AmInvestment Bank

Thematic Report

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PLANTATION SECTOR

Implied values of landbank are falling

NEUTRAL

(Maintained)

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Rationale for report : Sector Update

Investment Highlights

- **Taking a look at land values.** In this report, we look at the implied plantation land value of the companies or how much the market is valuing the planted areas of the companies. To arrive at this, we stripped out the value of the non-plantation assets from the market capitalisation of the plantation companies. Then, we divided the sum by the size of the planted areas of oil palm. Overall, the implied market value of the planted areas of the plantation companies in our coverage ranged from a low of RM15,121/ha to a high of RM102,630/ha (based on share prices as at 8 November 2021).

- **IOI Corporation is the most expensive in terms of asset value.** In our coverage, the implied value of the planted landbank of the integrated plantation companies is higher than the smaller players. We attribute the high asset values to the age profile and property development potential of some of the oil palm estates. IOI is the most expensive on an EV (enterprise value) per ha basis while KL Kepong (KLK) is second. The implied market value of IOI's planted landbank is RM102,630/ha while KLK's is RM54,373/ha.

- **Decline in the implied landbank values due to ESG.** Due to the lacklustre performance of the share prices, we find that the implied value of the planted landbank of some of the listed companies to be lower than the transacted prices of physical plantation land. If the large integrated companies had been trading at the peak of their share prices, we believe that their EV/ha would have been higher between RM60,000 and RM125,000.

- **What about FGV?** The implied market value of FGV's planted landbank is high at RM89,582/ha based only on its own landbank of 55,297ha. If we include the land leased from FELDA, the implied market value of FGV's planted landbank is low at RM15,121/ha. We believe that about 80% to 85% of FGV's landbank are leased from FELDA.

- **Cheaper to take over the company for land or buy the physical land instead?** The low implied landbank value of some of the planters implies that it would be cheaper to acquire the company for its oil palm estates instead of buying the physical land. We believe that the selling price of a prime oil palm estate in Sabah is about RM70,000/ha to RM100,000/ha presently. However, only plantation companies with deep pockets and a strong balance sheet would be able to carry out a cash take-over of a listed planter. In addition, it would take time to integrate the operations of the merged entity. Furthermore, there are sustainability issues to consider if the take-over target is not RSPO-compliant. KLK's cash take-over of IJM Plantations (IJMP) is estimated to cost about RM2.7bil (excluding assumption of IJMP's borrowings) in total.

- **Which companies have oil palm estates with property development potential?** KLK has 20,106ha (titled areas) of oil palm estates in Johor and 1,214ha in Sungai Buloh. These are about 9.5% of the group's FY20 planted areas of 223,623ha. Other companies with oil palm estates in Johor include IOI Corporation (23,968ha) and Genting Plantations (10,642ha).

- **What are the selling prices of oil palm estates with solar or property development potential?** In May 2020, Hap Seng Plantations sold 552ha of land in Tawau, Sabah to Hap Seng Consolidated for RM76.0mil or RM229,305/ha. In September 2020, Tradewinds Plantation sold 71ha of land in Alor Gajah, Melaka to Malakoff Corporation for RM150.0mil or RM2.1mil/ha. In September 2021, YTL Power acquired 664ha of oil palm estates in Kulai, Johor for RM428.8mil or RM645,783/ha from Boustead Plantations.

- **Will plantation companies trade at their asset values?** We believe this is unlikely due to a few reasons. First, a high asset value may not translate into high returns. Net earnings of the oil palm estates depend on palm prices, which are cyclical. On the other hand, CPO production costs increase every year. Return on equity of the plantation companies in our coverage ranged from a low of -5.0% to a high of only 8.9% in FY20. Second, plantation companies would have to monetise or sell their landbank to realise their asset values. As palm oil is a core business for planters, this is unlikely to take place unless the plantation company needs cash to reduce its net gearing ratio. Third, ESG issues such as greenhouse gas emissions and alleged forced labour conditions are affecting the share price performances of the planters currently.

- **Does it matter if the plantation land is RSPO-compliant?** So far, it appears that RSPO-compliance does not translate into a higher EV/ha. IJMP was not a member of RSPO but this did not deter KLK from making a cash offer for the group. We estimate that KLK's offer valued IJMP at an EV of RM52,399/ha. In addition, many RSPO-compliance companies have a low EV/ha such as Sime Darby Plantation and Genting Plantations (GenP).

