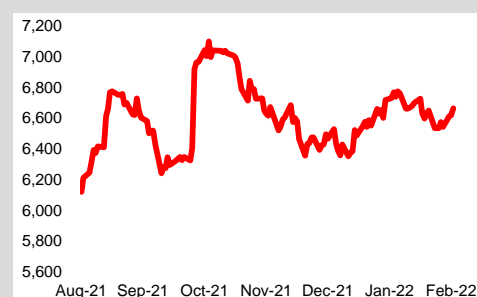


**PLANTATIONS**
**Overweight**
**KL PLANTATION INDEX**

**SECTOR PERFORMANCE**

	1M	3M	6M
Absolute Returns	-1.4	-1.3	9.5

**RECOMMENDATION TABLE**

	Current (RM)	Target (RM)	Upside (%)	Call
FGV	1.75	1.71	-2.3	N
GENP	8.50	9.02	6.1	N
IOI	4.33	4.67	7.9	N
KLK	26.60	31.05	16.7	O
SPB	2.84	4.27	50.4	O
SIMEPLT	4.91	5.09	3.7	N
Ta Ann	4.77	5.96	24.9	O
TSH	1.34	1.81	35.1	O

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**A Super-Cycle for the Palm Oil Industry**

The palm oil industry witnessed an unprecedented super-cycle with CPO futures topping RM6,000/mt yesterday for the first time. We turn bullish on the sector as we expect a strong earnings trajectory for the plantation companies. We think CPO prices will remain strong in the first half of 2022 given the tight global vegetable oil supplies and also supply constraint for palm oil in the top two producing countries. Hence, we revise up our CPO price assumption from RM3,500/mt to **RM4,300/mt and RM3,800/mt** for 2022 and 2023, respectively. Our preferred exposures are Sarawak Plantation and Ta Ann as we believe they can fully capture the current CPO price rally. Upgrade from Neutral to **Overweight** for the sector.

- § **Tightening supply ahead of Ramadan celebration.** Malaysian palm oil industry started off 2022 with low carry-over stocks, standing at 1.61m mt. As 1H is the seasonal low production period coupled with the growing demand ahead of the Hari Ramadan festive period, palm oil inventory is expected to remain tight in the near-term.
- § **Prefer pure upstream players in Malaysia.** Following our upward CPO price revision, we raise our FY22-24 EPS forecast by 25%-65% for the plantation companies under our coverage. Our top picks are Malaysian upstream players, namely, Sarawak Plantation and Ta Ann as their recorded CPO prices are more reflective of the current CPO prices in Malaysia given that they are not subject to the steep discount in Indonesia and majority of their CPO sales based on spot pricing.
- § **Raising CPO price forecasts.** In view of the stronger-than-expected CPO price performance, we revise up our 2022 CPO price forecast from RM3,500/mt to RM4,300/mt. For 2023, we raise our CPO price forecast from RM3,500/mt to RM3,800/mt. We think CPO price will remain strong in the 1H of 2022. Thereafter, CPO prices should ease as we expect production to increase when the foreign workers start returning to Malaysia.

**FINANCIAL SUMMARY**

Company	Price (RM) @17 Feb	Mkt Cap (RMm)	EPS (sen)		EPS Growth (%)		P/E (x)		P/B (x)		ROE (%)		Dividend Yield (%)	
			2022F	2023F	2022F	2023F	2022F	2023F	2022F	2023F	2022F	2023F	2022F	2023F
FGV	1.75	6,384.4	13.3	12.4	10.0	-6.7	13.2	14.1	1.3	1.3	24.4	13.1	3.8	3.5
Genting Plantations	8.50	7,624.5	50.6	46.5	4.1	-8.1	16.8	18.3	1.5	1.4	8.6	7.0	3.8	3.4
IOI Corp	4.33	27,209.7	30.1	24.5	35.0	-18.8	14.4	17.7	3.3	3.1	14.2	12.7	3.5	2.8
KL Kepong	26.60	28,329.0	209.8	172.2	33.8	-17.9	12.7	15.4	2.2	2.1	11.6	10.2	3.8	3.8
Sarawak Plantation	2.84	792.4	35.7	28.4	8.8	-20.0	8.0	10.0	1.1	1.0	14.4	10.6	3.5	3.5
Sime Darby Plantations	4.91	33,800.4	29.6	25.5	10.0	-13.8	16.6	19.3	1.8	1.8	12.8	8.9	3.1	2.7
Ta Ann	4.77	2,120.7	56.8	42.0	8.2	-26.0	8.4	11.4	1.2	1.1	14.3	9.2	2.1	2.1
TSH Resources	1.34	1,850.5	14.0	12.0	14.0	-14.3	9.6	11.2	1.0	1.0	11.8	7.9	0.8	0.8

