Maybank Kim Eng

Plantations

Regional

Regional Plantations

POSITIVE *[Unchanged]*

Negative IOD at play. La Nina to follow in Q4?

US drought risk is supportive of prices for now

2021 may just be another anomaly for MY and ID, thanks to negative IOD that brings above-normal rain during the usually dry Q3 period. While rainfall has been good for the past 19 months, 2H21 PO output risks being below potential due to the lagged effect of possibly low fertilizer applied over the last 2 years, and worker shortage in MY. In the US, weather has not been ideal, with further dry weather forecasts in the coming weeks. US' yields are at risk and will be supportive of prices. We maintain our POSITIVE sector view. Preferred BUYs: KLK, SOP & BPLANT.

Negative IOD brings rain to oil palm region

On 15 July, the ASMC announced the start of the dry season for the southern ASEAN region which is expected to last till Oct 2021. However, during this period, above-average rainfall is expected over most parts of the region. Unlike last year when weak La Nina conditions were present, La Nina is not yet confirmed as ENSO remains neutral (Fig.1). This round, the above-average rainfall forecast is due to a phenomenon called negative IOD (see Figs.2-3). The above-normal rainfall predictions were echoed by NCEP, ECMWF and UK Met office (Fig.4) in ASMC's recent outlook update. But occasional bout of dry weather and hotspots in fire-prone areas can still occur in Q3. As for Q4, will La Nina make a return following NOAA's issuance of a La Nina Watch (Fig.5)?

Parts of US is facing unfavourable weather

According to the USDA's US Drought Monitor report (13 July), the western region of the US has been hit by severe drought lately (Fig.6). About 36% of corn (Figs.7-9) and 31% of soybean (Figs.10-12) production in the US are within an area experiencing drought. Corn and soybean crop conditions have been deteriorating since the start of the planting season. Soybean is now entering its crucial pod setting months of July/ Aug but the drought forecast is likely to stay in the west north central region (Figs.13-14) till Oct 2021. However, in general, it is also important to note that genetically modified soybean varieties these days are more heat and drought resistant, and hence the final yield impact may not be as bad as what the market envisage. Nonetheless, the market has largely priced in the latest weather developments given US soybean prices have remained elevated of late amid present tightness in supply.

2H21 palm oil output: Good rainfall vs fertilizer cut?

In this region, good rainfall has been recorded the past 19 months (Appendix 1) and conducive for a strong PO output recovery in 2H21, after 2019-20's tree rest. But this favorable factor may have been mitigated by lower fertilizer application by growers, esp. smallholders, in 2019-20 due to the low CPO prices suffered in 2018-19, as alluded by some corporate captains of late. The proxy evidence was lower inorganic fertilizers imported by MY (-27% YoY) and ID (-24% YoY) in 2019, while 2020's volume was barely higher YoY (Fig.15). The lower fertilizer used may be partly intentional as growers stop fertilizing old trees usually 2 years before replanting while new trees require much less fertilizer. In addition, MY is experiencing a severe shortage of foreign workers (due to COVID) which may also result in 2021's yields coming in below potential. Lower-than-expected 2H21 PO supply will be supportive of CPO prices.

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Regional CPO price forecast

	2021F	2022F
	MYR/t	MYR/t
Full year avg (FOB)	3,100	2,600
MDEX / MPOB prices:		
3M CPO price (19 July)	4,151	
YTD (19 July) 3M CPO ASP	3,770	
YTD (19 July) spot CPO ASP	4,058	

Plantation stocks mentioned on cover page

Company	BBG ticker	Rec	Shr px	Tgt px
M'sia listed			LCY	LCY
KL Kepong	KLK	Buy	19.72	29.60
Swk Oil Palm	SOP	Buy	3.49	5.67
Bous.Plant	BPlant	Buy	0.61	0.79

Source: Maybank KE

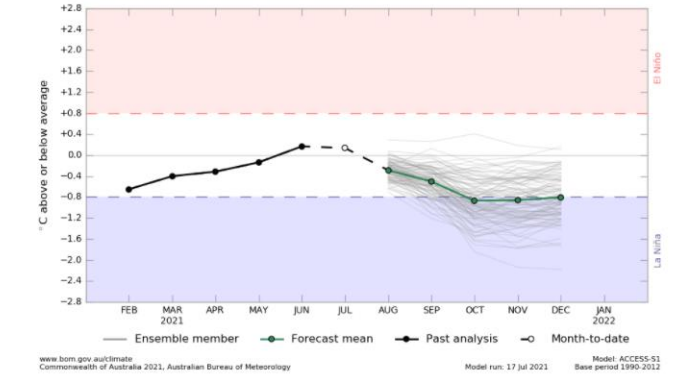
Terms used in this note:

ASMC - ASEAN specialized meteorological centre
ASP - Average Selling Price
CPO - Crude Palm Oil
ECMWF - European Centre for Medium-Range Weather Forecasts
ENSO - El Nino-Southern Oscillation
ID - Indonesia/ Indonesian
IOD - Indian Ocean Dipole
LCY - Local currency
mt - million tonnes
MY - Malaysia/ Malaysian
NCEP - National Centers for Environmental Prediction
NOAA -National Oceanic and Atmospheric Administration
PO - Palm Oil
t - tonnes
YoY - year on year