- **High asset values = high PE?** Coincidentally, integrated plantation companies such as IOI and KLK have higher EV/ha and PE compared with their smaller peers. The EV/ha of IOI and KLK are 52.0% to 186.8% higher than the smaller planters such as GenP and TSH Resources. In terms of PE, the integrated players are also more expensive than the smaller planters by 27% to 56%. We think that the integrated players are commanding higher PE multiples because of the size of their planted areas, global operations and integrated value chain.

- **Investing in companies with low EV/ha may not translate into higher returns.** The implied market value of GenP's landbank is only RM35,781/ha. From 31 December 2020 to 29 October 2021, GenP's share declined by 25.9% to RM7.30 from RM9.85. TSH's share price was relatively flat at RM1.17 as at 29 October 2021 vs. RM1.15 as at 31 December 2020. Exception to this was IJMP, which surged to RM3.10 from RM1.82 on the back of KLK's take-over.

- **As such, we reckon that PE is still the most apt.** We believe that PE is most apt compared with other valuation methods as it takes into account the earnings prospects of the companies. We reckon that EV/ha is a useful supplementary valuation tool to assess if a company is a take-over target. Currently, the integrated planters are trading at FY22F PEs of 18x to 22x vs. the smaller companies' 16x to 19x.

- **Neutral on the sector.** In spite of robust CPO prices, we think that ESG concerns would continue to drag the valuations and share price performances of the plantation companies in our coverage. Also at CPO prices of RM5,000/tonne and above, we reckon that there is more downside than upside. A recovery in industry CPO production from 2Q2021 onwards may exert downward pressure on palm prices. Nevertheless for investors, who would like exposure to the palm oil sector, we would recommend Sime Darby Plantation (Fair value: RM4.88/share) for its leverage to CPO prices and resilient downstream operations. Our average CPO price assumption is RM3,000/tonne for 2022F vs. RM3,500/tonne in 2021E.

EXHIBIT 1 : VALUATION MATRIX

	Share price	Basic EPS (sen)		Basic PE (x)		Fair values	Upside	FY21E/FY22F	FY21E/FY22F	Rec
	(RM)	FY21E/FY22F	FY22F/FY23F	FY21E/FY22F	FY22F/FY23F	(RM)		DPS (sen)	Div yield	
IOI Corp	3.89	19.2	17.9	20.3	21.7	4.20	8.0%	11.0	2.8%	Hold
KLK	20.78	131.4	101.0	15.8	20.6	22.22	6.9%	55.0	2.6%	Hold
SD Plantation	4.02	27.7	22.2	14.5	18.1	4.88	21.4%	16.0	4.0%	Buy
Gent Plant	7.02	37.7	37.9	18.6	18.5	8.30	18.2%	22.0	3.1%	Hold
IJM Plantations	3.10	20.2	15.7	15.3	19.7	3.10	0.0%	12.0	3.9%	Acc GO
TSH Resources	1.13	9.8	6.7	11.5	16.9	1.20	6.2%	2.0	1.8%	Hold
FGV Holdings	1.50	4.8	5.6	31.3	26.8	1.25	-16.7%	3.0	2.0%	Sell

Source: AmInvestment Bank Bhd

EXHIBIT 2: IMPLIED MARKET VALUE OF PLANTED LANDBANK (RM/HA)

	Implied Market Value of Planted Landbank (oil palm) (RM/ha)
IOI	102,630
KLK	54,373
Sime Darby Plantation (SDP)	48,801
TSH Resources	48,572
Genting Plantations	35,781
FGV Holdings	15,121
SOP	26,140
Ta Ann	20,510

Source: AmInvestment Bank
Note: FGV's implied market value of planted landbank is based on total planted landbank of 327,607ha, which includes leased land from FELDA
Note: Share prices as at 8 November 2021

METHODOLOGY

In this report, we take a look at the market value of the oil palm estates of the plantation companies in our coverage. In other words, we ascertain how much the market is valuing the companies' oil palm estates after excluding the non-plantation assets.

To do this, we have stripped out the value of the non-palm assets from the market capitalisation of the plantation companies *(see Exhibit 3)*.

Non-palm oil assets include investments in quoted shares, property landbank and downstream assets such as refining and oleochemical.

