Plantations

NEUTRAL Maintained

High on the radar screen of EM investors

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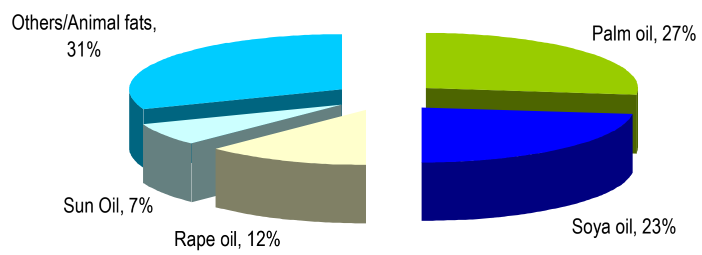
Roadshow in Europe and US

Over the past two weeks, we presented our view on the regional plantation sector to 51 fund managers and analysts from 39 asset management firms in Europe (London, Frankfurt, Edinburgh and Paris) and the US (New York, Boston, Austin, Los Angeles and San Diego). The roadshow comes on the back of our 5 Jun regional plantation report in which we suggested that investors may find better bargains among plantation stocks in 3Q due to our expectation of a correction in palm oil prices during that period. We also upgraded the Malaysian plantation sector to Neutral from Underweight in the note.

We saw a good response to our roadshow. Many investors were keen to get an update on the key drivers and direction for palm oil prices as well as stock picks for the sector. The regional palm oil sector offers exposure to the world's largest palm oil players, both upstream and downstream, through the Singapore, Malaysia and Indonesia equity markets. The palm oil plays are concentrated in these three markets as palm oil estates in Malaysia and Indonesia produce 86% of the global palm oil supply. As such, it is no surprise that there are only a handful of palm oil companies listed outside Malaysia, Singapore and Indonesia.

The other interesting fact is that palm oil has in recent years overtaken soya oil as the largest global edible oil, with 27% share of total global edible oil supply. This is a major reason for some emerging market (EM) investors' interest in the palm oil sector. We also noticed a surge in interest and knowledge on the palm oil sector compared to three years ago. We attribute this to: (1) the rise in interest in the commodity sector in recent years, (2) the biodiesel angle, which links CPO price to crude oil prices, (3) the sector's exposure to the consumption growth story in China and India, and (4) a wider selection of plantation stocks in the region following the listing of new big-cap palm oil companies in Singapore including Wilmar and Indofood Agri in recent years.

Figure 1: World Production of 17 Oils and Fats in 2008

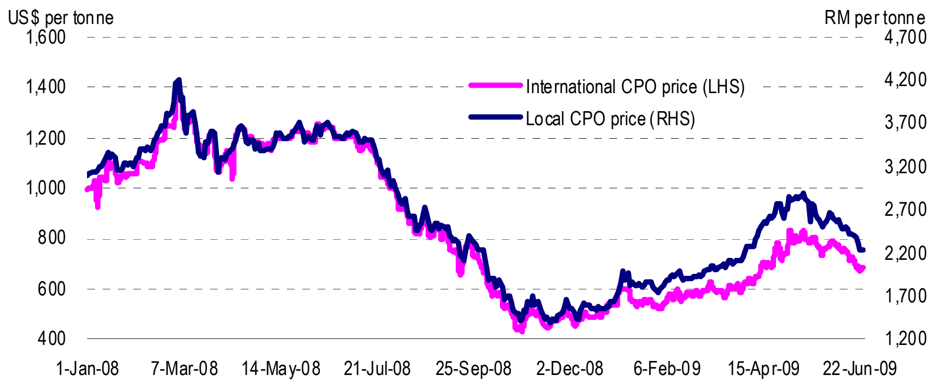


Source: MPOB, Bloomberg

Our view on the sector

Recap of CPO price. We explained to investors that CPO price has performed better than our and market expectations YTD due to supply issues and government policies. On the supply front, soybean harvests from South America were 18% below Dec 08 projections by industry analysts due to a severe drought. Palm oil harvests from Indonesia and Malaysia were also below forecasts due to heavier-than-usual rainfall and biological tree stress. Demand for palm oil was stronger than expected as palm oil enjoys zero import duty against 20% import duty for soya oil in India for four months starting 18 Nov 08.

Figure 2: CPO price performance since 1 Jan 2008



Source: MPOB, Bloomberg

Outlook for CPO price. We highlighted our view that CPO price will be relatively firm until end-Jun 09 due to tight palm oil and soya oil stocks in key producing countries, rising crude oil price and inflow of funds in the commodity sector. However, we expect CPO price to pull back in 3Q due to (1) seasonally higher FFB production in 3Q09, (2) expectation of higher soybean plantings by US farmers compared to the March planting intentions report, (3) a rebound in South America's soybean production in 2010, (4) potential demand destruction, and (5) higher-than-normal stockpile of palm oil in India and soybean in China. We are more optimistic about prospects for CPO price towards the end of this year as: (1) palm oil yields may be affected by lower fertiliser input, (2) it will benefit from the price support measures by the Malaysian government in the form of a replanting subsidy for 200,000ha of palm oil estates and 5% biodiesel mandate in 1Q10, and (3) stronger edible oil demand growth due to better economic prospects in 2010.

