MPOB Review and Outlook 2024

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CPO price to recover in 2024

Summary

- **Only two speakers expressed their view on CPO price but both maintained a bullish view. CPO price expected to range between RM3,900-RM4,200/tonne in 2024, with strong rebound anticipated in 2H24.**
- **We maintain Neutral view on the sector with no change to our CPO price assumption of RM4,000/tonne for 2024.**
- **We advocate investors to hold planters with strong dividend yield such as KMLOONG (HOLD; FV: RM1.84) and United Plantation (HOLD; FV: RM17.66).**

Plantation Outlook

- Both Datuk Ahmad and Dr. Julian expressed optimism on CPO prices, forecasting a range between RM3,900-RM4,200/tonne. Both speakers also anticipate tight palm oil supply, while demand is expected to remain robust going forward.

- Key focal points for 2024 include the impact of El Nino on palm oil production, EU deforestation law, soybean oil output, crude oil price and biodiesel mandate.

- We also highlight the potential implication of carbon pricing on the palm oil industry, as it could result in higher production costs. However, it is still in the early stages, and the government is currently working to strike a balance to achieve emissions reduction without hindering the growth of the sector.

- We are **Neutral** with the plantation sector for 2024 as we believe that the market has already factored in the recovery of CPO prices. For stocks under our coverage, we retain **HOLD** calls for **Kuala Lumpur Kepong Bhd (FV: RM 20.00)**, **Hap Seng Plantations Holdings Bhd (FV: RM1.80), Kim Loong Resources Bhd (RM1.84), United Plantation Bhd (FV: RM17.66)** and **Sarawak Plantations Bhd (FV:2.04)**. The Plantation sector is trading at forward PERs of 23.6x/17.3x for 2023F/2024F and is currently above its historical three-year average of 14.3x, implying the sector is overvalued at the moment.

Company	Price (RM) as at 12Jan24	P/E (x) 2022	P/E (x) 2023F	P/E (x) 2024F	Dividend Yield (%)	Target Price (RM)	Potential Upside
United Plantation Bhd	18.88	10.1	14.78	14.41	5.75	17.66	-6.5%
Kuala Lumpur Kepong Bhd#	22.42	28.19	19.45	20.09	3.86	20	-10.8%
Hap Seng Plantations Bhd	1.84	15.32	13.8	13.34	4.35	1.8	-2.2%
Kim Loong Resources Bhd#	2.14	12.19	12.1	12.39	5.69	1.84	-14.0%
Sarawak Plantations Bhd	2.14	9.67	10.39	9.32	3.85	2.04	-4.7%

 # Kuala Lumpur Kepong Bhd data bsased on FYE Sep
 # Kim Loong Resources Bhd data bsased on FYE Jan
Source: Apex Securities

Seminar Session 1 & 2

Mechanisation and Automation (David Ross Appleton)

- **The first panel session: Reimagining oil palm plantation with mechanisation and automation** was presented by Dr David Ross Appleton from Sime Darby Plantation (SDPL). Key highlights include the necessity to improve yields and mechanisation to reduce reliance on manual labor and tackle the problem of deforestation.

- In order to address those challenges, SDPL has undertaken research aimed at identifying a suitable genome sequence to enhance oil yield. Thus far, the company's genome planting initiatives have demonstrated strong positive improvements in yield potential. SDPL has disseminated the results of their research to contribute to the efforts of other researchers in the field. In addition to that, SDPL has also initiated "Project Infinity" to find a definitive solution to labour shortage. This project can be split into two key area of focus including: i) accelerating the implementation and progress of existing technology in its plantation operation while eliminating the need for manual worker in all non-harvesting activities and ii) establish internal robotics unit and develop in-house solutions including collaboration with startups to develop mechanized and autonomous machine.

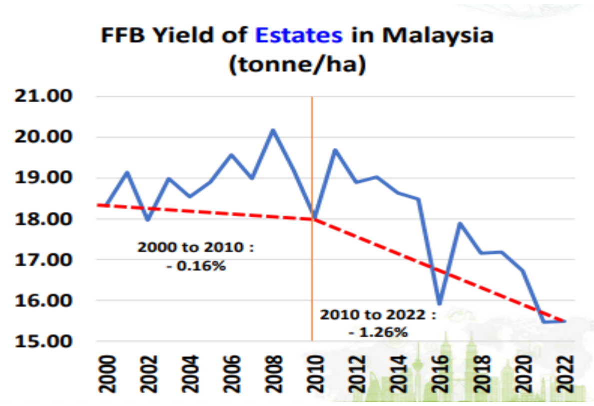
Malaysia Palm Oil Industry Performance and Outlook (Ahmad Parvees Hj Ghulam Kadir)

- **Malaysia Palm Oil 2023 review.** Director General of MPOB, Datuk Dr. Ahmad Parvees provided an overview of the palm oil outlook for 2023. Overall, Malaysia palm oil industry witnessed a mixed performance in 2023 where CPO production and stocks registered strong growth, while exports of palm oil fell due to lower demand. As a result, CPO prices slide below RM4,000/tonnes from the peak in 2022.