To value the investments in quoted shares, we have used the market capitalisation of the equity holdings. To arrive at the market capitalisation for instance, we have multiplied Synthomer's share price with the number of shares that Kuala Lumpur Kepong (KLK) owns. To recap, KLK owns 21.1% or 98.4mil shares in Synthomer PLC. TSH Resources owns 21.9% or 105.1mil shares in Innoprise Plantations.

To value the downstream and property assets, we have used PE. We have applied a PE on the estimated net profit of the downstream and property divisions.

For the integrated companies, we have applied a PE of 15x on the downstream earnings. To value KL Kepong's property division, we have applied a PE of 15x on the earnings.

After the value of the non-plantation assets from the market capitalisation has been excluded, we stripped out the cash and added back the debt at the company level.

Then, we divided the sum by the size of the planted landbank *(see Exhibit 3)*. We believe that planted areas are a better gauge of the asset value instead of the total size of the landbank.

Due to the slowdown in new plantings of oil palm and plasma requirements, a plantation company may not be able to plant fully on all of its landbank.

Furthermore as the RSPO approval process for new plantings of oil palm takes time, the size of new plantings has shrunk over the years.

Scrutiny by environmental organisations on new plantings of oil palm has also been intense. Hence, most plantation companies have been focusing on replanting of ageing oil palm trees instead of new plantings.

OUR FINDINGS

- ***Implied market value of landbank is higher for large plantation companies than the smaller ones***

Mostly, we find that the EV/ha corresponds to the size of the company. The implied market value of the planted areas of IOI and KLK are 52.0% to 186.8% higher than the smaller players *(see Exhibit 2)*.

Exception is Sime Darby Plantation (SDP), which has a low EV/ha of only RM48,801/ha. We attribute this to discounted valuations ascribed to SDP due to the ban on SDP's Malaysian products in the USA.

In our coverage, IOI Corporation has the highest implied market value of RM102,630/ha while FGV Holdings has the lowest of RM15,121/ha *(see Exhibit 2)*. Excluding the land leased from FELDA however, FGV's EV/ha would have been expensive at RM89,582/ha.

We believe that the market has accorded a premium to IOI's planted areas due to a few reasons.

First, some of IOI's oil palm estates are located in areas with property development potential such as Segamat (8,353ha) and Kluang (10,5012ha). Second, IOI's oil palm estates in Sabah have been planted for more than 10 years and as such, they do not require significant maintenance, upkeep and infrastructure costs.

In total, IOI has 23,968ha of oil palm estates in Johor *(see Exhibit 4)*. These are about 13.5% of the group's FY21 planted landbank of 176,926ha. Net book value of the oil palm estates was RM1.7bil as at end-June 2021 *(see Exhibit 4)*.

EXHIBIT 3 : SAMPLE CALCULATION – IMPLIED VALUE OF IOI'S PLANTED LANDBANK

Shares outstanding (million)	6,227.2
Share price (RM)	3.91
Market cap (RM'mil)	24,348.4
less:	**RM'mil**
less: Gross cash (co level)	84.9
add: Gross borrowings (co level)	864.2
less: Investment in other associates	2,710.5
less: Shares in Bumitama	818.8
less: Manufacturing earnings	3,745.8
Market value of plantation division	17,852.5
Planted landbank (ha)	173,951
Implied value of planted landbank (RM/ha)	102,629.63

Source: AmInvestment Bank

The implied market value of Genting Plantations (GenP) and TSH Resources' planted areas are RM35,781/ha and RM48,572/ha respectively *(see Exhibit 2)*.

Although GenP is larger than TSH, GenP's EV/ha is lower than TSH. We attribute this to GenP's premium outlet and property units, which negated the strong performance of the plantation division in 1HFY21.

❑ *Do companies with large Indonesian landbank command a landbank premium?*

It appears that the investment community does not ascribe a premium for plantation landbank in Indonesia.

We attribute this to the fact that the HGU land title in Indonesia lasts for only 30 years and then renewable for another 30 years. In addition, CPO prices are lower in Indonesia than Malaysia due to demurrage costs, transportation costs and the CPO export tax and levy.

About 33% of SDP's planted areas are in Indonesia. However, its EV/ha is only RM48,801/ha. On the other hand, the implied value of IOI's planted landbank is RM102,630/ha but roughly only 11.9% of IOI's planted areas are in Indonesia.

We reckon that market prices of oil palm estates in certain areas in Sumatra are close to Sabah's.

