

## Good 1Q17 on higher FFB and CPO prices

1Q17 plantation revenue was stronger as all the plantation companies in our universe saw higher FFB production due to a recovery from the severe El Nino effect in 2015/16, along with higher CPO and PK ASPs. KLK, FGV, HAPL and GENP results were inline with our expectations, while those from IOI Corp, SIME and IJMP came in below. As such, we had cut our earnings forecasts at IOI Corp, SIME and IJMP by 11-24% after the 1Q17 results. With our recent upgrade of GENP to BUY, the counter joins KLK on our top-picks list, as we expect higher FFB and CPO production to spur its earnings growth. We also downgraded IOI Corp to HOLD on valuation. We maintain our NEUTRAL sector rating.

### 1Q17 plantation revenue increased by 26% yoy

Plantation sector revenue increased by 25.7% yoy as all plantation companies under our coverage posted higher revenues on the back of higher FFB production as well as stronger CPO and PK ASPs. However, plantation sector earnings fell by 5% yoy, mainly dragged down by IOI Corp, which had lower one-off gains.

### Higher FFB production and CPO ASPs yoy

In 1Q17, own-FFB production increased by an average of 17% yoy as the El Nino effect on production in 2015/16 subsided. However, on a qoq basis, FFB production declined by 14% qoq mainly due to a seasonally lower production period. Meanwhile, 1Q17 CPO ASPs rose by an average of 10% qoq and 37% yoy partly due to tight supply of world edible oil, higher soybean oil premium and the weak RM against the USD.

### Recent changes to our forecasts

The 1Q17 results for KLK, FGV, HAPL and GENP were within our expectations, while those for IOI Corp, SIME and IJMP came in below our expectations. Thus, we recently cut our FY17-19E earnings for IOI Corp, SIME and IJMP by 11-24% after their weaker-than-expected results.

### Maintain NEUTRAL sector rating; top pick remains KLK, adding GENP

We maintain our NEUTRAL sector call. We reaffirm KL Kepong (KLK MK, RM24.86, BUY), as a top sector pick for its solid management and expect higher FFB and CPO production, as well as lower production cost to drive its earnings growth over 2017-19E. KLK is also a country top pick. Genting Plantation (GENP MK, RM11.20), a recent upgrade to BUY, is added to our top picks, while IOI Corp (IOI MK, RM4.55) was downgraded to HOLD.

### Key risks

Key downside risks to our NEUTRAL sector rating include weaker demand for vegetable oils, which would lower ASPs, and unfavorable changes in policies and taxes. The key upside risks would be a strong rebound in the global economy as well as demand for and prices of vegetable oils.

