Plantation

2QCY23 Report Card: Stabilising

NEUTRAL

↔

By Teh Kian Yeong I tehky@kenanga.com.my

There was a marked improvement in earnings delivery (against our expectations) by the sector in the recently-concluded 2QCY23 results season, vs. the washout in the preceding quarter. Looking ahead, firm crude palm oil demand and prices, seasonally higher harvest and lower input cost are coming together to provide a more conducive environment for better 2H earnings. Although US-based NOAA latest update on 14 Sept still fell short of raising the severity of the pending El Nino beyond "strong", possibility of stronger crude palm oil prices cannot be ruled out. We are keeping our CY23-24F CPO price of RM3,800 per MT as well as our NEUTRAL weighting due to the absence of strong re-rating catalyst. Otherwise, the sector is highly defensive as palm oil is essential in today's food chain. Our sector top picks are KLK (OP; TP: RM24.50) and PPB (OP; TP: RM19.30) in the sector.

There was a marked improvement in earnings delivery (against our expectations) by the sector in the recently-concluded 2QCY23 results season, vs. a washout in the preceding quarter, with 10%/50%/40% coming in above/within/below our forecasts, vs. 11%/89% coming in above/below in the preceding quarter (see table below).

A difficult 1H. Whilst CPO traded between RM3,500 to RM4,000 per MT for the past six months, the first quarter earnings disappointed as input costs shot up as some production remained disrupted by lingering labour shortfall. Consequently, earnings expectations were cut. Despite first quarter earnings downgrade, the recent second quarter earnings still proved disappointing. 2QCY23 edible oil prices, including CPO, were unusually weak and palm oil production stayed costly with downstream operations in loses or barely profitable.

Second half prospects should brighten. Thanks to a combination of higher production, lower input costs and relatively firm selling prices, plantation earnings should fare better in the 2H of 2023. Historically, about 55% of annual crude oil palm is harvested in the second half of the calendar year with Sept or Oct (occasionally in Nov or Aug) registering the best monthly output. This translates to 20% more output in the 2H to absorb relatively higher fixed estate cost compared to 1H.

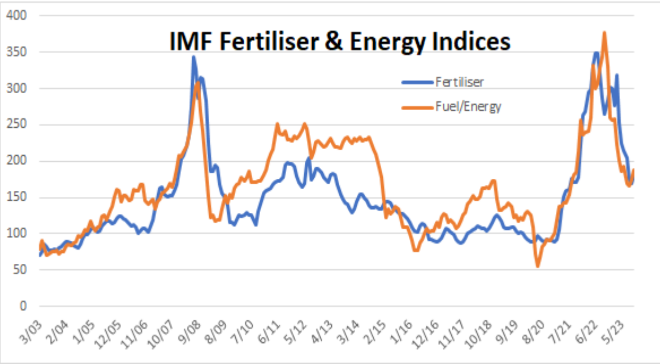
Input costs, such as fertiliser and diesel have also eased YoY. Fertiliser cost is about 40% below the peak in 2QCY22 but still 50% above the 10-year average. The energy cost has eased as well but higher wages will stay sticky. Palm kernel (PK), a side product of milling FFB to extract CPO, is sold to help offset CPO production cost. While CPO is mostly consumed (70%) as food, hence more resilient demand, PK ends up in personal care, cosmetics and industrial products which are currently facing slower off-take due to overstocking during the pandemic as well slower economic outlook. Consequently, recent PK oil (PKO) prices have been trading more or less at par with CPO prices instead of at the normal 20%−30% premium. In turn, PK sale proceeds used to lower CPO production cost have shrunk. PK and PKO inventories should eventually adjust but this will occur more likely in 2024 rather than this year..

Quarterly Results performance

	2QCY23						1QCY23					
	KENANGA			CONSENSUS			KENANGA			CONSENSUS		
	Above	Within	Below	Above	Within	Below	Above	Within	Below	Above	Within	Below
BPLANT			1			1		0			0	
GENP		1				1			1			1
HSPLANT			1			1			1			1
IOI		1			1				1		1	
KLK		1				1			1			1
PPB		1				1			1			1
SIMEPLNT	1					1			1			1
TAH		1				1			1			1
TSH			1			1	1			1		
UMCCA			1			1			1			1
Total	**1**	**5**	**4**	**-**	**1**	**9**	**1**	**-**	**8**	**1**	**1**	**7**
Total (%)	**10**	**50**	**40**	**-**	**10**	**90**	**11**	**-**	**89**	**11**	**11**	**78**

