SECTOR UPDATE

Plantation – Regional

CPO Prices Set for Gradual Uptrend Amid Supply Tightness

OVERWEIGHT

(Maintained)

The potential supply deficit could support elevated CPO prices in 2024, with marginal production growth in Malaysia offsetting weaknesses in Indonesia and other countries. Global vegoil supply faces constraints due to: a) Indonesia increasing domestic use, b) heightened biofuel usage in key oilseed-producing countries, and c) reduced oilseed crushing. Maintain OVERWEIGHT, and focus on Malaysian plantation companies and companies that have better-than-peers production growth.

- The forecasted supply deficit is set to uphold heightened CPO prices throughout 2024, propelled by the following factors:
  - a) **CPO** production is expected to experience marginal growth, primarily due to the impact of El Nino in 2H23. Among the major palm oil-producing nations, Malaysia is likely to stand out as the country with the highest production growth, helping counterbalance weaknesses in other key producing countries such as Indonesia, Thailand and Papua New Guinea.
  - b) **Global palm oil supply faces constraints,** with Indonesia increasing domestic use for both biodiesel and non-biodiesel applications.
  - c) **Despite an abundance of oilseeds globally, the availability of vegetable oil in the global market remains tight.** This scarcity is attributed to heightened biofuel usage in key producing countries and reduced oilseed crushing due to weakened demand for animal protein.
- **Catalysts:** Higher crude oil prices, the intensification of El Nino or the resurgence of La Nina, and the possibility of developing countries successfully pushing for stronger economic growth, leading to strengthened currencies that could, in turn, bolster vegetable oil demand.
- **Risks include: a)** South American soybean crops exceeding expectations, and b) the relaxation of biofuel policies by major oilseed and vegetable oil-producing countries will pose another risk to market dynamics.
- **Investment strategy: Maintain OVERWEIGHT with CPO ASP assumption at RM4,200 for 2024. We recommend investors to c**apitalise on the potential supply deficit in CPO through investment in Malaysia-based plantation companies. This preference is rooted in several factors, including: a) anticipated yield recovery facilitated by increased fertiliser application and enhanced maintenance efforts, with companies augmenting their workforce; b) lessened impact of El Nino; and c) a substantial decline in the cost of fertilisers.
- **Top picks:** Among companies with substantial exposure in Malaysia, IOI Corporation and Hap Seng Plantations are our top picks. Additionally, we favour companies that are poised to outperform their peers due to superior production growth stemming from a younger age profile and/or strategic operating locations that are relatively less affected by El Nino. Notable contenders in this category include Genting Plantations, Bumitama Agri, and Triputra Agro.

SEGMENTAL RATING

Segment	Rating
Indonesia	OVERWEIGHT (MAINTAINED)
Singapore	OVERWEIGHT (MAINTAINED)
Malaysia	OVERWEIGHT (MAINTAINED)

Source: UOB Kay Hian

SECTOR PICKS

Company	Ticker	Rec	Share Price (lcl currency)	Target Price (lcl currency)
Genting Plantations	GENP MK	BUY	6.30	6.40
Hap Seng Plantations	HAPL MK	BUY	1.84	2.25
IOI Corporation	IOI MK	BUY	3.98	4.80
Kuala Lumpur Kepong	KLK MK	BUY	22.42	25.90
Sime Darby Plantation	SDPL MK	BUY	4.31	5.00
Bumitama Agri	BAL SP	BUY	0.60	0.70
Astra Agro Lestari	AALI IJ	BUY	7,125	8,995
Triputra Agro	TAPG IJ	BUY	550	900

