Plantation

Downstream A Drag

NEUTRAL

↔

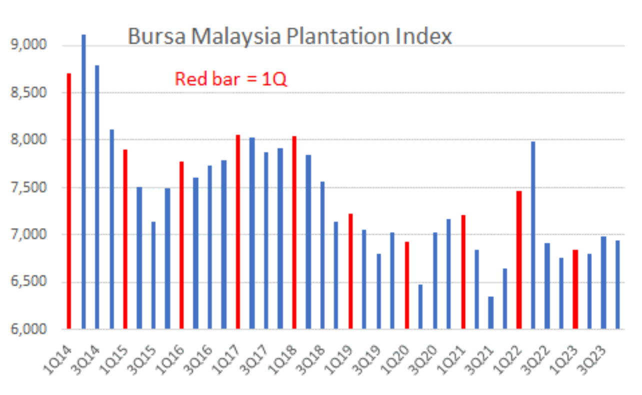
By Teh Kian Yeong I tehky@kenanga.com.my

We maintain our average CPO price assumption of RM3,800/MT in CY24. YTD equity performance of the plantation sector is divided—flat for the large integrated players while smaller, more upstream-centric players nudged up the Bursa Malaysia Plantation Index (BMPI) by 3%. Poor downstream margins are likely to continue to drag down earnings of large integrated players for another quarter or two. Nevertheless, the sector remains defensive given the inelastic demand for palm oil. Many have rich asset-backed balance sheets and the sector is Shariah compliant. Valuations are not demanding (1.2x PBV, 16x PER) but there is no substantial upside catalyst either. Stay NEUTRAL.

Bursa Malaysia Plantation Index (BMPI) has risen 3% QoQ, largely mirroring past intra-year pattern. YTD, the BMPI has inched up 3% above 4QCY23. This is quite in line with past trends where BMPI ticks up in 1Q then turns softer come 3Q. On a 10-year basis, the BMPI is 4% higher QoQ on the average during 1Q. The current YTD 3% increase is thus very much within the historical range. Underpinning such BMPI intra-year trading pattern is, to a large degree, due to the price movement of edible oil, including palm oil.

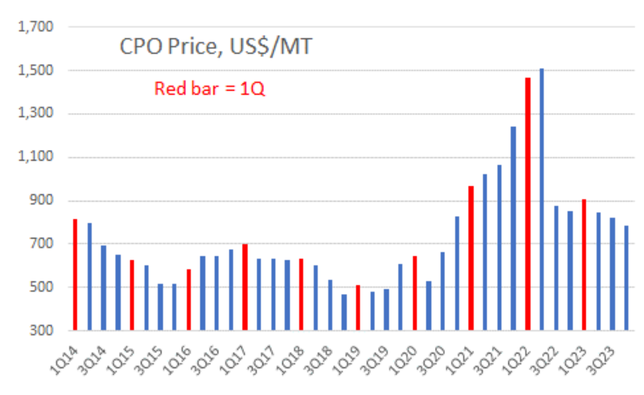
Globally, edible oil prices tend to be firmer in the 1H compared to 2H. We maintain our average CPO price assumption of RM3,800/MT in CY24. Prices are also usually firmer in 1Q and weakest in 3Q due mainly to the 3Q harvests of four major oil crops which make up 70%-80% of the world's edible oil production - palm, soya, rapeseed and sunflower. Of these crops, prices of soya bean oil tend to have lower volatility - probably due to the crop having two substantial harvests each year - 2Q in the southern hemisphere (mainly in Brazil) and 3Q in the north (mainly in US). On the other hand, palm oil prices tend to face more pronounced swings. Partly, its production peaks only once a year (in 3Q) but also it is the most widely traded edible oil in the world, subjecting the prices to various external factors, from geopolitical tension to supply chain disruption or weather uncertainties which affect other oil crops.

Bursa Plantation Index Often Fare Better in 1Q



Source: Bloomberg, Kenanga Research

1Q CPO Prices Also Tend To Be Good



Source: MPOB, Kenanga Research

Smaller players in BMPI are faring better YTD. Recent earnings of the "Big 3" large, integrated players – **IOI (MP; TP: RM3.80), KLK (MP; TP: RM23.00)** and **SIMEPLT (MP; TP: RM4.00)** – suffered as poor downstream margins dragged down otherwise decent upstream performance. Not surprisingly, the sector's smaller to mid-sized plantation players, which are more upstream centric, are outpacing their larger peers.