However, prices of oil palm estates in Kalimantan are still lower than Sabah. We believe that selling of oil palm estates in Sabah are about RM70,000/ha to RM100,000/ha currently.

In 2016, KLK proposed to acquire MP Evans PLC at an enterprise value (EV) of US$13,000/ha or RM53,851/ha. MP Evans' oil palm estates are located in North Sumatra, South Sumatra, Aceh, Bangka-Belitung and East Kalimantan.

In 2020, KLK proposed to acquire 10,816ha of oil palm estates in East Kalimantan from TSH Resources for RM517.6mil or RM47,857/ha. The proposed acquisition was subsequently rescinded.

❑ *TSH's EV/ha is higher than GenP and just below SDP*

The implied value of TSH's planted landbank is RM48,572/ha. This is just a tad below SDP's RM48,801/ha and higher than GenP's RM35,781/ha *(see Exhibit 2)*.

We believe that TSH's valuations have held up better than SDP and GenP due to a few reasons.

First, TSH has higher leverage to CPO prices as its FFB output growth is stronger than SDP and GenP. More than 90% of TSH's FFB production are from Indonesia. TSH's FFB output growth was 11.0% YoY in 9MFY21 vs. SDP's 0.3% and GenP's 1.0%.

Second, TSH's foreign shareholding is only less than 1.0% compared with SDP's 9.3% (end December 2019: 10.4%) and GenP's 6.0% (end December 2019: 9.0%). Hence, TSH is less vulnerable to foreign selling. We believe that foreign shareholding of the plantation companies has been declining in the past couple of years due to ESG concerns.

Third, SDP's valuations have been affected by the ban on its Malaysian palm products in the USA. SDP's foreign shareholding fell from 10.62% as at end January 2020 to 9.26% as at end September 2021.

EXHIBIT 4 : EXPOSURE TO JOHOR (HA)

	Estates in Johor (ha)	Net Book Value (NBV) (RMmil)	NBV per ha (RM)
IOI	23,968	1,666.3	69,522
KLK	20,106	215.3	10,708
Sime Plant	72,825	1.7	24
Genting Plantations	10,642	448.6	42,153
IJM Plantations	zero	zero	zero
TSH Resources	zero	zero	zero
FGV Holdings	33,911	218.1	6,432

Source: Companies, AmInvestment Bank
Note: NBV are based on historical costs and have not been revalued yet

- ***ESG issues affect valuations but no premium for RSPO compliance***

It appears that there is no premium for RSPO-compliance. Instead, there is a discount for ESG risks.

All of SDP's oil palm estates and 70 palm oil mills were RSPO-certified as at end December 2020. However due to the ban by the US CBP, SDP's Malaysia operations are being audited by the RSPO again this year.

As for GenP, 19 estates and seven out of 12 palm oil mills have been certified by the RSPO. As at December 2020, nine of TSH's oil palm estates and five palm oil mills had already been certified by the RSPO.

All of the plantation companies in our coverage are RSPO members. As such, most of the oil palm estates and palm oil mills of the planters have already been certified by the RSPO.

Exception is IJMP. IJMP was not a member of RSPO. Instead, IJMP had certifications from the MSPO and the ISCC (International Sustainability and Carbon Certification).

Despite IJMP's lack of RSPO certification, the group attracted buying interest from KLK. KLK plans to certify IJMP's operations with the RSPO within three years.

- ***In spite of ESG, few takers for RSPO-certified oil***

In spite of ESG concerns, there are only a few Chinese and Indian buyers for RSPO-certified oil. During the International Palm Oil Sustainability Conference in October 2020, an RSPO official said that the take-up for certified sustainable palm oil (CSPO) from India and China were just 5% and 2% respectively. Some of the largest consumers of CSPO are from the EU and USA.

In response, the RSPO has made certain targets mandatory for RSPO members. In 2021F, the uptake target is 2% growth in CSPO uptake for processors and traders.

For consumer goods manufacturers and retailers, the target is 12% growth for CSPO and 7% for CSPKO. The players are supposed to meet their uptake targets by buying physical RSPO-certified oil to boost the supply chain.

On a negative note, there are no sanctions or incentives for RSPO members if they do not comply.

- ***What about companies with plantations on peat soil?***

We estimate the implied market value of Sarawak Oil Palm's and Ta Ann Holdings' planted areas to be RM26,140/ha and RM20,510/ha respectively *(see Exhibit 2)*.