Two key swing factors. We mentioned two key swing factors that may change our view on CPO price: (1) potential El Nino event, and (2) crude oil price. Two influential weather forecasters recently raised the red flag on a potential El Nino event in 3Q. Traditionally, El Ninos are positive for planters' earnings as the rise in palm oil price more than offsets the reduction in production. It is currently not economically viable to produce biodiesel from palm oil. As such, crude oil price is currently not a key driver for the higher CPO price but merely acts as a support for CPO price.

Regional plantation strategy. We are Neutral on the regional plantation sector as (1) most plantation share prices have rallied YTD, in line with the CPO price, and (2) we expect CPO price to correct in 3Q. For exposure to the sector, we recommend investors to accumulate Wilmar, Indofood Agri, Sime Darby and London Sumatra on dips.

Feedback from investors

Most investors concur with our view on CPO price and stock picks. Questions asked included: (1) our view on the potential downside risk to CPO price in 3Q, (2) the CPO-biodiesel breakeven price at various crude oil prices, (3) likelihood of higher import duties for palm and soya oil in India, and (4) the exact impact of El Nino on CPO price and supply. We told them that at the current crude oil price and in view of the tightness in palm oil and soya oil stocks, we think there is support for CPO price at around the RM2,000 level. The RM2,195 CPO-biodiesel breakeven price with subsidy at the current crude oil price of US$68 per barrel will also act as a support for CPO price when palm oil supply improves in 3Q. There is a good chance that the Indian government will raise import duties for palm and soya oil to protect domestic farmers. Lastly, we explained that the exact impact of an El Nino is unclear at this juncture as we need to gauge the severity of this weather event after it develops and its impact on the major key planting regions. What we can establish is that this weather event has been net positive for CPO price in the past.

The investors we spoke to were keen on our top pick Wilmar though some voiced concern that the share price has done exceptionally well and is closing in on its all-time high of S$5.64. We highlighted the strong set of results posted by Wilmar as well as its competitive advantage and key catalysts in the form of a potential listing of its China operations as early as end of this year and a potential rise in its free float which will boost its weightings in major indices tracked by fund managers. We also put stress on the potential cost savings angle for Indofood Agri following its takeover of London Sumatra in 2H09. Our top plantation pick for exposure in Malaysia, Sime Darby, was well-received by investors due to its big-cap status, reasonable valuations and liquidity. However, some prefer a purer play on CPO price as the plantation division accounts for only 60-70% of Sime Darby's earnings. Lastly, we pointed out we prefer London Sumatra over Astra Agro for exposure in Indonesia as the former offers more attractive valuations and better growth prospects. Other plantation stocks that investors like or asked our opinion on during our roadshow included Golden Agri, KL Kepong and Kulim.

Figure 3: Estimated CPO breakeven price for biodiesel production at various crude oil prices

Crude oil price (US$/barrel)	CPO breakeven w'out subsidy (US$/tonne)	CPO breakeven with subsidy (US$/tonne)	Ex-rate MYR/USD	Local CPO price w'out subsidy RM per tonne	Local CPO price with subsidy RM per tonne
30	196	346	3.5	686	1,211
40	270	420	3.5	945	1,470
50	344	494	3.5	1,204	1,729
60	418	568	3.5	1,463	1,988
70	492	642	3.5	1,722	2,247
80	566	716	3.5	1,981	2,506
90	640	790	3.5	2,240	2,765
100	714	864	3.5	2,499	3,024
110	788	938	3.5	2,758	3,283
68.0	477	627	3.5	1,670	2,195

Source: Industry sources, CIMB/CIMB-GK Research,

Valuation and recommendation

Overall, we are buoyed by the strong interest shown by investors during our roadshow. Most of the clients we met were either Neutral or Underweight on the plantation sector but are keen to invest in the sector if the valuations become more attractive. Among the funds that we met that had plantation holdings, most preferred the planters listed in Singapore, followed by Malaysian planters, with Indon planters bringing up the rear. We are not surprised by this as the Singapore plantation companies offer more compelling valuations and better liquidity than their Indonesian counterparts.

There is no change to our CPO price forecasts (cif) of US$710 per tonne for 2009 and 2010. Our local CPO price forecasts of RM2,280 per tonne for 2009 and RM2,250 per tonne for 2010 are also intact. We maintain our NEUTRAL rating for the regional plantation sector as the share prices of most planters in our universe have done well YTD, reflecting the more upbeat CPO price outlook and expectations of a correction of CPO price in 3Q. However, we are now upgrading Golden Agri from Neutral to TRADING BUY as the stock has underperformed the market. Our top picks in the region are Wilmar, Sime Darby, Indofood Agri, Golden Agri and London Sumatra.

