

28 August 2017

Agriculture | Plantation

Sarawak Oil Palms

Buy (from Neutral)

Too Cheap To Ignore

Target Price:	MYR4.20
Price:	MYR3.59
Market Cap:	USD480m
Bloomberg Ticker:	SOP MK

SOP recorded spectacular earnings in 2Q17, backed by FFB growth of 36.7% YoY and a CPO price of MYR2,814/tonne. As yields and OER improved, unit costs also fell by an estimated 14% YoY during the quarter. We lift our earnings forecasts by 11-14.5% for FY17-19 and upgrade our recommendation to BUY (from Neutral), with a rolled over, revised TP of MYR4.20 (from MYR3.85, 17% upside). We think the dilution from SOP's acquisition of SYOP has been fully priced in, and that SOP would continue to benefit from the expanded landbank and younger age profile.

Share Data

Avg Daily Turnover (MYR/USD)	0.37m/0.09m
52-wk Price low/high (MYR)	3.39 - 4.00
Free Float (%)	33
Shares outstanding (m)	437
Estimated Return	17%

Sarawak Oil Palms' (SOP) 1H17 core net profit was above expectations, at 70-75% of our and consensus full-year estimates respectively. The main difference was lower unit costs, as FFB yields and OER improved, leading to better cost efficiencies.

Shareholders (%)

Shin Yang Group	28.6
PELITA Holdings	20.3

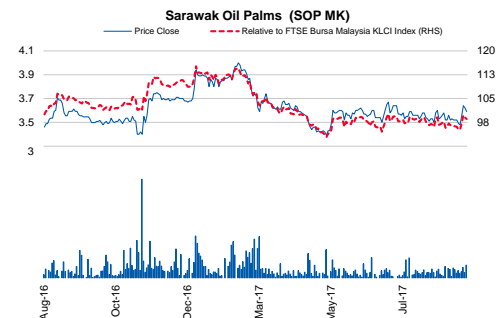
FFB production in 1H17 surged 49.4% YoY, due to the acquisition of Shin Yang Oil Palm (SYOP), which was completed in Dec 2016. This is in line with management's guidance of 50% and our projection of +42% YoY for FY17. As we expect the growth to moderate in 2H17, we are keeping our forecasts intact. Up to YTD-Jul 2017, SOP's FFB output growth has already moderated further to +44% YoY.

Share Performance (%)

	YTD	1m	3m	6m	12m
Absolute	(2.5)	2.3	(0.6)	(4.0)	4.0
Relative	(10.3)	2.0	(0.3)	(8.2)	(1.3)

Source: Bloomberg

SOP managed to register a strong CPO price of MYR2,814/tonne in 2Q17. Although this is above our projection of MYR2,600/tonne, we are maintaining our price forecasts, as we continue to see prices moderating in the last two months.



Source: Bloomberg

Upping forecasts to impute lower unit costs. We raise our net profit forecasts by 11-14.5% for FY17-19, after lowering our unit cost and raising our OER assumptions.

Upgrade to BUY. We roll over our valuation period to 2018F, but lower our target P/E to 14x (from 16x), in line with its 15-year historical mean. We believe valuations would revert to its historical mean of 14x, given the weaker CPO price outlook.

Nevertheless, as SOP is only trading at P/Es of 11-12x, we believe valuations are attractive at current levels. Our TP rises to MYR4.20 (from MYR3.85), which implies an EV/ha of USD10,000/ha. This is in line with its peers, which trade at USD8,000-13,000/ha.

We believe the dilution from SOP's acquisition of SYOP has been fully priced in, and SOP would continue to benefit from the expanded landbank and younger age profile. We upgrade the stock to BUY (from Neutral).