### Peer comparison

| Stock                                      | Stock code | Rating    | Sh Pr # (RM) | TP (RM) | Mkt Cap (RMm) | Year end | Core PE (x) |             | EPS growth (%) |             | EV/EBITDA FY17E (x) | P/BV FY17E (x) | ROE (%) CY17E | DY (%) FY17E |
|--|------------|-----------|--------------|---------|---------------|----------|-------------|-------------|----------------|-------------|---------------------|----------------|---------------|--------------|
|  |            |           |              |         |               |          | CY17E       | CY18E       | CY17E          | CY18E       |                     |                |               |              |
| Sime Darby                                 | SIME.MK    | HOLD      | 9.57         | 9.03    | 63,578        | June     | 26.6        | 22.9        | 19.1           | 16.1        | 16.5                | 1.9            | 6.6           | 3.1          |
| IOI Corp                                   | IOI.MK     | HOLD      | 4.55         | 4.50    | 29,530        | June     | 24.0        | 22.3        | 13.3           | 7.8         | 20.5                | 4.9            | 20.0          | 2.6          |
| KL Kepong                                  | KLK.MK     | BUY       | 24.86        | 29.00   | 26,538        | Sept     | 19.6        | 18.6        | 20.5           | 5.0         | 12.0                | 2.4            | 12.5          | 2.4          |
| Felda Global                               | FGV.MK     | HOLD      | 1.62         | 1.87    | 5,910         | Dec      | 21.1        | 19.0        | 81.2           | 11.0        | 7.0                 | 0.9            | 4.5           | 3.1          |
| Genting Plant                              | GENP.MK    | BUY       | 11.20        | 13.35   | 8,635         | Dec      | 20.7        | 18.4        | 38.5           | 12.5        | 14.7                | 1.7            | 8.3           | 0.9          |
| IJM Plant                                  | IJMP.MK    | BUY       | 3.13         | 3.73    | 2,756         | Mar      | 19.8        | 16.1        | 52.6           | 22.9        | 12.8                | 1.5            | 6.4           | 3.2          |
| Hap Seng Plant                             | HAPL.MK    | HOLD      | 2.60         | 2.74    | 2,080         | Dec      | 15.1        | 14.2        | 10.9           | 6.3         | 8.9                 | 1.0            | 6.7           | 4.2          |
| Wilmar *                                   | WIL.SP     | Not Rated | 3.52         | n.a     | 22,250        | Dec      | 16.4        | 12.9        | 27.7           | 7.1         | 11.8                | 1.1            | 7.4           | 2.8          |
| Astra Agro **                              | AALI.U     | Not Rated | 14,275       | n.a     | 27,475        | Dec      | 12.6        | 14.1        | (10.7)         | 10.5        | 7.5                 | 1.5            | 16.1          | 3.1          |
| <b>Mkt Cap weighted average (excl FGV)</b> |            |           |              |         |               |          | <b>23.9</b> | <b>21.3</b> | <b>19.9</b>    | <b>11.8</b> | <b>16.2</b>         | <b>2.7</b>     | <b>10.8</b>   | <b>2.8</b>   |

\* S\$ \*\* IDR # Share prices as at 6 June 2017

Source: Affin Hwang forecasts, Bloomberg

## Sector Update

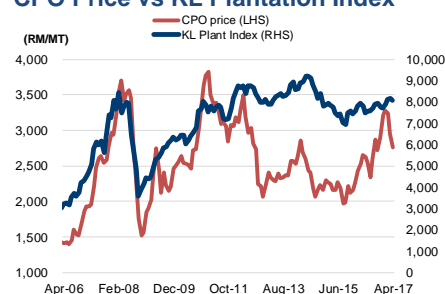
# Plantation

## NEUTRAL (maintain)

### Absolute Performance (%)

|      | 1M     | 3M    | 12M    |
|------|--------|-------|--------|
| FGV  | -15.2% | -10%  | +18.2% |
| GENP | -2.4%  | -1.7% | +7.7%  |
| HAPL | +0.4%  | -4.4% | +8.8%  |
| IJMP | +1.0%  | -6.0% | -7.9%  |
| IOI  | -0.4%  | -3.2% | +6.6%  |
| KLK  | +0.6%  | +2.0% | +6.9%  |
| SIME | +2.7%  | +4.7% | +26.1% |

### CPO Price vs KL Plantation Index



Source: Affin Hwang, Bloomberg

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## Higher yoy production and CPO prices in 1Q17

### 1Q17 plantation sector revenue increased by 25.7% yoy

In 1Q17, plantation sector revenue increased by 25.7% yoy. All plantation companies under our coverage posted higher yoy revenue underpinned by higher FFB production, coupled with higher ASPs for CPO and palm kernel (PK). The highest increase in revenue was from GENP by 53.4% yoy as their FFB production rose by 29% yoy on the back of strong production at their Indonesia plantations with more mature estates along with a higher CPO ASP by 34% yoy to RM3,053/MT. On the other hand, FGV showed the slowest increase in revenue (+15.1% yoy) mainly as its FFB production only grew by 3% yoy due to replanting of certain estates though its CPO ASP was higher by 33% yoy to RM3,061/MT. Meanwhile, on qoq basis, plantation companies posted a decline in revenue (except HAPL, IJMP and SIME) because of the seasonally lower FFB production, but this was partially mitigated by the higher CPO ASP.