- Malaysia's CPO and CPKO production experienced a recovery throughout the year, reaching its highest point in October 2023, due to improved FFB yield yield and OER following the return of foreign labor. However, both indicators declined towards the end of the year as most planters were impacted by the monsoon season. Concurrently, the closing stocks of palm oil followed a similar trajectory, surpassing the 2.0m tonnes threshold in October 2023 as CPO production peaked.

- **Top three major palm oil consuming countries** consists of Indonesia (24%), India (12%) and European Union (8%). Indonesia has the highest consumption of palm oil due to the implementation of higher biodiesel mandate, increasing the mandatory blending of palm oil-based biodiesel.

- **Decreasing trend of productivity.** Datuk Dr. Ahmad emphasized that the main factor contributing to the declining yield trend in palm oil estates is due to shortage of labor, along with issues related to fertiliser application, weather conditions, and the aging of palm trees. In response, the government has allocated RM100.0mm to support Oil Palm Replanting Program Initiative. The goal of this incentive is to enhance smallholders' income by encouraging the cultivation of high-quality seedlings and the adoption of Good Agricultural Practices (GAP). To date, the initiative has provided grants and loans, covering a total of 5,900-ha across Malaysia.



Source: MPOB R&O 2024

- **Moving onto 2024**, a modest growth in CPO production at +1.1%, reaching 18.8m tonnes is projected, as some degree of labor shortages is likely to persist into the upcoming year. Conversely, palm oil stocks are projected to experience a significant decline of -14.8% yoy, falling below the 2.0m tonnes threshold due to higher palm oil exports. In addition, Datuk Dr. Ahmad projected **CPO price to range between RM3,900 to RM4,200/tonne** driven by tight palm oil supply. The projection is premised to the assumption that i) implementation of the B35 biodiesel mandate in Indonesia will limit the global palm oil supply for the export market, ii) unfavorable weather conditions in 2023 iii) the expectation of tight soybean production at least until April 2024, and iv) the anticipation of Malaysia's palm oil stocks falling below 2.0m tonnes will provide some support to the CPO price.

Acceptance of Certified Sustainable Palm Oil (Ku Kok Peng)

- **Major certifications in the palm oil industry**. According to Mr. Ku, Chief Sustainability Officer of Kuala Lumpur Kepong, the palm oil industry recognises four prominent certificates, namely the Roundtable on Sustainable Palm Oil (RSPO), Malaysian Sustainable Palm Oil (MSPO), Indonesian Sustainable Palm Oil (ISPO), and International Sustainability & Carbon Certification (ISCC). Each of these certifications primarily centers on palm oil, with the exception of ISCC, which specifically addresses biofuel. Notably, RSPO and ISCC operate on a voluntary basis, while both MSPO and ISPO are mandatory and regulated by the respective governments of the countries involved.

- **Limitation of sustainability certification**. Mr Ku mentioned that growth in RSPO certified area has been stagnant in recent years. Although RSPO commands a substantial 20% share of global production, it lacks the influence needed across the entire palm oil industry. On the other hand, MSPO and ISPO faces challenges in uptake due to difficulties in resolving land legality issues, while ISCC has limited relevance in markets beyond the EU.

- **Differentiation between sustainability certification and traceability.** Mr Ku stressed that there is clear distinction between palm oil sustainability certification and traceability. Although both concepts are often used interchangeably but they refer to different aspects of the palm oil industry. Certification schemes typically involve audits and assessments of the palm oil production process, including the environmental impact, labour conditions, and community engagement while traceability refers to the ability to track palm oil and its derivatives through the supply chain from the point of origin to the final product.

- **Does certification have a role in EU Deforestation-free Regulation (EUDR).** In essence, information provided through certification schemes may be considered in the risk assessment conducted by operators, but having a certificate alone is not sufficient to demonstrate compliance with the EUDR requirements. As the EU nations have yet to publish a detail compliance mechanism, certification providers face challenges in aligning seamlessly with the EUDR. Another crucial concern revolves around the lack of traceability within the Malaysian palm oil supply chain. Despite being a topic of discussion for many years, there has been no significant progress in addressing this issue

Carbon Pricing Instruments (Maximilian Tariq Conrad)

- **Mr Maximilian from Fiscal and Economics Division, Ministry of Finance** started the session by explaining about carbon pricing and its instruments. There are several carbon pricing instruments that was already in place around the world which can be divided into two main categories: i) Compliance market, typically imposed by the international organization/government and requires mandatory obligation and ii) Voluntary market, which allows the private sector the use of carbon credits/offsets to meet internal targets.

