Focused on lifting of RSPO suspension

IOI is focused on taking corrective actions for early lifting of the RSPO membership suspension. We believe a prolonged suspension will have significant impact on its profitability and valuation as the specialty oils & fats business accounts for around 11% of group EBIT. We maintain our forecasts and target price but upgrade the stock rating from SELL to HOLD on valuation.

Focus on corrective actions to lift RSPO membership suspension

With regard to the temporary RSPO membership suspension, IOI has revised the action plans after discussions with NGOs. Meanwhile, HCV assessment reports will be reviewed by a RSPO approved reviewer.

Appointed specialist consultants GEC and Proforest

IOI has also engaged Global Environment Centre, a specialist in peatland conservation and rehabilitation, and Proforest, a consultant on responsible production and sourcing as well as land use and conservation.

Prolonged suspension will have significant impact on group EBIT

Prolonged RSPO suspension will significantly affect IOI's specialty oils & fats business, which accounts for around 11% of group EBIT.

FFB production growth expected to resume when El Niño ends

We expect the FFB production to decline by 5%-6% in FY16, but barring the re-occurrence of extreme weather conditions, grow by 6%-8% in FY17.

Looking for more land in Indonesia to boost planted areas

The group is still looking to acquire more plantation land to boost CPO supply for its downstream operations.

Valuation at more reasonable level now, upgrade to HOLD

Pending the outcome of the next RSPO meeting on its membership, possibly in May, we maintain our forecasts and target price for IOI. We believe its valuation has moderated, and upgrade our rating from SELL to **HOLD**. We expect the 3QFY16 core net profit to be lower qoq mainly due to lower contribution from the upstream segment.

Key risks

Key downside risks include prolonged RSPO membership suspension and sharp decline in CPO price while key upside risks include a sharp rise in vegetable demand and change in policies leading to higher CPO price.

Earnings & Valuation Summary

FYE 30 Jun	2014	2015	2016E	2017E	2018E
Revenue (RMm)	11,910.6	11,621.0	13,392.6	13,980.3	14,545.2
EBITDA (RMm)	2,179.9	679.7	1,782.7	1,965.8	2,053.9
Pretax profit (RMm)	1,670.8	457.0	1,687.6	1,882.7	1,962.2
Net profit (RMm)	1,254.6	168.1	1,262.4	1,412.9	1,475.2
EPS (sen)	19.5	2.6	19.5	21.8	22.7
PER (x)	22.0	164.9	22.0	19.6	18.8
Core net profit (RMm)	1,304.1	959.7	1,262.4	1,412.9	1,475.2
Core EPS (sen)	20.2	14.8	19.5	21.8	22.7
Core EPS growth (%)	(20.0)	(26.9)	31.5	11.9	4.4
Core PER (x)	21.1	28.9	22.0	19.6	18.8
Net DPS (sen)	20.0	9.0	12.0	12.0	12.0
Dividend Yield (%)	4.7	2.1	2.8	2.8	2.8
EV/EBITDA (x)	14.2	47.8	18.1	16.2	15.2
Chg in EPS (%)			0.0	0.0	0.0
Affin/Consensus (x)			1.1	1.1	1.1

Source: Company, Affin Hwang estimates, Bloomberg

Company Update

IOI Corp

IOI MK
Sector: Plantation

RM4.27 @ 5 May 2016

HOLD (upgrade)

Downside: 0.7%

Price Target: RM4.24

Previous Target: RM4.24

Price Performance

	1M	3M	12M
Absolute	-6.2%	-10.3%	-0.7%
Rel to KLCI	-2.2%	-9.6%	+10.0%

Stock Data

Issued shares (m)	6,360.4
Mkt cap (RMm)/(US$m)	27,159/6,775
Avg daily vol - 6mth (m)	6.1
52-wk range (RM)	3.70-5.04
Est free float	55%
BV per share (RM)	0.76
P/BV (x)	5.6
Net cash/ (debt) (RMm) (4Q15)	(5,604)
ROE (FY16E)	23.8%
Derivatives	No
Shariah Compliant	Yes

Key Shareholders

Progressive Holdings Sdn Bhd	47.0%
EPF Board	7.2%

Source: Affin Hwang, Bloomberg

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Focused on lifting of RSPO suspension

Focused on corrective actions to lift RSPO membership suspension

With regard to the temporary RSPO membership suspension, IOI submitted a list of action plans to address complaints in early April and has put in place a more formalised sustainability governance structure. The action plans are also being revised and fine-tuned after discussions with NGOs (Aidenvironment and Greenpeace). Meanwhile, HCV (High Conservation Value) assessment reports for the three affected subsidiaries (PT Bumi Sawit Sejahtera, PT Berkat Nabati Sejahtera and PT Sukses Karya Sawit) will be reviewed by a RSPO-approved reviewer.