Source: Bloomberg, UOB Kay Hian

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PEER COMPARISON

Company	Ticker	Rec	Share Price 12 Jan 24 (local currency)	Target Price	Market Cap (US$m)	PE 2022 (x)	PE 2023F (x)	PE 2024F (x)	ROE (%)	P/B (x)	2024F Div	Div Yield (%)
Malaysia			(RM)	(RM)							(sen)	
Genting Plantations	GENP MK	BUY	6.30	6.40	1,216	12.0	18.2	16.7	9.1	1.1	16.5	2.6
Hap Seng Plantations	HAPL MK	BUY	1.84	2.25	317	7.0	11.8	8.4	11.0	0.8	13.1	7.1
IOI Corporation	IOI MK	BUY	3.98	4.80	5,312	15.6	16.5	15.1	10.0	2.2	13.7	3.4
Kuala Lumpur Kepong	KLK MK	BUY	22.42	25.90	5,202	11.2	16.5	14.0	5.8	1.7	80.0	3.6
Sime Darby Plantation	SDPL MK	BUY	4.31	5.00	6,413	14.3	25.3	14.6	13.8	1.5	17.7	4.1
Kim Loong Resources	KIML MK	HOLD	2.14	1.95	448	11.3	11.7	11.1	19.7	2.4	16.3	7.6
Sarawak Oil Palms	SOP MK	HOLD	2.63	3.00	504	4.9	7.6	6.1	15.7	0.7	17.3	6.6
Singapore			(S$)	(S$)							(cent)	
Bumitama Agri	BAL SP	BUY	0.60	0.70	781	8.4	6.2	2.9	24.8	1.3	4.6	8.3
First Resources	FR SP	HOLD	1.47	1.65	1,728	14.4	10.0	4.7	25.9	1.3	10.1	7.3
Wilmar International	WIL SP	HOLD	3.45	3.80	16,175	9.9	8.1	6.3	12.0	0.8	22.0	6.4
Indonesia			(Rp)	(Rp)							(Rp)	
Astra Agro Lestari	AALI IJ	BUY	7,125	8,995	882	16.5	5.8	8.4	8.2	0.6	445.7	6.3
Triputra Agro	TAPG IJ	BUY	550	900	702	11.5	9.4	3.8	34.0	1.1	45.2	8.2
London Sumatra	LSIP IJ	HOLD	885	1,150	388	8.7	6.1	6.3	9.8	0.5	51.6	5.8

Source: Bloomberg, UOB Kay Hian

ESSENTIALS

- CPO prices have been under pressure lately due largely to a drag from the soybean market as the recent rains in South America reduced bullishness on soybean outlook and resulted in selling pressure. In addition, the recent El Nino turned out to be milder than expected, thus resulting in concerns on the negative impact on palm oil production subsiding. However, we maintain our view that CPO prices are set for a gradual upward trend and we forecast an ASP of RM4,200/tonne for 2024. This forecast is backed by:

  a) **The global vegetable oil market is expected to face tighter conditions throughout 2024** due to higher domestic usage by producing countries. Despite the strong 5.4% yoy increment in oilseeds production for 2023/24, global vegoil production is expected to only increase by 2.9% yoy. We attribute this to:

     i) **Slower soybean crushing in China.** China is the largest soybean oil consumer, accounting for about 28% of the global total soybean oil consumption. We expect soybean crushing volume to be lower in 1H24 as China's pig farming industry is still dealing with overcapacity currently, and pork consumption has not recovered, which would reduce soybean meal demand. Hence, lower soybean crushing is expected for 2024, which would result in lower soybean oil in the market.

     ii) **Higher biofuel/biodiesel demand.** Based on the Oil World report, global biodiesel consumption is expected to increase by 6.5% yoy, with the most significant increase from the US, Argentina, Brazil and Indonesia. Most of the crop-producing countries have also increased their domestic biodiesel mandate to leverage on their own domestic production. For instance, the Indonesian government is maintaining the biodiesel mandate at B35 for 2024 (note that Indonesia started their B35 biodiesel mandate in Aug 23, with B30 biodiesel mandate before that), The Brazilian government has also recently increased the biodiesel mandate from B12 to B14, effective from Mar 24.

     iii) **US renewable diesel capacity continues to expand with more planned additional capacity coming on-stream.** Based on the US Energy Information Administration, the potential for US renewable diesel production capacity to surpass current levels and possibly more than double by end-25 is driven by numerous project announcements underway or in the pipeline, for which the usual feedstock would be soybean and rapeseed.

  b) **Weather-related challenges.** The impact of El Nino restrained FFB production growth, especially in Indonesia. Hence, we expect CPO production growth to be flat yoy in 2024. Note that palm oil-producing areas were affected by El Nino from Jul-Aug 23 onwards, especially in South Sumatera, South Kalimantan and Central Kalimantan. The number of hotspots in Indonesia had also increased significantly in Aug-Sep 23 due to El Nino. The impact from El Nino would be reflected in 2Q24-3Q24's FFB production. These regions contribute about 28% of Indonesia's palm oil production, translating to about 16% of global palm oil production.