Source: Public Invest Research estimates

*Supply constraint from Indonesia is causing a steeper discount to Malaysian CPO prices*

*Worker shortage issue continue plaguing the production in Malaysia*

*Low single-digit FFB production growth from the top two producing countries*

§ **Supply limit by Indonesia.** Indonesia has imposed a new rule that makes it mandatory for local palm oil producers to sell 20% of their output to domestic refiners at fixed prices. The Domestic Market Obligation requirement comes as the global largest palm oil producer is in a bid to curb a rise in domestic cooking oil prices that have climbed about 40% YoY. Indonesian authorities have imposed a mandate, which requires 20% of the palm oil exports to be sold domestically at a price ceiling of 9,300 rupiah (USD0.65)/kg for CPO and 10,300 rupiah (USD0.72)/kg for palm olein. The capped prices will see palm oil products to be sold domestically at steep discounts of RM2,715/mt for CPO and RM3,024/mt for palm olein. It is worth noting that Malaysian CPO and palm olein prices currently stand at RM5,700/mt and RM5,717/mt, respectively. The trade ministry expects the new policy to remain until cooking oil prices return to a stable condition like before. With the new restrictive policy in place, there will be a cut in Indonesian palm oil exports in the subsequent months as about 6.6m mt or 12% of palm oil supplies will be wiped out from the global export markets. This should result in further tightening of global palm oil supply, which is already affected by the lack of new planting activities in recent years.

§ **No sign of incoming foreign workers.** Though Malaysian government has agreed to bring in 32,000 foreign plantation workers to ease the acute worker shortage in the harvesting field, our channel checks reveal that there are no signs of incoming foreign workers. No Memorandum of Understanding has been signed till now following the government-to-government talks. Several articles highlighted that there are some technical issues with regards to the minimum wage policy, related costs, new standard operating procedure and visa issue as well. There is approximately 5.8ha of palm oil plantations in Malaysia with a ratio of 1 worker to eight ha, which means the labour-intensive sector requires about 725k workers. There have not been any intakes since March 2020 and we estimate the present shortage would have ballooned to 90k-100k level.

§ **Expecting a slight increase in production.** Malaysian Palm Oil Board expects CPO production to improve 4.9% this year to 19m mt from 18.12 mt recorded in 2021, while stocks are projected to pick up 23.4% to 1.95m mt vs 1.58m mt last year. Meanwhile, Malaysian palm oil exports are expected to increase by 9.3% YoY to 17m mt this year from 15.56m mt previously. For Indonesia, palm oil production is expected to rise from 51.3m mt to 53.8m mt this year. Indonesian Palm Oil Association estimates the Indonesian palm oil exports would drop by 1m or 3% to 33.2m mt this year, as domestic consumption increases, which is expected to rise 12% this year to 20.6m mt (biodiesel mandate: 8.8m mt, domestic demand for cooking oil: 8m mt (5.7 kiloliters)).

§ **A steep increase in minimum wage by year-end.** Malaysia's Human Resources Minister, Datuk Seri Saravanan Murugan recently said that the minimum wage is expected to increase from the current of RM1,200/mth to RM1,500/mth by the end of the year. That is a steep growth of 25%. We believe that the labour-intensive palm oil sector is unlikely to experience significant financial impact as more than 75% of the industry workers are already earning above the proposed minimum wage. Labour cost normally makes up about 20%-30% of the total operating costs but we expect an increase of only 5%-7% in the labour cost upon the implementation of the proposed minimum wage.

