Plantation

Supply Recovery to Stay Fragile in CY24

NEUTRAL

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Fragile supply recovery for CY23 may now extend into CY24 on a subdued inventory outlook following smaller-than-expected soyabean surplus in South America. Fortunately, palm oil supply should recover in CY23 with CPO prices likely to stay relatively firm over CY23 and into CY24 unless palm, soy or rapeseed harvests prove exceptionally good later in CY23. We are keeping our CY23F CPO price of RM3,800 per MT intact but revising up CY24F CPO price from RM3,500 to RM3,800 per MT. Positive factors for the sector include: (i) palm oil being an essential food and fuel for markets in emerging economies such as China, India and Indonesia, (ii) players' asset-rich NTA, and (iii) share valuation at 1.1x PBV with a lot of the bad news already priced in. It is also Shariah compliance (9.6% of FBM Shariah Index, 9.4% of FBMKLCI) but we are keeping our NEUTRAL weight intact in the absence of a strong upside catalyst. Our CPO price upgrade for CY24 is a positive but not enough to justify an upgrade. Our sector pick is KLK (OP; TP: RM27.00) and PPB (OP, RM19.30).

Recovery of edible oil supply in CY23 is underway but less robust than expected. Record outlook for a Brazilian soyabean harvest is likely but so is for a very poor Argentinean harvest. While Brazil is the top producer, Argentina is actually more important for international trade, often ranking as the 3rd or 4th largest edible oil exporter in the world after Indonesia, Malaysia and sometimes Russia. Fortunately for the edible oil supply market, palm oil supply should also improve. However, even as supply recovers, demand is also expected to recover, potentially at a faster pace:

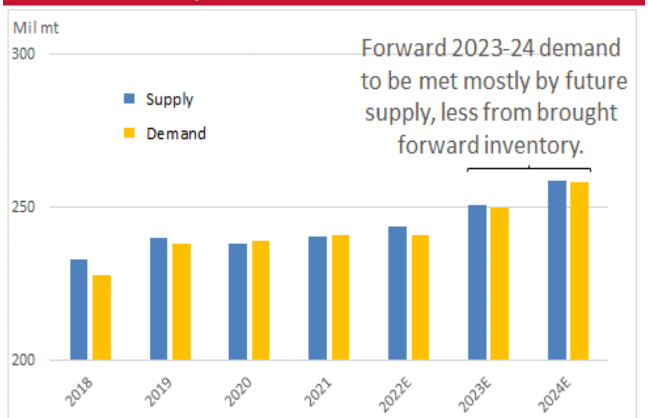
1. **Asia Pacific's demand for food and fuel**. Asia Pacific is the world's biggest market for edible oil. Notable users such as China - the world's no. 1 market - is already consuming almost as much as the EU and US combined while India should surpass the US soon with Indonesia close behind. Demand from the region is also expected get higher on demographic growth and rising affluence. Among the most widely used edible oil in the region is palm oil.
2. **Abundant, affordable and flexible.** Before it overtook soyabean oil to become the leading edible oil by volume around the turn of this century, palm oil used to enjoy premium prices. Commanding around 35% of market share currently and half of all edible oil traded internationally, palm oil is often more affordable than many other alternatives.
3. **Biofuel demand.** Much like the EU, Indonesia's biofuel policy aims to improve energy security and preserve the environment but also to support the rural economy. Today, US and Indonesia are near equal as the 2nd and 3rd biggest biofuel users after EU. Biofuels such as bioethanol is derived from sugar/starch-rich crops (sugarcane or corn) while biodiesel is from edible oils. The main palm-based biodiesel market is Indonesia which just raised its B30 blend to B35 in Feb this year. Brazil also recently raised its soy-based biodiesel B10 blend to B12 last week with B15 as the target by 2026.

With robust demand recovery, we maintain a fragile CY23 supply-demand outlook with firm CPO prices likely. Our present concern is that the tight balance may extend into CY24 on likely smaller-than-expected South American soyabean surplus. Higher palm oil production of 3-5% YoY in CY23 should ease oil supply, even if on a limited scale.