Appointed GEC, a specialist firm in peat, HCV and conservation

IOI has also engaged Global Environment Centre (GEC), a specialist firm in peatland conservation as well as river, forest and coastal rehabilitation, to conduct field investigation and a report is expected in May. Recommendations by GEC to improve peat rehabilitation and restoration efforts following an April field trip have been accepted by IOI. The findings and recommendations by GEC related to the action plans were discussed with Aidenvironment, the outcome of which has not been announced.

Appointed Proforest, PT KPAM development deferred

In addition, the group has appointed Proforest, to advise the group on the implementation of sustainability policy commitments and in relation to the PT Kalimantan Prima Agro Mandiri (PT KPAM) development. Proforest is a consultant on responsible production and sourcing, investment, and land use and conservation. Following the appointment of Proforest, clearing for the PT KPAM development has been deferred to end-Sept16.

Prolonged suspension will have significant impact on group EBIT

IOI's resource-based manufacturing accounts for around one-third of group EBIT, which is further split at around 35%, 40%, and 25% between specialty oils & fats, oleochemicals and refining respectively. Loss of the specialty oils & fats business in a worst case scenario could therefore potentially impact group EBIT by as much as 11%, in our view. Prolonged RSPO membership suspension hence will have significant impact on profitability and stock valuation.

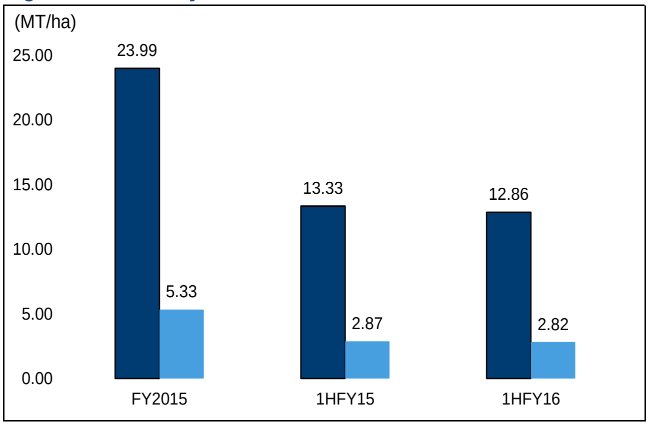
Oleochemicals should continue to do well

While the specialty oils & fats business is under threat and refining margin remains poor, the oleochemicals segment is doing well. Margins on oleochemicals range from 9%-15% and the acquisition of the Cremer plant in Feb16 should enable the group to expand further into the high-margin specialty esters for pharmaceutical and personal care applications.

FFB production growth expected to resume when El Niño ends

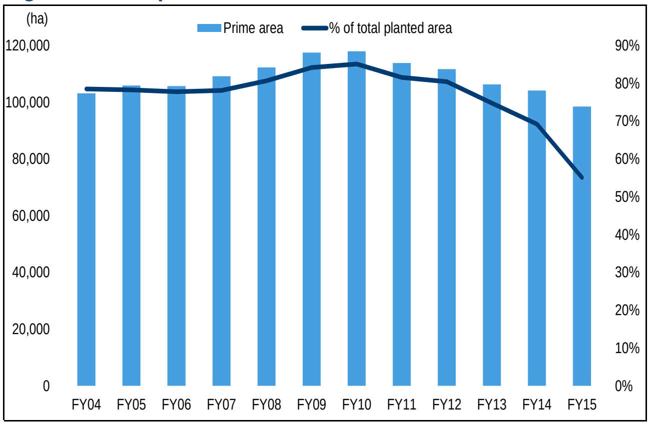
FFB production declined 8.5% yoy in 9MFY16 due to the negative impact of the on-going El Nino on rainfalls and yields. Management however expects yield recovery in 4QFY16 to narrow production decline in FY16 to 5%-6%. Barring the occurrence of extreme weather conditions again, we expect FFB production to grow by 6%-8% in FY17, mainly due to yield improvements and new areas in Indonesia coming into maturity. Clonal materials yielding OER of around 27% have been planted in around 20,000 ha. The average age of palms is around 13 years and replanting of 6,000-9,000 ha p.a. will continue. Meanwhile, proportion of prime areas has been declining in the last five financial years.