§ **Indonesian production growth is slowing down.** The Indonesian government is expected to find a balance between the new planting activities and environmental issues. Without further new planting in the last 6 years and no replanting activities in a sizeable development, Indonesian palm oil production is expected to see negative growth in 2023, the first decline in a decade. (refer to Figure 8 and Figure 9) Meanwhile, the domestic demand has been picking up, led by higher demand for cooking oil and an increase in biodiesel mandate. The slowdown in palm oil production coupled with the rising demand has put tremendous pressure on the palm oil stockpiles in the largest producing country as it is facing supply constraint.

Cost-pushed inflation factor driving up the CPO base

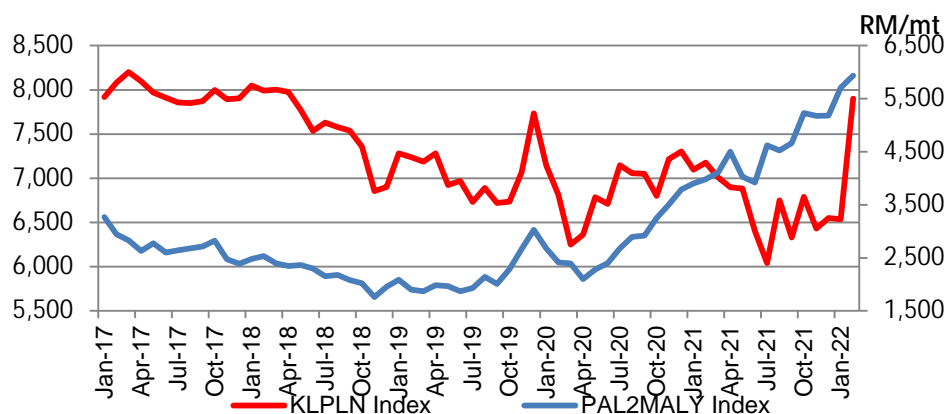
Bursa's plantation index has been catching up following the CPO price rally

La Nina event is over but the impact will be felt in the next 12 months

§ **A new base for the CPO prices.** The 10-year average for the CPO price is RM2,742/mt, which is far from the current level of RM5,951/mt. Due to the massive jump in agricultural related expenses (wages, fertilizer and pesticide), we believe CPO prices are heading to a higher base, led by cost-pushed inflation factor as breakeven level for the CPO price will inch higher going forward. Based on our analysis, RM1,800/mt was the near breakeven level in the past. Given the rising costs, RM2,200-2,400/mt would be the new breakeven level in the future. This would also indirectly push up the long-term average to around RM3,000/mt, which is the psychological level for CPO prices.

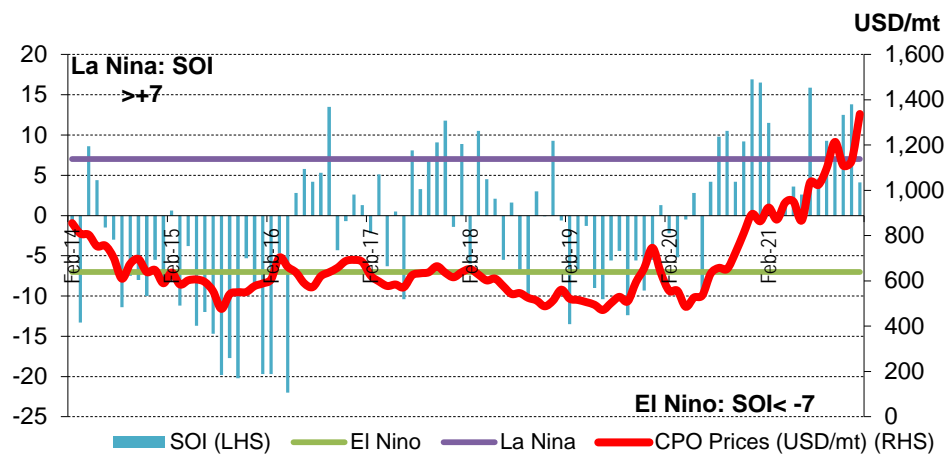
§ **A tale of two halves.** We expect stronger CPO performance in the 1H before seeing softer level for the CPO prices. We forecast CPO price average of RM5,000/mt for the first 5 months before retracing to RM4,000/mt level in the 2H as production starts recovering. The returning of the foreign workers could play a wild card in Malaysian inventories as the prolonged worker shortage issue could continue dragging down the production in Malaysia.

