PLANTATION SECTOR UPDATE

Golden Momentum?

Industry Has Started to Show Recovery ?

Indonesian CPO production recorded an increase of 12.91% YoY to 47.43 million tons in FY18 (vs. 42.01 million tons in FY17) with domestic consumption at 13.49 million tons. Indonesia's CPO exports during FY18 also recorded an increase of 7.85% YoY to 34.70 million tons. However, CPO prices are still decreasing until April 2019 by 6.19% YoY.

Potential Declining Indian Import Tax and Zero Export Tariff and B20 Implementation Becomes a Positive Catalyst

The India government reduced import duties for the shipment of CPO and its derivatives from countries in Southeast Asia, including Indonesia. Tariff reduction from in 54% slipping to 50%, will drive Indonesian PO RBD exports up to 96.5 thousand tons. Ministry of Finance applies the implementation of new levies based on the boundaries of the CPO price value, where the export levies of CPO products and derivatives will be zeroed (0%). This is a positive thing to expand Indonesia's CPO export market. In addition, the government seeks to increase domestic CPO consumption through expansion of B20, We believe the B20 mandatory expansion program is effective, thus increasing domestic CPO consumption.

Risks from the Implementation of the Renewable Energy Directive (RED) II

The European Union (EU) stipulates that CPO is a category of high risk food crops, so the EU will limit the use of palm oil and remove CPO gradually from the EU biofuels market. We judge that with the enactment of RED II, it will have a negative impact on the decline in the CPO export market for Indonesia.

NEUTRAL Recommendation with Top Picks: LSIP and AALI

We still maintain the **NEUTRAL** outlook for the plantation sector in FY19F. We predict the plantation sector has the potential to move stagnant until the end of 2019. We believe that positive issues both in terms of increasing domestic demand and decreasing inventories due to weather factors will be an interesting turnaround story going forward. However, we see several factors that are negative catalysts for declining CPO inventories and CPO prices such as: 1) Changes in regulation of importing countries that have the potential to decrease demand; 2) Increased CPO production. We recommend **LSIP (BUY, TP: Rp1,420)** because of a healthy balance sheet condition, and **AALI (BUY, TP: Rp13,825)** because of the chance of increasing CPO demand from the implementation of B20.

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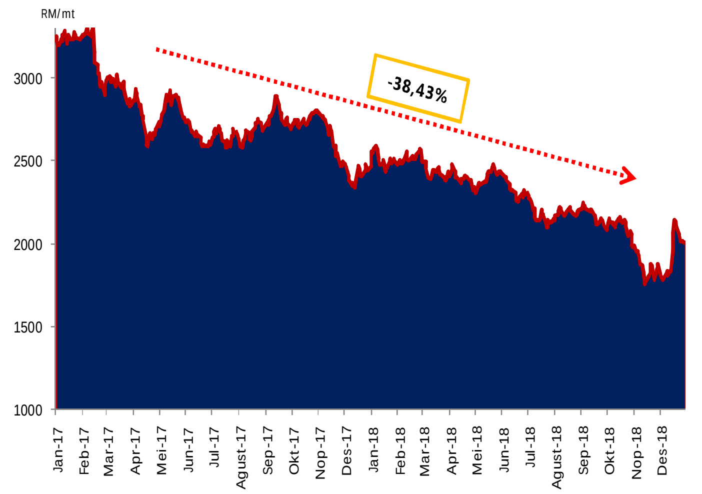
Ticker	Market Cap (IDR bn)	P/E (x)		PBV (x)		Rec.	Target Price (IDR)
		FY19E	FY20F	FY19E	FY20F		
LSIP	7,505.15	13.93	11.05	0.86	0.83	BUY	1,420
AALI	20,642.28	14.53	13.55	1.07	1.03	BUY	13,825

Sources: Bloomberg, MNCS (as of April 30, 2019)

Oversupply challenge through FY18: Slowly Improving?

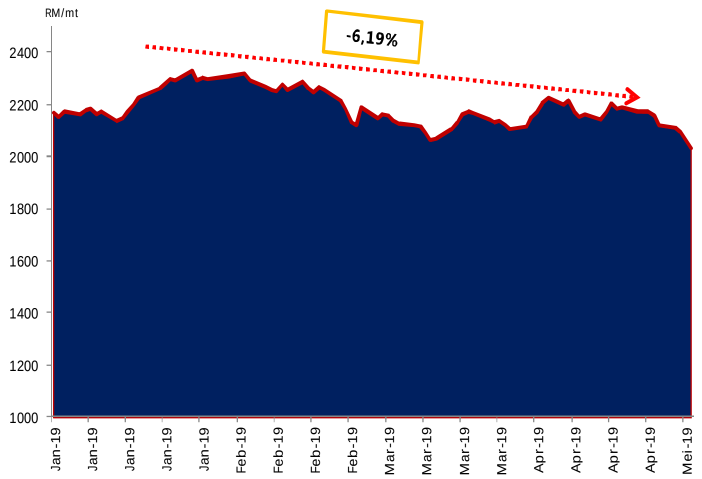
CPO prices was still depressed through end-2018, along with export volumes which declined by monthly. The high supply of vegetable oil-producing commodities such as soybean oil, rapeseed oil, and sunflower seeds oil, kept the price of palm oil abnormally low. In the last 2 years, CPO prices have dropped by 38.43%, touching the lowest level of RM1,759. However, entering April 2019, global CPO prices showed a decrease of -6.19% to RM2,032 per metric ton. Meanwhile, Indonesian CPO production recorded an increase of 12.91% YoY to 47.43 million tons in FY18 (vs. 42.01 million tons in FY17) with domestic consumption at 13.49 million tons. Indonesia's CPO exports during FY18 also recorded an increase of 7.85% YoY to 34.70 million tons (vs. 32.18 million tons in FY17). Higher domestic consumption also helped shrink FY18 inventory stocks, which were at 3.26 million tons (vs. 4.90 million tons in 7M18). On the other hand, a painful 3-million-ton oversupply is clearly evident in Malaysia. Based on MPOB data, Malaysian CPO production during FY18 fell 2.02% YoY to 19.51 million tons (vs. 19.91 million tons in FY17). Malaysian CPO exports also declined, down by 0.44% YoY to 16.48 million tons in FY18. However, we see a potential increase in domestic consumption in FY19E, supported by the implementation of a Government program to develop CPO-based downstream industries. We project CPO prices to potentially move in a range of RM2,300-RM2,500 in FY19E.