**Fig 1: Plantation companies earnings (1Q17)**

| RMm                           |      | FGV                | GENP               | HAPL               | IJMP              | IOI Corp          | KLK                | SIME              |
|-------------------------------|------|--------------------|--------------------|--------------------|-------------------|-------------------|--------------------|-------------------|
| Revenue                       | 1Q16 | 3,755.4            | 260.9              | 104.2              | 115.0             | 2,866.0           | 3,702.6            | 10,232.8          |
|                               | 4Q16 | 5,195.7            | 513.4              | 128.5              | 220.3             | 3,665.7           | 5,496.1            | 12,339.0          |
|                               | 1Q17 | 4,323.2            | 400.2              | 144.1              | 192.6             | 3,472.7           | 5,470.9            | 12,446.0          |
| PBT                           | 1Q16 | (81.8)             | 38.5               | 22.9               | 3.2               | 836.7             | 242.9              | 791.0             |
|                               | 4Q16 | 219.6              | 274.6              | 59.4               | 28.9              | 128.8             | 472.4              | 921.0             |
|                               | 1Q17 | (31.3)             | 122.5              | 45.4               | 36.9              | 392.0             | 395.6              | 1,007.0           |
| Net Profit                    | 1Q16 | (81.1)             | 27.0               | 16.6               | (16.5)            | 729.4             | 168.5              | 662.8             |
|                               | 4Q16 | 110.6              | 201.9              | 45.0               | 23.6              | 15.6              | 360.7              | 676.0             |
|                               | 1Q17 | 2.5                | 80.1               | 34.1               | 22.0              | 305.3             | 289.6              | 699.0             |
| Core Net Profit               | 1Q16 | (79.0)             | 35.7               | 16.7               | (25.8)            | 154.7             | 198.8              | 383.6             |
|                               | 4Q16 | 265.5              | 132.8              | 45.0               | 42.3              | 376.8             | 447.4              | 753.0             |
|                               | 1Q17 | 67.2               | 83.8               | 33.6               | 14.7              | 225.4             | 276.8              | 632.0             |
| Results against our estimates |      | Within expectation | Within expectation | Within expectation | Below expectation | Below expectation | Within expectation | Below expectation |

Source: Companies, Affin Hwang

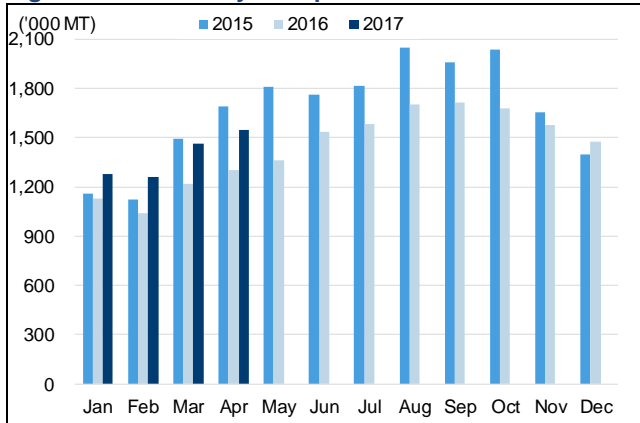
**Fig 2: Plantation companies' FFB & CPO production and CPO ASPs**

| Company  | FFB (MT)  |           |           | CPO (MT)  |           |           | CPO ASP (RM/MT) |       |       |
|----------|-----------|-----------|-----------|-----------|-----------|-----------|-----------------|-------|-------|
|          | 1Q16      | 4Q16      | 1Q17      | 1Q16      | 4Q16      | 1Q17      | 1Q16            | 4Q16  | 1Q17  |
| FGV      | 781,216   | 935,193   | 804,127   | 485,370   | 736,516   | 565,553   | 2,303           | 2,835 | 3,061 |
| GENP     | 315,729   | 531,229   | 405,831   | N/A       | N/A       | N/A       | 2,273           | 2,858 | 3,053 |
| HAPL     | 124,730   | 181,024   | 133,346   | 30,297    | 39,746    | 29,588    | 2,375           | 2,924 | 3,268 |
| IJMP     | 151,340   | 240,825   | 197,515   | 37,556    | 55,116    | 45,417    | 2,289           | 2,840 | 3,075 |
| IOI Corp | 525,615   | 827,580   | 655,274   | 116,768   | 184,597   | 138,297   | 2,289           | 2,768 | 3,118 |
| KLK      | 771,309   | 1,044,615 | 908,474   | 177,635   | 229,273   | 199,475   | 2,205           | 2,720 | 2,999 |
| SIME     | 2,087,933 | 2,719,979 | 2,458,935 | 537,451   | 687,514   | 626,854   | 2,113           | 2,835 | 3,088 |
| MPOB     |           |           |           | 3,391,903 | 4,726,528 | 3,999,407 | 2,407           | 2,947 | 3,126 |

