

Sarawak Oil Palms (SOP MK)

ESG: Building a sustainable future

Relatively good ESG credentials

We assess SOP's overall ESG risk factors to be medium as its ESG credentials appear to be relatively good, with transparent and detailed sustainability disclosures. Its geographical exposure to just Sarawak also helps limit SOP's ESG risks relative to peers. Maintain BUY with unchanged TP of MYR5.60 on 13x FY22 PER peg, its 5Y mean. With net gearing at just 3% (end Sept 21), 8x FY22E PER and an unadjusted EV/ha of MYR25,000 (below replacement cost), SOP is undervalued.

Zero burning and NDPE commitments at its core

Although SOP is not yet a RSPO member, it has good and sustainable practices with zero burning and No Deforestation, No Peat and No Exploitation (NDPE) commitments at its core. SOP is 100% MSPO certified since 2019. And 6 of its 7 palm oil mills are also International Sustainability & Carbon Certification certified since 2017. To reduce GHG emissions, SOP plans to install methane capture facilities for all 7 palm oil mills (presently just 1 installed), but has not yet specified an execution timeline.

Eradicating poverty & raising socioeconomic status

SOP started as a JV between the Commonwealth Development Corporation (CDC) and the Sarawak State government in 1968 to pioneer the commercial planting of oil palms in Sarawak with an initial land area of ~4,600 ha. The aim was to eradicate poverty among local communities and to-date, the socioeconomic status of the local communities has improved remarkably. In addition to windfall and corporate taxes paid to the Federal government, SOP has also contributed over MYR300m (by our estimate) in Sarawak sales taxes since 2010 that has helped the state government with its community development programmes.

Targets to minimise impact on planet by lifting yields

In 2019, SOP introduced an in-house "555 Target" with the goal to achieve 5t/ha (FY20: 3.3t/ha) of palm oil in 5 years with MYR5b in market capitalization. The ambitious target is aimed at sweating its assets by achieving optimum FFB yield and OER via best management practices to minimise the impact on the planet.

FYE Dec (MYR m)	FY19A	FY20A	FY21E	FY22E	FY23E
Revenue	2,916	2,759	3,541	3,126	3,062
EBITDA	308	489	709	520	532
Core net profit	82	197	368	246	258
Core EPS (sen)	14.4	34.5	64.4	43.1	45.1
Core EPS growth (%)	21.1	139.3	86.5	(33.1)	4.8
Net DPS (sen)	5.0	6.0	19.3	12.9	13.5
Core P/E (x)	28.4	11.6	5.2	7.8	7.4
P/BV (x)	1.1	1.0	0.7	0.7	0.7
Net dividend yield (%)	1.2	1.5	5.7	3.8	4.0
ROAE (%)	4.1	8.8	14.8	9.2	9.0
ROAA (%)	2.0	4.7	8.4	5.3	5.4
EV/EBITDA (x)	9.3	5.3	2.9	3.5	3.0
Net gearing (%) (incl perps)	17.6	6.6	net cash	net cash	net cash
Consensus net profit	-	-	368	248	267
MKE vs. Consensus (%)	-	-	(0.1)	(1.0)	(3.4)

BUY

Share Price	MYR 3.36
12m Price Target	MYR 5.60 (+72%)
Previous Price Target	MYR 5.60

Company Description

Sarawak Oil Palms is a Sarawak-based integrated palm oil producer with refinery and biodiesel plants in Malaysia.

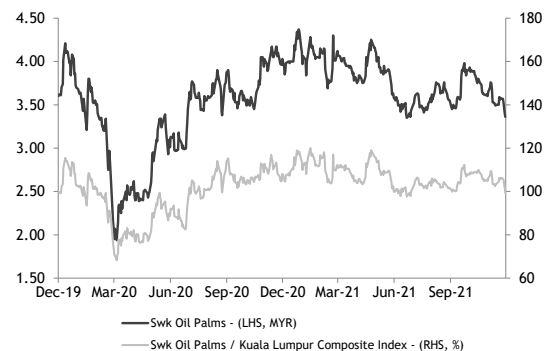
Statistics

52w high/low (MYR)	4.37/3.35
3m avg turnover (USDm)	0.2
Free float (%)	16.6
Issued shares (m)	572
Market capitalisation	MYR1.9B USD455M

