SECTOR UPDATE

Plantation – Malaysia

2H24 Outlook: Anticipate Higher CPO Prices Due To Tighter Palm Oil Supplies

We expect higher CPO prices in 2H24 due to tighter supplies and gradually returning demand as palm oil regains its pricing competitiveness. This can be further supported by lower production due to unfavourable weather in 2H23 and 1Q24, along with recovering demand, as Indian and Chinese palm oil inventories have been trending downwards. Maintain OVERWEIGHT and pick companies with good growth prospects and dividend yields.

WHAT'S NEW

- **Maintain our CPO price forecast for 2024 at RM4,200/tonne.** Ytd CPO prices average RM4,029/tonne (US$852/tonne), which are still within our expectation. We anticipate CPO prices trading higher in 2H24 due to tighter palm oil supplies, while demand is gradually returning as palm oil regains its pricing competitiveness. Additionally, short-term weather disruptions are affecting other crops, leading to lower production and shipment delays due to Red Sea tensions, and may continue to support CPO prices at the current level, trading in the range of RM3,800-4,500/tonne.

- **Margins are improving.** Based on companies' latest 1Q24 earnings announcements, most of them reported a weaker qoq earnings growth mainly due to lower CPO production and sales volume despite an improvement in CPO ASP. Having said that, operating margin improved significantly from 13.8% in Dec 23 to 17.2% in 1Q24, thanks to lower production costs and stable CPO ASP. We expect sector earnings growth to remain robust at 49% yoy in 2024. This projection is underpinned by the expected expansion of margins, driven by reduced production costs (especially fertiliser prices), yield recovery and our internal forecast of a higher CPO price of RM4,200/tonne for 2024. On top of that, we have also observed higher pricing for by-products such as palm kernel oil and palm stearin which have improved by 23.5% and 9.4% ytd respectively.

- **Strong cash balance, high dividend.** In the past two years, many plantation players have become net cash companies due to strong cash flow from high CPO prices and low capex. This financial strength has allowed them to raise dividend yields through higher payout ratios. Given their strong cash positions, plantation companies are expected to continue offering relatively high dividend yields, reflecting their financial stability and commitment to shareholder returns. Companies have been providing strong dividend yields of 5-10% in recent years, supported by strong cash flows resulting from higher CPO prices.

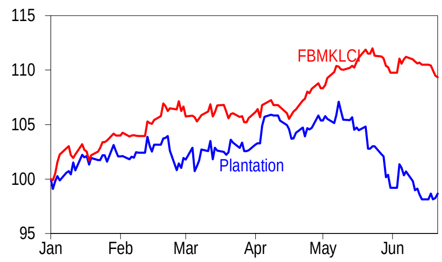
ACTION

- **Maintain OVERWEIGHT** as we foresee the elevated CPO prices continuing to support earnings and good dividend payout. Steady earnings growth may not be as attractive relative to the thematic theme now, but this sector could be a good investment for investors looking for steady capital appreciation as CPO prices may be supported by limited production growth going forward and good dividend yield. Top picks: IOI Corporation (IOI MK) and Hap Seng Plantations (HAPL MK).

OVERWEIGHT

(Maintained)

PLANTATION INDEX UNDERPERFORMED THE FBMKLCI

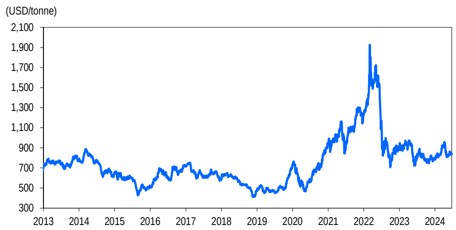


Source: Bloomberg

1H24 REVIEW

- Underperformed by -1.3% ytd in 2024
- CPO prices trading at RM3,700-4,500/tonne
- Tight palm oil supply a supportive factor for 1H24

CPO PRICE MOVEMENT



Source: Bloomberg

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PEER COMPARISON

Company	Ticker	Rec	Price @ 2 July 24 (RM)	Target Price (RM)	Market Cap (US$m)	PE 2023 (x)	PE 2024F (x)	PE 2025F (x)	ROE (%)	P/B (x)	2024F Div (sen)	Div Yield (%)
Malaysia												
Genting Plantations	GENP MK	BUY	6.09	6.65	1157.3	17.6	17.6	15.6	4.8	1.0	17.1	2.8
Hap Seng Plantations	HAPL MK	BUY	1.74	2.25	294.7	6.6	15.2	8.8	4.7	0.7	11.8	6.8
IOI Corporation	IOI MK	BUY	3.73	4.8	4901.3	14.6	14.0	13.2	10.0	2.0	14.7	3.9
KL Kepong	KLK MK	BUY	20.48	24.8	4756.1	10.2	14.0	13.4	5.8	1.5	76.3	3.7
Kim Loong	KIML MK	HOLD	2.18	1.95	450.2	11.5	13.0	12.0	17.4	2.5	15.5	7.1
SD Guthrie	SDG MK	HOLD	4.24	4.15	6210.8	14.1	36.0	17.5	9.6	1.5	14.5	3.4
Sarawak Oil Palms	SOP MK	HOLD	2.81	3	530.8	5.2	8.3	6.5	8.8	0.7	8.6	3.1

