high temperature frying oil to shorteners and as a more competitive substitute to some petrochemical products. Its environmental footprint is significantly smaller than other oil crop as it is so much more productive on per Ha basis. Moreover, the sector has successfully managed numerous ESG issues to enjoy some of the highest standards in agriculture.

Our top integrated pick is KLK (OP, TP: RM30.00) which offers strong YoY earnings growth in FY22, a beneficiary of firm prices of edible oils and biofuels with strong balance sheet and track record. We also like mid-caps such as BPLANT (OP, TP RM1.00) and HAPLNT (OP, TP RM3.30) for their generous dividends, and TSH (OP, TP RM1.90) for long-term growth as it seeks to expands its planted area from under 40k Ha to 60-65K Ha over the next 6-8 years.

Peer Comparison

Name	Last Price (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.	1-Yr. Fwd.		
STOCKS UNDER COVERAGE																	
BOUSTEAD PLANTATIONS BHD	0.805	1,803.2	Y	12/2022	30.7%	-27.7%	35.1%	-48.2%	7.4	5.5	10.6	0.7	0.6	24.4%	17.4%	1.00	OP
FGV HOLDINGS BHD	1.51	5,508.7	Y	12/2022	10.9%	-6.1%	-2.2%	-20.9%	4.7	4.8	6.1	1.0	0.9	19.5%	5.3%	2.30	MP
GENTING PLANTATIONS BHD	6.60	5,921.5	Y	12/2022	23.0%	-5.4%	32.1%	-6.2%	14.7	11.1	11.9	1.2	1.1	10.4%	4.2%	9.50	OP
HAP SENG PLANTATIONS HOLDINGS	2.27	1,815.3	Y	12/2022	32.0%	-14.7%	15.0%	-17.2%	9.1	7.9	9.5	1.0	0.9	13.1%	7.9%	3.30	OP
IOI CORP BHD	4.11	25,532.8	Y	06/2022	46.7%	-15.7%	64.6%	-17.5%	23.9	14.5	17.6	2.5	2.3	15.8%	3.2%	4.65	MP
KUALA LUMPUR KEPONG BHD	22.50	24,258.5	Y	09/2022	26.1%	-2.8%	23.4%	-3.3%	14.4	11.7	12.1	2.0	1.8	17.3%	2.4%	30.00	OP
PPB GROUP BHD	16.40	23,330.6	Y	12/2022	12.0%	5.2%	-7.7%	7.9%	15.6	16.9	15.6	1.0	0.9	5.7%	2.4%	15.00	UP
SIME DARBY PLANTATION BHD	4.52	31,259.0	Y	12/2022	19.9%	-13.2%	39.1%	-23.0%	15.5	11.1	14.5	2.1	1.9	17.4%	5.3%	5.25	MP
TA ANN HOLDINGS BHD	3.80	1,673.8	Y	12/2022	17.7%	-6.5%	-7.4%	-3.7%	5.8	6.3	6.6	1.1	1.0	16.3%	7.9%	6.00	MP
TSH RESOURCES BHD	1.07	1,476.8	Y	12/2022	38.4%	-8.9%	11.5%	5.2%	6.8	6.1	5.8	0.9	0.6	34.8%	3.7%	1.90	OP
UNITED MALACCA BHD	5.40	1,132.8	Y	04/2023	1.9%	-1.2%	-5.4%	-14.4%	10.0	10.5	12.3	0.8	0.8	7.6%	2.8%	5.90	MP
Simple Average					**22.9%**	**-6.9%**	**16.3%**	**-9.3%**	**12.1**	**10.1**	**11.2**	**1.4**	**1.2**	**15.8%**	**4.5%**		

Source: Bloomberg, Kenanga Research

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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