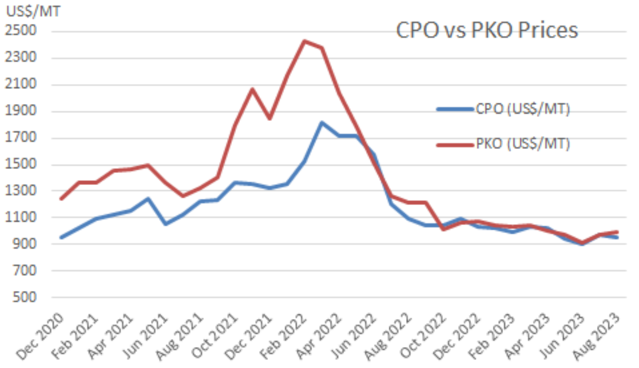
Source: Kenanga Research, Bloomberg, Bursa Malaysia

Lower Fertiliser & Energy Costs But Still High



Source: Kenanga Research

Unusually Low PKO Prices Since Mid-2022



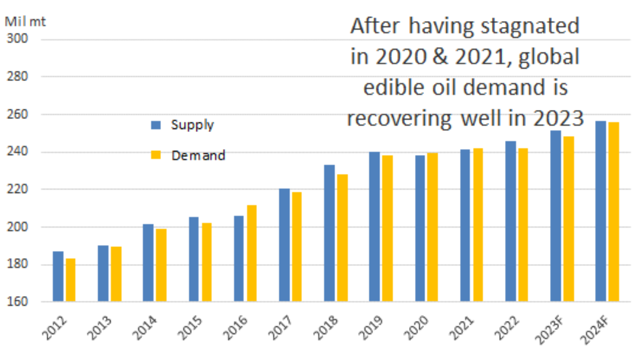
Source: IMF, Kenanga Research

Palm oil prices have been trading range bound for much of 2023 and are likely to stay so for the rest of the year. Unless the pending El Nino turns out more severe than forecasted, we expect CPO prices to average RM3,800 per MT over 2023 and 2024 from healthy demand on the back of the following:

1. **Growing Asia Pacific's food intake**. Underpinned by demographic growth and rising affluence, Asia Pacific is the world's leading market for edible oils. China's intake alone is almost 1.5x that of EU, the second largest market while India and Indonesia are in the midst of surpassing the US. Importantly, palm oil is king in the Asia Pacific.
2. **Abundant and affordable.** Palm oil's dominance is underpinned by its price competitiveness and availability throughout the year. About half of all the edible oils traded internationally are palm oil. It is not just widely available and more affordable but palm oil is also flexible, including being turned into biodiesel.
3. **Biofuel demand.** Indonesia has adopted a biofuel policy, akin to the EU, to improve energy security and the environment whilst concurrently supporting its rural economy. Today, Indonesia is the 3rd biggest biofuel market after the EU and US. More importantly, Indonesia is the single largest palm-based biodiesel market in the world.

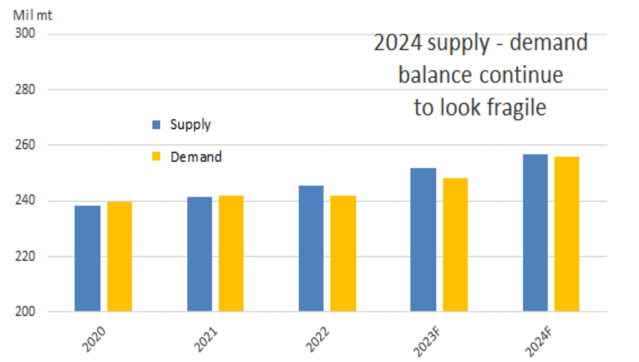
With a robust demand, 2024 supply-demand balance continue to look delicate.