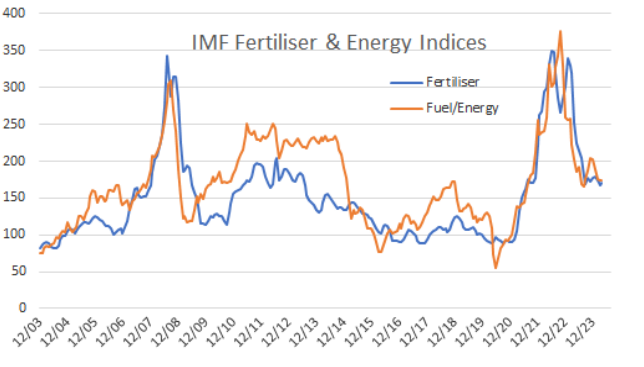
Upstream earnings look set to stay key. We expect upstream margins to improve, albeit slight, over CY24-25 on the back of firm but flattish CPO prices amidst easier operating cost environment:

a. **Firm but flattish CPO prices.** Global balance of edible oil is expected to stay tight in CY24, potentially up to mid-CY25. Supply is expected to just about meet demand in CY24 with risk of even coming short. Therefore, CY25 is expected to start the year with lower YoY inventory levels or flattish at best. While tighter inventory is supportive of even higher prices, it is a tightening from above-trend level in CY23 towards the longer-term average; hence, our assumptions of firm but flattish CPO price of RM3,800/MT over CY24-25.

b. **Production cost should ease** as global fertiliser and fuel costs have been trending down since mid-CY23. Nevertheless, Jan-Feb CY24 prices are still 5-10% lower compare to 4QCY23 (15-35% lower YoY). However, minimum wages in Malaysia may be raised by 5-10% given the cumulative official inflation of 6% over CY22-23.

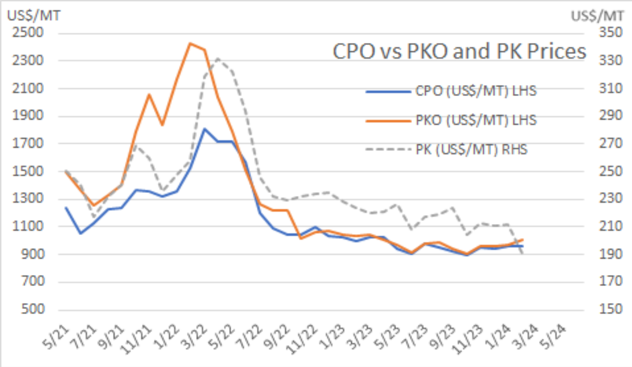
c. **Palm kernel (PK) prices may be approaching the bottom**. Although Feb 2024 PK prices weakened, palm kernel oil (PKO) prices picked up. While it is still too early to conclude this uptick is a trend, it is encouraging as we are expecting some restocking to nudge up oleochemicals demand as 2HCY24 approaches. If PKO demand picks up, the buying for PK would eventually tick up as well.

Fertiliser & Energy Prices Are Still Easing



Source: MPOB, Kenanga Research

PK & PKO Prices Could Be Near The Bottom



Source: IMF, Kenanga Research

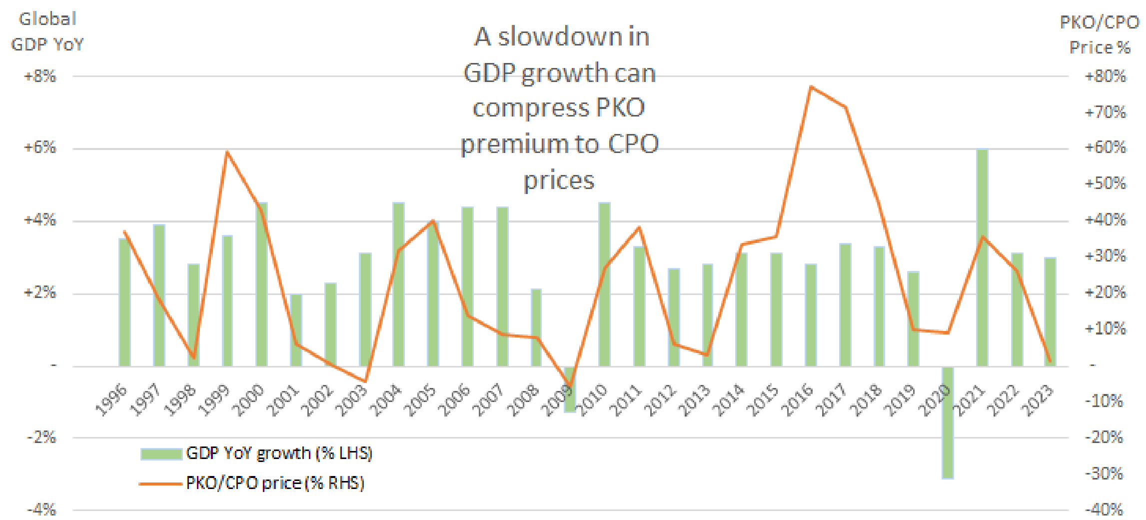
Downstream margins likely to stay weak for another quarter or two. We expect a mixed outlook for downstream, poor for basic, more commoditised oils and fats (e.g. basic refining) as well as basic oleochemicals (such as fatty acids and fatty alcohols). Specialty or performance specific oils and fats such as cocoa butter equivalent or customised oleochemicals to meet specific pharmaceutical for example should continue to enjoy better margins even if the broader market is soft as volume for specialty products can be small.