Long Term Edible Oil Demand – Resilient

Source: Oil World, FAO, Kenanga Research

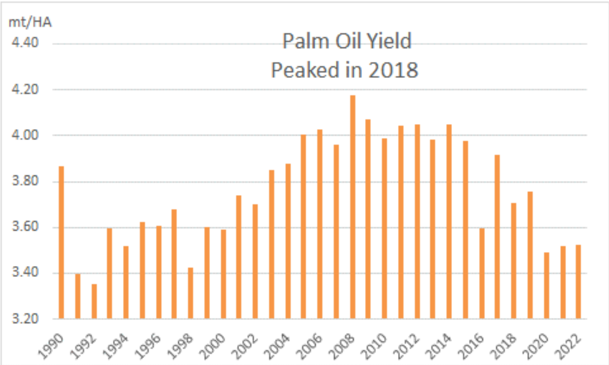
Covid Has Dampened Demand Growth



Source: Oil World, FAO, Kenanga Research

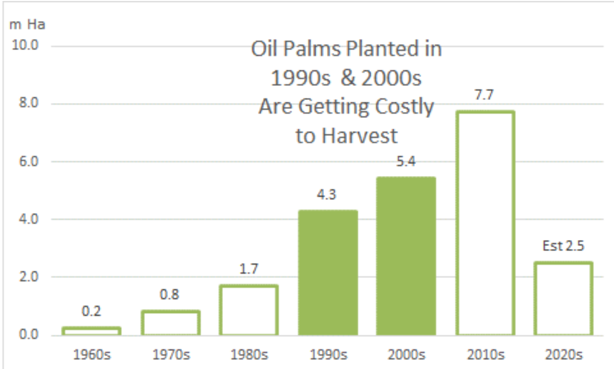
Nevertheless, easing labour shortfall in Malaysia should help nudge FFB up by 1-2m MT YoY. Longer term, the growth for palm oil looks less rosy. Expansion in the form of new oil palm planting is slowing due to tighter regulations. Indonesia, which has 15m Ha area of oil palm trees has only 3-4m Ha left for the crop while Malaysian oil palm area has been contracting even before reaching a voluntary cap of 6.5m Ha. This implies fewer young and prime palms over the coming years while palms planted in the 1990s and 2000s are growing older and taller, slowing down harvest, lowering FFB yield and pushing up costs. Replanting will eventually be necessary leading to a production pause for 3-5 years.

CPO Yield Still Trending Down



Source: Oilworld, Kenanga Research

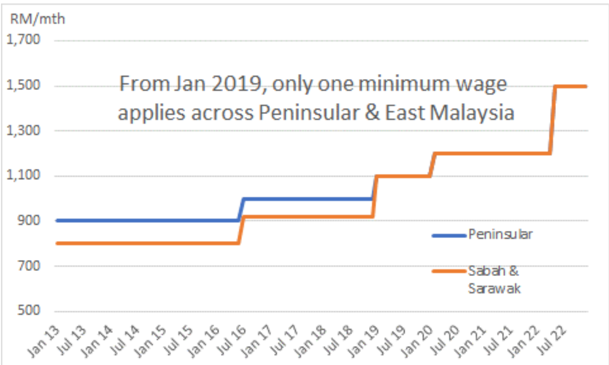
Sizeable Replanting Ahead



Source: Kenanga Research

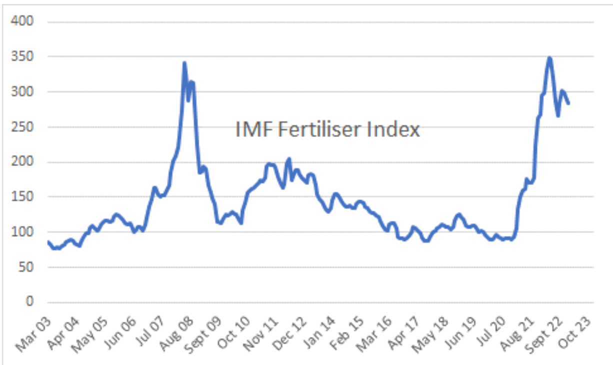
Cost is easing but still elevated and sticky. Fertiliser cost has eased by around 20% from the peak in 2QCY22 but wage increase will need time to be absorbed, mainly by improving productivity through better planting material, mechanisation and/or field operations. Meanwhile for CY23, cost inflation will be negated in part by recovering FFB yields among some Malaysian planters as the workers shortage eases. Overall, CPO production cost is estimated to have risen from RM2,000 (or less) in CY21 to RM2,000-2,500 per MT for CY23.

Minimum Wage Hikes in Malaysia



Source: Kenanga Research

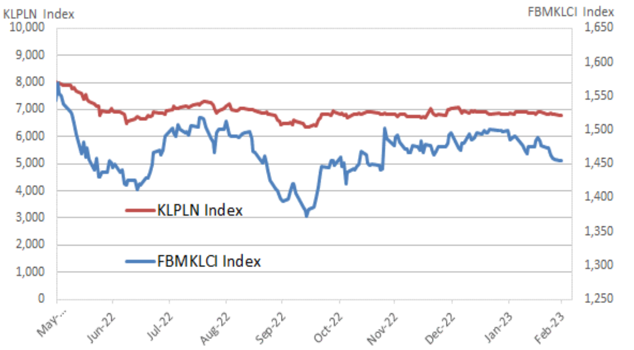
Elevated Fertiliser Prices Despite Easing