Source: Bursa Malaysia, Companies, MPOB

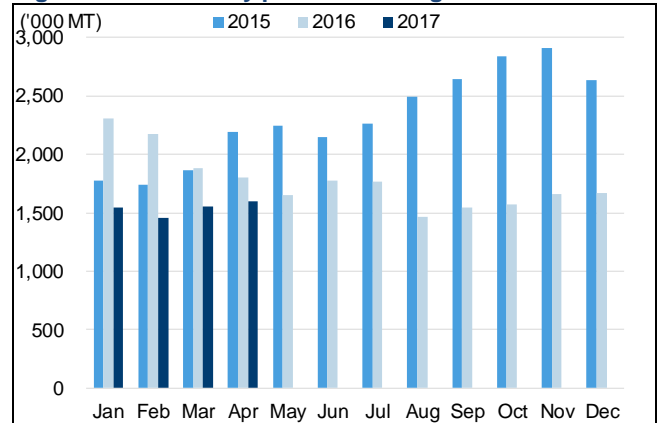
Outthink. Outperform.

**Fig 3: MPOB monthly CPO production**



Source: MPOB

**Fig 4: MPOB monthly palm oil closing stocks**

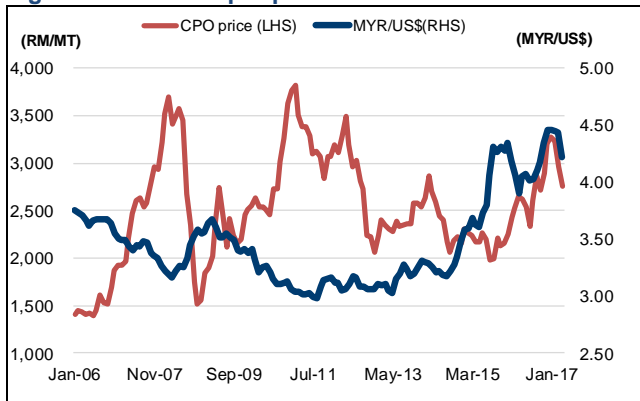


Source: MPOB

**1Q17 FFB production up by 17% yoy, but down 14% qoq**

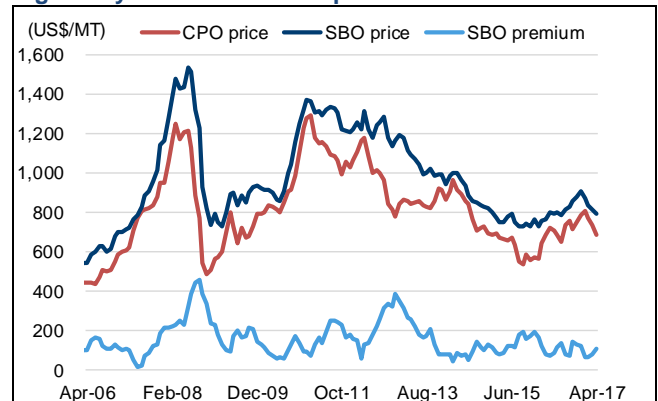
Own-FFB production for our universe of plantation companies increased by an average of 17% yoy in 1Q17. The recovery in production was as we had expected given that the previous El Nino phenomenon badly affected production back in 2015/16. Plantation companies with exposure to Indonesia showed a higher increment in FFB production as more Indonesian estates mature and their young palm-tree age profile. Meanwhile, on a qoq basis, FFB production for our universe of plantation companies fell by 10% qoq mainly due to the seasonally lower production months.