Source: Bloomberg, UOB Kay Hian

ESSENTIALS

- **Production may come in lower than market expectations.** Our recent meetings with producers indicate that Malaysian and Indonesian palm oil production may fall short of market expectations. The market was optimistic due to the strong production recovery in 5M24 despite flooding in some parts of Sabah and Kalimantan. However, we expect slower production growth in 2H24 due to impact from the unfavourable weather conditions in 2H23 and 1Q24. The recent high rainfall in Sabah and East Kalimantan also affected the oil extraction rate (immediate impact leading to lower CPO production) and pollination rate (4-6 months lag impact).
- **Production could be lower, but supply could be even tighter.** We expect higher domestic demand yoy in Indonesia for 2H24 (potentially higher biodiesel blending volume), while production is forecast to be lower yoy as mentioned above. This will result in less palm oil available for export. Additionally, smaller palm oil exporters such as Thailand and Papua New Guinea are experiencing declining production due to dryness in 2023 and high rainfall respectively.
- **Demand is recovering.** Indian and Chinese palm oil inventories have been trending downwards, with the latest data showing a decline of 44.8% and 57.9% ytd respectively. The demand recovery since Apr 24 has been driven by a recent price rally for competing vegetable oils, making palm oil prices more competitive and providing positive import and processing margins for importers in destination markets.
- **Events to watch out for.** The following events could impact our current key assumptions:

  a) **Swing from El Nino to La Nina in the same year.** The 2023/24 El Nino event, which helped fuel a spike in global temperatures and extreme weather around the world, is showing signs of ending. There is likely to be a swing back to La Nina conditions later this year with a 70% possibility during Aug-Nov 24. La Nina is causing high rainfall in palm oil-producing countries and dryness in countries that produce soybean oil (SBO). This may affect soybean production in Brazil and Argentina. In the palm oil space, should La Nina materialise, the resulting heavy rain in Indonesia and Malaysia will cause delays in harvesting, slowing down fruit evacuation and disrupting logistic connections to mills, refineries and ports.

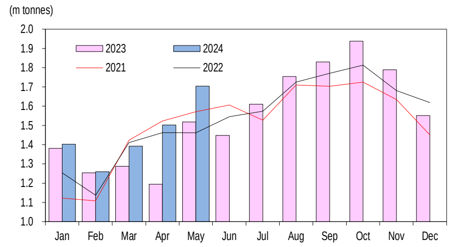
  b) **Record soybean harvests year after year.** Ample soybean supplies with good production were seen from South America despite some weather disruption during the planting season in North Brazil and high rainfall during the harvesting season in South Brazil and Argentina. In addition, in the latest United States Department of Agriculture (USDA) forecast, the US is also expected to plant more soybean in the 2024/25 season with an estimated production of 121.11m tonnes or 6.8% growth yoy. USDA also made an estimation of 8.3% yoy growth for soybean production from Brazil and Argentina. However, crushing utilisation is more critical, ie, if soybean is not crushed then there would be lower supply of soybean oil. One of the critical factors to monitor which influence soybean crushing utilisation would be demand for animal protein.

  c) **Macroeconomic uncertainties persist,** including the pace of China's economic recovery, potential slowdown in the US, escalating tensions in regions like Russia-Ukraine and Israel-Pakistan, and the impact on freight rates.

ACTION

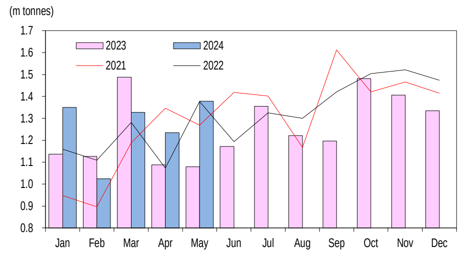
- **Hap Seng Plantation (HAPL MK/BUY/Target: RM2.25)** will benefit the most as it only sells in the spot market and enjoys better CPO ASP. As one of the most cost-efficient plantation companies, HAPL's EBIT margin was 31% in 1Q24, compared with the peer average of 17%. Our target price of RM2.25 is based on 11x 2024F PE, or -1SD to its five-year mean.
- **IOI Corporation (IOI MK/BUY/Target: RM4.80)** has the highest exposure to Malaysia, as well as higher refining margins as compared with other big-cap plantation companies. Valuation is also cheaper at about 15x as compared with other big-cap plantation players which are trading at 20-25x. The SOTP-based target price is pegged to 17x FY25F PE for the plantation division, 15x FY25F PE for the resources-based manufacturing division, a fair value of S$0.70/share for its 32% stake in Bumitama Agri and 18x FY25F PE for the contribution from Loders.

MALAYSIA PALM OIL PRODUCTION



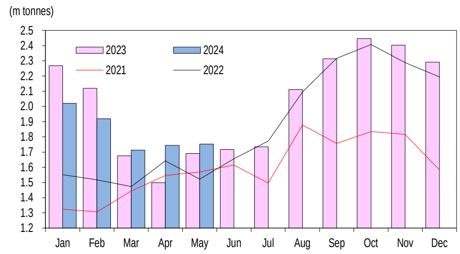
Source: MPOB

MALAYSIA PALM OIL EXPORTS



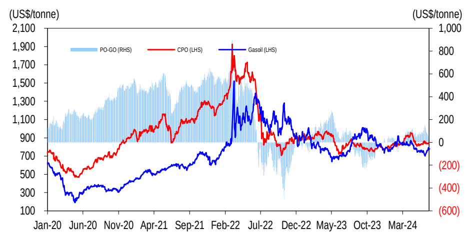
Source: MPOB

MALAYSIA PALM OIL INVENTORY



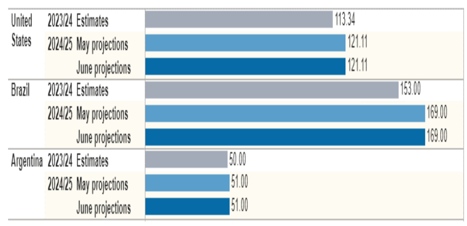
Source: MPOB

CPO PRICES AT A PREMIUM TO GAS OIL PRICES



Source: Bloomberg

USDA FORECAST FOR 2024/25 SOYBEAN PRODUCTION



Source: USDA

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