

SECTOR UPDATE

Plantation – Malaysia

Malaysia CPO Production Lags In 3Q21

Malaysia's palm oil stocks were lower than expected at 1.61m tonnes in Jun 21 due to lower-than-expected CPO production. This is similar to our expectation where 3Q21 production growth would be lower than market expectation and the strong production recovery would only come in in 4Q21. Maintain MARKET WEIGHT in view of the weakening CPO prices. For investors who want exposure to this sector, our top picks would be Hap Seng Plantations and Kuala Lumpur Kepong.

MPOB JUN 21 STATISTICS SUMMARY

| (m tonne) | Jun 21 | mom % chg | yoy % chg | 1H21 | yoy % chg |
|-----------------------|--------|-----------|-----------|---------|-----------|
| CPO Production | 1.61 | 2.2 | (14.8) | 8,359 | (7.6) |
| Pen Malaysia | 0.88 | 2.7 | (18.8) | 4,619 | (6.6) |
| Sabah | 0.40 | 3.5 | (11.2) | 1,928 | (14.7) |
| Sarawak | 0.33 | (0.5) | (7.4) | 1,811 | (1.3) |
| Palm Oil Stocks | 1.61 | 2.8 | (15.0) | 1.61 | (15.0) |
| Palm Oil Domestic Use | 0.26 | (30.4) | (28.7) | 1.65 | (5.6) |
| Palm Oil Exports | 1.42 | 11.8 | (16.9) | 7.07 | (9.3) |
| Oleochemical | 0.23 | 4.8 | (15.8) | 1.45 | (5.9) |
| Biodiesel | 0.04 | 101.5 | 148.9 | 0.14 | (26.3) |
| Palm Oil Imports | 0.11 | 27.1 | 139.9 | 0.70 | 87.9 |
| CPO Price (RM/tonne) | 3,831 | (16.2) | 58.8 | 4,051.3 | 63.2 |

Source: MPOB, UOB Kay Hian

WHAT'S NEW

- Inventory was lower than market expectation.** The Malaysian Palm Oil Board (MPOB) reported lower-than-expected inventory of 1.61m tonnes in Jun 21 vs the market expectation of 1.65-1.69m tonnes, mainly due to lower-than-expected production. As mentioned in our previous reports, we expect 3Q21 CPO production growth to come in lower than market expectation mainly due to: a) the impact of the dry spell in 2019, and b) the older age profile of Malaysia estates also delayed the yield recovery timeline as compared to Indonesia.
- Will production come in below 19m tonnes for 2021?** Our full-year CPO production for 2021 is at 19.2m tonnes, where 1H21 CPO production of 8.4m tonnes contributed to about 43.5% of our full-year assumption. With the delay in hiring foreign labour in Malaysia and the lagging behind in estate maintenance, we remain sceptical as to whether CPO production will be able to exceed 19m tonnes.
- Export increased by 12% mom in Jun 21,** with export to China increasing by 47% mom as China palm oil inventory remains low and higher demand due to the upcoming mooncake festival in Sep 21. Imports from Malaysia to India remains low at 281k tonnes in Jun 21. With the India import duty reduction on CPO and refine palm oil products which has taken effect from 30 Jun 21, we expect the export to India to increase in the upcoming months. Having said that, we might see a demand shift where India might import more refined palm oil products from Indonesia due to competitive pricing.