**Figure 1: Correlation for KLCI Plantation vs MPOB CPO Price**



Source: Bloomberg, PublicInvest Research

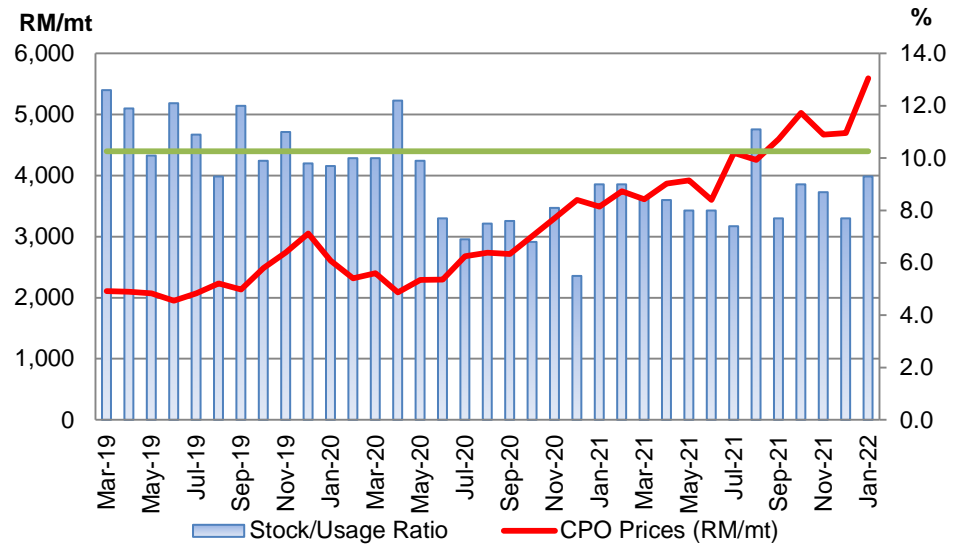
**Figure 2: Emergence of La Nina**



Source: Australia's Bureau of Meteorology, PublicInvest Research

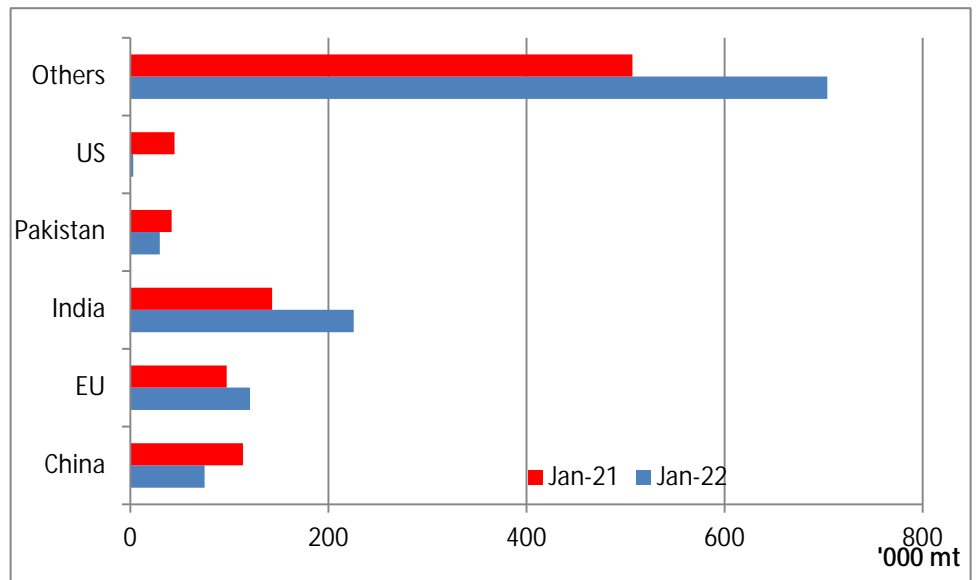
Current palm oil inventory stands at 6-month low