**Fig 5: MPOB CPO spot prices vs. the USD/MYR**



Source: MPOB, Bloomberg

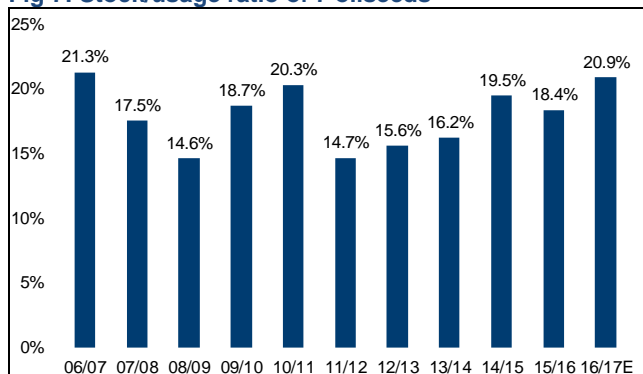
**Fig 6: Soybean oil and CPO price**



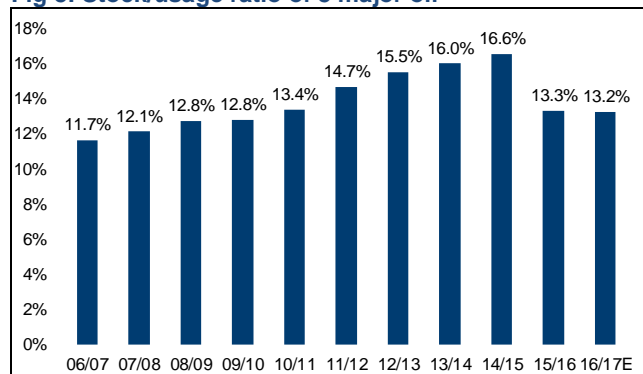
Source: Oil World

**CPO ASP increased by 10% qoq and 37% yoy in 1Q17**

During 1Q17 CPO ASPs for the plantation companies under our coverage rose by 10% qoq and 37% yoy to RM3,095/MT (MPOB's average CPO prices for Malaysia was at RM3,126/MT in 1Q17). The increase in CPO price was partly due to: 1) the world supply of edible oils remaining tight; 2) soybean prices remaining high; 3) the MYR still being weak vs. the USD since early this year. Companies with exposure to Indonesia saw their blended CPO ASPs come down in 1Q17 mainly due to the export levy of USD50/MT on CPO.

**Fig 7: Stock/usage ratio of 7 oilseeds**

Source: Oil World

**Fig 8: Stock/usage ratio of 8 major oil**

Source: Oil World

**1Q17 net profit dragged down by IOI Corp**

The plantation sector 1Q17 net profit dropped by 5% yoy, mainly dragged down by IOI Corp which recognized a lower net forex translation gain and lower fair value on derivatives (see Fig 1). Other plantation companies like KLK, FGV, HAPL, GENP, SIME and IJMP showed yoy improvements in their earnings, which was attributable to their better FFB production and stronger ASPs for CPO and PK.

**Recent changes in forecasts**

For 1Q17, results for KLK, FGV, HAPL and GENP were within our expectations, while at IOI Corp (variance was due to lower-than-expected contribution from the plantation and resource-based manufacturing divisions), SIME (variance was due to lower-than-expected contribution from property and industrial divisions) and IJMP (variance was due to lower-than-expected CPO production and a higher effective tax rate) results were below our expectations. As such, we had made changes to our forecasts for IOI Corp, SIME and IJMP to take into account the 1Q17 results (see Fig 7). Also, despite FGV's 1Q17 earnings being within our expectations, we had cut our forecasts by 9% due to the lower earnings contribution from the sugar business (mainly from MSM). Sector-wise, we maintain our CPO ASP for 2017E at RM2,600/MT. We believe the downward pressure on CPO prices will likely continue in 2H17 onwards with the expected higher CPO production, higher soybean production (especially in the US and Brazil) and strengthening of the RM vs. the USD.