SEE PAGE 13 FOR IMPORTANT DISCLOSURES AND ANALYST CERTIFICATIONS

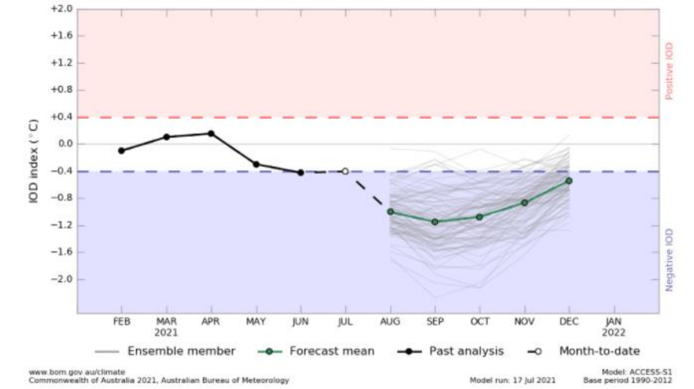
Stock	Bloomberg code	Mkt cap (USD'm)	Rating	Price (LC)	TP (LC)	Upside (%)	P/E (x) 21E	P/E (x) 22E	P/B (x) 21E	P/B (x) 22E	Div yld (%) 21E	Div yld (%) 22E
Sime Darby Plant	SDPL MK	6,014	Hold	3.69	4.71	29	19.4	27.1	1.8	1.7	2.8	1.8
IOI Corp	IOI MK	5,520	Buy	3.71	4.71	29	19.9	23.6	2.4	2.3	3.5	2.5
KL Kepong	KLK MK	5,046	Buy	19.72	29.60	52	18.3	20.6	1.9	1.8	3.3	2.9
First Resources	FR SP	1,540	Buy	1.33	1.88	43	11.7	10.6	1.4	1.3	4.3	4.7
Genting Plant	GENP MK	1,432	Buy	6.74	8.96	36	22.6	22.6	1.2	1.2	2.7	2.7
Bumitama Agri	BAL SP	578	Buy	0.45	0.65	46	8.3	6.0	0.9	0.8	4.8	6.7
Swk Oil Palms	SOP MK	472	Buy	3.49	5.67	66	7.9	8.6	0.8	0.7	3.8	3.5
TSH Resources	TSH MK	337	Buy	1.03	1.40	37	13.1	15.8	0.9	0.9	2.3	1.9
Boustead Plant	BPLANT MK	323	Buy	0.61	0.79	32	22.6	27.8	0.5	0.5	2.7	2.2
Ta Ann	TAH MK	284	Buy	2.70	3.45	33	9.8	11.7	0.8	0.8	5.1	4.3
TH Plantations	THP MK	99	Sell	0.48	0.44	(7)	12.0	16.4	0.7	0.7	0.0	0.0

Fig 1: Monthly sea surface temperature anomalies for NINO3.4 region - in Neutral region now



Source: Australia Bureau of Meteorology (updated 20 July)

Fig 2: Monthly sea surface temperature anomalies for IOD region - in Negative IOD region now

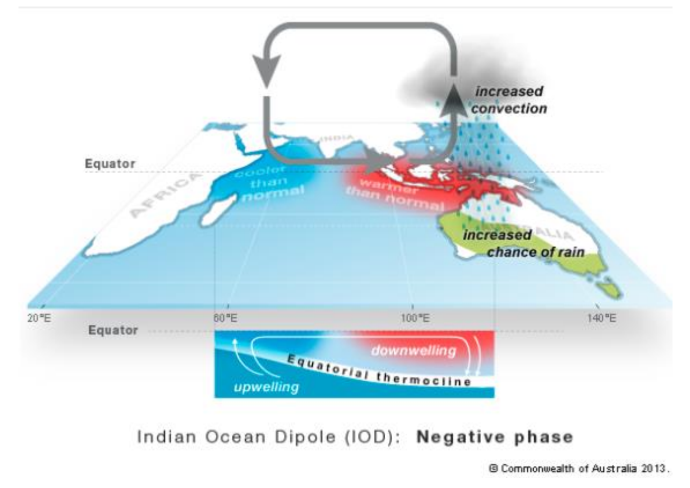


Source: Australia Bureau of Meteorology (updated 20 July)

About lesser known Indian Ocean Dipole (IOD)

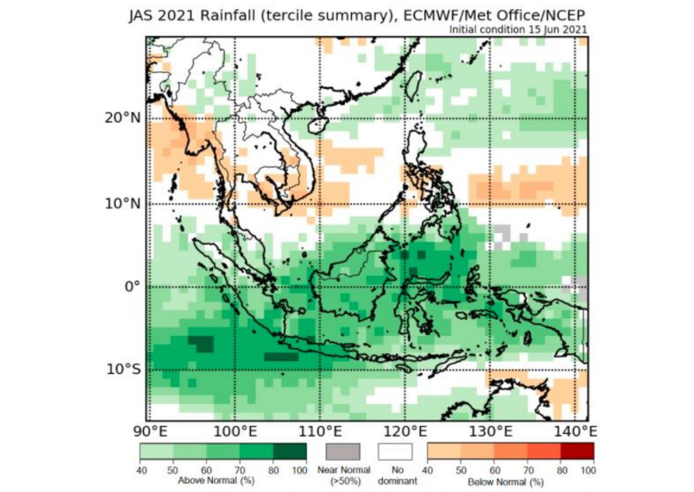
According to the Australian Bureau of Meteorology (ABM), Indian Ocean sea surface temperatures impact rainfall and temperature patterns over Australia. We understand it also brings rainfall to the southern ASEAN region. Basically, the Indian Ocean Dipole or IOD is the sustained changes in the difference between sea surface temperatures of the tropical western and eastern Indian Ocean. During a negative IOD phase (see Fig.3), there is a distinct temperature difference across the Indian Ocean, with warmer than normal water temperature in the east and cooler than normal water in the west, which then results in higher precipitation in this region.

Fig 3: About Negative IOD phase



Source: Australia Bureau of Meteorology

Fig 4: Rainfall tercile summary predictions of multi-model ensemble model for July-Aug-Sept (JAS) 2021

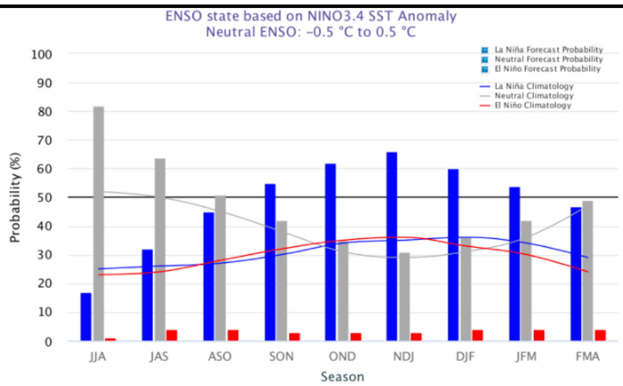


Source: ASMC

Increasing risk of La Nina?

