Thematic

Sector Update

Overweight◄►

Outlook 2H21: In the limelight

- **Our base case scenario is for CPO price to continue trading above RM3,300/MT in the short-term before moderating in the later part of 3Q21.**
- **Given impact on productivity due to labor shortage issue, CPO production is forecast to increase slightly to 19.17m MT in 2021 from 19.14m MT in 2020.**
- **Ending stocks is anticipated to close circa 1.82m tonnes - as production improve whilst demand moderates in view of a setback in consumption as pandemic concerns continue to unfold in the importing countries.**
- **Demand is projected to remain supportive at 17.48m tonnes vs. 17.37m tonnes recorded in 2020 – as reopening of major economies may drive up demand.**
- **Maintain Overweight with new average CPO price forecast of RM3,100/MT (RM2,950/MT previously) for 2021 and RM2,700/MT for 2022.**

First-half 2021 in retrospect

The price of CPO (local delivery) started 2021 on a strong note at RM3,903/MT and beating its record high on 18th May 2021 at RM4,773.50/MT before being under pressure in the middle of June on concern over high production of palm oil in Indonesia, slower demand and steep decline in soybean oil price in Chicago soybean oil market and Dalian Commodity Exchange. The weakness in CBOT was due to improved supply prospect on favourable weather pattern in crop growing areas, as well as the US' intentions to ease biofuel requirement for biofuel blending mandate, and stronger USD. Nonetheless, CPO price capped its decline, trading above RM3,500/MT on expectations of higher exports and rebound in SBO prices.

Tight supply set to keep CPO price supported

Our base case scenario is for CPO price to continue trading above RM3,300/MT in the short-term before moderating in the later part of 3Q2021. Our bullish outlook on CPO price is a reflection of the anticipated tight supply of edible oils including palm oil production and stockpiles in Malaysia, compounded by improving demand scenario and rally in soybean oil (SBO) prices. Although any price increase could be capped by the narrowing of the price differential between CPO and SBO, we believe this is inconsequential. Supply constraints due to Covid-19 related supply chain disruptions and low inventories in some vegetable oils producing or importing countries, as well as easing of coronavirus restrictions could improve demand. These factors mean CPO price could retain its upward trajectory, trading between RM3,300/MT – RM3,600/MT, possibly up until July/Aug 2021. Hence, we raised our average CPO forecast for 2021 to RM3,100/MT from RM2,950/MT previously.

Remain Overweight on the sector

We remain positive on the earnings prospect of plantation's companies in the short-to-medium term as we believe earnings will inevitably remain exciting as PO price stays elevated above RM3,000/MT (currently at RM3,640/MT). The higher price will amplify the revenue and earnings growth momentum possibly for the rest of 2021. Nevertheless, we are cautious that high operational costs and suppressed profit margin on lower-than-expected production due to weaker yield and labour productivity on labour shortage issue would continue to be main risks to listed planters' earnings. Maintain Overweight on plantation sector with BUY call on HAPL (RM2.17), SOP (RM4.50), IOI (RM4.80), KLK (RM24.40) and SIME Darby Plants (TP: RM5.00), whilst HOLD recommendation on Sarawak Plant (RM2.64), TSH (TP: RM1.23), GENP (TP: RM9.00) and FGV (TP: RM1.30); and non-rated for TH Plant.

Plantation

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Equity

Promising Outlook

Whether for good or bad, we totally cannot ignore the importance of palm oil in our daily consumption, be it as food or otherwise such as for household and personal care products, animal feed meal and biofuel's feedstock. With these benefits and advantages, palm oil and palm kernel oil are both included in the world largest consumed edible oils. In 2020, the world has consumed approximately 75.3m MT of PO and PKO or approximately 31.9% of the world total oils & fats consumptions, followed by Soybean oil [SBO] of 57.9m MT (24.5%) and Rapeseed oil of 25m MT or 10.6%. We believe the long-term outlook of the palm oil industry to remain bright. This is premised on promising palm oil prospects on the back of growing population and per capita income as well as its price competitiveness and its established health qualities, of which in our view, would drive healthier demand for palm oil products in the future. On the other hand, the demand for its derivatives especially for its oleochemical products i.e., serving the household and personal care products is expected to continue to be satisfactory given rise in hygiene awareness worldwide.