**Figure 3: Closing Stocks vs CPO Prices**



Source: MPOB, PublicInvest Research

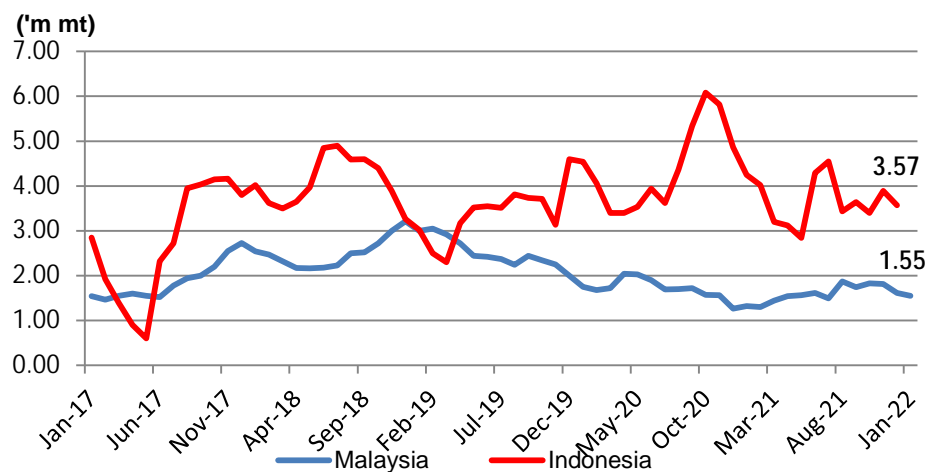
**Figure 4: Malaysia's Palm Oil Export Performance**



Source: MPOB, PublicInvest Research

Both Indonesia and Malaysia are facing supply crunch for palm oil due to rising domestic consumption and acute worker shortage issue

**Figure 5: Palm Oil Inventory level in Indonesia and Malaysia**



Source: Bloomberg, PublicInvest Research

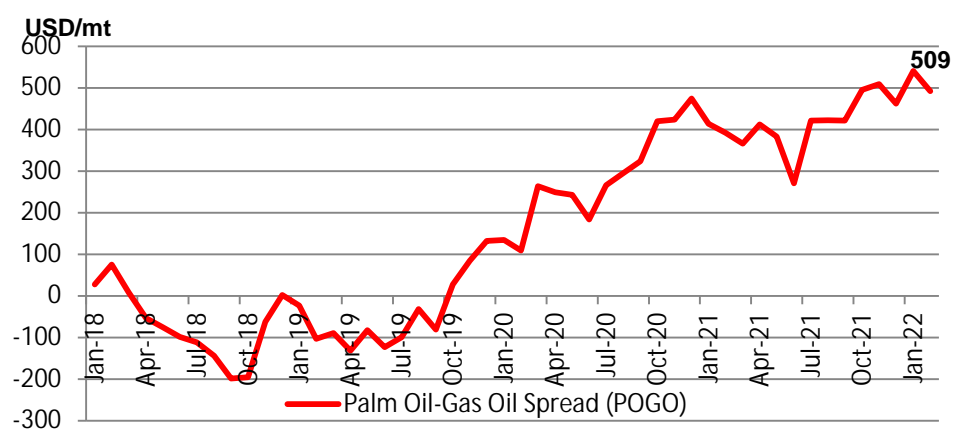
**Figure 6: Indonesian CPO prices**

CPO price (RM/mt)	5,900	5,800	5,700	5,600	5,500	5,400	5,300	5,200	5,100	5,000	4,900
CPO price (USD/mt)	1,422	1,398	1,373	1,349	1,325	1,301	1,277	1,253	1,229	1,205	1,181
Export Levy (B)	200	200	200	200	200	200	200	200	200	200	200
Export Tax (USD/mt) ©	175	175	175	175	175	175	175	175	175	175	175
Net Indonesian CPO Price (USD/mt) (A-B-C)	1,047	1,023	998	974	950	926	902	878	854	830	806
RM/mt	4,344	4,244	4,144	4,044	3,944	3,844	3,744	3,644	3,544	3,444	3,344