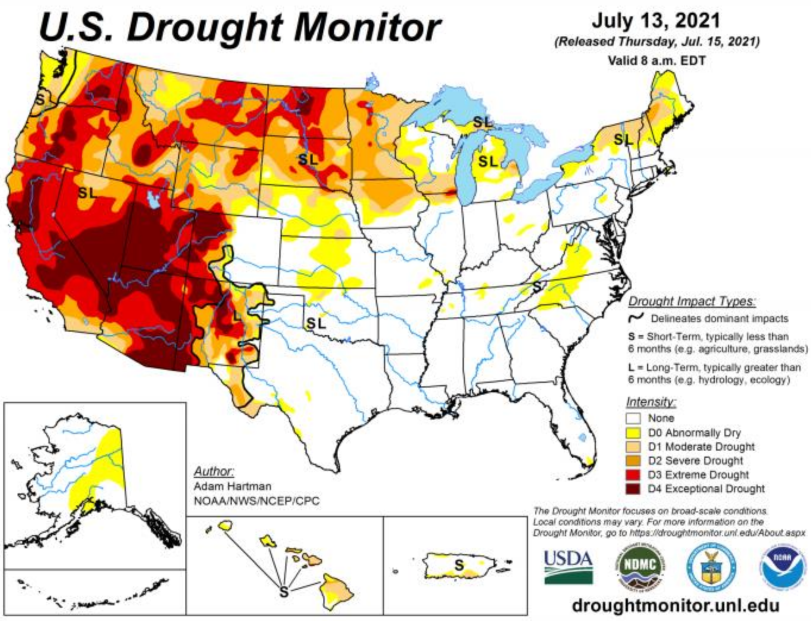
According to the NOAA (8 July update), there is a 66% probability that La Nina conditions may develop in Nov/Jan (Fig.5). La Nina usually brings above-normal rainfall to Southeast Asia. Conversely, La Nina increases the risk of below-normal rainfall in southern Brazil, central & northern Argentina. Already, some of these latter regions are presently suffering from moisture deficit and a confirmation of La Nina may cause further concerns to the market.

Fig 5: Early-July 2021 CPC/IRI Official Probabilistic ENSO forecast



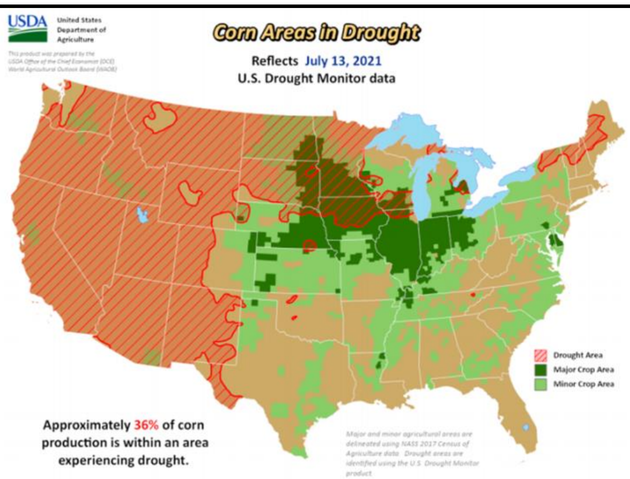
Source: CPC/ IRI

Fig 6: U.S Drought monitor (as at 13 July)



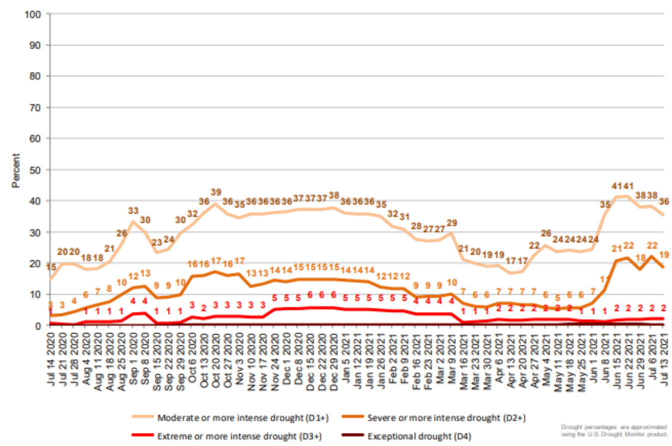
Source: USDA

Fig 7: Corn areas in drought (as at 13 July)



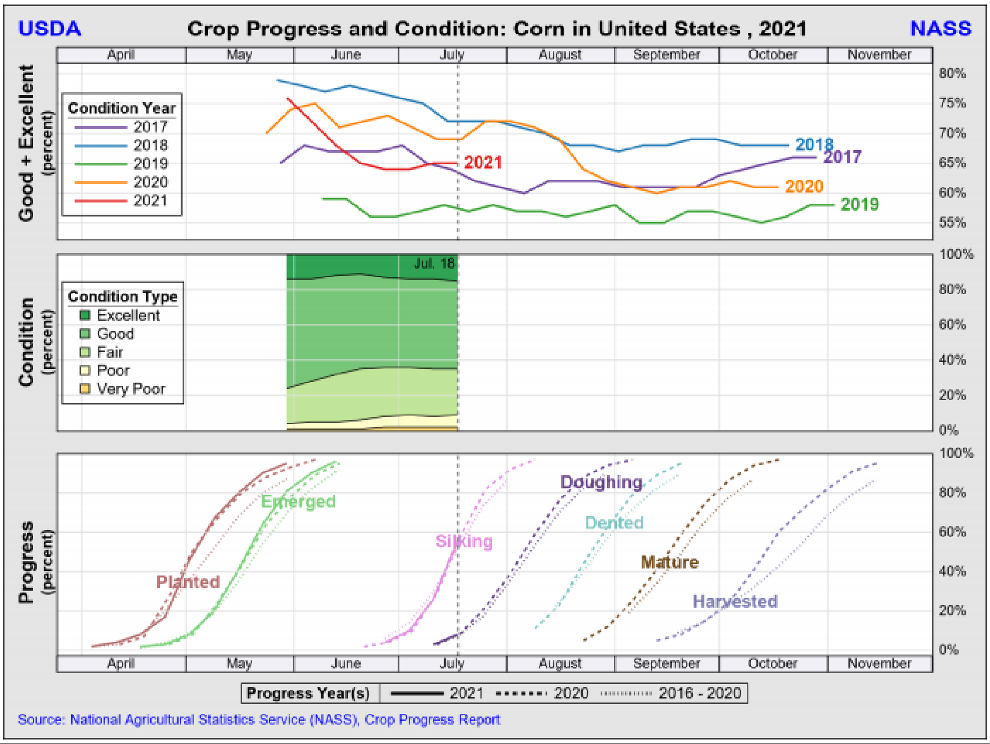
Source: USDA

Fig 8: Percent of United States corn located in drought



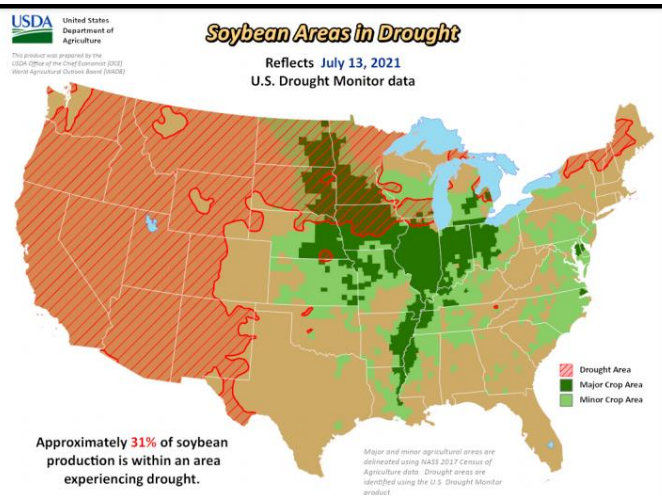
Source: USDA

Fig 9: USDA's Crop Progress and Condition: Corn (as at 18 July)