Our base case scenario is for CPO price to continue trading above RM3,300/MT in the short-term before moderating in the later part of 3Q 2021. We believe our bullish outlook in CPO price is a reflection of the anticipated tight supply of edible oils including palm oil production and stockpiles in Malaysia, compounded by improving demand scenario and rally in soybean oil (SBO) prices. Although any price increase could be capped by the narrowing of the price differential between CPO and SBO, we believe this is inconsequential. Supply constraints due to Covid-19 related supply chain disruptions and low inventories in some vegetable oils producing or importing countries, as well as easing of coronavirus restrictions could improve demand for CPO. These factors will lead to elevated level of CPO, trading between RM3,300/MT – RM3,600/MT, possibly up until July/Aug 2021. Hence, we raised our average CPO forecast for 2021 to RM3,100/MT from RM2,950/MT previously. The higher average price ties in with our assumptions on:

1. Tight palm oil supply situation in Malaysia. The CPO supply in Malaysia is anticipated to be curbed given unresolved labour shortage issues and recent Malaysian government's decision to impose a stricter implementation of Movement of Order Control (MCO). Government decision to temporary close the palm oil mills or palm oil estates operations if their employees affected by Covid-19 in a bid to curb the spread of COVID-19 is further worsens the situation and thus, restraint the palm oil production. Conversely, closure of borders and inter-state travelling add another challenge to the industry as hiring new workers or returning of workers from their home country is freeze. Hence, this will in turn impact productivity and the quality of crude palm oil produced especially when it comes to the annual seasonal high cycle that typically begins in July. On the flip-side, the lower-than-expected production from Malaysia will keep CPO price supported. Given that CPO production during the five-months period to May 2021 of 6.76m tonnes is 5.7% lower than the 7.17m tonnes achieved in 2020, we revised our CPO production forecast for 2021 lower to 19.17m tonnes from 19.56m tonnes initially estimated i.e., +0.2% yoy increase from 2020 production of 19.14m tonnes (Table 1).
2. Strength in rival edible oils price. Although SBO price at CBOT is foreseen to continue to trade above USD45 cents/bushel (August contract as at 25th June21: USD57.89 cents/bushel), the volume of the upcoming soybean harvest and demand from China needs to be closely monitored. The current price momentum is driven by tight supply situation of edible oils (soybean, rapeseed, sunflower), on unfavorable weather in global crops growing regions, rising inventory build-up for food reserves, increase demand for crop-based fuels and strong demand especially from China as China increased their soybean import to accommodate it pig herd industry requirement – following the recovery from the African swine fever experience in 2018 and 2019. Based on data compiled from Bloomberg on China soybean import, as for Jan-May21 period, China imports approximately 38.2m tonnes of soybean or 13% higher from the same period last year (Chart 4). Nonetheless, the recent improved weather pattern in global crop growing regions in US and Canada as well as record high CPO

output forecast from Indonesia of 49m tonnes, 3.4% increase from 2020 production of 47.4m tonnes (based on GAPKI); Jan-Mar21 period, Indonesia's CPO production increased +1.4% yoy to 11.1m MT – has restored the edible oils supply prospect, hence, induce volatility to SBO price and subsequently to PO price.