Note: based on exchange rate of 4.15

Source: Companies, PublicInvest Research

**Figure 7: Biodiesel Spread**



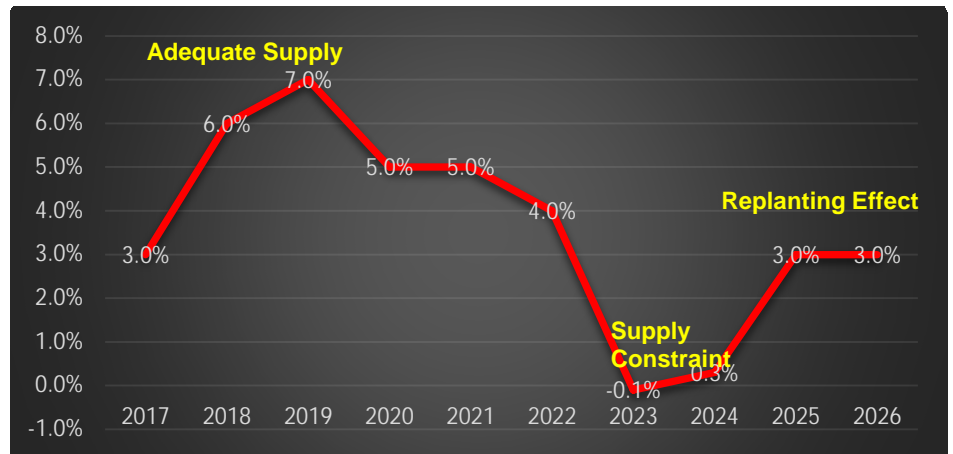
Source: Bloomberg, PublicInvest Research

Indonesia's CPO price discount to Malaysia has widened to RM1,600/mt (USD380/mt)

Small production growth going forward due to lack of new plantings and sizeable replanting activities

Dragged by the severe draught, South America soybean production is shrinking to the lowest level since 2018