PEER COMPARISON

| Company | Ticker | Rec | Price @ 12 Jul 21 | Target Price | Market Cap (US\$m) | PE | | | ROE | P/B | 2021F Div | Div Yield |
|-----------------------|---------|------|----------------------|-----------------|--------------------------|-------------|--------------|--------------|------|-----|--------------|--------------|
| | | | (RM) | (RM) | | 2020 (x) | 2021F (x) | 2022F (x) | (%) | (x) | (sen) | (%) |
| Malaysia | | | | | | | | | | | | |
| Hap Seng Plantations | HAPL MK | BUY | 1.80 | 2.45 | 343 | 15.9 | 10.9 | 18.9 | 5.4 | 0.8 | 11.5 | 6.4 |
| Kim Loong | KIML MK | BUY | 1.40 | 1.75 | 312 | 10.5 | 8.9 | 10.4 | 12.9 | 1.7 | 8.7 | 6.2 |
| KL Kepong | KLK MK | BUY | 19.62 | 25.00 | 5,047 | 27.1 | 18.9 | 17.8 | 7.3 | 1.9 | 90.0 | 4.6 |
| Sarawak Oil Palms | SOP MK | BUY | 3.37 | 4.75 | 460 | 9.5 | 7.9 | 11.9 | 8.9 | 0.8 | 23.5 | 7.0 |
| IOI Corporation | IOI MK | HOLD | 3.70 | 4.50 | 5,511 | 38.5 | 23.3 | 21.0 | 6.5 | 2.4 | 8.0 | 2.2 |
| IJM Plantations | IJM MK | HOLD | 3.08 | 3.10 | 647 | 20.0 | 19.6 | 26.3 | 15.6 | 1.9 | 5.1 | 1.7 |
| Sime Darby Plantation | SDPL MK | HOLD | 3.80 | 4.70 | 6,270 | 30.9 | 19.4 | 33.9 | 8.8 | 1.9 | 9.8 | 2.6 |
| Genting Plantations | GENP MK | SELL | 6.80 | 8.00 | 1,456 | 23.9 | 20.4 | 27.0 | 5.2 | 1.2 | 20.0 | 2.9 |

Source: UOB Kay Hian

MARKET WEIGHT

(Maintained)

TOP PICKS

| Company | Share Price (RM) | Target Price (RM) |
|---------|---------------------|----------------------|
| HAPL MK | 1.80 | 2.45 |
| KIML MK | 1.40 | 1.75 |
| KLK MK | 19.62 | 25.00 |
| SOP MK | 3.37 | 4.75 |

Source: Bloomberg, UOB Kay Hian

CPO PRICE ASSUMPTIONS (RM/TONNE)

| | CPO Price (RM/tonne) |
|------------------------------------|----------------------|
| 2020 | 2,686 |
| Our forecast: | |
| 2021F | 3,000 |
| 2022F | 2,600 |
| CPO Price: | |
| MPOB @ 10 Jul 21 | 4,002 |
| BMD 3 rd Month Contract | 3,863 |

Source: UOB Kay Hian

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ACTION

• **Maintain MARKET WEIGHT.** Given the expectation of weakening CPO prices, the sector is likely to continue underperforming the market. Having said that, we expect CPO ASP for 2021 to beat our assumption of RM3,000/tonne and come in at RM3,300-3,500/tonne. For investors who want exposure to this sector, we recommend small/mid-sized plantation companies such as Hap Seng Plantations, Kim Loong Resources and Sarawak Oil Palms. They sell their products at spot price, and hence enjoy higher earnings leverage to CPO prices as compared with peers. This allows better yoy earnings growth for the small/mid-sized companies as compared with others. For large caps, we prefer Kuala Lumpur Kepong for its undemanding valuation and potential earnings enhancement from its proposed acquisition of IJM Plantations.

ESSENTIALS

• **Major trends to watch out in Malaysia's palm oil sector in 2H21:**

- Better yield could be in 4Q21 instead of 3Q21.** 2H is a seasonally high production period for oil palm trees with peak production usually happening in 3Q. For 2H21, we reckon there is a high possibility of 4Q21 production being higher than 3Q21's as Malaysia's trees have older age profiles and have had less exposure to sunshine over the past six months. These could have an impact on oil content and delay the ripening process.
- Labour situation may worsen before it gets better.** As the intake of foreign workers remains slow with current COVID-19 situation in Malaysia, we may see higher outflow of foreign workers rather than inflow when the border reopens. Labour shortage not only affects the harvesting process but also leads to the lack of attention to field management. Companies are losing crops due to the rising rat population which is harming the young trees and damaging the FFB. The spread of Ganoderma disease has also reduced tree stand per hectare. All these could be minimised with early detection when estates have sufficient workers to carry out the field upkeep and maintenance.
- External demand may see some weaknesses as Indonesia captures more market share in India.** Malaysia has been the main supplier to India with the restriction on the import of refined palm oil products. However, with the Indian government temporarily lifting this restriction from July to end-Dec 21, India is likely to buy more refined products from Indonesia where the prices are more competitive than CPO prices in Malaysia. Thus, Malaysia's exports in 2H may come in lower than expected which will result in faster inventory build-up. CPO prices are negatively correlated to inventory, thus as inventory builds up, prices will weaken.