Source: IMF, Kenanga Research

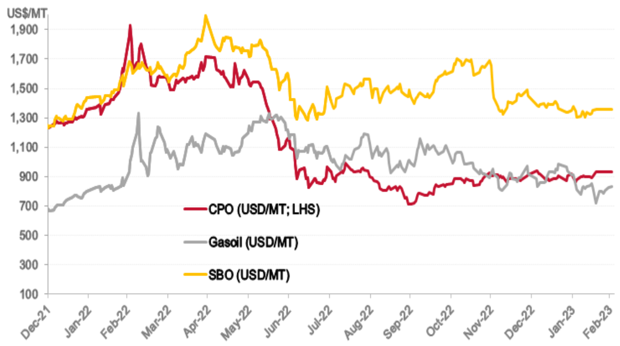
Defensive demand, balance sheet and ratings. The plantation sector is currently already trading close to book value which is often understated as many players hold estates which are worth more than their reported value. Gearing is not excessive either with some holding net cash. Although costs have risen resulting in tighter margins, they are still decent overall and palm oil is also an essential consumable (as food and fuel), popular with emerging economies. The sector is also Shariah compliant (9.6% of FBM Shariah Index, 9.4% of FBMKLCI). However, there is no strong upside catalyst even though the sector is highly defensive and ratings are far from demanding. Sector consolidation is a possible upside but best evaluated on a case-by-case basis. **Maintain NEUTRAL with KLK (OP, TP RM27.00) as our sector pick** given its track record, efficient upstream operations and strong regional presence. Thanks to non-oil palm agribusiness, consumer and FMCG contributions, **PPB (OP, RM19.30)** should see earnings bottoming out earlier than peers. **TSH (OP; TP: RM1.35)** is set to expand its planted area from 40k Ha to 60k-65k Ha after paring net debt from RM816m in FY21 to RM179m for FY22 (9% net gearing). **HSPLANT (OP; TP: RM2.30)** offers pure upstream exposure with strong net cash holdings and decent dividend yields prospects.

KLCI vs KL Plantation Index



Source: Bloomberg, Kenanga Research

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



Source: Bloomberg, Kenanga Research

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Peer Table Comparison

Name	Rating	Last Price @ 15 Sept (RM)	Target Price (RM)	Upside (%)	Market Cap (RM'm)	Shariah Compliant	Current FYE	Core EPS (sen)		Core EPS Growth		PER (x) - Core Earnings		PBV (x)	ROE (%)	Net. Div. (sen)	Net Div Yld (%)
								1-Yr. Fwd.	2-Yr. Fwd.	1-Yr. Fwd.	2-Yr. Fwd.	1-Yr. Fwd.	2-Yr. Fwd.	1-Yr. Fwd.	1-Yr. Fwd.	1-Yr. Fwd.	1-Yr. Fwd.
PLANTATION																	
FGV HOLDINGS BHD	MP	1.61	1.40	-13.04%	5,873.5	Y	12/2023	23.8	23.9	-38.6%	0.3%	6.8	6.7	0.9	13.3%	8.0	5.0%
GENTING PLANTATIONS BHD	MP	5.88	5.50	-6.46%	5,275.5	Y	12/2023	40.9	41.8	-21.9%	2.1%	14.4	14.1	0.9	7.0%	20.0	3.4%
HAP SENG PLANTATIONS HOLDINGS	OP	1.80	2.30	27.78%	1,439.4	Y	12/2023	19.2	20.1	-25.0%	4.8%	9.4	9.0	0.7	7.8%	12.0	6.7%
IOI CORP BHD	MP	3.82	4.20	9.95%	23,711.4	Y	06/2023	26.8	21.2	-7.6%	-20.8%	14.3	18.0	2.2	15.7%	14.0	3.7%
KUALA LUMPUR KEPONG BHD	OP	20.80	27.00	29.81%	22,431.5	Y	09/2023	171.6	168.4	-10.5%	-1.9%	12.1	12.4	1.5	13.1%	50.0	2.4%
PPB GROUP BHD	OP	16.52	19.30	16.83%	23,501.4	Y	12/2023	122.8	136.4	-19.5%	11.1%	13.5	12.1	0.8	6.6%	45.0	2.7%
SIME DARBY PLANTATION BHD	UP	4.22	3.65	-13.51%	29,184.3	Y	12/2023	24.3	23.8	-17.8%	-2.1%	17.4	17.7	1.7	10.0%	16.0	3.8%
TA ANN HOLDINGS BHD	MP	3.18	3.90	22.64%	1,400.7	Y	12/2023	41.7	42.5	-45.9%	2.0%	7.6	7.5	0.8	10.4%	25.0	7.9%
TSH RESOURCES BHD	OP	1.01	1.35	33.66%	1,394.0	Y	12/2023	12.4	12.1	-39.5%	-2.1%	8.2	8.4	0.6	14.6%	3.0	3.0%
UNITED MALACCA BHD	MP	5.36	5.00	-6.72%	1,124.4	Y	04/2023	41.1	40.4	-25.6%	-1.7%	13.0	13.3	0.8	5.6%	15.0	2.8%
Sector Aggregate					**115,336.0**					**-19.6%**	**-2.4%**	**13.1**	**13.5**	**1.1**	**10.4%**		**4.1%**

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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