Forecasts and Valuations	Dec-15	Dec-16	Dec-17F	Dec-18F	Dec-19F
Total turnover (MYRm)	3,642	4,303	5,091	4,802	4,966
Reported net profit (MYRm)	85	130	183	172	175
Recurring net profit (MYRm)	76	110	183	172	175
Recurring net profit growth (%)	(34.6)	44.6	65.9	(6.1)	1.8
Recurring EPS (MYR)	0.17	0.22	0.32	0.30	0.31
DPS (MYR)	0.06	0.05	0.05	0.05	na
Recurring P/E (x)	20.7	16.4	11.2	11.9	11.7
P/B (x)	1.13	1.09	1.02	0.95	0.89
P/CF (x)	na	4.6	13.1	8.4	9.1
Dividend Yield (%)	1.7	1.5	1.4	1.4	na
EV/EBITDA (x)	9.12	7.70	6.37	6.23	5.76
Return on average equity (%)	6.2	8.0	9.4	8.3	7.9
Net debt to equity (%)	43.5	23.7	16.8	10.5	5.8
Our vs consensus EPS (adjusted) (%)			22.1	5.5	(0.9)

Source: Company data, RHB

Analyst

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Financial Exhibits

Financial model updated on : 2017-08-27.

Asia	Financial summary	Dec-15	Dec-16	Dec-17F	Dec-18F	Dec-19F
Malaysia	Recurring EPS (MYR)	0.17	0.22	0.32	0.30	0.31
Agriculture	EPS (MYR)	0.19	0.26	0.32	0.30	0.31
Sarawak Oil Palms	DPS (MYR)	0.06	0.05	0.05	0.05	0.00
Bloomberg SOP MK	BVPS (MYR)	3.17	3.29	3.53	3.78	4.04
Buy	Weighted avg adjusted shares (m)	440	505	570	570	570
Valuation basis	Valuation metrics	Dec-15	Dec-16	Dec-17F	Dec-18F	Dec-19F
We apply a target P/E of 13x on 2018 earnings (in line with its historical mean) to derive our TP. This is backed by an EV/ha of USD10,000, in line with its peers' EV/ha range of USD8,000-13,000.	Recurring P/E (x)	20.7	16.4	11.2	11.9	11.7
	P/E (x)	18.6	13.9	11.2	11.9	11.7
	P/B (x)	1.13	1.09	1.02	0.95	0.89
	FCF Yield (%)	(14.3)	16.8	1.2	2.4	1.1
	Dividend Yield (%)	1.7	1.5	1.4	1.4	0.0
	EV/EBITDA (x)	9.12	7.70	6.37	6.23	5.76
	EV/EBIT (x)	15.7	12.0	8.9	9.0	8.4
Key drivers	Income statement (MYRm)	Dec-15	Dec-16	Dec-17F	Dec-18F	Dec-19F
i. CPO price movements;	Total turnover	3,642	4,303	5,091	4,802	4,966
ii. FFB production output.	Gross profit	198	256	382	360	372
	EBITDA	256	301	395	387	405
	Depreciation and amortisation	(107)	(107)	(111)	(119)	(128)
	Operating profit	148	193	284	268	277
	Net interest	(36)	(27)	(26)	(26)	(31)
	Income from associates & JVs	0	2	3	3	3
	Exceptional income - net	9	20	0	0	0
	Pre-tax profit	121	188	261	245	249
	Taxation	(32)	(47)	(63)	(59)	(60)
	Minority interests	(3)	(11)	(15)	(14)	(14)
	Recurring net profit	76	110	183	172	175
Key risks	Cash flow (MYRm)	Dec-15	Dec-16	Dec-17F	Dec-18F	Dec-19F
i. Weather;	Change in working capital	(241)	(16)	(63)	23	0
ii. Exchange rates;	Cash flow from operations	(106)	396	157	243	226
iii. Global supply and demand dynamics of edible oils.	Capex	(121)	(92)	(132)	(194)	(203)
	Cash flow from investing activities	(106)	(331)	(120)	(181)	(191)
	Proceeds from issue of shares	13	380	0	0	0
	Dividends paid	(18)	(28)	(30)	(29)	(29)
	Cash flow from financing activities	352	615	(108)	(21)	(16)
	Cash at beginning of period	488	450	736	797	951
	Net change in cash	140	680	(71)	41	19
	Ending balance cash	628	1,130	665	837	969
Company Profile	Balance sheet (MYRm)	Dec-15	Dec-16	Dec-17F	Dec-18F	Dec-19F
Sarawak Oil Palms is involved in oil palm cultivation and CPO refining in the state of Sarawak.	Total cash and equivalents	450	736	797	951	1,089
	Tangible fixed assets	1,777	2,691	2,004	2,066	2,119
	Intangible assets	5	170	170	170	170
	Total other assets	78	75	75	75	75
	Total assets	2,967	4,426	3,937	4,111	4,323
	Short-term debt	634	863	814	850	891
	Total long-term debt	467	340	340	340	340
	Other liabilities	0	0	0	0	0
	Total liabilities	1,471	2,454	1,812	1,829	1,880
	Shareholders' equity	1,395	1,874	2,011	2,155	2,301
	Minority interests	102	99	114	128	142
	Total equity	1,496	1,972	2,125	2,282	2,443
	Net debt	651	467	357	239	141
	Total liabilities & equity	2,967	4,426	3,937	4,111	4,323
	Key metrics	Dec-15	Dec-16	Dec-17F	Dec-18F	Dec-19F
	Revenue growth (%)	26.7	18.1	18.3	(5.7)	3.4
	Recurrent EPS growth (%)	(34.8)	25.9	46.9	(6.1)	1.8
	Gross margin (%)	5.4	6.0	7.5	7.5	7.5
	Operating EBITDA margin (%)	7.0	7.0	7.8	8.1	8.2
	Net profit margin (%)	2.3	3.0	3.6	3.6	3.5
	Dividend payout ratio (%)	32.4	23.4	15.6	16.6	0.0
	Capex/sales (%)	3.3	2.1	2.6	4.0	4.1
	Interest cover (x)	3.11	4.79	5.39	5.09	4.82