Major shareholders:

Shin Yang Group of Cos.	46.4%
State of Sarawak	28.2%

Price Performance



	-1M	-3M	-12M
Absolute (%)	(7)	(5)	(15)
Relative to index (%)	(6)	(2)	(5)

Source: FactSet

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Risk Rating & Score ¹	N/A
Score Momentum ²	N/A
Last Updated	N/A
Controversy Score ³ (Updated: N/A)	N/A

Business Model & Industry Issues

- SOP is an integrated plantation group which is predominantly in oil palm plantation, refinery, biodiesel, phytonutrient plant, and consumer products based in Sarawak, Malaysia. It has a property development arm that is also helping to unlock the value of some of its well-located estates near Miri, Sarawak.
- It has 121,994 ha of land concession (about 1.7x the size of Singapore), of which 87,964 ha are planted with oil palm in 2020. The group provides employment for over 9,400 workers in 2020. Its single geographical exposure limits its ESG risks. Key risks include natural disasters, deforestation, labour practises, supply chain monitoring, and governance and corruption.
- SOP attained 100% Malaysian Sustainable Palm Oil (MSPO) certification in 2019. Further, 6 of out its 7 palm oil mills are also International Sustainability & Carbon Certification (ISCC) certified since 2017.

Material E issues

- SOP adopted zero burning policy for the past decades. With the launch of its Oil Palms Sustainability Policy on No Deforestation, No Peat and No Exploitation (NDPE) in 2019, SOP has started to address the challenges of ensuring compliance of NDPE within its supply chain too.
- As of 2020, the CPO and PK required for its refinery have achieved 100% traceability up to the mill level. And FFB from the Group's own plantations are 100% traceable to the estates. It aims to achieve 100% traceability throughout the supply chain by end-2021.
- To reduce GHG emissions, SOP plans to install methane capture facilities for all its' 7 palm oil mills. In 2020, it has commissioned a methane capture facility for 1 mill.
- Plantations and mills recorded an average GHG emission of 0.30t CO₂ eq/mt of palm products (-14% YoY).

Material S issues

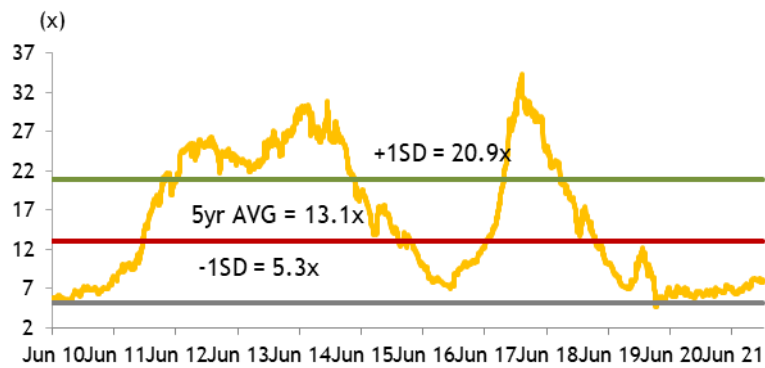
- Women make up 34% of its workforce (as palm oil industry can be physically demanding). No worker under the age of 18 years old was employed.
- SOP recognizes the rights of indigenous and local communities which include securing their Free, Prior and Informed Consent (FPIC) with active communication in a transparent manner. It also undertakes Corporate Social Responsibility (CSR) programme for the local communities.
- In response to COVID-19 and MCO, SOP distributed essential food items, face masks, hand sanitizers and disinfectants to staffs.
- SOP established 14 Community Learning Centres based on Indonesia National Education for children of foreign workers. It has also started a Montessori Kindergarten in 2018 with 19 students.
- SOP provides insurance coverage for the plantation workers, free medical check-ups and hospitalization allowance.
- As at 14 Dec 2021, we are not aware of any outstanding complaint involving local communities or environment.