Carbon pricing instruments

Compliance Markets		Voluntary Markets	
Instruments	***Features***	***Instruments***	***Features***
Carbon taxation (CT)	• Government sets tax rate, scope. • Tax incentivizes relevant actors to change behavior, maximize profit. • Emissions reductions dependent on tax rates, supporting policies.	Voluntary carbon markets	• Enable firms to purchase credits, offset emissions to meet internal targets, low-carbon objectives. • Credits supplied by low-carbon project originators, fitting specific criteria. • Verification of authenticity of credits provided by authorized third-party(s).
Emissions trading systems (ETS)	• Government sets emissions cap, scope. • Price fluctuates according to supply/demand for allowances.		
Carbon crediting and offsetting	• In tandem with CT, ETS, can support firm-level emissions reductions and offset tax liabilities or need to purchase allowances. • Rules may govern use of offsets within compliance scheme, e.g. limited scope of sectors/activities, share of emissions that can be offset, or only in addition to other decarbonization, etc..	Internal carbon pricing	• Encompasses several options, including shadow carbon pricing, internal carbon taxes, use of cost-of-carbon metrics for internal decisionmaking
Regulatory use of SCC	• Used in lieu of CT/ETS (low political will). • SCC used as variable in lawmaking / policymaking, deterring harmful actions.	Carbon crediting and offsetting	• Components within VCMs, referring to the process of origination, sale and purchase, and utilization of credits or offsets.

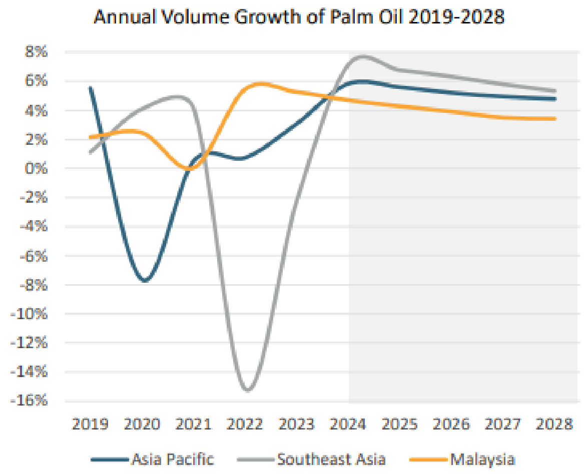
Source: MPOB R&O 2024

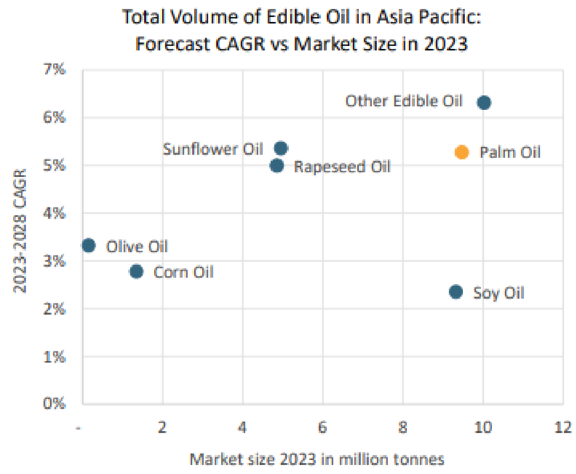
- **MOF is undergoing feasibility study on suitable carbon pricing to implement.** The Malaysia government has identified three primary carbon pricing instruments under consideration, namely carbon tax, the Emissions Trading System (ETS), and regulatory measures. Although the government has already introduced the Bursa Malaysia Carbon Exchange (BCX), it is still importing credits from external sources due to the inability to generate local credits. Nevertheless, the Malaysian government is currently actively exploring strategies to develop local carbon credits.

- **Multiple study is ongoing but no concrete solution in place yet**. To enact carbon pricing policies effectively, the government has engaged in collaboration with various stakeholders to acquire a more thorough understanding of domestic circumstances. A primary challenge lies in aligning Malaysian carbon pricing with the European Union Carbon Border Adjustment Mechanism (CBAM). This has become a significant concern, not just within Malaysia but also across the broader ASEAN region, given the considerable potential impacts of CBAM on exports in affected industries. Furthermore, Mr. Maximilian has also raised a key question of whether to adopt international standards or to develop Malaysia's own standards. The main apprehension associated with using international standards is that it might limit the scope for developing domestic resources. Lastly, the government is also exploring ways to integrate both the carbon tax and the Domestic Emissions Trading Scheme (DETS) to avoid "double taxation" while leveraging on the strengths of each instrument.