**Fig 7: Recent changes in our earnings, target prices and ratings**

| Year end                    | FGV<br>Dec | GENP<br>Dec | HAPL<br>Dec | IJMP<br>Mar | IOI<br>Jun | KLK<br>Sept | SIME<br>Jun |
|-----------------------------|------------|-------------|-------------|-------------|------------|-------------|-------------|
| <b>FY17E earnings (RMm)</b> |            |             |             |             |            |             |             |
| - Old                       | 309.1      | 416.4       | 137.6       | 181.2       | 1,432.2    | 1,340.4     | 2,387.5     |
| - New                       | 280.0      | 416.4       | 137.6       | 149.6       | 1,173.0    | 1,340.4     | 2,136.7     |
| <b>TPs (RM)</b>             |            |             |             |             |            |             |             |
| - Old                       | 1.86       | 11.88       | 2.58        | 4.19        | 5.00       | 28.72       | 8.61        |
| - New                       | 1.87       | 13.35       | 2.74        | 3.73        | 4.50       | 29.00       | 9.03        |
| <b>Ratings</b>              |            |             |             |             |            |             |             |
| - Old                       | HOLD       | HOLD        | HOLD        | BUY         | BUY        | BUY         | HOLD        |
| - New                       | HOLD       | BUY         | HOLD        | BUY         | HOLD       | BUY         | HOLD        |

Source: Affin Hwang forecasts; note: FY18E earnings for IJMP

### Sector rating is still at NEUTRAL

Across our coverage universe post the 1Q17 results, we have **BUY** ratings on **KL Kepong (KLK MK, RM24.86)**, **Genting Plantation (GENP MK, RM11.20)** and **IJM Plantation (IJMP MK, RM3.13)**; while **Felda Global (FGV MK, RM1.62)**, **IOI Corp (IOI MK, RM4.55)**, **Sime Darby (SIME MK, RM9.57)** and **Hap Seng Plantation (HAPL MK, RM2.60)** carry **HOLD** ratings (please refer to our peer comparison table). We had upgraded GENP to BUY as we expect higher FFB and CPO production to drive earnings growth, but had downgraded IOI Corp to HOLD on valuation grounds.

For plantation-sector exposure, KLK remains our top sector pick. We continue to like KLK for its good management and expect higher FFB and CPO production as well as a lower cost of production to drive its earnings growth in FY17-19E. KLK is also a country top pick (see [\*Stars are still aligning\*](#), 2 June 2017). With our recent upgrade, we also like Genting Plantation. We maintain our plantation sector NEUTRAL rating.

### Key risks

Key downside risks to our NEUTRAL sector rating and stock calls would be: (i) weaker-than-expected demand and higher-than-expected production, which would lower prices of vegetable oils; (ii) a decline in CPO production that is not offset by higher CPO ASPs; (iii) delays in implementation of biodiesel mandates in Indonesia and Malaysia; and (iv) unfavourable policies and taxes. Key upside risks would be a strong rebound in the global economy as well as demand for and prices of vegetable oils.

### Our recent updates:

**Felda Global:** [\*Sugar business dragging earnings\*](#) (1 June 2017)

**Genting Plant:** [\*Upgrading: a good start to the year\*](#) (29 May 2017)

**Hap Seng Plant:** [\*Results within expectations, no major surprises\*](#) (24 May 2017)

**IJM Plant:** [\*Below expectations\*](#) (25 May 2017)

**IOI Corp:** [\*Below our expectations\*](#) (16 May 2017)

**KL Kepong:** [\*Solid 1HFY17 earnings on high CPO and PK prices\*](#) (22 May 2017)

**Sime Darby:** [\*9MFY17 results below expectations\*](#) (31 May 2017)

**Equity Rating Structure and Definitions**


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|                  |  |
|------------------|--|
| <b>BUY</b>       | Total return is expected to exceed +10% over a 12-month period   |
| <b>HOLD</b>      | Total return is expected to be between -5% and +10% over a 12-month period   |
| <b>SELL</b>      | Total return is expected to be below -5% over a 12-month period  |
| <b>NOT RATED</b> | 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.*

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