EVENTS TO WATCH

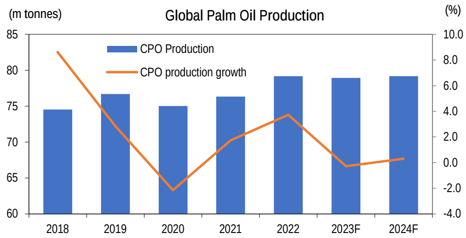
- **Indonesia and a year of elections.**

  a) **Presidential and regional elections.** The policies related to the palm oil industry are not expected to be significantly affected by the Indonesian Presidential election, which is set to take place on 14 Feb 24. However, domestic consumption could increase due to handout of goodies, which could reduce the availability of Indonesia palm oil exports. Note that Indonesia's regional elections will take place on 27 Nov 24.

  b) **Policy risk.** Note that the Indonesian Domestic Market Obligation (DMO) for palm oil is still in effect, and any significant increase in prices could prompt the Indonesian government to intervene by controlling cooking oil prices under the DMO regulation. Such intervention could impact domestic palm oil pricing in Indonesia and result in export limitations. Recall that the government increased DMO volume and reduced the exports permits ration before Lebaran (2024 Lebaran is on 10/11 Apr 24).

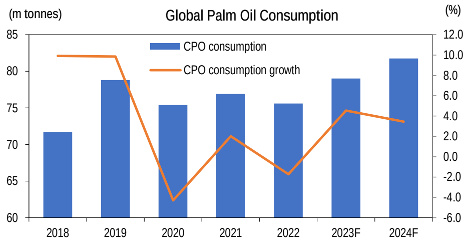
  c) **B40 biodiesel mandate from Indonesia.** Indonesia's biodiesel programme consumes about 15% of global palm oil production. The current biodiesel mandate for 2024 is at B35, which would consume about 13.4m kl (equivalent to 11.5m tonnes) of biodiesel. If

GLOBAL PALM OIL PRODUCTION GROWTH DECERERATING



Source: Oil World, UOB Kay Hian

GLOBAL PALM OIL CONSUMPTION STILL GROWING DRIVEN BY BIOFUEL



Source: Oil World, UOB Kay Hian

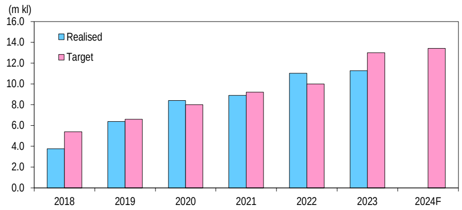
HIGHER BIOFUEL DEMAND FOR 2024

BIODIESEL & HVO : World Production by Ctry (Mn T)

January/December	2024F	2023	2022	2021	2020
EU-27	15.40*	15.20*	15.34	15.28	15.40
U.K.	.32*	.31*	.31	.33	.31
U.S.A.	14.50*	13.38*	10.23	8.49	7.86
Canada	.47*	.43*	.31	.37	.39
Argentina	1.30*	.90*	1.91	1.72	1.16
Brazil	7.30*	6.45*	5.47	5.92	5.64
China	2.50*	2.40*	2.20	1.80	1.50
Colombia	.80*	.77*	.74	.68	.53
India	1.05*	.80*	.50	.25	.15
Singapore	2.30*	2.00*	1.75	1.80	1.80
Indonesia	11.25*	10.80*	10.00	8.44	7.48
Malaysia	1.05*	1.10*	.90	.92	.91
Thailand	1.50*	1.60*	1.40	1.60	1.65
Oth. ctries	1.69*	1.52*	1.48	1.53	1.52
Total	**61.43***	**57.66***	**52.54**	**49.12**	**46.28**
Change in (Mn T)	*+3.77**	*+5.12**	*+3.42*	*+2.84*	*+.28*

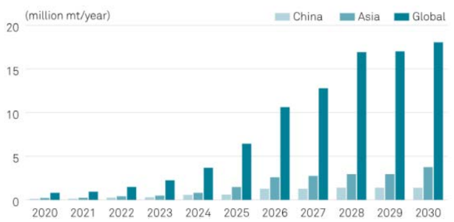
Source: Oil World

INDONESIA BIODIESEL ANNUAL ALLOCATIONS



Source: APROBI, ESDM

ESTIMATED GLOBAL SUSTAINABLE AVIATION FUEL PRODUCTION



Source: S&P Global Commodity Insight

the Indonesia government raises the biodiesel mandate to B40, biodiesel consumption is expected to increase 14% (based on annualised forecast) to 15.3m kl (equivalent to 13.2m tonnes). This would contribute about 19% of global palm oil production.

- **Rising geo-political risks could disrupt global trade flow.**

  a) **Russia-Ukraine war still ongoing with escalation risk.** This could potentially impact trade flow from both countries. In addition, the impact from the destruction of the Kakhovka Dam in Ukraine on the next planting season is still not clear. Ukraine and Russia are the key exporters of wheat and sunflower seeds/oils. Any major disruption would tighten the supply of grain and vegoil market.

  b) **Middle East tensions escalating as well.** The impact of crude oil price (positive correlation to vegoil prices) and Red Sea disruption could lead to rising freight cost and trade disruptions.