Fig 1: FFB and oil yields in FY15 and 1HFY16



Source: Company

Fig 2: Trend of prime areas



Source: Company

Looking for more land in Indonesia to boost planted areas

The group currently produces around 800,000 MT of CPO annually, which is not sufficient for its own use as feedstocks for its downstream operations. As such, the group is still looking to acquire more plantation land to boost its oil palm planted hectarage.

Valuation at more reasonable level now, upgrade to HOLD

We believe IOI's temporary suspension of RSPO membership was both unexpected and unfortunate as the group is well-managed and stands out in terms of yield and integration. Pending the outcome of the next RSPO meeting, possibly this month, we maintain our forecasts and target price of RM4.24 for IOI. Our target price is based on a target PE of 19x applied to our CY17E EPS. The group still has around a month of supply of CSPO stocks, which should help lessen the impact on FY16 earnings. As valuation has moderated with the share price at a more reasonable level, we upgrade IOI to **HOLD** from SELL. Foreign shareholding is around 17.5%, up slightly from around 16% previously.

3QFY16 profit likely capped by sharp qoq and yoy drop in production

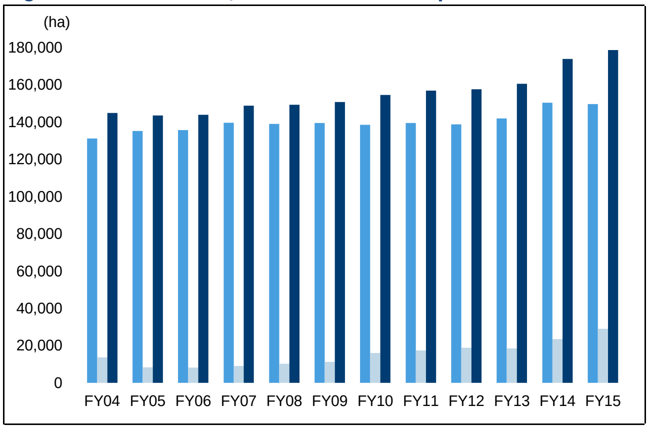
We expect the 3QFY16 core net profit to be announced in the third week of May to be lower than the RM324.4m recorded in 2QFY16, mainly due to lower contribution from the upstream segment. While average MPOB locally delivered prices increased by 11.2% qoq and 5.9% yoy, IOI's FFB production declined by 44.5% qoq and 21.6% yoy. However, we expect the manufacturing profit to remain good qoq due to steady capacity utilisation and margins. 3QFY16 headline net profit is likely to be boosted by a significant unrealised translation gain following the appreciation of the Ringgit.

Key risks

Key downside risks include (i) prolonged RSPO membership suspension; (ii) weaker economic growth; (iii) higher-than-expected vegetable oil production; (iv) sharp decline in CPO price; and (v) spike in cost of production. Key upside risks include sharp rise in vegetable demand and change in policies leading to higher CPO price.