Key G metrics and issues

- There are 10 Board members comprising 3 Independent Non-Executive Directors (INED; 30%), 6 Non-Independent Non-Executive Directors (NINED; 60%), and 1 Executive Chairman (EC; 10%).
- The Shin Yang group and family members hold a 46%-equity stake in SOP, whereas the State of Sarawak holds 28%. They are represented by the 5 NINED and 1 EC.
- Its Nomination Committee comprises 2 INED and 1 NINED; chaired by an INED.
- Its Remuneration Committee comprises 2 INED and 1 NINED; chaired by an INED.
- Its Audit and Risk Management Committee comprises 3 INED and 1 NINED; chaired by an INED.
- One of its INED has been a Board member for more than 9 years. The Board agreed that INEDs who have served for a cumulative term of beyond 12 years will be subjected to a Two-Tier voting process.
- There are currently 2 female Board members (ie 20%).
- The Board members received a combined Directors' remuneration of MYR3.95m (which included Executive Chairman's MYR2.3m remuneration) in FY20 (FY19: MYR3.86m), or 2% of core PATMI.
- The top five senior management remuneration packages are not separately disclosed on the grounds of confidentiality. Their combined remuneration for FY20 was -MYR4.76m (FY19: MYR4.6m) or 2.4% of core PATMI.
- KPMG has been SOP's external auditor for the past 2 years, having replaced EY.
- The Sustainability Governance Structure comprises of Board of Directors (BOD), Group Management Committee (GMC; comprising Heads of Department) and Group Sustainability Committee (GSC). The BOD oversees SOP's sustainability performance and policies. The GSC, led by the CEO, is responsible for overall policy implementation, reporting and stakeholders' engagement.
- There have been no questionable related-party transactions for the recent past five years.

¹**Risk Rating & Score** - derived by Sustainalytics and assesses the company's exposure to unmanaged ESG risks. Scores range between 0 - 50 in order of increasing severity with low/high scores & ratings representing negligible/significant risk to the company's enterprise value, respectively, from ESG-driven financial impacts. ²**Score Momentum** - indicates changes to the company's score since the last update - a **negative** integer indicates a company's improving risk score; a **positive** integer indicates a deterioration. ³**Controversy Score** - reported periodically by Sustainalytics in the event of material ESG-related incident(s), with the impact severity scores of these events ranging from Category 0-5 (0 - no reports; 1 - negligible risks; ...; 5 - poses serious risks & indicative of potential structural deficiencies at the company).

SOP's 12M forward PER



Sources: Bloomberg, Maybank IB

Risk statement

There are several risk factors for our earnings estimates, price target, and rating for Sarawak Oil Palms (SOP). Key risks to the palm oil sector and SOP are: (i) weather anomalies resulting in poorer-than-expected output growth, (ii) lower-than-expected CPO price achieved, (iii) negative policies imposed by import countries, (iv) unfriendly policies imposed by the Malaysian and Indonesian government on upstream or downstream segments, (v) sharply lower crude oil prices which makes palm biodiesel demand not viable, and (vi) weaker competing oil prices (like soybean and rapeseed).