Source: Company data, RHB

Figure 1: Review of SOP's FY16 results

FYE Dec (MYRm)	2Q16	1Q17	2Q17	QoQ (%)	YoY (%)	1H16	1H17	YoY (%)	Comments
Revenue	953.6	1,117.4	1,216.5	8.9	27.6	1,989.3	2,333.9	17.3	Growth due to higher FFB output and CPO prices
EBITDA	73.7	102.3	148.5	45.1	101.5	121.1	250.8	107.1	
<i>EBITDA Margin (%)</i>	7.7	9.2	12.2			6.1	10.7		
Depreciation	(26.4)	(34.1)	(33.7)	(1.4)	27.3	(53.4)	(67.8)	27.1	
EBIT	47.2	68.2	114.8	68.3	143.0	67.8	183.0	170.0	
<i>EBIT Margin (%)</i>	5.0	6.1	9.4			3.4	7.8		
Interest expense	(9.8)	(9.3)	(15.7)	68.6	61.3	(18.7)	(25.1)	34.1	
Interest income	4.3	3.6	4.9	37.9	15.8	6.3	8.5	34.9	
Associates	0.9	(0.6)	0.0	(101.7)	(98.9)	2.2	(0.6)	nm	
EI/Others	2.0	42.3	(12.1)	(128.6)	(706.1)	18.7	30.2	nm	EI includes fair value gains on outstanding derivatives contracts of MYR32.3m, offset by a MY2.1m unrealised forex loss
Pretax profit	44.6	104.2	91.9	(11.8)	105.9	76.2	196.1	157.1	Improved due to higher CPO sales volume and higher CPO prices
Core PBT	42.6	61.9	104.0	68.1	144.0	57.5	165.8	188.2	
<i>Pretax Margin (%)</i>	4.7	9.3	7.6			3.8	8.4		
Tax	(9.7)	(30.0)	(20.7)	(31.0)	113.3	(17.3)	(50.6)	192.0	
<i>Effective tax rate (%)</i>	(21.7)	(28.8)	(22.5)			(22.7)	(25.8)		
Minority Interest	(1.4)	(5.7)	(4.1)	(27.5)	201.6	(0.3)	(9.8)	2,962.3	
Net Profit	33.6	68.5	67.1	(2.2)	99.8	58.6	135.6	131.4	
Core Profit	31.6	26.2	79.2	202.2	150.9	39.9	105.4	164.2	Above our and consensus expectations, at 70-75% of FY17 forecasts
<i>Net Margin (%)</i>	3.3	2.3	6.5			2.0	4.5		
Operational stats	4Q15	3Q16	4Q16	QoQ (%)	YoY (%)	FY15	FY16	YoY (%)	Comments
FFB production	241,935	312,694	330,702	5.8	36.7	430,525	643,396	49.4	Higher than our FY17 projection of 41.5% YoY
CPO production	83,685	84,339	101,770	20.7	21.6	148,536	186,109	25.3	
PK production	17,976	18,179	20,267	11.5	12.7	31,851	38,446	20.7	
Avg MPOB CPO price, MYR/tonne	2,595	3,114	2,749	(11.7)	5.9	2,500	2,931	17.2	
Realised palm price, MYR/tonne	2,608	3,153	2,814	(10.8)	7.9	2,430	2,984	22.8	Higher than our FY17 projection of MYR2,600 per tonne, but we expect this to moderate going forward
Realised PK price, MYR/tonne	2,637	3,476	2,262	(34.9)	(14.2)	2,377	2,869	20.7	In line with expectations

