

SECTOR UPDATE

Plantation – Malaysia

Sustainability Is Being Paid Off Slowly

From our dialogue session with the CEO of RSPO, Mr Joseph D'Cruz, we gathered that both the supply and demand for CSPO have been increasing over the years with global awareness on sustainable supply chain. This had also benefitted some of the CSPO producers with price premium given to CSPO, where the price premium can range between 3-10% above the current CPO prices. Maintain MARKET WEIGHT. Top picks are IOI and HAPL on the back of better financial performance.

WHAT'S NEW

- **More RSPO certified palm oil in the pipeline.** The Roundtable on Sustainable Palm Oil certified sustainable palm oil (CSPO) production had increased by 5.7% yoy in 2021 to 14.7m tonnes, representing 19% of the global CPO production. If all RSPO grower members' palm oil production is 100% RSPO certified, the estimated total CSPO would represent about 41% of total global production.
- **Higher demand for CSPO.** Alongside the increased awareness on supply chain sustainability, the demand for CSPO had increased over the years with CSPO consumption representing almost 12% of global palm oil consumption. CSPO consumption had increased by 12% yoy to 8.53m tonnes in 2021. We also gathered that the demand for identity preserved (IP) and segregated (SG) certified palm oil has been increasing over the years (especially from Europe, North America and Japan). (Kindly refer to the type of RSPO certification in the next page).
- **Not all CSPO are sold as sustainable palm oil.** Despite the growing supply and demand for CSPO, only 61% of CSPO are sold/recognised as sustainable palm oil. This was mainly because 19% of the CSPO are sold as other under schemes (such as the International Sustainability & Carbon Certification (ISCC)) and the remaining 20% were mainly sold in the conventional markets without any premium given despite being certified.
- **Leading to price premium.** Based on our channel checks, some of the sustainable palm oil producers enjoy a higher price premium, thanks to their sustainability-related certification (such as RSPO or ISCC) and marketing strategy which is in line with higher consumer awareness on supply chain sustainability. The IP certified palm oil has price premium of about 3-4 times as compared with the mass balance (MS) certified palm oil. Generally, RSPO certified palm oil price premium can range between 3-10% above the current CPO prices.

ACTION

- **Maintain MARKET WEIGHT.** We expect CPO prices to recover from the current level as production from both Malaysia and Indonesia in 4Q22 may not be as great as market expectation due to the triple La Nina weather phenomenon and low yield due to a lack of fertiliser application in the previous years. However, there are no near-term catalysts for plantation share price performance with the exception of IOI Corporation (IOI MK/BUY/Target: RM4.80) and Hap Seng Plantations (HAPL MK/BUY/Target: RM2.80), where we expect their financial performance to outperform peers' and be supportive to share price performance. On top of that, IOI's Peninsular Malaysia CPO production and HAPL's CPO production are certified under IP certification, which command the highest premium.

PEER COMPARISON

Company	Ticker	Rec	Price @ 14 Sep 22	Target Price	Market Cap (US\$m)	PE			ROE (%)	P/B (x)	2022F Div	Div Yield (%)
			(RM)	(RM)		2021 (x)	2022F (x)	2023F (x)			(sen)	
Malaysia												
Hap Seng Plantations	HAPL MK	BUY	2.32	2.80	410	8.3	8.1	16.5	12.5	1.0	17.2	7.4
IOI Corporation	IOI MK	BUY	4.08	4.80	5,598	18.4	16.1	20.6	16.5	2.3	13.2	3.2
Kim Loong	KIML MK	HOLD	1.70	1.80	364	8.6	9.0	9.6	17.5	1.9	15.4	9.1
KL Kepong	KLK MK	HOLD	22.08	25.25	5,258	10.5	13.3	16.1	19.9	1.8	99.8	4.5
Sime Darby Plantation	SDPL MK	HOLD	4.33	4.75	6,614	12.7	13.5	28.3	13.6	1.6	9.8	2.3
Sarawak Oil Palms	SOP MK	HOLD	2.54	2.47	499	2.8	4.4	7.9	19.7	1.0	23.0	9.1
Genting Plantations	GENP MK	HOLD	6.40	5.90	1,268	13.3	15.3	25.4	8.6	1.1	25.2	3.9

Source: UOB Kay Hian

MARKET WEIGHT

(Maintained)

STOCK PICKS

Company	Rec	Share Price (lcl currency)	Target Price (lcl currency)
Hap Seng Plantations	BUY	2.32	2.80
IOI Corporation	BUY	4.08	4.80

Source: UOB Kay Hian

RSPO-CERTIFIED PLANTATION COMPANIES

Companies	RSPO
GENP MK	√
IOI MK	√
KLK MK	√
SDPL MK	√
HAPL MK	√
SOP MK	x
KIML MK	x

Source: RSPO

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ESSENTIALS

- **Allegations on forced labours on two RSPO members.** US Customs and Border tactionion (US CBP) issued the withhold release order to two RSPO members (Sime Darby Plantation and FGV Holdings) in 2020 due to forced labour. Sime Darby Plantation had submitted its independent audited assessment report to US CBP and is waiting for a response, while FGV Holdings intends to submit its final assessment report to US CBP by the end of 2022. RSPO mentioned that it is still collaborating with both companies on the forced labour issues if there is such violation under RSPO standards. Note that RSPO standards always align with International Labour Standards (ILO) where there are independent auditors involved.