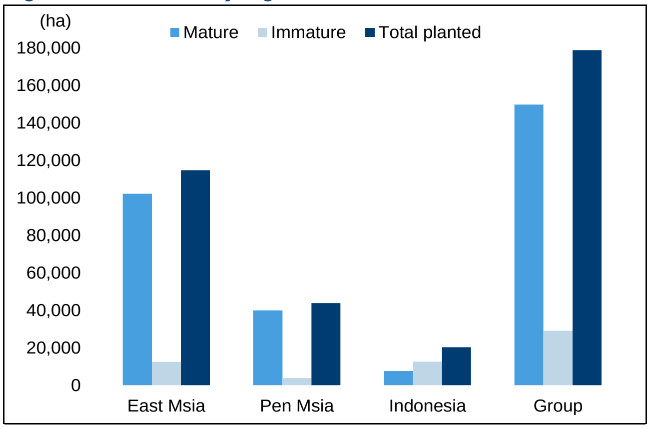
Focus Charts

Fig 3: Trend of mature, immature and total planted areas



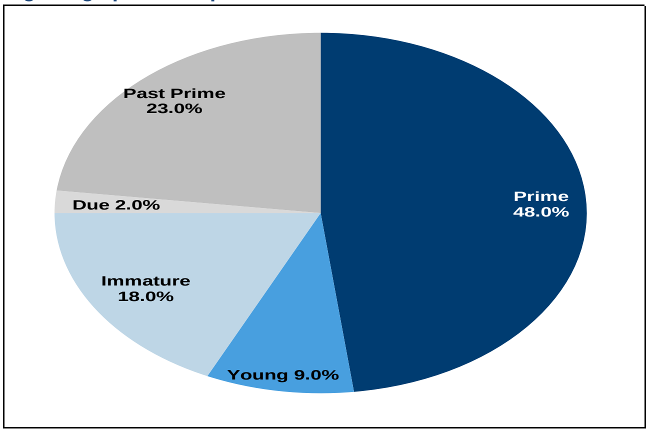
Source: Company. Affin Hwang estimates

Fig 4: Planted areas by region as at 30 June 2015



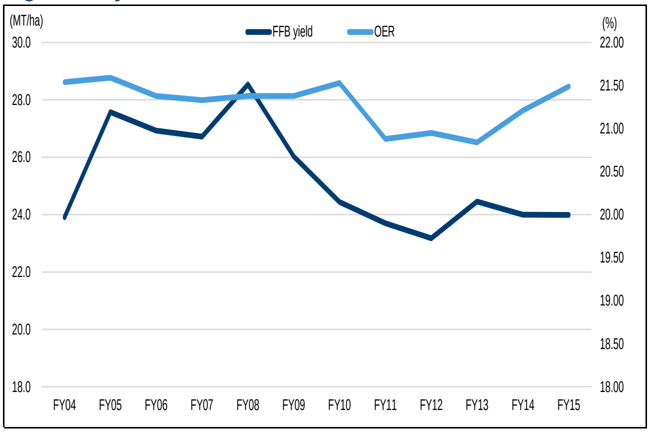
Source: Company

Fig 5: Age profile of palms as at 31 March 2016



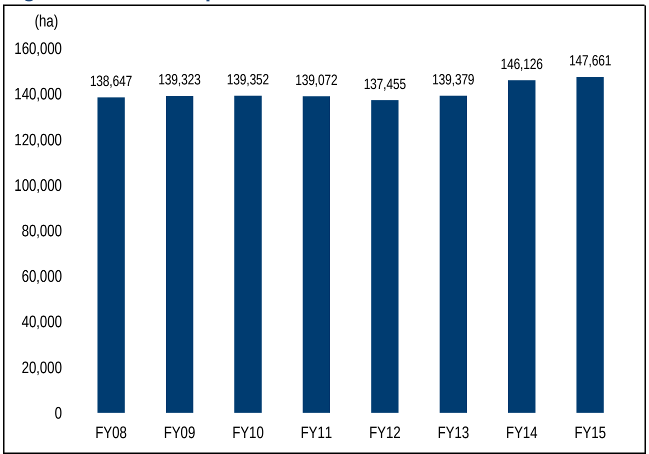
Source: Company

Fig 6: FFB yield and OER



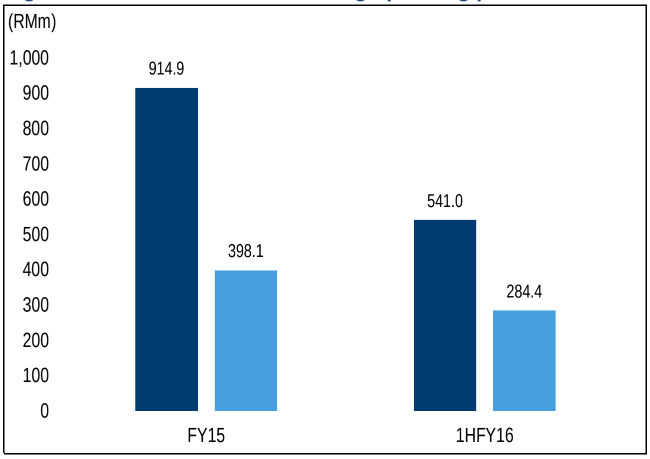
Source: Company

Fig 7: Trend of FFB production



Source: Company

Fig 8: Plantation and manufacturing operating profits



Source: Company, Affin Hwang estimates

IOI CORP – FINANCIAL SUMMARY

Profit & Loss Statement

FYE 30 June (RMm)	2014	2015	2016E	2017E	2017E
Revenue	11,910.6	11,621.0	13,392.6	13,980.3	14,545.2
Operating expenses	(9,730.7)	(10,941.3)	(11,609.8)	(12,014.5)	(12,491.3)
EBITDA	2,179.9	679.7	1,782.7	1,965.8	2,053.9
Depreciation	(85.8)	(92.7)	(100.1)	(108.1)	(116.7)
EBIT	2,094.1	587.0	1,682.6	1,857.7	1,937.2
Net int income/(expense)	(234.6)	(195.0)	(154.0)	(142.0)	(130.0)
Associates' contribution	132.3	120.0	185.0	185.0	185.0
Pretax profit	1,670.8	457.0	1,687.6	1,882.7	1,962.2
Tax	(408.4)	(284.6)	(385.3)	(429.8)	(448.0)
Minority interest	(16.7)	(4.3)	(40.0)	(40.0)	(39.0)
Net profit	1,254.6	168.1	1,262.4	1,412.9	1,475.2

Balance Sheet Statement

FYE 30 June (RMm)	2014	2015	2016E	2017E	2017E
Fixed assets	6,440.1	6,682.3	6,850.0	6,900.0	7,000.0
Other long term assets	1,505.5	1,625.5	1,664.1	1,664.1	1,664.1
Total non-current assets	**7,945.6**	**8,307.8**	**8,514.1**	**8,564.1**	**8,664.1**
Cash and equivalents	4,068.4	1,895.7	2,983.5	3,371.3	3,871.4
Stocks	2,154.6	2,083.1	2,383.1	2,433.1	2,483.1
Debtors	1,062.7	1,062.4	1,200.0	1,250.0	1,250.0
Other current assets	100.3	84.9	0.0	0.0	0.0