Plantation companies in Sarawak have oil palm estates, which are on peat soil. It was reported that about 60% to 70% of Ta Ann's planted areas are on peat soil. Also, most plantation companies in Sarawak are not members of RSPO.

According to *Bloomberg* consensus estimates, Sarawak plantation companies such as Ta Ann and Sarawak Oil Palms are currently trading at FY22F PEs of 8x to 10x compared to TSH and Hap Seng Plantation's 13x to 15x.

- ***SDP – low value for PNG assets***

SDP's EV/ha of RM48,801 implies that the market is valuing all of SDP's oil palm estates including those in Papua New Guinea (PNG) below RM50,000/ha.

This is lower than SDP's purchase price of its oil palm estates in PNG. We believe that SDP paid an EV/ha of about RM84,200/ha for New Britain Palm Oil Ltd (NBPOL) back in 2014.

We attribute the large discrepancy between the implied market value and the actual purchase price of the PNG oil palm estates to a few reasons.

First, SDP's purchase of NBPOL was proposed in 2014 when average CPO price was RM2,408/tonne. Subsequently, average CPO prices plunged to RM2,172/tonne in 2015 before rising to RM2,640/tonne in 2016.

EXHIBIT 5 : HISTORICAL MATURE AND IMMATURE AREAS OF PLANTERS (HA)

	Mature (ha)	Immature (ha)	Total planted (ha)
IOI	143,749	33,177	176,926
KLK	178,562	45,061	223,623
Sime Plant	489,393	93,946	583,339
Genting Plantations	111,522	27,703	139,225
TSH Resources	39,718	2,554	42,272
FGV Holdings (leased and own landbank)	275,562	59,842	335,404

Source: Companies, AmInvestment Bank

As a result, the earnings of the PNG division were mixed from FY14 to FY19. From FY14 to FY19, SDP's PNG division swung into the red two times.

On a positive note, SDP's PNG division has performed well so far in FY21E due to strong palm product prices. The PNG division recorded an EBIT of RM431.0mil in 1HFY21 vs. RM97.0mil in 1HFY20 as it recorded an average CPO price of RM4,147/tonne.

Second, production cost of SDP's PNG unit is high at about RM1,700/tonne to RM1,800/tonne compared to the cost of SDP's CPO production in Malaysia of RM1,400/tonne to RM1,500/tonne.

In the past, there were news reports that SDP may pare down its stake in the PNG plantation division or list it on a stock exchange. However, these did not materialise.

We believe that it would be challenging to list the PNG division. For the listing exercise to be value-enhancing, the PNG division has to be listed at a PE higher than SDP's own FY22F PE of 18.1x.

❑ *Why do smaller companies have lower EV/ha?*

We attribute this to a few reasons. First, the plantation landbank of the large companies in Indonesia have been almost fully planted with oil palm.

These companies ventured into Indonesia back in the 1990s or early-2000s i.e before RSPO was established. KLK ventured into Indonesia in 1994. SDP (through Kumpulan Guthrie) ventured into Indonesia in 2001.

In contrast, the younger plantation companies may not be able to plant fully on their landbank in Indonesia going forward. This is due to intense scrutiny by the environmental organisations and RSPO's slow approval process for new plantings of oil palm. RSPO was set up in 2004.

These companies include TSH Resources, which is estimated to have almost 32,000ha of plantable reserves left in Indonesia and GenP, which has an estimated 46,000ha of plantable land left *(see Exhibit 6)*.

Also as the large companies have already established their plantation operations in Indonesia, there are no major issues with logistics and infrastructure.

In addition as they were planted many years ago, the oil palm trees are already prime and they do not require heavy maintenance and upkeep.

Furthermore, some of the Malaysian oil palm estates of the smaller plantation companies may not be located in areas with property or solar development potential.

❑ *Can the companies realise the enterprise value or monetise the landbank?*

It is unlikely that plantation companies would be able realise their asset values fully. As oil palm is a core business activity, we reckon that plantation companies would not be disposing their oil palm estates just to realise the value.

First exception is if the company needs to raise cash to reduce the net gearing ratio. Second exception is if there is a compulsory acquisition of land by the Malaysia government.