3. The reopening of major economies driving up demand. We expect demand to improve once the coronavirus pandemic subsides in major importing countries. Unlike India, demand for PO and SBO improved on rapid recovery in China. China's intake of PO and SBO increase 23.6% and 126% respectively to 2.48m tonnes and 447.9k tonnes this year against the same period Jan-May 2020 last year (Chart 3); with PO constituting approximately 47% of total edible oils import by China while 9% for SBO (Jan-May20: 50% for PO and 5% for SBO). Nevertheless, demand from India is expected to be muted in the next couple of months as the country was hard hit by the coronavirus pandemic and is under partial or complete lockdowns and night curfews since the end of April 2021 in most parts of the country. Demand is expected to improve once the movement restriction or lockdowns are lifted and HORECA sector reverts to normal. The HORECA sector constitutes about 33% of PO consumption mix in India with 18% preferred by household sector. India and China are expected to continue its restocking activities as their accumulated stock level of PO (according to MPOC) by end of May-2021 was at a relatively low level, i.e., 15% lower yoy to 447,900MT for China and a tad lower of 314,760MT against 315,101MT recorded in 2020 for India. India's move in reducing the benchmark base import price of CPO to $1,136/ton from $1,222/ton would also be supportive for demand and hence, supportive for the CPO price, in our view, although India is price sensitive country where demand is depends on palm oil prices.

   We forecast demand to be moderate, an increase 0.7% yoy to 17.5m tonnes from 17.8m tonnes initially estimated for 2021 whilst stock level is forecast to settle at 1.82m tonnes by year-end 2021. Although this appears elevated against 1.26m tonnes registered in 2020, this is still substantially lower than previous peak of 3.2m tonnes recorded in 2018.

Table 1: Plantation Key Annual Statistics – forecast figure for 2021

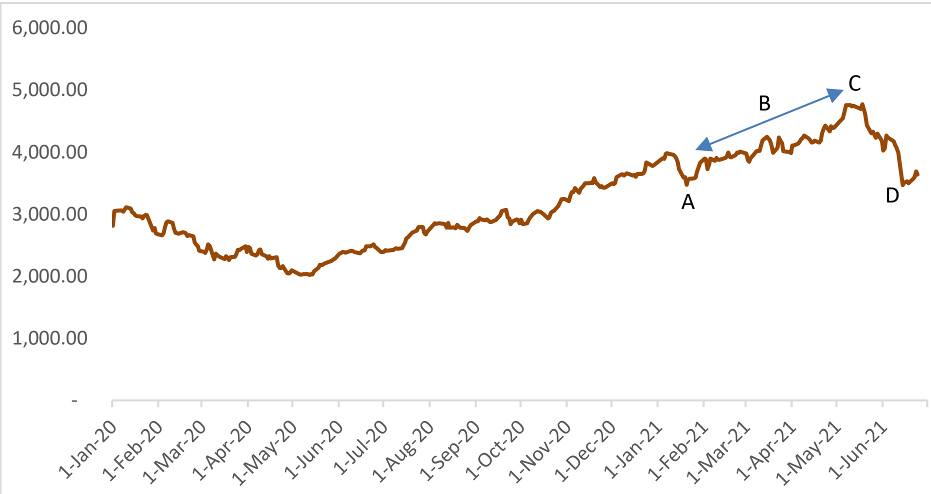
						% Change					YTD May	YTD May	% Change
	2017	2018	2019	2020	2021F	2017	2018	2019	2020E	2021F	2021	2020	
Average CPO Price (RM/MT)	2,798.00	2,235.00	2,079.00	2,685.50	3,100.00	5.5	(20.1)	(7.0)	29.2	15.4	4,095.50	2,496.60	64.0
CPO Production (Million Tonnes)	19.92	19.52	19.86	19.14	19.17	15.0	(2.0)	1.8	(3.6)	0.2	6.76	7.17	(5.7)
Palm Oil Export (Million Tones)	16.56	16.49	18.47	17.37	17.48	3.2	(0.4)	12.0	(6.0)	0.7	5.65	6.09	(7.3)
Ending Stocks (Million Tonnes)	2.73	3.22	2.01	1.26	1.82	63.9	17.8	(37.5)	(37.1)	44.2	1.57	2.03	(22.7)

Source: BIMB Securities/ MPOB

On the contrary, CPO price is anticipated to be modest in the later part of 3Q21. Higher-than-expected soybean supply in marketing year 2021/22 (according to USDA data released on June 2021, total world soybean production is expected to increase 5.9% yoy to 385.5m tonnes with U.S. recording 6.5% yoy increase to 119.9m tonnes, followed by Argentina 10.6% to 52.0m tonnes and Brazil 5.1% to 144.0m tonnes) on improved supply prospect on favourable weather pattern in crop areas as well as concern over easing of biofuel requirement for biofuel blending mandate in US, Brazil and Argentina exert pressure to SBO price and subsequently to PO price.