**Figure 8: Indonesia's CPO Supply Outlook**



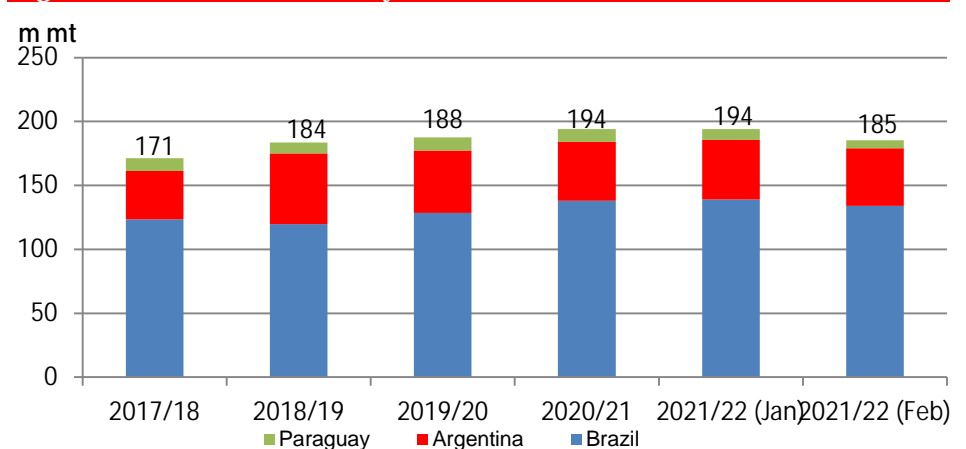
Source: POC2017, Public Invest Research

**Figure 9: Projected New Planting Area in Indonesia**



Source: Directorate General of Estate Crop (2012-2016), POC2017

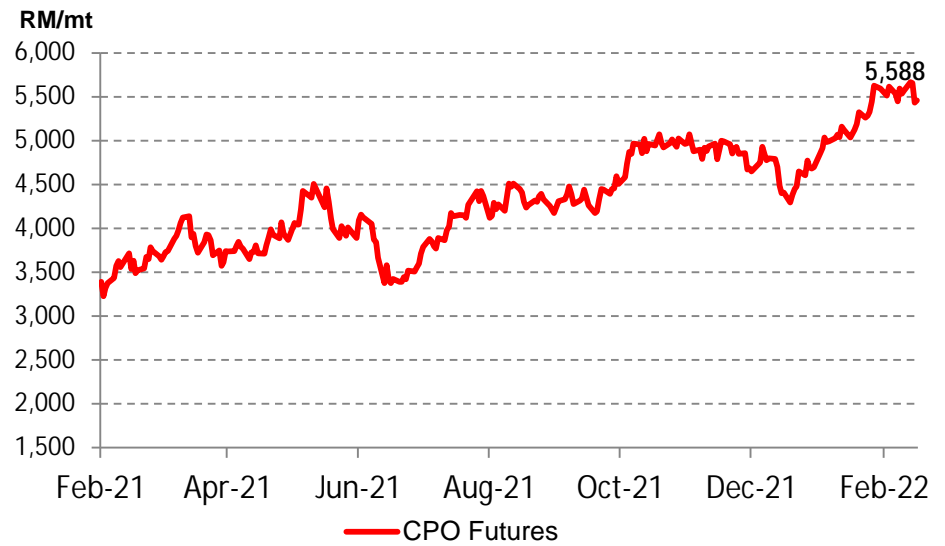
**Figure 10: South America Soybean Production**



Source: USDA, Public Invest Research

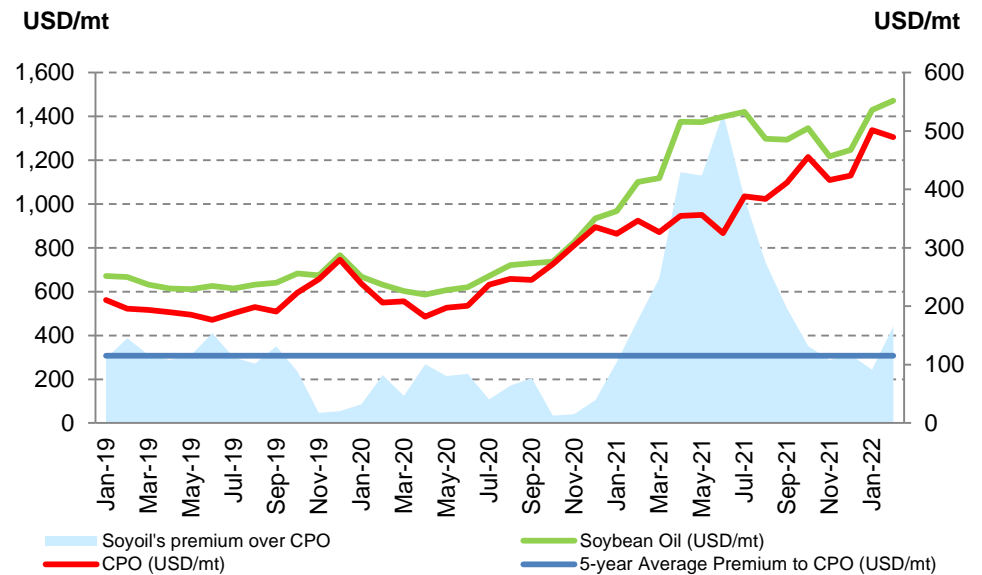
YTD, CPO futures rose 19% to RM5,588/mt

**Figure 11: CPO Futures**



Source: Bloomberg, PublicInvest Research

**Figure 12: soybean Oil Price's Premium Over CPO Price**



Source: Bloomberg, PublicInvest Research

CPO's discount to soybean oil prices has expanded to USD166/mt, the widest level in 5 months

**Figure 13: CPO Price Forecasts**

Malaysia	2019	2020A	2021A	2022F	2023F
Old Forecast	2,128	2,781	4,429	2,500	2,500
CPO Forecast (RM/mt)	2,128	2,781	4,429	4,300	3,800
Exchange	4.14	4.15	4.15	4.15	4.15
CPO Forecast (USD/mt)	514	670	1,067	1,036	916

Company	FGV	GENP	IOI Corp	KLK	Sarawak Plantation	Sime Darby Plant	TSH Resources	Ta Ann
Financial Year	Dec	Dec	June	Sept	Sept	Dec	Dec	Dec
FY22 Average CPO price assumption (RM/mt)	4,300	4,300	4,350	4,350	4,300	4,300	4,300	4,300
FY23 Average CPO price assumption (RM/mt)	3,800	3,800	4,050	3,950	3,800	3,800	3,800	3,800