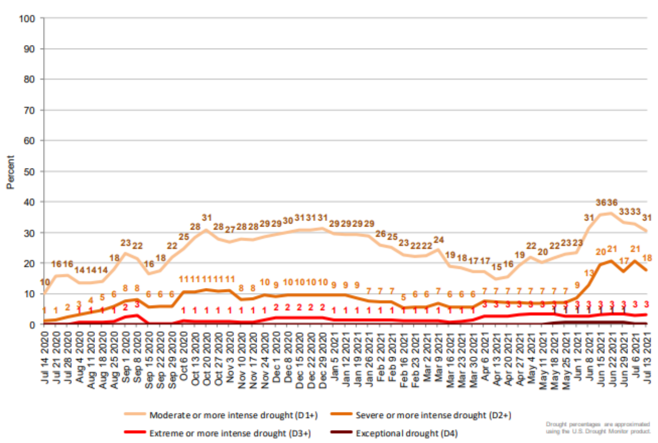
Source: NASS, Crop Progress Report

Fig 10: Soybean areas in drought (as at 13 July)



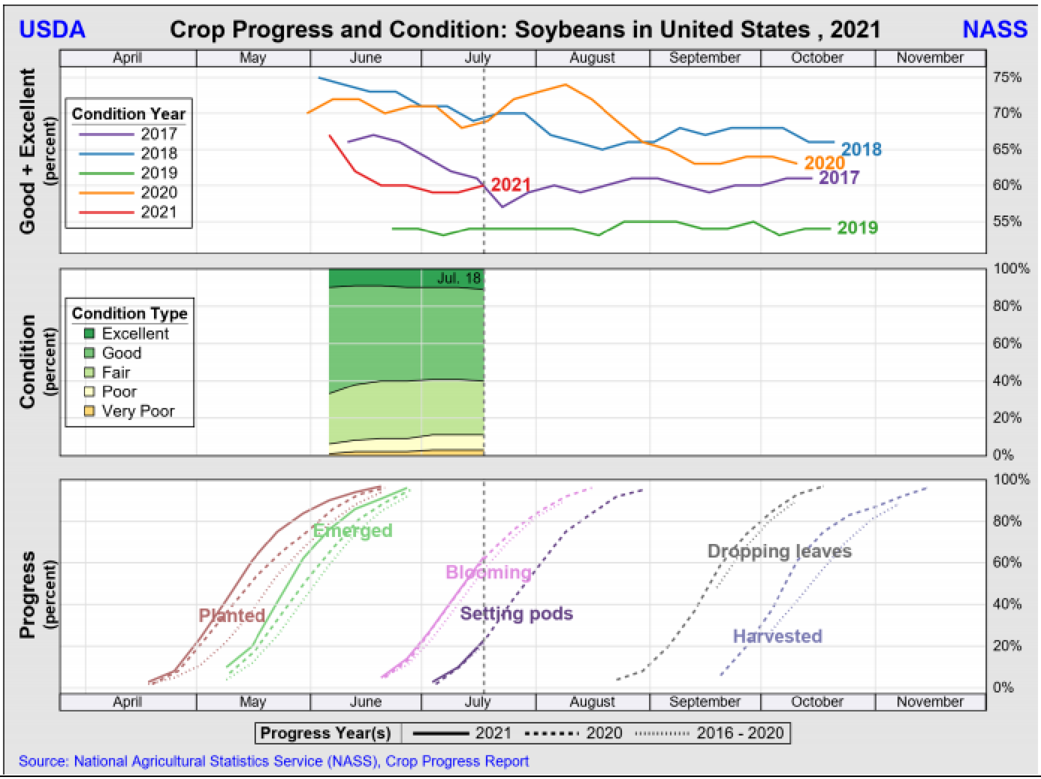
Source: USDA

Fig 11:Percent of United States soybeans located in drought



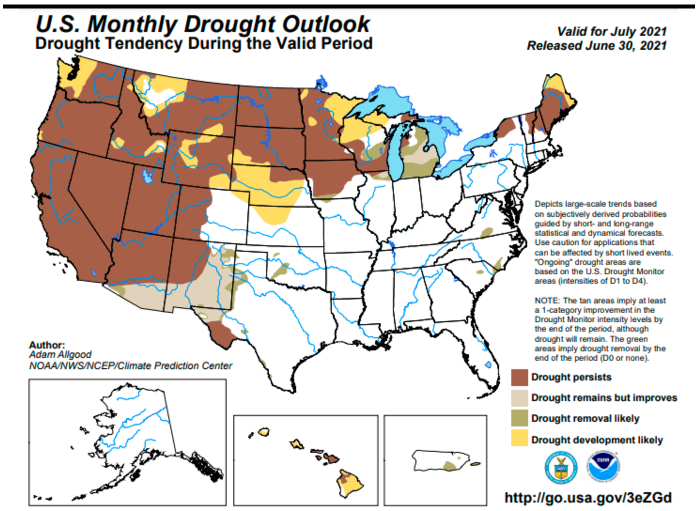
Source: USDA

Fig 12: USDA's Crop Progress and Condition: Soybeans (as at 18 July)