We believe the possible negative factors for our CPO price forecast in 2H 2021 would be 1) slower economic growth and consumption of edible oils, 2) lower-than-expected demand and changes on government policies of importing countries, 3) higher-than-expected supply and stockpiles of Soybean and SBO, 4) narrowing of the price differential between CPO and SBO, 5) weakening of crude oil prices, 6) changes in biofuels law with new blending mandates in Malaysia, Indonesia, US, Argentina and Brazil, and 7) unforeseen market changes i.e., prolong Covid-19 pandemic and movement restriction.

Chart 1: MPOB (local delivery) - CPO price trend (Jan 2020 to 25 June 2021)



Remarks:

A. Demand concern – CPO price dropped to RM3,474/MT on 20th Jan 2021.

B. CPO price rebound tracking soybean oil market and positive sentiments on strong export demand of PO.

C. Hitting its record high on 18th May 2021 at RM4,773.50/MT.

D. CPO price was under pressure on concern over high production of PO in Indonesia, slower demand and decline in SBO price in CBOT on improved soybean supply prospect and US intentions to ease biofuel blending mandate.Lowest: RM3,471.50/MT, 14 Jun21.

E. CPO capped its decline on expectatiopn of higher ecports and rebound in SBO price. Closed at RM3,640/MT on 24 June 2021.

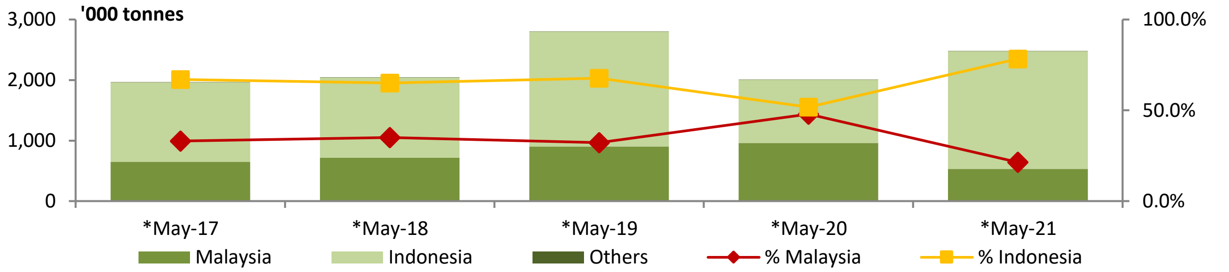
Source: MPOB, BIMB Securities

Table 2: Malaysia - Export by Selected Destination (yoy growth)

	2015	2016	2017	2018	2019	2020	YTD May21	YTD May20
India	13.4%	-23.3%	-28.2%	23.9%	75.4%	-37.7%	766.9%	-87.9%
China	-16.2%	-20.9%	1.9%	-3.0%	33.9%	9.6%	-42.0%	27.7%
EU	0.9%	-15.3%	-3.3%	-4.0%	8.7%	-6.8%	-31.4%	-2.0%
USA	-10.2%	-16.1%	-6.0%	-2.5%	0.3%	-0.3%	-51.8%	10.9%
Pakistan	-10.8%	21.0%	15.5%	14.2%	-6.5%	-7.5%	-46.1%	-16.1%
Total export	0.9%	-8.1%	3.2%	-0.4%	12.0%	-5.8%	-7.3%	-14.2%