Source: MPOB, PublicInvest Research

**Figure 14: Earnings sensitivity of companies to changes in CPO prices**

	Net profit change for every RM100/mt change
FGV	7-9%
Genting Plantations	8-10%
IOI Corp	4-6%
KLK	5-7%
Sarawak Plantation	10-15%
Sime Darby Plantation	4-7%
Ta Ann	11-13%
TSH Resources	6-9%

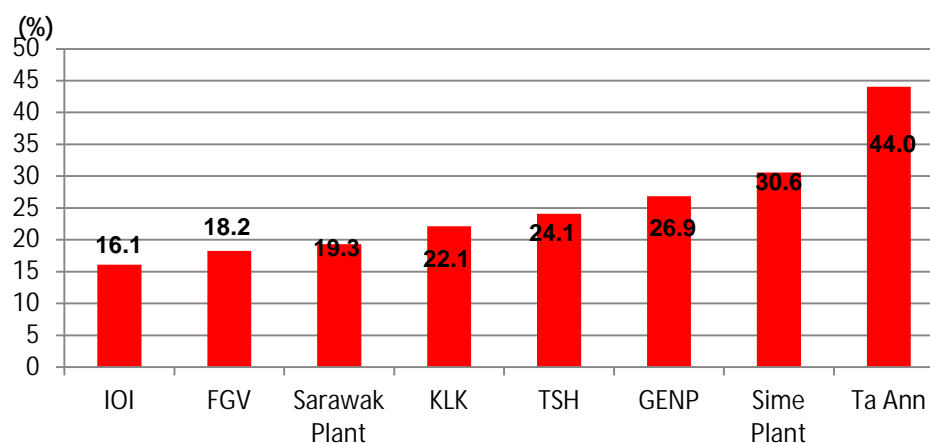
Source: Companies, PublicInvest Research



**Figure 15: Change of Target Price**

Stock	Old Call	New Call	Valuation basis	Old TP	New TP
FGV	Neutral	Neutral	18x for FY22 plantation earnings	1.59	1.71
GENP	Neutral	Neutral	SOP-based, 20x for FY22 plantation earnings	8.23	9.02
IOI Corp	Neutral	Neutral	SOP-based, 20x for FY23 plantation earnings	4.29	4.67
KLK	Outperform	Outperform	SOP-based, 20x for FY22 plantation earnings	25.11	31.05
Sarawak Plant	Outperform	Outperform	15x for FY22 plantation earnings	3.88	4.27
Sime Darby Plant	Neutral	Neutral	20x for FY22 plantation earnings	4.12	5.09
Ta Ann	Outperform	Outperform	SOP-based, 15x for FY22 plantation earnings	4.11	5.96
TSH	Outperform	Outperform	16x for FY22 plantation earnings	1.60	1.68

Source: Companies, Bloomberg, PublicInvest Research

**Figure 16: Plantation Stock Performance YTD**


Source: Bloomberg, PublicInvest Research

YTD, Ta Ann is the top performer, up 44%

## RATING CLASSIFICATION

**STOCKS**

<b>OUTPERFORM</b>	The stock return is expected to exceed a relevant benchmark's total of 10% or higher over the next 12 months.
<b>NEUTRAL</b>	The stock return is expected to be within +/- 10% of a relevant benchmark's return over the next 12 months.
<b>UNDERPERFORM</b>	The stock return is expected to be below a relevant benchmark's return by -10% over the next 12 months.
<b>TRADING BUY</b>	The stock return is expected to exceed a relevant benchmark's return by 5% or higher over the next 3 months but the underlying fundamentals are not strong enough to warrant an Outperform call.
<b>TRADING SELL</b>	The stock return is expected to be below a relevant benchmark's return by -5% or more over the next 3 months.
<b>NOT RATED</b>	The stock is not within regular research coverage.

**SECTOR**

<b>OVERWEIGHT</b>	The sector is expected to outperform a relevant benchmark over the next 12 months.
<b>NEUTRAL</b>	The sector is expected to perform in line with a relevant benchmark over the next 12 months.
<b>UNDERWEIGHT</b>	The sector is expected to underperform a relevant benchmark over the next 12 months.

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