Edible Oils in Packaged Food Consumer Markets (Emil Fazira)

- **Ms Emil Fazira from Euromonitor** believed that the volume consumption of palm oil is expected to rebound from 2024 onward, after experiencing volatility during the pandemic period. Apart from that, she stated that palm oil is on a relatively better position compared to other edible oils supported by the large market size and strong growth over next 5 years.





Source: MPOB R&O 2024

- **Future growth driver for edible oil.** Moving forward, Ms. Emil believe that future growth for edible oil will be led by the shift in sales channel and packaging preference coupled with the return of foodservice.

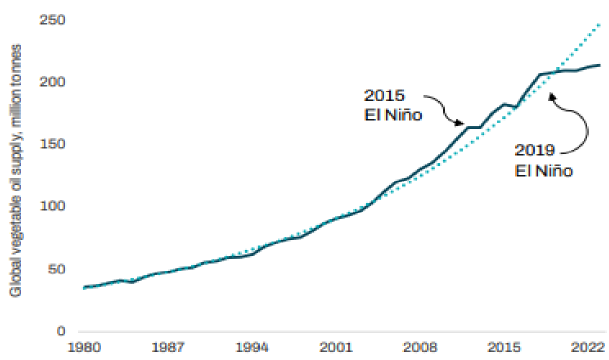
- As indicated by the survey from Euromonitor, consumer spending underwent a transformation in 2022, moving towards money-saving mindset. This shift led to the adoption of more frugal habits, such as opting for discount stores and increased spending towards groceries rather than dining out at restaurants. It is notable that post pandemic, consumers has changed their shopping locations, favouring convenience store and online purchases. Ms Emil mentioned that smaller packaging sizes has also gained popularity, mainly due to its lower price point.

- In regards to the resurgence of foodservice, she predicts that cafes and bars will achieve a robust CAGR of 6.8% from 2023 to 2028, rebounding from losses experienced during the pandemic. This rebound is attributed to consumers perceiving cafes as an affordable indulgence. On the other hand, full-service restaurants are projected to have the slowest CAGR of 3.8%, given that budgetary habits will constrain premium dining.

Market prospect & Palm Oil Price Outlook (Julian Conway McGill)

- **Supply and demand dynamic in favour of producer**. Dr. Julian opined that historically, the growth of vegetable oil output followed an exponential pattern. However, starting from 2019, production significantly lagged behind the established trend. This deviation is primarily attributed to the fact that the supply of palm oils is no longer growing due to lack of expansion in Indonesia and Malaysia coupled with stagnant to declining yields. On the contrary, demand has substantially increased primarily driven by the need for biofuels.

Global vegetable oil production against exponential trend



Source: MPOB R&O 2024

- **Implication of El Nino.** Dr. Julian explains that an El Nino weather is officially designated when the Oceanic Nino Index (ONI) value remains above 0.5 for more than three consecutive months. That implies the palm oil industry is already undergoing the effects of El Nino. Typically, this condition will lead to droughts in Southeast Asia, resulting in decrease in yields by c.15%. While the ONI initially appeared to follow a trajectory similar to the significant events of 1997/98 and 2015/16, the current intensity seems less severe. The impact on rainfall has also been less pronounced, with only a few regions experiencing three consecutive months of rainfall below 100mm. That being said, Dr Julian expect palm oil output growth will remain subdue due to lack of expansion in new planted area and declining yield.

- **Soybean is relied on for oil**. As vegetable oil consumption continues to rise due to a growing population, soybean oil has been utilised to fill the gap left by palm oil. Dr. Julian opined that the surging demand for biodiesel has created a mismatch between the growth of soybean oil and meal demand with the former surging more rapidly. Meanwhile, the economic slowdown in China and a rising health consciousness have contributed to a reduction in pork consumption, thereby further impacting meal demand. As meal prices continue to decline, farmers will need to raise soybean oil prices to offset the losses. Consequently, Dr. Julian anticipates palm oil prices will recover above RM4,000/tonne in 2H24, in tandem with the higher soybean oil prices.

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RESEARCH RECOMMENDATION FRAMEWORK

STOCK RECOMMENDATIONS
BUY: Total returns* are expected to exceed 10% within the next 12 months.
HOLD: Total returns* are expected to be within +10% to – 10% within the next 12 months.
SELL: Total returns* are expected to be below -10% within the next 12 months.
TRADING BUY: Total returns* are expected to exceed 10% within the next 3 months.
TRADING SELL: Total returns* are expected to be below -10% within the next 3 months.
*Capital gain + dividend yield

SECTOR RECOMMENDATIONS
OVERWEIGHT: The industry defined by the analyst is expected to exceed 10% within the next 12 months.
NEUTRAL: The industry defined by the analyst is expected to be within +10% to – 10% within the next 12 months.
UNDERWEIGHT: The industry defined by the analyst, is expected to be below -10% within the next 12 months.

DISCLAIMER