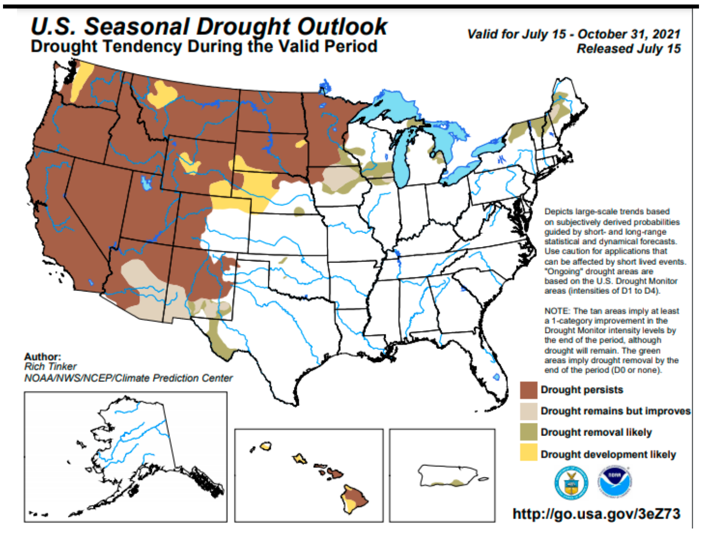
Source: NASS, Crop Progress Report

Fig 13: U.S. Monthly Drought Outlook (July 2021)



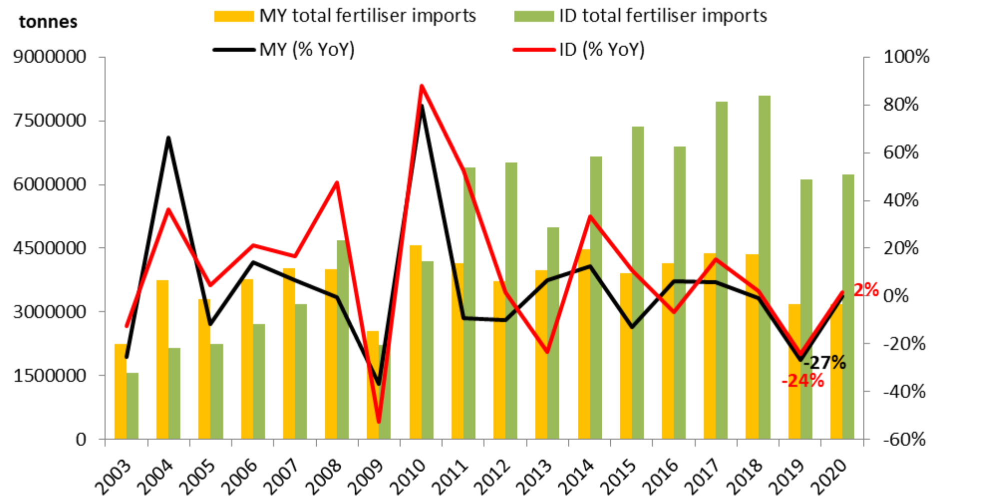
Source: NOAA

Fig 14: U.S. Seasonal Drought Outlook (15 July-31 Oct 2021)



Source: NOAA

Fig 15: Total fertilizer imports by MY and ID (in tonnes)

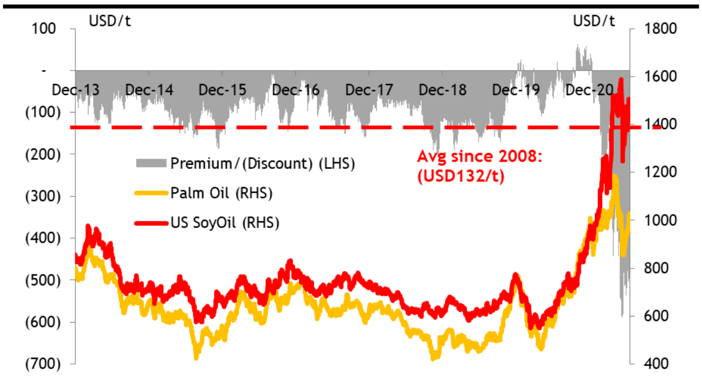


Source: UN COMTRADE statistics, BPS- Statistics Indonesia, Department of Statistics Malaysia

Weather risk premium built into prices

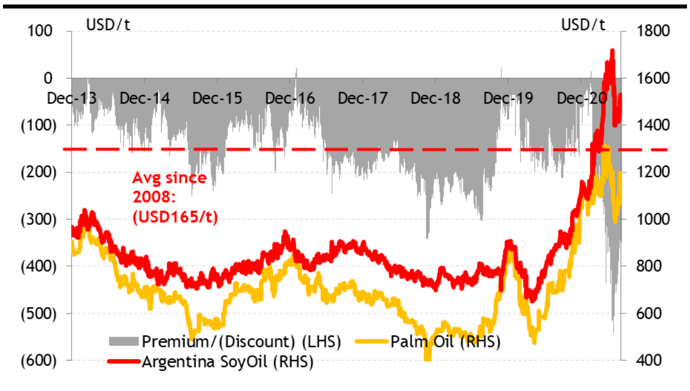
The market is presently pricing in some weather risk premium, especially the drought risk in the US, amidst present global tight supplies of oils and fats. CPO prices have benefited from the weather risk premium too of late despite favourable weather here. However, CPO price continues to trade at healthy discounts to other major vegetable oils, namely SBO (USD350-443/t) and EU rapeseed oil (USD251/t) - Figs.16-19. If weather risk weakens, we should see large supplies of US soybean/soybean oil in 2H21 to help ease the present tightness of global oils supplies. Still, a normalization of overall supplies may still take another 12 months. Nonetheless, we should see CPO price easing somewhat from its present lofty levels on seasonally high output in 2H21. Overall, the risk to our 2021 CPO ASP forecast of MYR3,100/t is on the upside if (i) the anticipated strong PO output recovery in 2H21 did not materialize, which in part, could be contributed by the acute shortage of workers in MY, and (ii) there is a slower-than-expected build-up in MY's PO inventory by year end.

Fig 16: 1M palm oil price at a steep discount to US soybean oil at USD443/t (19 July 2021)



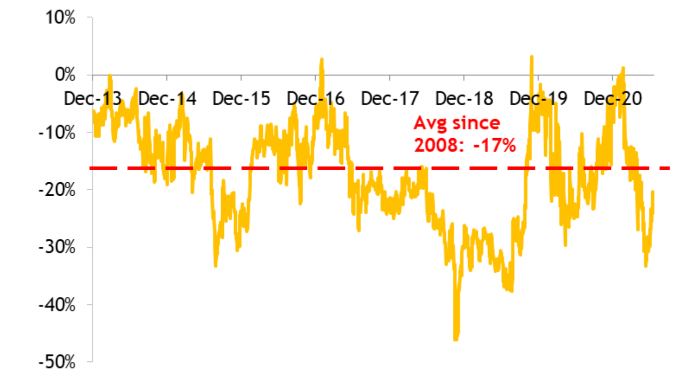
Source: Bloomberg

Fig 17: Rotterdam Palm Oil CIF price discount to Argentina Soybean Oil at USD350/t (19 July 2021)