Long-term Edible Oil Demand Is Growing Again



Source: Oil World, FAO, Kenanga Research

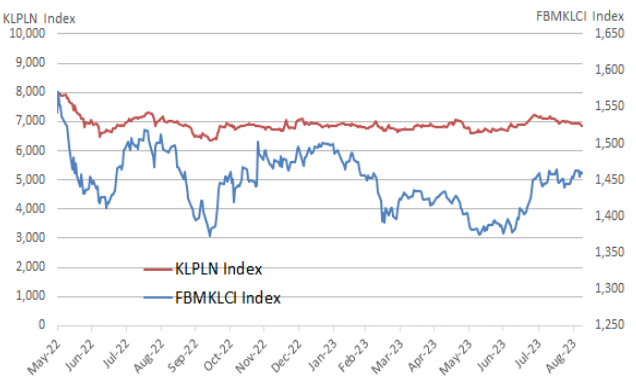
Covid Has Dampened Demand Growth



Source: Oil World, FAO, Kenanga Research

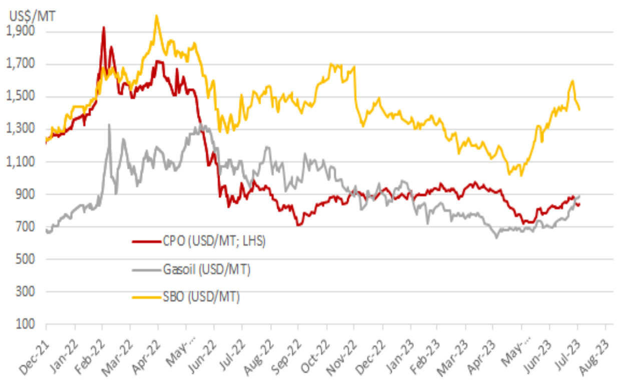
Higher likelihood of El Nino but severity has yet to worsen, so far. Upstream as well as downstream plantation earnings were weak in 1HCY23. Upstream earnings should improve in upcoming 2H from seasonally higher output, softer input costs and firm crude palm oil prices. With demand for crude palm oil remaining robust and growing, earnings may bottom out in 2023 or 2024 on CPO price of RM3,800 per MT. Sector gearing is also manageable. Even KLK, which is offering to buy up to 65% of Boustead Plantations should not see its net gearing exceeding 60%. The sector is also Shariah compliant but the sector lacks a strong upside catalyst. A very severe El Nino may trigger crude palm oil to trade at higher prices but, so far, in its latest 14 Sept 2023 update, US-based NOAA have raised the odds of an El Nino occurring but continues to maintain the severity as "strong" (rather than "very strong" or "moderate"). **Maintain NEUTRAL on KLK (OP; TP: RM24.50) as our sector pick** given its track record, efficient upstream and strong regional presence. Its recent general offer for Boustead Plantations is also fairly priced even after factoring the urgent replanting need of some of the latter's estates. We also like **PPB (OP; TP: RM19.30)** for its strong market niches in selected regional consumer and FMCG exposure**.**

KLCI vs KL Plantation Index



Source: Bloomberg, Kenanga Research

Palm Oil vs. Soyabean Oil vs. Gasoil Prices (USD/MT)



Source: Bloomberg, Kenanga Research

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																	
BOUSTEAD PLANTATIONS BHD	AO*	1.49	1.50	-57.0%	3,337.6	Y	12/2023	2.0	3.1	-85.5%	53.1%	73.8	48.2	1.2	1.6%	8.0	5.4%
GENTING PLANTATIONS BHD	MP	5.21	5.50	5.6%	4,674.4	Y	12/2023	25.2	26.9	-51.8%	6.5%	20.6	19.4	0.8	4.2%	13.0	2.5%
HAP SENG PLANTATIONS HOLDINGS	MP	1.87	1.80	-3.7%	1,495.4	Y	12/2023	10.6	11.8	-58.4%	10.7%	17.6	15.9	0.8	4.4%	7.0	3.7%
IOI CORP BHD	MP	4.08	3.80	-6.9%	25,311.1	Y	06/2024	24.6	24.7	1.4%	0.1%	16.6	16.5	2.3	14.5%	11.0	2.7%
KUALA LUMPUR KEPONG BHD	OP	21.72	24.50	12.8%	23,423.6	Y	09/2023	118.3	155.7	-38.6%	31.6%	18.4	14.0	1.6	7.8%	50.0	2.3%
PPB GROUP BHD	OP	15.88	19.30	21.5%	22,590.9	Y	12/2023	75.0	114.3	-50.8%	52.4%	21.2	13.9	0.8	4.1%	45.0	2.8%
SIME DARBY PLANTATION BHD	UP	4.40	3.65	-17.0%	30,429.1	Y	12/2023	11.2	10.7	-62.3%	-4.3%	39.5	41.2	1.8	5.0%	8.0	1.8%
TA ANN HOLDINGS BHD	MP	3.40	3.40	0.0%	1,497.6	Y	12/2023	32.8	34.4	-65.5%	4.6%	10.4	9.9	0.8	8.2%	25.0	7.4%
TSH RESOURCES BHD	MP	1.00	1.00	0.0%	1,380.2	Y	12/2023	4.2	6.3	-79.6%	51.6%	24.0	15.8	0.7	6.5%	1.0	1.0%
UNITED MALACCA BHD	MP	5.04	5.00	-0.8%	1,057.2	Y	04/2024	29.7	36.4	1.0%	22.4%	16.9	13.8	0.7	4.4%	12.0	2.4%
Sector Aggregate					**120,268.1**					**-48.5%**	**19.9%**	**21.3**	**17.8**	**1.1**	**6.4%**		**3.2%**

**AO – Accept offer price of RM1.50*

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.

Published 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