In July 2021, TSH Resources proposed selling 2,933ha of oil palm estates and a palm oil mill in Sabah to Sharikat Keratong Sdn Bhd for RM248.0mil. The repayment of borrowings from the disposal proceeds would help reduce TSH's net gearing ratio to 55% from 78.9% (as at end FY20).

EXHIBIT 6 : ESTIMATED PLANTABLE RESERVES OF PLANTERS (HA)

	Plantable Reserves (ha)
IOI	554
KLK	13,604
Sime Plant	12,000
Gent Plantations	46,000
TSH Resources	32,000

Source: Companies, AmInvestment Bank

To raise cash, TH Plantations (THP) sold 2,594.5ha of land in Terengganu to TDM Bhd for RM69.0mil in FY20. THP's net gearing stood at 195.1% as at end-September 2020.

SDP has earmarked 2,324 acres of land for disposal to raise cash of RM1.0bil. Up to June 2020, the group has sold about 1,350 acres. SDP's net gearing stood at 63.0% as at end-December 2020 (including RM2.2bil perpetual sukuk).

- ***Fewer land-banking activities in 2021E vs. 2020 but higher value***

We estimate that there have been five M&A activities in the plantation industry so far this year compared with nine transactions in 2020. However in terms of value, we believe that this year's acquisitions were higher than 2020.

A notable acquisition, which took place this year was KLK's RM2.7bil cash take-over of IJM Plantations. The number of acquisitions of plantation land for the purpose for building solar farm projects has also risen this year.

We reckon that land-banking activities were the most active from 2013 to 2016. From 2013 to 2016, we estimate that there were 48 palm oil land transactions involving Malaysian plantation companies or about 12 transactions per year on average.

In contrast, there were 30 transactions involving Malaysian planters from 2017 to 2020 or roughly eight transactions per year. We attribute the drop in the number of land acquisitions to soft CPO prices and a slowdown in new plantings of oil palm.

Based on last year's transactions, the market value for palm oil land with property development potential in Tawau is more than RM200,000/ha.

Market value of oil palm estates in East Kalimantan is about RM47,857/ha or US$11,672/ha based on TSH's proposed disposal of land to KLK.

Market value of oil palm estates with connectivity to the electricity grid network in Alor Gajah is about RM2.1mil/ha based on the sale of 71ha of oil palm estates from Tradewinds Plantation to Malakoff in September 2020.

- ***Market prices of palm oil land to remain high regardless of CPO prices***

We find that market prices of plantation landbank are not affected by the CPO price cycle. Even during downturns, market prices of plantation landbank remained high.

When CPO prices were in the doldrums in 2018/2019, Boustead Plantations acquired 4,415ha of oil palm estates in Kinabatangan, Sabah for RM322.8mil or RM73,115/ha, from Sit Seng and Sons Realty.

As young oil palm trees enter the prime age of eight to 15 and prime property land becomes scarce, we believe that the market value of palm oil land would continue increasing.

DO COMPANIES WITH LOW EV/HA OUTPERFORM?

- ***No correlation between share price performance and EV/ha; not all companies with low EV/ha are take-over targets***

We find that planters with low EV/ha do not out-perform those with high EV/ha. Exceptions are IJMP and FGV, which received take-over offers.

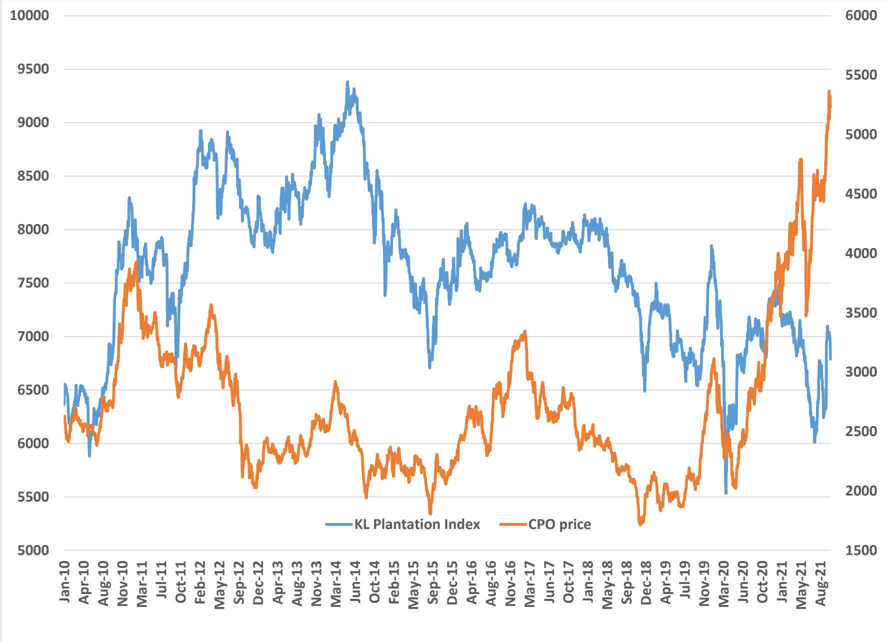
Furthermore, we believe that not all companies with low EV/ha are take-over targets. Apart from the acquisition cost, the acquirer has to consider the quality of the acquiree's landbank.