Total current assets	**7,386.0**	**5,126.1**	**6,566.6**	**7,054.4**	**7,604.5**
Asset held for sale/distr	-	-	-	-	-
Creditors	866.7	833.4	1,150.0	1,100.0	1,100.0
Short term borrowings	2,454.3	812.5	2,200.0	2,250.0	2,300.0
Other current liabilities	175.8	219.4	195.0	195.0	195.0
Total current liabilities	**3,496.8**	**1,865.3**	**3,545.0**	**3,545.0**	**3,595.0**
Liabilities of disposal grp	-	-	-	-	-
Long term borrowings	5,069.2	5,835.9	5,300.0	5,200.0	5,100.0
Other long term liabilities	532.5	484.3	500.0	500.0	500.0
Total long term liabilities	**5,601.7**	**6,320.2**	**5,800.0**	**5,700.0**	**5,600.0**
Shareholders' funds	**6,036.8**	**5,059.1**	**5,546.4**	**6,184.2**	**6,884.3**
Minority interests	**196.3**	**189.3**	**189.3**	**189.3**	**189.3**

Cash Flow Statement

FYE 30 June (RMm)	2014	2015	2016E	2017E	2017E
EBIT	2,094.1	587.0	1,682.6	1,857.7	1,937.2
Depreciation & amortisation	224.0	235.5	100.1	108.1	116.7
Working capital changes	(270.8)	143.1	(60.5)	(150.0)	(50.0)
Cash tax paid	(491.0)	(384.6)	(385.3)	(429.8)	(448.0)
Others	112.9	776.7	32.0	42.0	32.0
Cashflow from operation	**1,669.2**	**1,357.7**	**1,368.9**	**1,428.0**	**1,587.9**
Capex	(329.4)	(457.7)	(160.3)	(42.0)	(91.4)
Disposal/(purchases)	(40.1)	(6.0)	47.0	47.0	47.0
Others	657.1	160.4	20.0	20.0	20.0
Cash flow from investing	**287.6**	**(303.3)**	**(93.3)**	**25.0**	**(24.4)**
Debt raised/(repaid)	(108.1)	(4,336.1)	1,267.5	(70.0)	(70.0)
Equity raised/(repaid)	0.0	0.0	0.0	0.0	0.0
Net interest income/(exp)	(234.6)	(268.2)	(154.0)	(142.0)	(130.0)
Dividends paid	(1,051.1)	(1,049.3)	(775.1)	(775.1)	(775.1)
Others	(5.5)	2,397.5	(211.0)	(222.0)	(233.0)
Cash flow from financing	**(1,399.3)**	**(3,256.1)**	**127.4**	**(1,209.1)**	**(1,208.1)**
Free Cash Flow	**1,339.8**	**900.0**	**1,208.6**	**1,386.0**	**1,496.6**