FYE 31 Dec	FY19A	FY20A	FY21E	FY22E	FY23E
Key Metrics					
P/E (reported) (x)	15.9	9.5	5.2	7.8	7.4
Core P/E (x)	28.4	11.6	5.2	7.8	7.4
P/BV (x)	1.1	1.0	0.7	0.7	0.7
P/NTA (x)	1.1	1.0	0.7	0.7	0.7
Net dividend yield (%)	1.2	1.5	5.7	3.8	4.0
FCF yield (%)	13.9	13.3	15.3	16.6	15.6
EV/EBITDA (x)	9.3	5.3	2.9	3.5	3.0
EV/EBIT (x)	18.1	7.7	3.6	4.9	4.2
INCOME STATEMENT (MYR m)					
Revenue	2,915.5	2,759.4	3,541.2	3,125.7	3,062.2
EBITDA	308.3	488.9	708.8	520.0	532.4
Depreciation	(149.9)	(153.7)	(147.7)	(148.6)	(149.6)
Amortisation	0.0	0.0	0.0	0.0	0.0
EBIT	158.4	335.2	561.1	371.4	382.7
Net interest income / (exp)	(30.9)	(20.9)	(17.7)	(17.5)	(14.4)
Associates & JV	(0.4)	(14.0)	(2.0)	0.0	2.0
Exceptionals	0.0	0.0	0.0	0.0	0.0
Other pretax income	0.0	0.0	0.0	0.0	0.0
Pretax profit	127.2	300.3	541.4	353.9	370.4
Income tax	(35.1)	(82.0)	(141.9)	(92.4)	(96.2)
Minorities	(2.3)	(16.1)	(32.0)	(15.7)	(16.5)
Discontinued operations	0.0	0.0	0.0	0.0	0.0
Reported net profit	89.8	202.2	367.6	245.8	257.7
Core net profit	82.4	197.1	367.6	245.8	257.7
BALANCE SHEET (MYR m)					
Cash & Short Term Investments	830.2	947.1	1,126.0	1,368.0	1,586.3
Accounts receivable	206.3	214.7	275.5	243.1	238.2
Inventory	253.7	276.8	350.5	322.0	312.1
Property, Plant & Equip (net)	2,617.2	2,569.8	2,542.1	2,523.5	2,503.8
Intangible assets	168.3	168.3	168.3	168.3	168.3
Investment in Associates & JVs	39.9	23.3	21.3	21.3	23.3
Other assets	65.0	57.9	57.9	57.9	57.9
Total assets	4,180.6	4,257.8	4,541.5	4,704.1	4,890.0
ST interest bearing debt	435.6	392.3	392.3	392.3	392.3
Accounts payable	216.0	210.3	266.2	244.6	237.1
LT interest bearing debt	803.0	719.5	719.5	719.5	719.5
Other liabilities	410.0	435.0	435.0	435.0	435.0
Total Liabilities	1,865.0	1,756.8	1,812.8	1,791.1	1,783.6
Shareholders Equity	2,203.7	2,376.7	2,594.0	2,766.1	2,946.5
Minority Interest	111.9	124.3	134.7	146.9	159.8
Total shareholder equity	2,315.6	2,501.0	2,728.7	2,913.0	3,106.3
Total liabilities and equity	4,180.6	4,257.8	4,541.5	4,704.1	4,890.0
CASH FLOW (MYR m)					
Pretax profit	127.2	300.3	541.4	353.9	370.4
Depreciation & amortisation	149.9	153.7	147.7	148.6	149.6
Adj net interest (income)/exp	30.9	20.9	36.7	42.2	44.5
Change in working capital	118.0	(35.4)	(97.4)	14.4	(22.8)
Cash taxes paid	3.3	(60.6)	(141.9)	(92.4)	(96.2)
Other operating cash flow	52.0	37.5	0.0	0.0	0.0
Cash flow from operations	450.7	409.5	464.7	449.3	429.1
Capex	(125.8)	(105.1)	(120.0)	(130.0)	(130.0)
Free cash flow	324.9	304.4	292.7	319.3	299.1
Dividends paid	(28.5)	(28.5)	(110.3)	(73.8)	(77.3)
Equity raised / (purchased)	(0.5)	0.0	0.0	0.0	0.0
Change in Debt	(35.4)	(129.6)	0.0	0.0	0.0
Other invest/financing cash flow	(4.7)	(3.5)	(55.5)	(3.5)	(3.5)
Effect of exch rate changes	0.0	0.0	0.0	0.0	0.0
Net cash flow	255.8	142.8	178.9	242.0	218.3