SECTOR CATALYSTS

- **Lower-than-expected Malaysia palm oil production.** Due to the weather uncertainties and a triple-dip La Nina weather phenomenon, we expect a slower-than-expected yield recovery from the older trees and lower oil extraction rate (OER). Hence, we expect Malaysia palm oil production to come in lower than market expectation at around 18.0m tonnes (market expectation: 18.3-18.7m tonnes)
- **Indonesia's production growth may suffer from crop losses.** Recall that some of the Indonesian palm oil mills were closed or refused to take in external crops in 2Q22 due to internal stockpile. Hence, there were a lot of fruit left on the trees to rot. This would affect the production in the upcoming months where harvesters would need to spend more time to trim the branches and may also affect the production yield moving forward. With this, we expect Indonesia's palm oil production growth may come in lower than market expectations.

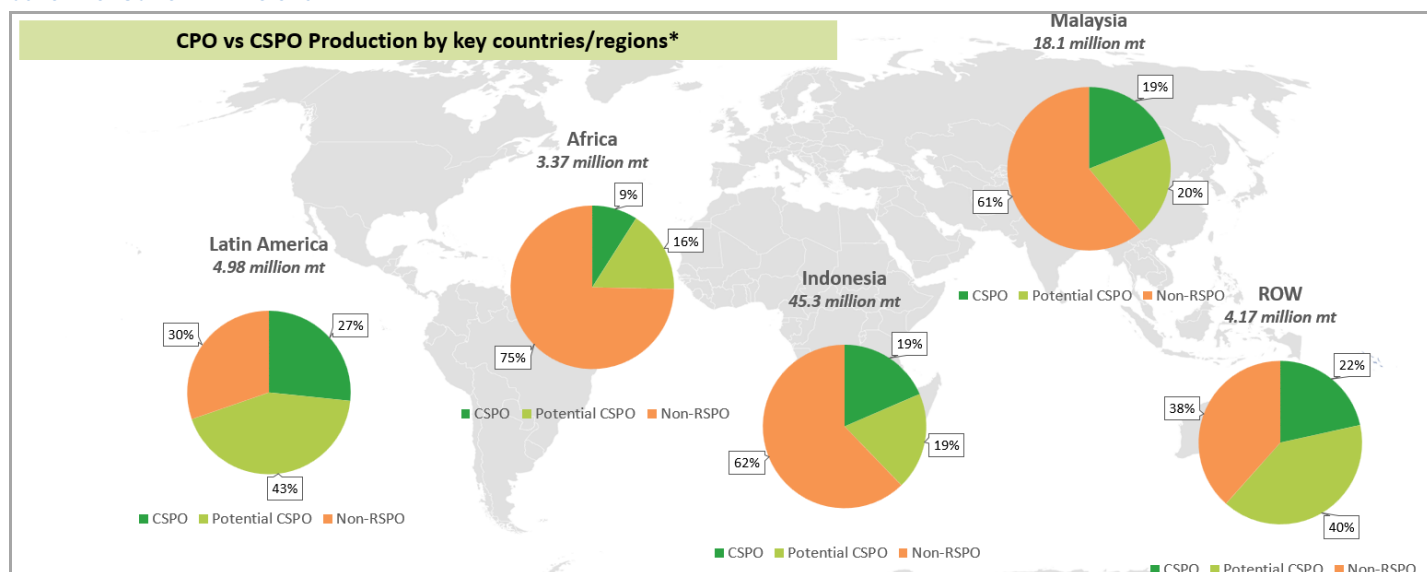
ASSUMPTION CHANGES

- **No change to CPO ASP assumptions.** We maintain our CPO price assumptions at RM5,200/tonne and RM4,000/tonne for 2022 and 2023 respectively.

RISKS

- Higher demand from biodiesel and renewable diesel may lead to higher-than-expected vegoil consumption and mitigate the recession risk concern.

CSPO PRODUCTION BY REGIONS

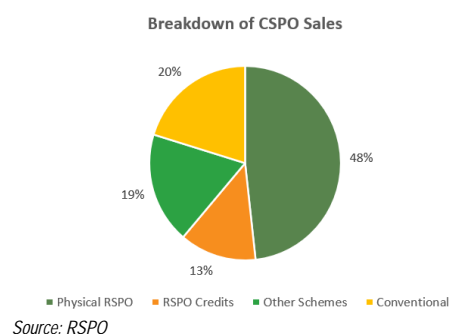


TYPE OF RSPO CERTIFICATIONS



Source: RSPO

BREAKDOWN OF CSPO SALES



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