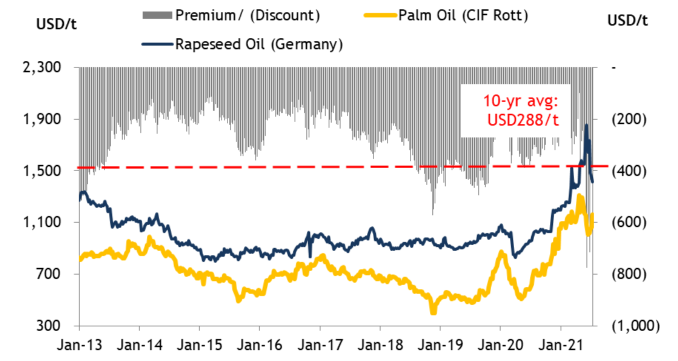
Source: Bloomberg

Fig 18: Palm oil price discount (in %) to Argentina soybean oil at -23% (19 July 2021)



Source: Bloomberg

Fig 19: Palm Oil price discount to Germany rapeseed oil at USD251/t (17 July 2021)



Source: Bloomberg (quoted weekly)

Risk statement

There are several risk factors that may affect our sector view, earnings estimates, price targets, and ratings of stocks under coverage. Key risks to the sector and companies are:

Upside risks: (i) Weaker-than-expected production recovery of palm oil and other vegetable oils in 2021; (ii) Brent crude oil price recovers closer to USD80/barrel; (iii) Weather anomalies at major palm oil and oilseeds producing regions.

Downside risks: (i) Reversal of Brent crude oil price to sharply below USD40/barrel; (ii) Negative policies imposed by importing countries; (iii) Unfriendly government policies at producing or exporting countries; (iv) Production in 2021 turns out much stronger than expected; (v) Global demand turns out to be weaker than expected; and (v) Weaker competing oil prices (like soybean and rapeseed).