- **Weather risks.** The latest weather forecasts have confirmed that El Nino has peaked, but the transition to ENSO-neutral has been delayed to April-June (from Mar-May 24). In addition, there are also increasing odds of La Niña happening in 2024 following a shift to ENSO-neutral (from Jul 24 onwards). The resurgence of La Niña needs to be monitored closely as it will lead to dryness in North America

ACTION

- **Maintain OVERWEIGHT.** We expect CPO prices to trade between RM3,800-4,200/ tonne in 1Q24. This projection is influenced by the intensifying El Nino phenomenon and the constrained supply of alternative vegetable oils. In light of this outlook, we recommend investors to strategically accumulate positions in upstream plantation companies exhibiting better-than-peers production growth.

- **Higher earnings yoy, margin expansion in 2024.** We note that net profit margin is normalising with the cost of production normalising from the crazy high of RM2,800-3,200/tonne in 2022-1H23 brought about by record-high fertiliser prices and crude oil prices. Based on the recent earnings announcement, most plantation companies reported significant qoq growths in 3Q23 mainly due to lower production costs; we expect this cost to continue softening in 2024. We expect the growth in sector earnings to remain robust at +36% yoy in 2024. This projection is underpinned by the expected expansion of margins, driven by reduced production costs (especially fertiliser price) and our internal forecast of a higher CPO price at RM4,200/tonne for 2024

- **Sector earnings.** Malaysia-listed plantation companies have a higher expected earnings growth at about 41% yoy for 2024, while Indonesia- and Singapore-listed plantation companies should see earnings growth of about 32% yoy. The variance is attributable to lower production growth among Indonesian companies, a consequence of the dryness impact from El Nino.

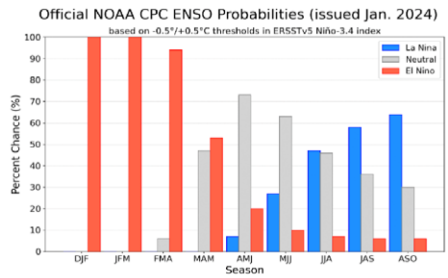
- **Prefer pure Malaysian plantation companies.** If investors are keen on this sector, we recommend pure Malaysian plantation companies as they are able to leverage on high CPO prices without being affected by policy uncertainties. Among companies with substantial exposure in Malaysia, **IOI Corporation and Hap Seng Plantations** are our top picks.

- We also favour companies poised to **outperform their peers due to superior production growth stemming from a younger age profile and/or strategic operating locations** that are relatively less affected by El Nino. Notable contenders in this category include **Genting Plantations, Bumitama Agri, and Triputra Agro.**

- Additionally, we wish to **highlight Genting Plantations (GENP) for its promising upside in valuation,** primarily attributed to its involvement in the Johor property market. This is particularly noteworthy in light of the upcoming Johor-Singapore Special Economic Zone and the proposed high-speed rail connecting Kuala Lumpur to Singapore. GENP is actively engaged in two township projects in Batu Pahat and Kulai, boasting a substantial landbank of 8,596 ha. Assuming that Genting Plantations converts 1,000 ha in Kulai for property development at RM12 psf (based on the latest land acquisition price in Kulai in Sep 23 by Eco World Development), the potential land sale value per share for Genting Plantations could amount to RM1.44.

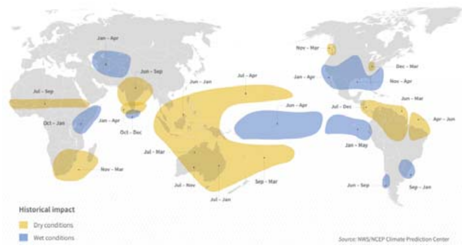
- **To capitalise on the uptrend in CPO prices,** we suggest exploring short-term trading opportunities with Kuala Lumpur Kepong, Sime Darby Plantations, and Astra Agro Lestari.

EL NINO SUBSIDING, BUT RISING ODDS FOR THE RETURN OF LA NINA



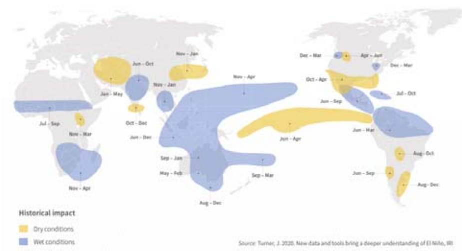
Source: NOAA

EL NINO AND RAINFALL



Source: NWS/NCEP Climate Prediction Center

LA NINA AND RAINFALL



Source: NWS/NCEP Climate Prediction Center

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