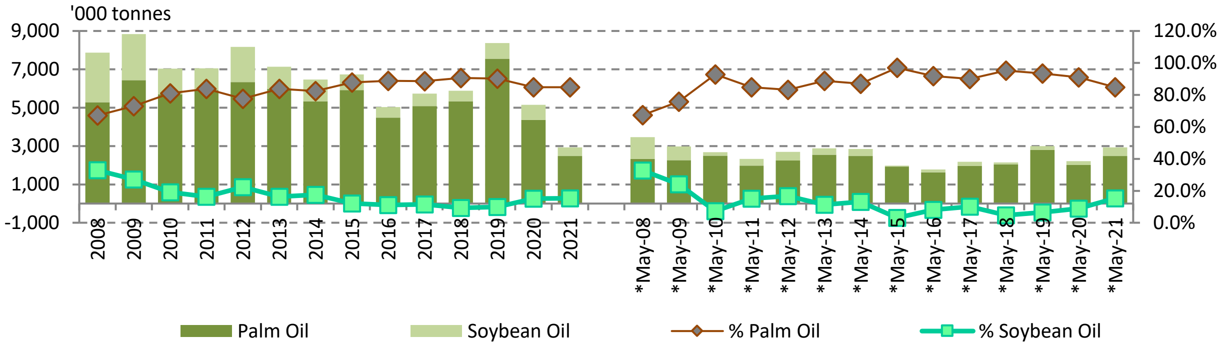
Source: BIMB Securities/ MPOB

Chart 2: China Palm Oil Imports



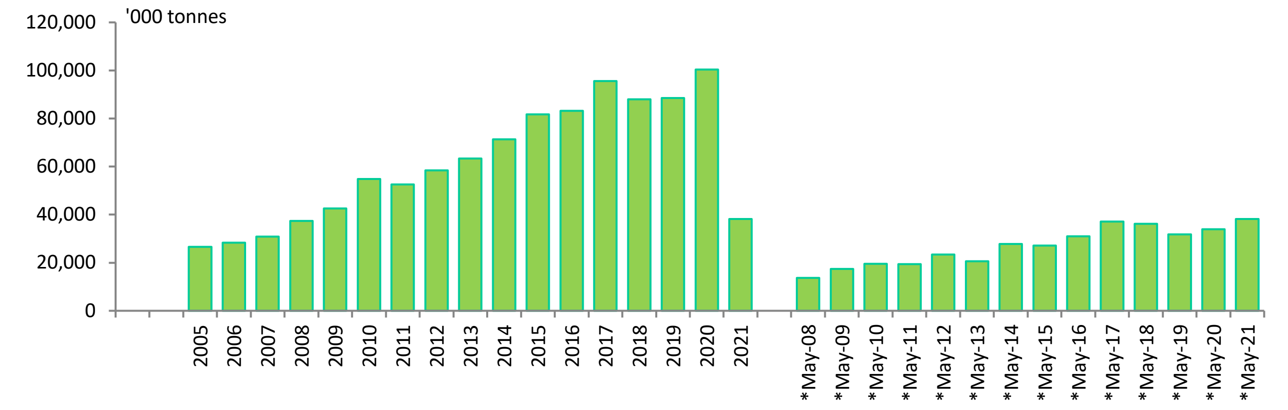
Source: BIMB Securities/ Bloomberg

Chart 3: China Palm Oil and Soybean Oil Imports



Source: BIMB Securities/ Bloomberg

Chart 4: China Soybean Imports



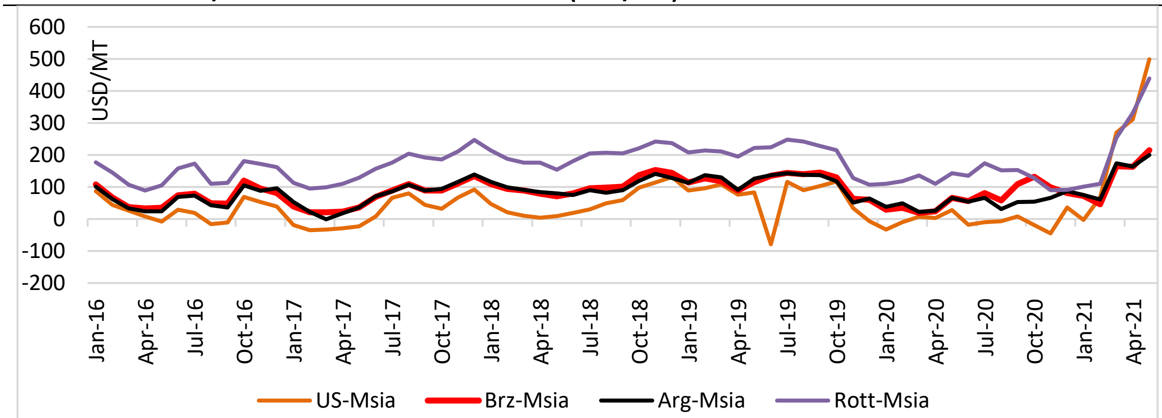
Source: BIMB Securities/ Bloomberg

Premium/discount spread between SBO and PO price

The near-term higher price momentum is seen to be supported by the widening discount of the price differential between PO and SBO at CBOT, Argentina, Brazil and Rotterdam (Chart 5) as the current discount parity is at USD499/MT in CBOT, followed by USD215/MT in Brazil, USD200/MT in Argentina and USD439/MT in Rotterdam (against 3-yrs and 5-yrs average discount of USD65/MT and USD48/MT respectively). To put things into perspective, the widening of the price discount between PO and SBO would make palm oil more competitive against its substitute oil especially to the price sensitive importing countries. Nonetheless, the anticipation of improved edible oils supply prospect and easing of biofuel blending mandate in US, Brazil and Argentina may prompt a moderation in the short-to-medium-term prices going forward, in our view.