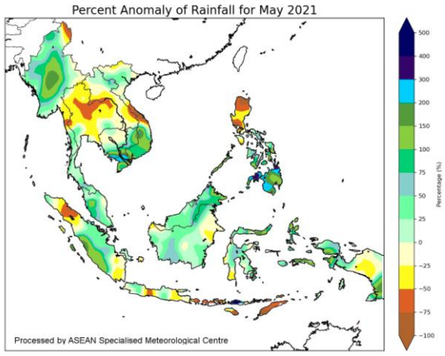
Appendix 1

Percentage of Monthly Normal of Rainfall for Jan- May 2021

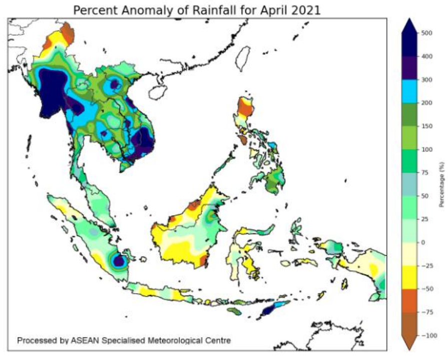
% of Anomaly Rainfall for June 2021

Not available yet

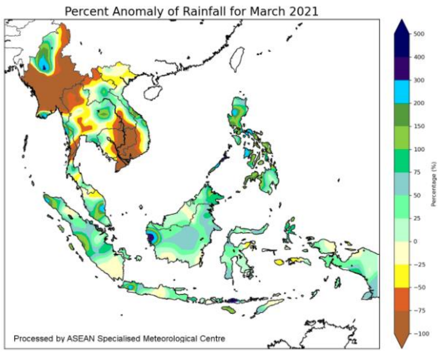
% of Anomaly Rainfall for May 2021



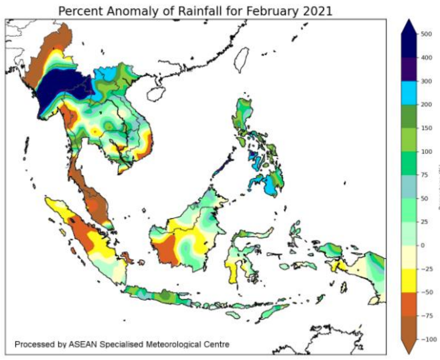
% of Anomaly Rainfall for Apr 2021



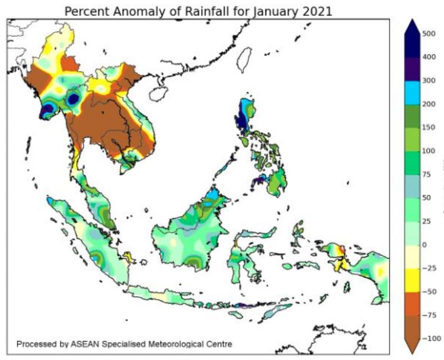
% of Anomaly Rainfall for Mar 2021



% of Anomaly Rainfall for Feb 2021



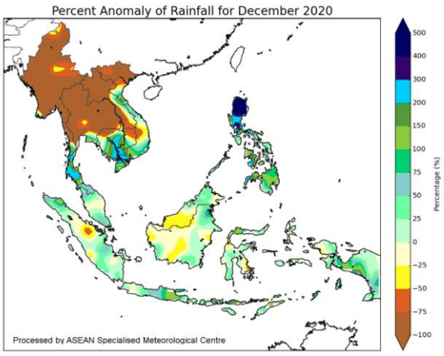
% of Anomaly Rainfall for Jan 2021



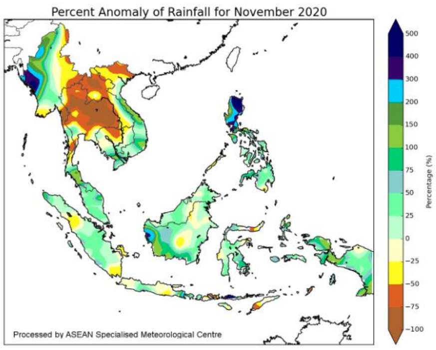
Source: ASMC

Percentage of Monthly Normal of Rainfall for Jan- Dec 2020

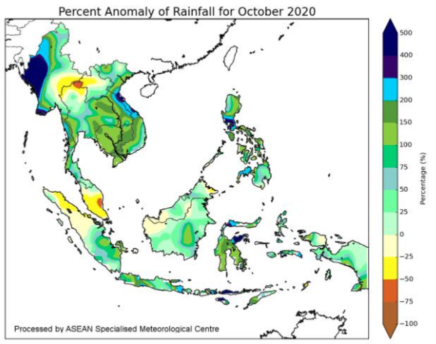
% of Anomaly Rainfall for Dec 2020



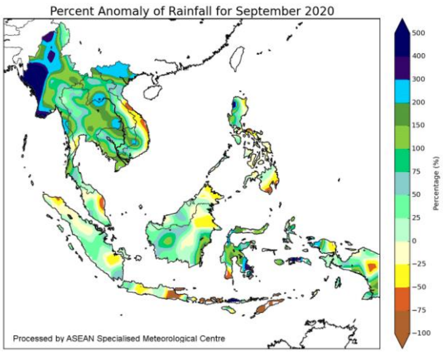
% of Anomaly Rainfall for Nov 2020



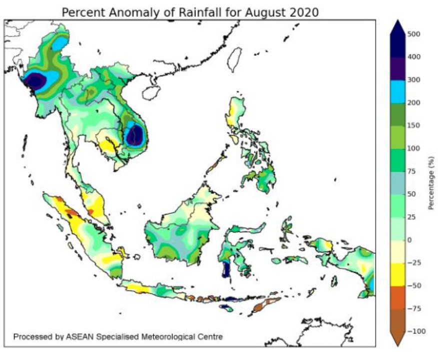
% of Anomaly Rainfall for Oct 2020



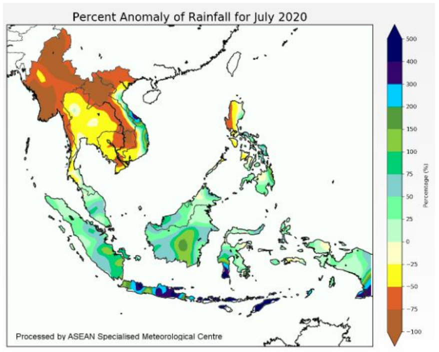
% of Anomaly Rainfall for Sept 2020



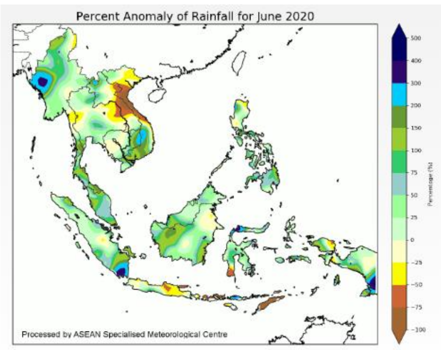
% of Anomaly Rainfall for Aug 2020



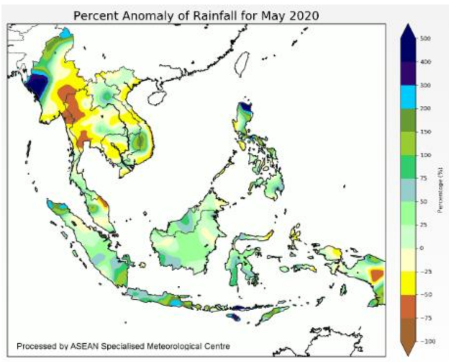
% of Anomaly Rainfall for July 2020



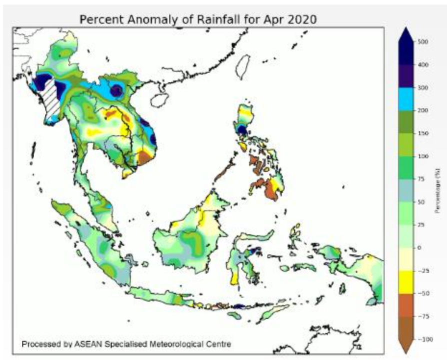
% of Anomaly Rainfall for June 2020



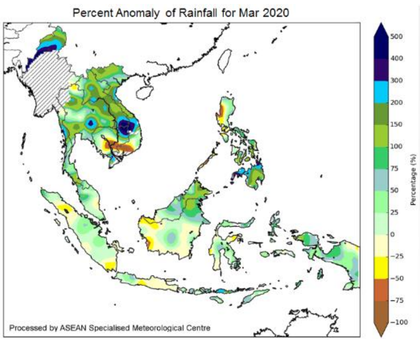
% of Anomaly Rainfall for May 2020



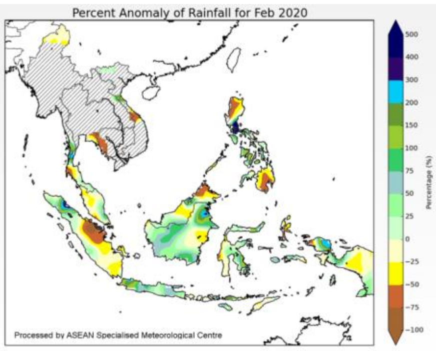