Two companies with low EV/ha are SDP and GenP. In spite of the low EV/ha, the share price performances of the companies were lacklustre. SDP's share price fell by 19.6% from 31 December 2020 to 29 October even as CPO prices surged by 88.9% to RM5,402/tonne. GenP's share price slid to a low of RM6.46 on 5 August 2021 in spite of high palm product prices.

Even as CPO prices reached a high of RM5,446/tonne on 3 November 2021, there has been little interest in plantation stocks. Instead, ESG has become increasingly prominent.

We estimate the correlation coefficient between CPO price and the KL Plantation Index to be 0.68x from 2015 to 2019. However, the relationship between CPO prices and share

EXHIBIT 7 : KL PLANTATION INDEX (POINTS) VS CPO PRICE (RM/TONNE)



Source: Bloomberg

prices fell apart in 2020 *(see Exhibit 7)*. From 1 January 2020 to 29 October 2021, the correlation coefficient between CPO price and the KL Plantation Index was a mere 0.08x.

In September 2020, the US Customs and Border Protection (US CBP) banned FGV Holdings' palm products due to allegations of labour abuse. Sime Darby Plantation faced a similar fate in December 2020. There are concerns that European companies may follow the path of US CBP.

- ***Higher PEs for companies with elevated asset values?***

The PEs of larger plantation companies are higher than the smaller ones. IOI and KLK are currently trading at FY22F PEs of 20x to 21x compared with TSH's and GenP's 16x to 19x.

Apart from high EV/ha values, we believe that there are other factors contributing to the premium PE multiples of the large planters. These include the size of the landbank and integrated nature of the operations. Also, companies like KLK, IOI and SDP are KLCI index-linked stocks.

The size of the large companies' planted landbank are between 150,000ha and 600,000ha. In contrast, the planted landbank of GenP and TSH range from 40,000ha to 140,000ha.

In terms of production cost per tonne however, we believe that they are almost the same. The all-in cost of CPO production for Genting Plantations (GenP) was RM1,860/tonne in FY20, which is close to IJMP's all-in cost of production of RM1,800/tonne for Malaysia and RM2,000/tonne for Indonesia.

KLK's ex-mill cost of CPO production was RM1,465/tonne in FY20 (group level) compared with TSH's FY20 ex-mill costs of CPO production of RM1,522/tonne in Sabah and RM1,599/tonne in Indonesia.

However in respect of FFB yields, we find that the bigger companies are more efficient as they have larger proportion of oil palm trees in the prime age of eight to 15 years old. KLK's FFB yield was 22.0 tonnes/ha in FY20 compared with GenP's 17.9 tonnes/ha.

- ***When to use EV/ha?***

We believe that asset values are useful during mergers and acquisitions.

However in arriving at a company's fair value, we reckon that earnings potential should be taken into account. Although a company may have large tracts of oil palm estates, this may not necessarily translate into strong earnings or positive returns.

Hence, we would still use PE as the main valuation method with EV/ha as a supplement.

For instance, KLK's planted landbank of 223,623ha is 60.6% bigger than GenP's 139,225ha. However, KLK's return on equity was only 7.3% in FY20 compared with GenP's 5.2%.

In terms of the cost of CPO production per tonne, we believe that both companies are almost similar. The difference lies in KLK's downstream operations, which are larger than GenP.

Selling landbank would allow the owner to realise the value of the asset at market prices. However as mentioned earlier, palm oil is a core business activity. Hence, most plantation companies would only sell their oil palm estates to reduce borrowings or if the land is compulsorily acquired by the government.

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