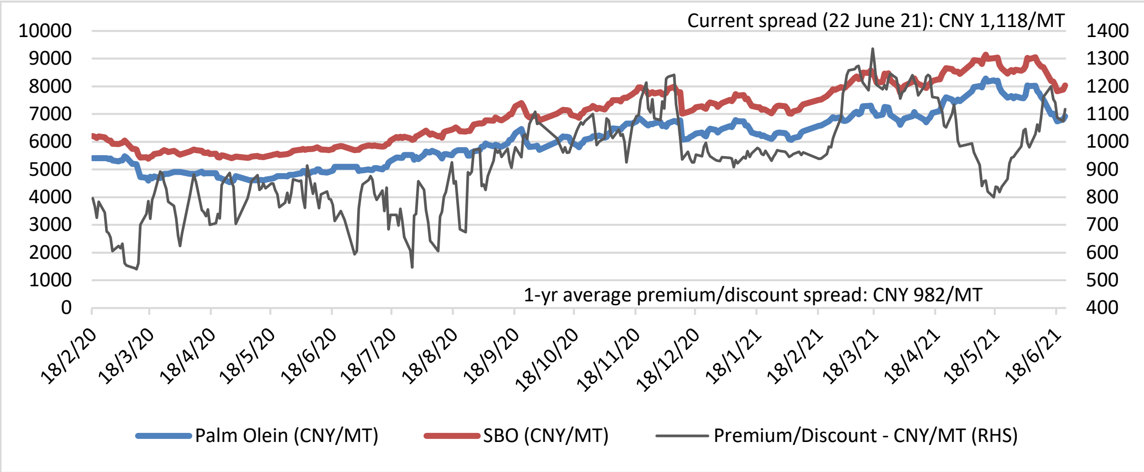
On the other hand, the widening of the price differential between PO and SBO prices at the Dalian Exchange of CNY 1,118/MT versus 1-year average of CNY 982/MT (Chart 6) may provide short-to-medium-term demand for palm oil against SBO – given the price competitiveness. The caveat is that the growing demand of SBM (soybean meal) would encourage more soybean to be crush in the local market, hence, increase SBO locally produce by China and subsequently reduce the spread between SBO price and PO price – which makes PO less competitive. Conversely, as shown in Chart 2, Indonesia's price advantage towards palm oil trade has benefited Indonesia's palm oil market share in China. For Jan-May 2021 period, Malaysian PO market share fell to 21.4% from its highest level of 47.9% in the same period last year as Malaysian refineries had to operate under a less competitive global business environment. Meanwhile, Indonesia increased its market share to 78.4% from 51.7% registered in the same period last year.