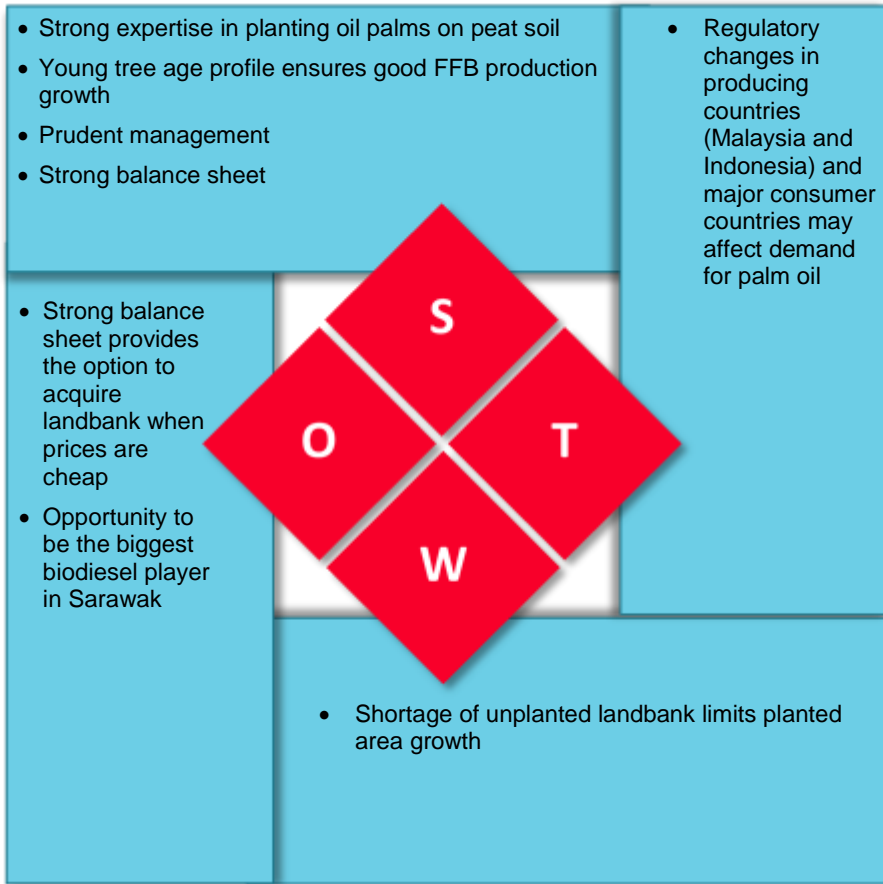
Source: Company data

Figure 2: Key assumptions

	FY14	FY15	FY16	FY17F	FY18F	FY19F
FFB production, tonnes	1,044,109	1,098,075	979,423	1,385,536	1,535,517	1,614,902
% change	8.9%	5.2%	-10.8%	41.5%	10.8%	5.2%
Effective CPO price (MYR)	2,439	2,138	2,610	2,600	2,400	2,500
Refinery utilization rate	100%	95%	95%	95%	95%	95%

Source: Company data, RHB

SWOT Analysis



Recommendation Chart



Source: RHB, Bloomberg

Date	Recommendation	Target Price	Price
2017-05-29	Neutral	3.85	3.60
2017-03-30	Neutral	3.85	3.60
2016-12-01	Neutral	3.90	3.74
2016-08-01	Neutral	3.67	3.38
2016-07-05	Neutral	3.78	3.69
2016-06-19	Neutral	3.78	3.77
2015-11-30	Buy	6.53	4.35
2015-10-21	Buy	6.03	4.59
2015-08-31	Buy	4.84	3.54
2015-05-18	Buy	7.07	4.17

Source: RHB, Bloomberg

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