



AmInvestment Bank

Sector report

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PLANTATION

Price effect offsets lower output

UNDERWEIGHT

Gan Huey Ling, CFA

gan-huey-ling@ambankgroup.com

+603 2036 2305

Rationale for report : Sector update

Investment Highlights

- **Upstream net profit growth of 10% to 55% YoY in 1Q2020 driven mainly by CPO price.** The quarterly results of most plantation companies were weaker than consensus estimates in spite of the strong 10% to 50% YoY growth in upstream profits. Upstream earnings were tempered by softer downstream profits and lower-than-expected FFB production in 1Q2020. Also, CPO prices have fallen since 1Q2020 and are expected to remain unexciting in 2Q2020.
- **Strong CPO prices helped compensate for the YoY fall in industry FFB production in 1Q2020.** Average CPO prices realised by the planters ranged from RM2,599/tonne to RM2,704/tonne in 1Q2020, more than 30% YoY higher.
- **FFB production growth was poor YoY in 1Q2020.** The YoY decline in industry FFB production in 1Q2020 can be attributed to the lagged impact of the drought and haze in Malaysia and Indonesia, which took place in 3Q2019. In the case of FGV Holdings, the group's FFB yield was also hit by lower fertiliser application in FY19. FGV only applied 65% of its full-year fertiliser requirements in FY19. FFB production of the planters in our universe plunged by 9.8% to 32.6% YoY in 1Q2020. In our coverage, FGV recorded the sharpest YoY drop in FFB production in 1Q2020. In contrast, IJM Plantations and TSH Resources bucked the downward trend by achieving YoY increases of 2.1% and 1.6% in FFB output in 1Q2020 respectively.
- **Going forward, we believe that industry FFB production would rise QoQ in 2Q2020.** Oil palm trees are entering the peak production period in 3Q2020. Also, as estate workers are not allowed to return home for the Aidilfitri holidays, they would be harvesting more FFB in the estates. In previous years, estate workers took a two- to four-week break for the Aidilfitri holidays. This resulted in industry CPO production being weak for the month.
- **Downstream earnings were mixed in 1Q2020.** IOI Corporation experienced a YoY erosion in downstream margin in 1Q2020. This was mainly due to lower sales volume and a surge in CPO prices in 1Q2020, which resulted in a higher cost of feedstock. In contrast, Sime Darby Plantation's (SDP) downstream EBIT margin improved YoY in 1Q2020 on the back of fair value gains of RM62mil in commodity hedges.
- **IOI's manufacturing EBIT margin declined to 2.7% in 1Q2020 from 7.9% in 1Q2019 while SDP's manufacturing EBIT margin rose to 3.8% in 1Q2020 from 2.7% in 1Q2019.** Going forward, we think that downstream earnings would remain lacklustre. Although CPO prices have declined in 2Q2020, we believe that oleochemical companies would be affected by lower selling prices and weaker demand resulting from Covid-19.
- **2Q2020 upstream earnings to be weaker than in 1Q2020 and 2Q2019.** We believe that upstream results of plantation companies would be weaker in 2Q2020 compared with that of 1Q2020 due to the decline in CPO prices. Average MDEX spot price has been RM2,188/tonne so far in 2Q2020 compared with average MPOB spot price of RM2,703/tonne in 1Q2020. Comparing 2Q2020 against 2Q2019, we reckon that plantation results would be flat or lower. Average MPOB spot price was RM1,978/tonne in 2Q2019.
- **UNDERWEIGHT.** We maintain UNDERWEIGHT on the plantation sector as CPO prices are expected to be unexciting for now. We believe that any increase in CPO price would be capped by weak global demand. We are keeping our average CPO price assumption of RM2,300/tonne for Malaysia in 2020F (2019 MPOB spot price: RM2,119/tonne).