Source: Company, Affin Hwang forecasts

Key Financial Ratios and Margins

FYE 30 June (RMm)	2014	2015	2016E	2017E	2017E
Growth					
Revenue (%)	(2.4)	(2.4)	15.2	4.4	4.0
EBITDA (%)	29.3	(68.8)	162.3	10.3	4.5
Core net profit (%)	(19.8)	(26.4)	31.5	11.9	4.4
Profitability					
EBITDA margin (%)	18.3	5.8	13.3	14.1	14.1
PBT margin (%)	14.0	3.9	12.6	13.5	13.5
Net profit margin (%)	10.5	1.4	9.4	10.1	10.1
Effective tax rate (%)	24.4	62.3	22.8	22.8	22.8
ROA (%)	8.2	1.3	8.4	9.0	9.1
Core ROE (%)	13.2	17.3	23.8	24.1	22.6
ROCE (%)	12.1	4.6	13.6	13.9	13.9
Dividend payout ratio (%)	102.8	347.5	61.7	55.1	52.8
Liquidity					
Current ratio (x)	2.1	2.7	1.9	2.0	2.1
Op. cash flow (RMm)	1,669.2	1,357.7	1,368.9	1,428.0	1,587.9
Free cashflow (RMm)	1,339.8	900.0	1,208.6	1,386.0	1,496.6
FCF/share (sen)	20.8	13.9	18.6	21.4	23.1
Asset management					
Debtors turnover (days)	33	33	33	33	31
Stock turnover (days)	66	65	65	64	62
Creditors turnover (days)	27	26	31	29	28
Capital structure					
Net gearing (%)	57.2	93.9	81.4	66.0	51.3
Interest cover (x)	7.7	2.3	6.9	7.6	8.0

Quarterly Profit & Loss

FYE 30 June (RMm)	2Q15	3Q15	4Q15	1Q16	2Q16
Revenue	2,881.5	2,776.6	2,942.0	3,086.7	2,968.5
Operating expenses	(2,294.3)	(2,322.4)	(2,530.6)	(2,705.4)	(2,163.4)
EBITDA	587.2	454.2	411.4	381.3	805.1
Depreciation	(60.2)	(59.6)	(56.1)	(49.0)	(84.5)
EBIT	130.9	(52.8)	230.5	(636.5)	911.1
Net int income/(expense)	(71.6)	(75.4)	(54.3)	(44.8)	(41.5)
Associates' contribution	38.9	23.1	29.8	39.6	19.5
Exceptional Items	29.7	90.3	85.5	(146.0)	265.6
Pretax profit	94.6	(109.2)	203.3	(654.0)	876.5
Tax	(69.0)	(80.3)	(47.6)	(62.4)	(139.7)
Minority interest	(6.0)	1.5	4.0	(2.6)	(12.0)
Net profit	19.6	(188.0)	159.7	(719.0)	724.8
Core net profit	386.0	169.1	199.0	395.8	324.4
Margins (%)					
EBITDA	20.4	16.4	14.0	12.4	27.1
PBT	3.3	(3.9)	6.9	(21.2)	29.5
Net profit	0.7	(6.8)	5.4	(23.3)	24.4

Equity Rating Structure and Definitions

BUY	Total return is expected to exceed +10% over a 12-month period
HOLD	Total return is expected to be between -5% and +10% over a 12-month period
SELL	Total return is expected to be below -5% over a 12-month period
NOT RATED	Affin Hwang Investment Bank Berhad does not provide research coverage or rating for this company. Report is intended as information only and not as a recommendation

The total expected return is defined as the percentage upside/downside to our target price plus the net dividend yield over the next 12 months.

OVERWEIGHT	Industry, as defined by the analyst's coverage universe, is expected to outperform the KLCI benchmark over the next 12 months
NEUTRAL	Industry, as defined by the analyst's coverage universe, is expected to perform inline with the KLCI benchmark over the next 12 months
UNDERWEIGHT	Industry, as defined by the analyst's coverage universe is expected to under-perform the KLCI benchmark over the next 12 months

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