ASSUMPTION CHANGES

- **We maintain our CPO price assumptions of RM3,000/tonne and RM2,600/tonne for 2021 and 2022 respectively.**
- If the CPO prices continue to stay elevated, we expect the CPO ASP to be higher than our assumption at about RM3,300-3,500/tonne. Refer to table for the earnings sensitivity.

COMPANIES' EARNINGS SENSITIVITY

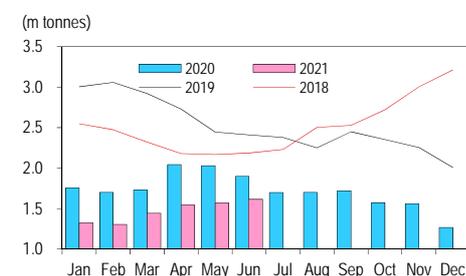
| Company | RM3,300/tonne | RM3,500/tonne |
|-----------------------|---------------|---------------|
| Hap Seng Plantations | 31.8 | 52.3 |
| Kim Loong | 13.6 | 22.4 |
| KL Kepong | 19.9 | 33.2 |
| Sarawak Oil Palms | 20.9 | 34.8 |
| IOI Corporation | 11.1 | 18.9 |
| IJM Plantations | 12.9 | 25.7 |
| Genting Plantations | 20.0 | 33.4 |
| Sime Darby Plantation | 8.6 | 14.1 |

Source: UOB Kay Hian

SECTOR CATALYSTS

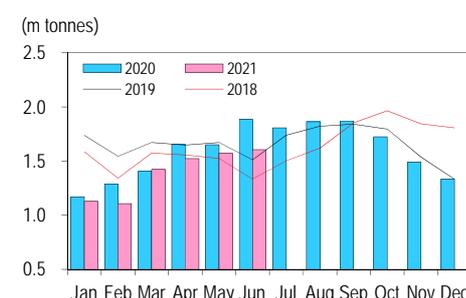
- Changes in Indonesia's palm oil export levy.
- Lower-than-expected global vegoil supply due to the impact of La Nina.
- Stronger-than-expected commodity cycle.

BUILDING UP INVENTORY LEVEL



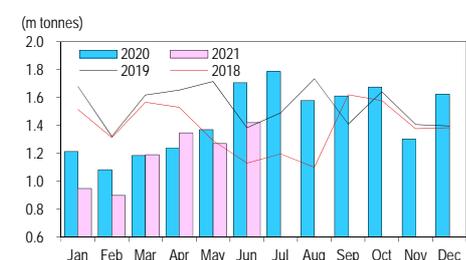
Source: Malaysian Palm Oil Board (MPOB)