FYE 31 Dec	FY19A	FY20A	FY21E	FY22E	FY23E
Key Ratios					
Growth ratios (%)					
Revenue growth	(19.1)	(5.4)	28.3	(11.7)	(2.0)
EBITDA growth	4.7	58.5	45.0	(26.6)	2.4
EBIT growth	5.8	111.6	67.4	(33.8)	3.1
Pretax growth	16.7	136.2	80.3	(34.6)	4.6
Reported net profit growth	43.7	125.1	81.8	(33.1)	4.8
Core net profit growth	21.1	139.3	86.5	(33.1)	4.8
Profitability ratios (%)					
EBITDA margin	10.6	17.7	20.0	16.6	17.4
EBIT margin	5.4	12.1	15.8	11.9	12.5
Pretax profit margin	4.4	10.9	15.3	11.3	12.1
Payout ratio	31.8	16.9	30.0	30.0	30.0
DuPont analysis					
Net profit margin (%)	3.1	7.3	10.4	7.9	8.4
Revenue/Assets (x)	0.7	0.6	0.8	0.7	0.6
Assets/Equity (x)	1.9	1.8	1.8	1.7	1.7
ROAE (%)	4.1	8.8	14.8	9.2	9.0
ROAA (%)	2.0	4.7	8.4	5.3	5.4
Liquidity & Efficiency					
Cash conversion cycle	39.2	36.4	35.0	41.7	39.8
Days receivable outstanding	29.6	27.5	24.9	29.9	28.3
Days inventory outstanding	42.3	45.6	41.9	49.1	47.9
Days payables outstanding	32.7	36.7	31.8	37.3	36.4
Dividend cover (x)	3.1	5.9	3.3	3.3	3.3
Current ratio (x)	1.9	2.2	2.5	2.8	3.2
Leverage & Expense Analysis					
Asset/Liability (x)	2.2	2.4	2.5	2.6	2.7
Net gearing (%) (incl perps)	17.6	6.6	net cash	net cash	net cash
Net gearing (%) (excl. perps)	17.6	6.6	net cash	net cash	net cash
Net interest cover (x)	5.1	16.0	31.6	21.3	26.6
Debt/EBITDA (x)	4.0	2.3	1.6	2.1	2.1
Capex/revenue (%)	4.3	3.8	3.4	4.2	4.2
Net debt/ (net cash)	408.5	164.7	(14.2)	(256.2)	(474.5)

Source: Company; Maybank

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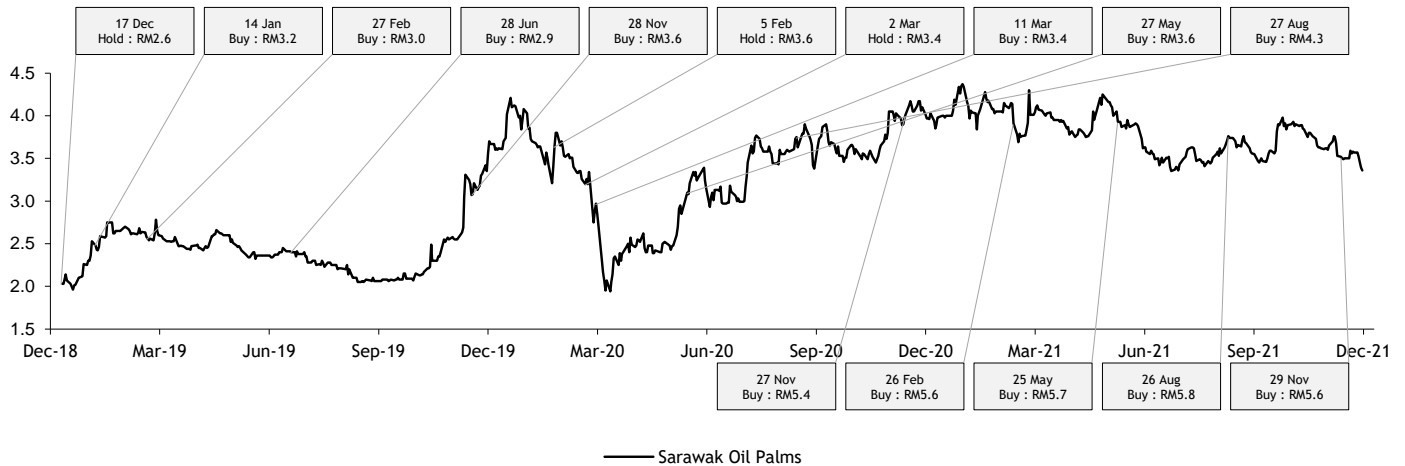
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