% of Anomaly Rainfall for Apr 2020



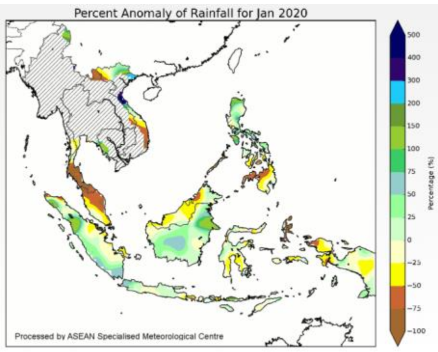
% of Anomaly Rainfall for Mar 2020



% of Anomaly Rainfall for Feb 2020



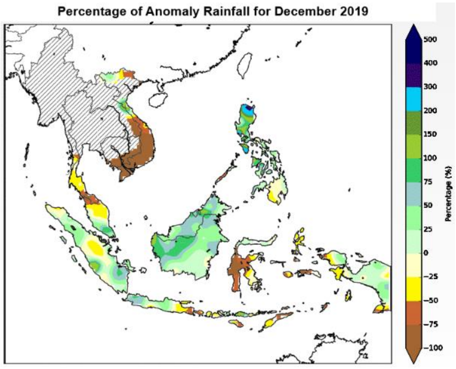
% of Anomaly Rainfall for Jan 2020



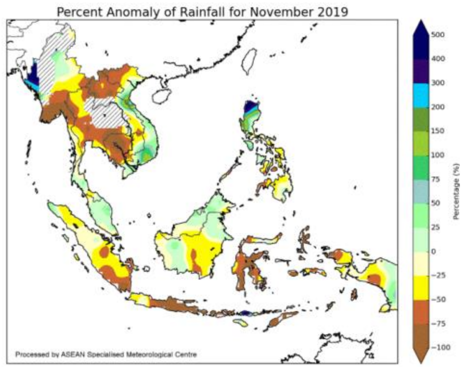
Source: ASMC

Percentage of Monthly Normal of Rainfall for Jan- Dec 2019

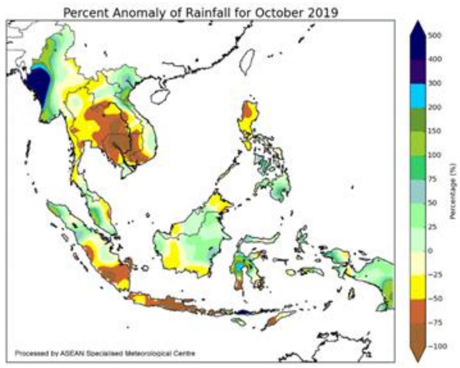
% of Anomaly Rainfall for Dec 2019



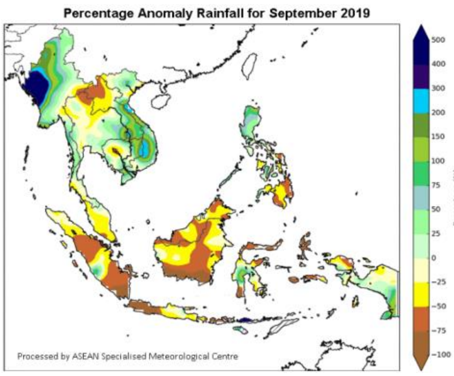
% of Anomaly Rainfall for Nov 2019



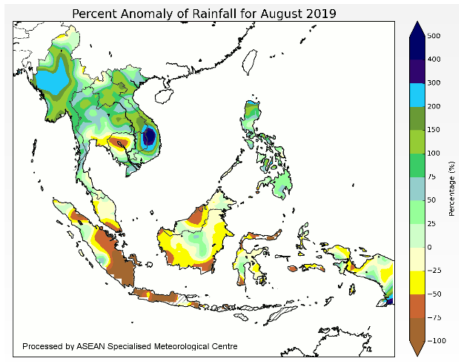
% of Anomaly Rainfall for Oct 2019



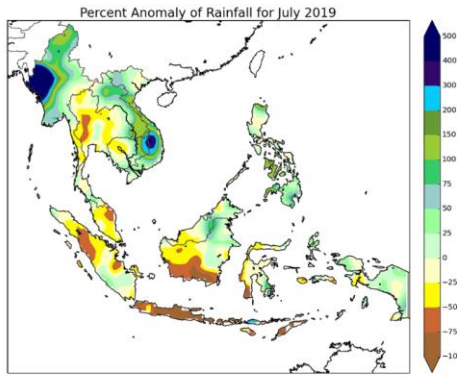
% of Anomaly Rainfall for Sept 2019



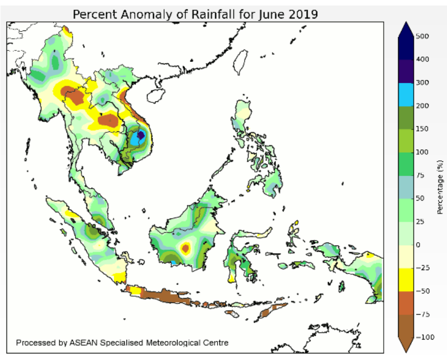
% of Anomaly Rainfall for Aug 2019



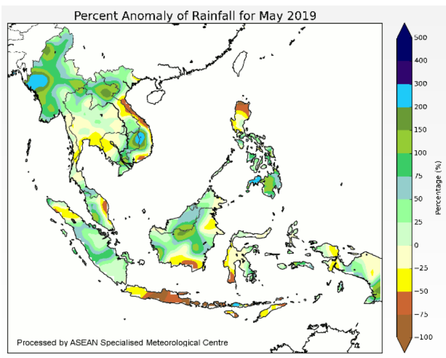
% of Anomaly Rainfall for July 2019



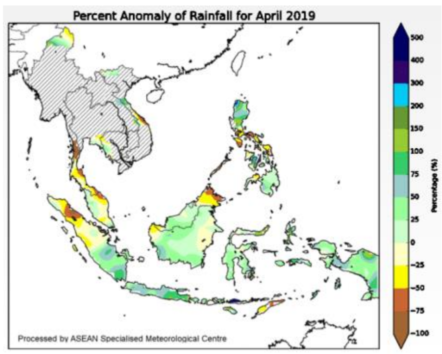
% of Anomaly Rainfall for June 2019



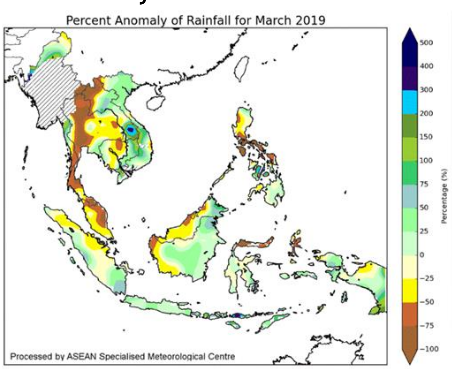
% of Anomaly Rainfall for May 2019



% of Anomaly Rainfall for Apr 2019



% of Anomaly Rainfall for Mar 2019



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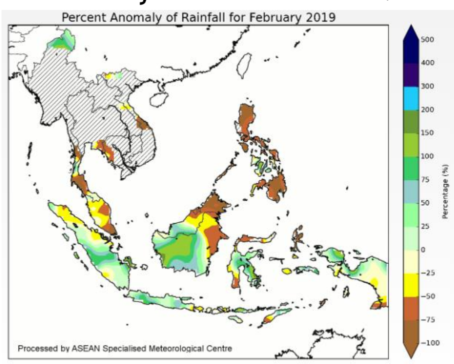

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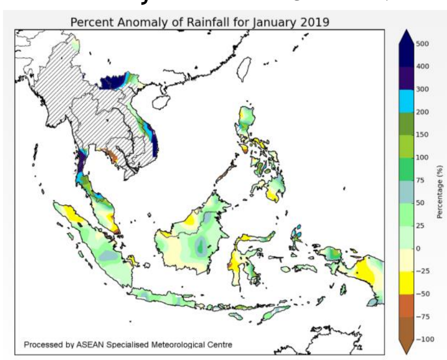

Source: ASMC

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