Chart 5: Premium/Discount between SBO and PO (USD/MT)



Source: Foreign Agricultural Service/USDA

Chart 6: Premium/Discount between SBO and Palm Olein at Dalian Exchange (CNY/MT)



Source: Bloomberg

Sustainability – Oil Palm remains a controversial industry

Health claims and environment issues pertaining to production and consumption of palm oil as well as social issue, particularly related to labour such as forced labour, human trafficking and child labour, are among the negative perceptions that have been prevalent or put forward by the NGOs (Non-Governmental Organizations) to plantation players in Malaysia and Indonesia. Recent allegations over forced labour which recently came under investigation by the U.S. Customs and Border Protection (CBP) is are directed on IOI Corporation – although IOI is a founding member of Roundtable on Sustainable Palm Oil (RSPO) and among the first Malaysian companies to announce a zero recruitment fees policy in 2017.

Earlier, on 30th Sept 2020, US's CBP has placed a detention order on palm oil and palm oil produced made by FGV (its subsidiaries and JV) with the indication of the use of forced labour in Malaysia. In the same vein, on the 30th of December 2020, SIME Darby Plantation Berhad (SDPL) also has been alleged of using forced labour in its production process – all the necessary steps and measures to address any gaps or potential areas of concern and allegation are still on going for both companies.

Although IOI, FGV and SDPL's exports to US are below 5% of their total export, we are of the view that these allegations although not as a blanket allegation or ban against Malaysia's palm oil industry, the repercussion would somehow remain at the forefront especially with international buyers such as the US and European countries. The negative aftermath is this might be followed by other importing countries with ESG concerns. At the same time the ESG concerns are echoed in the share price performance of plantations' companies. Based on our observation, the current higher CPO price environment was not reflected in plantation counters share prices although earnings increases have been substantial while potential to record higher profits remain high for these companies. This underperformance is possibly, in our view, due to increase in ESG concerns by local and international fund managers in constructing their portfolios.

Maintain Overweight

Maintain Overweight call on plantation sector. Our base case scenario is for CPO prices to continue their upward trajectory in the short-term – due to tighter supplies and improved demand and then moderate in the later part of 3Q21. In view of this, we expect plantation companies' earnings to remain firmly as CPO price is anticipated to trade above RM3,000/MT that will amplify the revenue and earnings growth momentum possibly for the rest of 2021. Nevertheless, we are cautious that high operational costs and suppressed profit margin on lower-than-expected production due to weaker yield and labour productivity on labour shortage issue would continue to be main risks to listed planters' earnings. We have BUY call on HAPL (RM2.17), SOP (RM4.50), IOI (RM4.80), KLK (RM24.40) and SIME Darby Plants (TP: RM5.00), whilst HOLD recommendation on Sarawak Plant (RM2.64), TSH (TP: RM1.23), GENP (TP: RM9.00) and FGV (TP: RM1.30); and non-rated for TH Plant.

Table 3: Plantation Matrix

Comp	Total Landbank (Ha)	Total Oil Palm planted area (ha)	Age Profile				Young Mature		Average Age (years)	FFB Yield per mature ha	CPO OER (%)	Oil Yield per Hectare	Immature to young mature (%)
			Immature		Mature								
			Ha	%	Ha	%	Ha	%					
SDPL	745,301	583,340	93,334	16	490,005	84	151,668	26	12.3	19.1	21.4	4.1	42
IOIC	206,567	176,909	30,053	17	146,856	83	24,767	14	13.6	21.2	21.8	4.6	31
KLK	275,428	213,411	35,701	17	177,710	83	53,706	25	12.2	22.0	21.9	4.8	42
TSH Res*	99,507	32,452	1,612	5	30,840	95	12,452	38	10.9	23.7	20.1	4.8	43
HAPL*	39,727	35,434	3,148	9	32,286	91	5,040	14	15.5	19.7	20.6	4.1	23
GENP	243,446	139,225	27,845	20	111,380	80	11,138	8	12.3	17.9	21.3	3.8	28
THP*	97,289	56,763	5,920	10	50,843	90	14,358	25	10.7	16.1	19.5	3.1	36
FGVH#	439,275	335,404	53,665	16	281,739	84	87,205	26	14.8	16.9	20.3	3.4	42
SOP	121,994	87,964	6,766	8	81,198	92	23,005	26	12.6	16.6	19.7	3.3	34
SPB*	43,576	34,226	5,042	15	29,184	85	3,669	11	13.7	17.5	19.5	3.4	25