EXHIBIT 1 : VALUATION MATRIX

	Share price	Basic EPS (sen)		Basic PE (x)		Fair values	Upside	FY20F	FY20F
	(RM)	FY20F	FY21F	FY20F	FY21F	(RM)		DPS (sen)	Div yield
IOI Corp	4.48	12.6	15.8	35.6	28.4	3.17	-29.2%	8.0	1.8%
KLK	22.10	67.0	90.4	33.0	24.4	18.10	-18.1%	55.0	2.5%
SD Plantation	5.10	10.1	13.7	50.5	37.2	3.43	-32.7%	5.0	1.0%
TH Plantations	0.32	2.4	3.7	13.1	8.5	0.19	-39.7%	2.0	6.3%
Gent Plant	9.88	31.0	36.0	31.9	27.4	7.19	-27.2%	14.0	1.4%
IJM Plantations	1.61	2.8	6.3	57.5	25.6	1.13	-29.8%	2.0	1.2%
TSH Resources	0.84	4.3	4.4	19.4	19.0	0.66	-21.0%	1.5	1.8%
FGV Holdings	1.02	-1.4	2.1	-72.9	48.6	0.70	-31.4%	2.5	2.5%

Source: AmInvestment Bank Bhd

EXHIBIT 3: NET GEARING RATIOS

	Net gearing end-Mar 2020	Net gearing end-Dec 2019	Net gearing end-Sept 2019	Net gearing end-Jun 2019	Net gearing end-Mar 2019	Net gearing end-Dec 2018	Net gearing end-Sept 2018
	(%)	(%)	(%)	(%)	(%)	(%)	(%)
KL Kepong	25.5	27.2	27.2	24.0	25.1	25.1	24.6
IOI Corporation	32.9	23.6	21.7	24.3	26.9	29.5	38.9
IJM Plantations	na	47.6	52.1	51.6	48.8	51.6	48.3
Gent Plantations	35.0	33.5	29.9	28.0	41.2	44.6	40.7
TSH Resources	101.2	90.8	95.7	98.1	97.9	98.4	109.8
Sime Darby Plantation	72.5	72.0	71.5	71.2	69.7	68.9	63.9
FGV	81.1	83.9	89.0	94.3	103.4	99.0	82.9
TH Plantations	na	214.5	169.6	166.5	163.7	150.2	88.0

Source: Companies, AmInvestment Bank

FFB production to pick up in 2Q2020

We believe that industry FFB production in Malaysia and Indonesia would rise QoQ in 2Q2020 as oil palm trees are entering the peak production period in 3Q2020.

In most of the past years, the highest monthly level of CPO production took place in either October or November. Malaysia's CPO production rose by 18.3% MoM and 0.2% YoY in April 2020.

Oil World has forecast Malaysia's CPO production to be 20mil tonnes in 2020F vs. 19.9mil tonnes in 2019. *Oil World* has also estimated CPO output in Indonesia to be 45.4mil tonnes in 2020F vs. 44.1mil tonnes in 2019.

Weaker MYR vs. USD to result in unrealised forex losses on USD borrowings in 2Q2020

We believe that plantation companies in Malaysia may continue to record unrealised forex losses on their foreign denominated borrowings in 2Q2020 as the MYR has depreciated against most currencies.

The weaker MYR is also expected to result in higher net gearing ratios for companies with higher foreign borrowings.

Companies with high foreign denominated borrowings include IJMP and IOI. However, we draw comfort from the fact that the net gearing ratios of these companies are still comfortably below 50% each.

IJMP's net gearing ratio stood at 47.6% as at end-December 2020. About 69.3% of IJMP's gross borrowings of RM852.6mil were denominated in USD. IJMP will be releasing its 4QFY20 results on 26 June 2020.

IOI's net gearing stood at 32.9% as at end-March 2020. Roughly 80.3% of IOI's gross borrowings of RM5.0bil were denominated in USD.

In our coverage, TH Plantations (THP) has a high net gearing ratio of 214.5%. However, all of THP's RM1.28bil borrowings are in MYR and consist mainly of Islamic notes taken up by Lembaga Tabung Haji.

Since the beginning of the year, the MYR has declined against the USD. The USD/MYR exchange rate was US\$1.00:RM4.3465 as at 29 May 2020 compared with the closing rate of US\$1.00:RM4.3212 as at end-March 2020.

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