ENTERING HIGH PRODUCTION PERIOD



Source: MPOB

HIGHER EXPORT IN JUNE 21

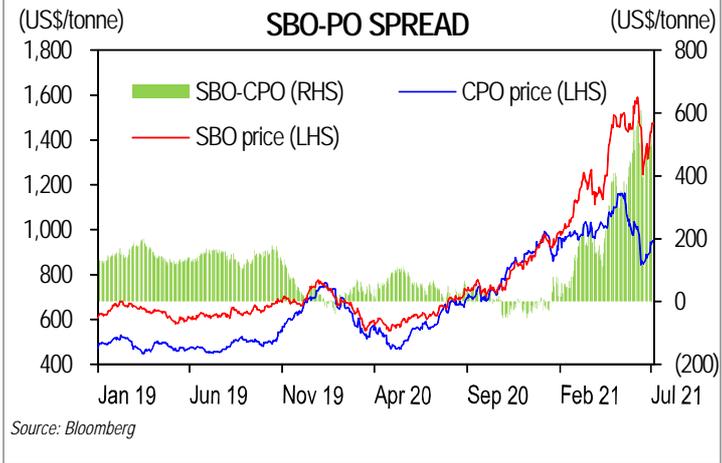
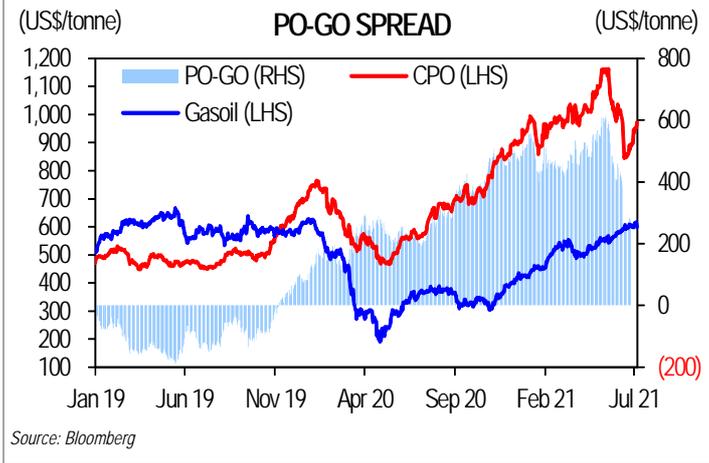
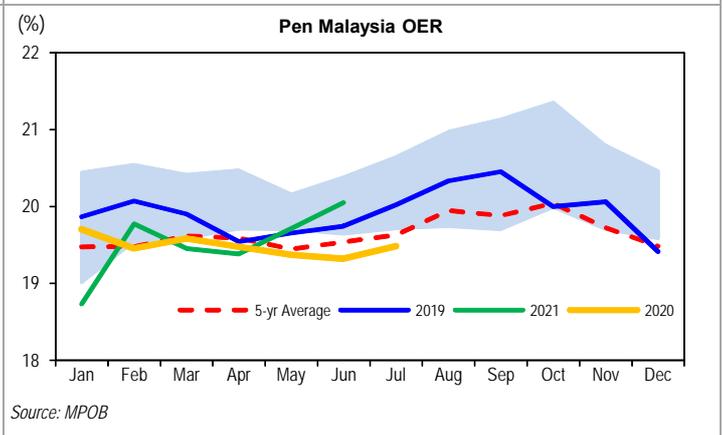
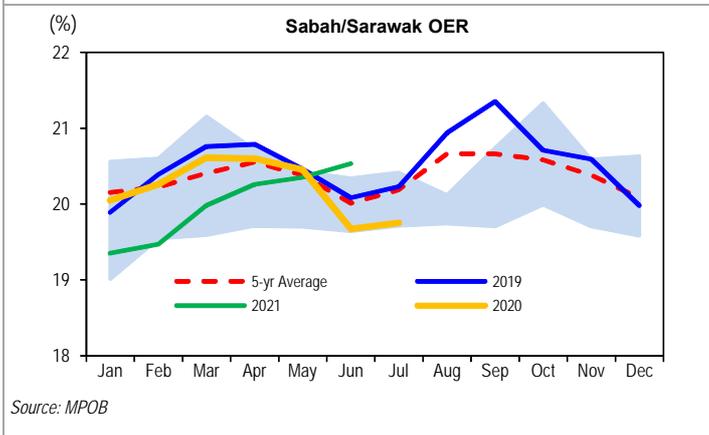
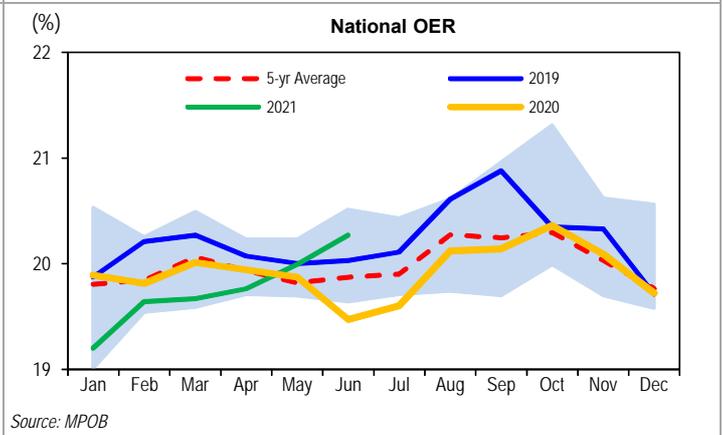
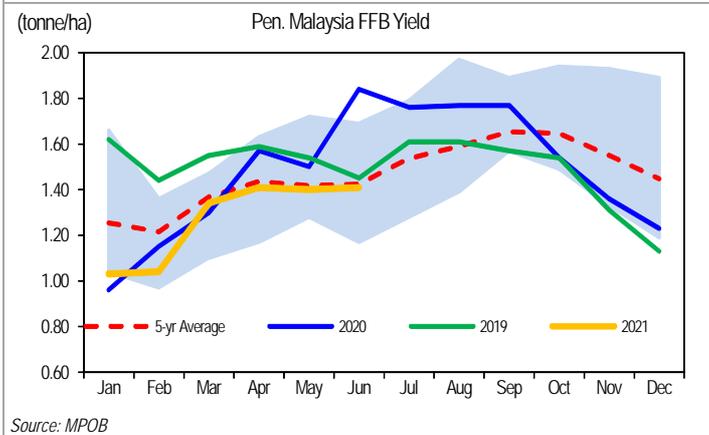
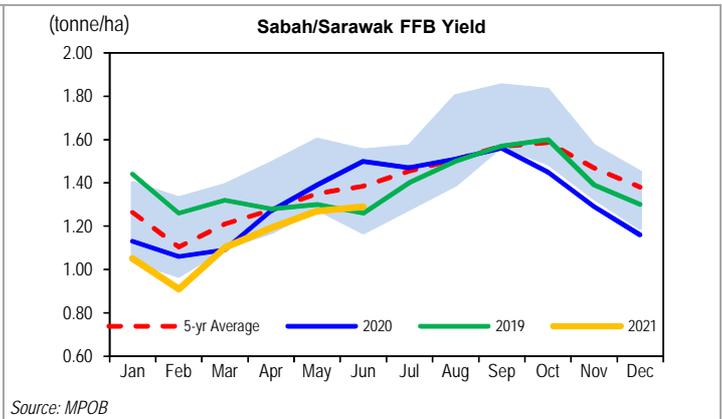
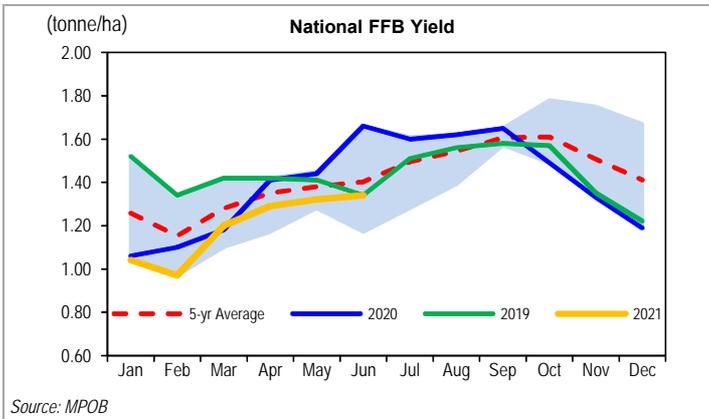


Source: MPOB

MALAYSIA: PALM OIL EXPORTS BY COUNTRY

| ('000 tonne) | Jun 21 | mom % chg | yoy % chg | 1H21 | yoy % chg |
|--------------|--------|-----------|-----------|-------|-----------|
| TOTAL | 1,419 | 11.8 | (17.1) | 7,067 | (9.3) |
| China | 213 | 47.4 | (39.4) | 739 | (41.3) |
| Pakistan | 66 | 32.3 | (49.6) | 306 | (46.9) |
| EU | 148 | 1.1 | 16.3 | 754 | (25.8) |
| India | 281 | (27.8) | 14.1 | 1,571 | 295.5 |
| US | 12 | (45.8) | (75.0) | 131 | (55.5) |
| Japan | 38 | 17.2 | 13.0 | 208 | (9.5) |
| Others | 661 | 36.4 | (14.6) | 3,358 | (16.5) |

Source: MPOB



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