Notes: * pure upstream players; # Land bank comprises of 362,747ha (LLA) and 77,875ha (non-LLA)
Industry average (MPOB): FFB yield/ha = 17.89 (2017) 17.16 (2018) 17.19 (2019) 16.73 (2020); CPO OER = 19.72% (2017) 19.95% (2018) 20.21% (2019) 19.92% (2020); Oil yield/ha = 3.53(2017) 3.42 (2018) 3.47 (2019) 3.33 (2020)

Source: BIMB Securities/ Bloomberg

Table 4: Stock under coverage – peer comparison

Companies	Price (RM)	Market Cap (RM m)	Net Profit (RM m)			PER (x)			FY1 Div. Yield	ROE	Target Price (RM)	Rating
			FY0	FY1	FY2	FY0	FY1	FY2				
SDPL	4.19	28,976.8	1346.7	1390.9	1349.5	21.5	20.8	21.5	1.9%	9.9	5.00	**Buy**
IOI Corp	3.82	23,878.4	600.9	1055.9	1033.6	39.7	22.6	23.1	2.1%	6.5	4.80	**Buy**
KLK	20.54	22,151.1	772.6	1075.0	981.6	28.7	20.6	22.6	2.4%	7.3	24.40	**Buy**
FGV	1.31	4,779.1	146.2	176.5	203.1	32.7	27.1	23.5	2.3%	3.5	1.30	Hold
TH Plantations	0.47	415.4	14.0	44.4	40.6	29.7	9.3	10.2	0.0%	2.4	NA	Non-Rated
Genting Plant	7.06	6,334.2	254.4	219.1	206.5	24.9	28.9	30.7	1.8%	5.2	9.00	Hold
Hap Seng	1.84	1,471.4	90.3	94.3	86.2	16.3	15.6	17.1	3.8%	5.4	2.17	**Buy**
TSH Resources	1.05	1,449.2	79.5	75.3	68.3	18.2	19.3	21.2	1.4%	5.5	1.23	Hold
SOP	3.49	1,995.1	204.1	287.0	254.1	9.8	7.0	7.9	1.7%	8.6	4.50	**Buy**
Sarawak Plant	2.21	616.7	61.0	75.4	66.8	10.1	8.2	9.2	4.5%	10.4	2.64	Hold

Source: BIMB Securities/ Bloomberg

DEFINITION OF RATINGS

BIMB Securities uses the following rating system:

STOCK RECOMMENDATION

BUY	Total return (price appreciation plus dividend yield) is expected to exceed 10% in the next 12 months.
TRADING BUY	Share price may exceed 15% over the next 3 months, however longer-term outlook remains uncertain.
HOLD	Share price may fall within the range of +/- 10% over the next 12 months
TAKE PROFIT	Target price has been attained. Fundamentals remain intact. Look to accumulate at lower levels.
TRADING SELL	Share price may fall by more than 15% in the next 3 months.
SELL	Share price may fall by more than 10% over the next 12 months.
NOT RATED	Stock is not within regular research coverage.

SECTOR RECOMMENDATION

OVERWEIGHT	The Industry as defined by the analyst's coverage universe, is expected to outperform the relevant primary market index over the next 12 months
NEUTRAL	The Industry as defined by the analyst's coverage universe, is expected to perform in line with the relevant primary market index over the next 12 months
UNDERWEIGHT	The Industry as defined by the analyst's coverage universe, is expected to underperform the relevant primary market index over the next 12 months

Applicability of ratings

The respective analyst maintains a coverage universe of stocks, the list of which may be adjusted according to needs. Investment ratings are only applicable to the stocks which form part of the coverage universe. Reports on companies which are not part of the coverage do not carry investment ratings as we do not actively follow developments in these companies.

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