Palm kernel oil prices may be bottoming but sustainable recovery may still need time. The earliest beneficiary is the upstream sector then only the downstream oleochemical segment as and when the world economic outlook brightens.

A byproduct of milling FFB to extract CPO, PK is sold and the proceeds applied to reduce CPO production cost. Consequently, the first to benefit from higher PK prices is upstream. Meanwhile, PKO is an important oleochemical input so higher PKO prices means higher cost to oleochemical producers until their end-product selling prices can be raised.

Our current expected scenario, is for the oleochemical sector to undergo some restocking; thus, raising the demand for PKO and hence eventually the requirement for PK as well. However, the underlying oleochemical market may need a brighter global economic outlook before any meaningful demand and hence selling price hikes can be sustained. Such recovery may have to wait till CY25 or beyond.

Current PKO Price Parity to CPO Suggests PKO Prices May Be Bottoming



Source: World Bank, Oilworld, Kenanga Research

Defensive, undemanding ratings but upside catalyst remains elusive. Although the plantation sector's quarterly earnings can be volatile, the sector is defensive as palm oil is essential in the global food and biofuel chain. Sector gearing is also manageable to very strong, upstream operations are cashflow generative and many planters operate on very valuable landbanks. Trading at just 1.2x PBV, and Shariah compliant, the sector's downside looks limited but a substantial upside catalyst is still elusive. Maintain **NEUTRAL.**

Within the sector, we prefer growth over yields, hence PPB (OP; TP: RM18.50) is attractive given its own and associate's Wilmar agribusiness in SE Asia, China and India. After aggressive asset divestments over FY22-FY23 to cut debts, **TSH (OP; TP: RM1.30)** is now preparing to develop and plant up 8k-10k Ha (or an expansion of 25-30%) of oil palm on land it already owns.

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																	
GENTING PLANTATIONS BHD	MP	6.13	6.00	-2.1%	5,499.6	Y	12/2024	33.9	36.1	21.0%	6.4%	18.1	17.0	1.0	5.6%	21.0	3.4%
HAP SENG PLANTATIONS HOLDINGS	MP	1.92	2.00	4.2%	1,535.4	Y	12/2024	12.8	13.1	13.0%	2.9%	15.0	14.6	0.8	5.1%	7.0	3.6%
IOI CORP BHD	MP	3.98	3.80	-4.5%	24,690.7	Y	06/2024	20.0	23.0	-17.9%	14.9%	19.9	17.3	2.2	12.1%	11.0	2.8%
KUALA LUMPUR KEPONG BHD	MP	22.02	23.00	4.5%	24,142.8	Y	09/2024	113.3	138.8	50.6%	22.5%	19.4	15.9	1.6	8.2%	50.0	2.3%
PPB GROUP BHD	OP	15.50	18.50	19.4%	22,050.3	Y	12/2024	115.9	137.1	44.0%	18.3%	13.4	11.3	0.8	5.8%	45.0	2.9%
SIME DARBY PLANTATION BHD	MP	4.34	4.00	-7.8%	30,014.2	Y	12/2024	16.6	18.8	30.1%	13.5%	26.2	23.0	1.7	6.6%	15.0	3.5%
TA ANN HOLDINGS BHD	MP	3.97	4.00	0.8%	1,748.6	Y	12/2024	40.9	43.5	3.5%	6.2%	9.7	9.1	1.0	10.0%	25.0	6.3%
TSH RESOURCES BHD	OP	1.13	1.30	15.0%	1,559.6	Y	12/2024	7.2	7.4	29.2%	3.7%	15.7	15.2	0.8	10.3%	3.0	2.7%
UNITED MALACCA BHD	MP	5.01	5.00	-0.2%	1,050.9	Y	04/2024	21.7	29.0	-34.2%	33.3%	23.1	17.3	0.7	2.7%	12.0	2.4%
Sector Aggregate					**112,292.2**					**19.5%**	**16.2%**	**18.7**	**16.1**	**1.2**	**7.4%**		**3.3%**

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