Figure 1: Sector comparisons

	Bloomberg ticker	Recom.	Price (Local)	Target price (Local)	Mkt cap (US$ m)	Core P/E (x) CY2009	Core P/E (x) CY2010	3-yr EPS CAGR (%)	P/BV (x) CY2009	ROE (%) CY2009	Div yield (%) CY2009
Sime Darby	SIME MK	TB	6.80	8.40	11,552	17.3	14.3	(6.6)	1.8	10.5	4.7
KLK	KLK MK	U	12.00	12.70	3,621	16.0	16.8	(13.8)	2.2	12.0	3.0
IOI Corp	IOI MK	N	4.62	5.30	8,158	17.5	15.3	(1.8)	3.0	15.6	2.4
Genting Plantations	GENP MK	U	5.60	5.70	1,199	15.1	13.3	(7.0)	1.6	11.4	1.4
Hap Seng Plant	HAPL MK	N	2.10	2.45	475	10.6	10.3	1.1	1.0	9.5	7.5
Wilmar	WIL SP	O	4.90	5.45	20,839	16.9	15.6	(1.8)	2.0	12.2	1.4
Golden Agri	GGR SP	TB	0.38	0.43	2,750	16.6	11.7	(18.7)	0.6	3.8	0.9
Indofood Agri	IFAR SP	TB	1.22	1.55	1,214	11.7	10.5	(8.2)	1.4	12.7	0.0
Astra Agro	AALI IJ	N	17,800	18,500	2,700	13.5	12.1	(5.8)	4.3	34.9	2.8
Lonsum	LSIP IJ	O	5,800	6,850	762	13.0	10.8	(0.2)	2.3	17.4	0.0
Sampoerna Agro	SGRO IJ	N	1,620	1,750	295	13.1	9.9	(13.8)	1.7	15.3	2.9
Bakrie Plantation	UNSP IJ	U	700	660	255	11.7	10.6	(13.2)	1.0	7.9	1.1
Simple average						**14.4**	**12.6**	**(7.5)**	**1.9**	**13.6**	**2.3**

O = Outperform, N = Neutral, U = Underperform, TB = Trading Buy and TS = Trading Sell
Source: Company, CIMB/CIMB-GK Research

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OUTPERFORM: The stock's total return is expected to exceed a relevant benchmark's total return by 5% or more over the next 12 months.	**OVERWEIGHT:** The industry, as defined by the analyst's coverage universe, is expected to outperform the relevant primary market index over the next 12 months.
NEUTRAL: The stock's total return is expected to be within +/-5% of a relevant benchmark's total return.	**NEUTRAL:** The industry, as defined by the analyst's coverage universe, is expected to perform in line with the relevant primary market index over the next 12 months.
UNDERPERFORM: The stock's total return is expected to be below a relevant benchmark's total return by 5% or more over the next 12 months.	**UNDERWEIGHT:** The industry, as defined by the analyst's coverage universe, is expected to underperform the relevant primary market index over the next 12 months.
TRADING BUY: The stock's total return is expected to exceed a relevant benchmark's total return by 5% or more over the next 3 months.	**TRADING BUY:** The industry, as defined by the analyst's coverage universe, is expected to outperform the relevant primary market index over the next 3 months.
TRADING SELL: The stock's total return is expected to be below a relevant benchmark's total return by 5% or more over the next 3 months.	**TRADING SELL:** The industry, as defined by the analyst's coverage universe, is expected to underperform the relevant primary market index over the next 3 months.

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NEUTRAL: Expected total returns of between -15% and +15% over the next 12 months.	**NEUTRAL:** The industry, as defined by the analyst's coverage universe, has either (i) an equal number of stocks that are expected to have total returns of +15% (or better) or -15% (or worse), or (ii) stocks that are predominantly expected to have total returns that will range from +15% to -15%; both over the next 12 months.
UNDERPERFORM: Expected negative total returns of 15% or more over the next 12 months.	**UNDERWEIGHT:** The industry, as defined by the analyst's coverage universe, has a high number of stocks that are expected to have total returns of -15% or worse over the next 12 months.
TRADING BUY: Expected positive total returns of 15% or more over the next 3 months.	**TRADING BUY:** The industry, as defined by the analyst's coverage universe, has a high number of stocks that are expected to have total returns of +15% or better over the next 3 months.
TRADING SELL: Expected negative total returns of 15% or more over the next 3 months.	**TRADING SELL:** The industry, as defined by the analyst's coverage universe, has a high number of stocks that are expected to have total returns of -15% or worse over the next 3 months.

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