Exhibit 01. CPO Price Movement Cycle FY18



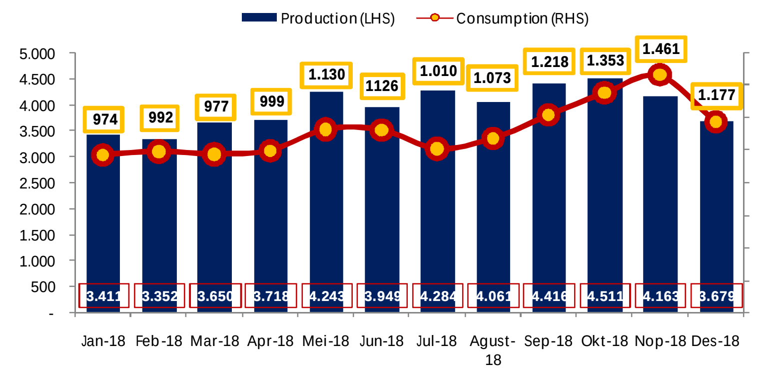
Source : Bloomberg

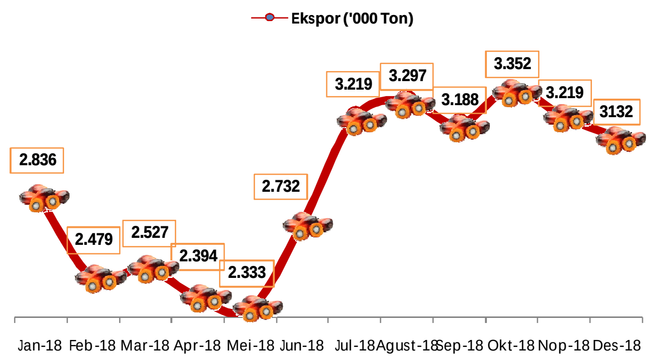
Exhibit 02. CPO Price Movement Cycle 4M19



Source : Bloomberg

Exhibit 03. Indonesia 2018 CPO Production, Consumption and Export





Source : GAPKI

Declining India's Import Tax Could Potentially Sharpen Indonesia's CPO Competitiveness

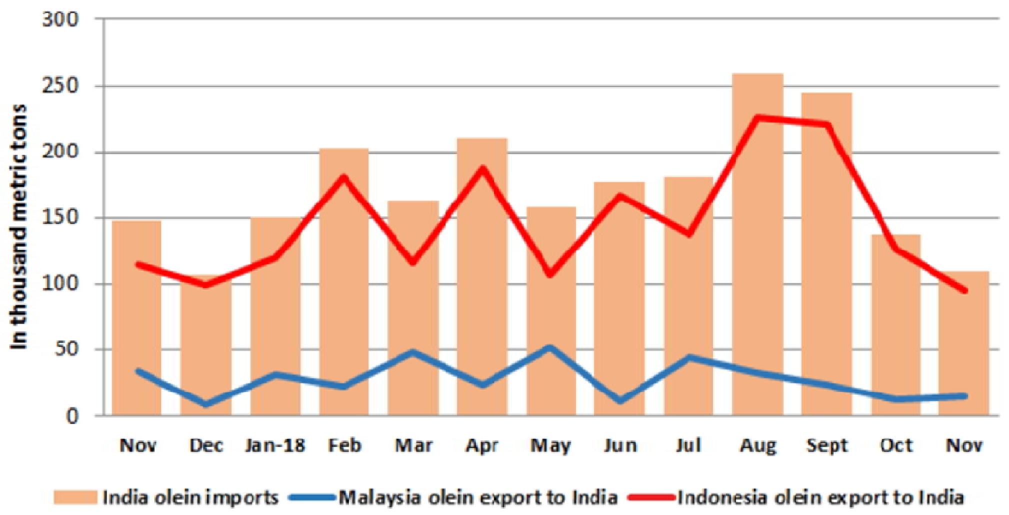
The India government reduced import duties for the shipment of CPO and its derivatives from countries in Southeast Asia, including Indonesia and Malaysia, effective from January 2nd, 2019. India's CPO import duty for Malaysia fell to 40% from 44% and import duties for derivative products (RBD Palm Oil) was reduced from 54% to 45%. Meanwhile, the reduction in India's CPO import duty rates for Indonesia, to 40% from 44%, and import duties for derivative products (Palm Oil RBD/PO RBD) came down from 54% to 50%. The Solvent Extractors Association (SEA) estimates that India will consume 23.5 million tons in FY19E, importing 15.5 million tons of vegetable oil. We see that if the import tariff of the Indian PO RBD is raised, it will exert a significant impact on the import volume of PO RBD from Indonesia, where every 1% increase in tariffs in India has the potential to reduce import volume from Indonesia by 2,010 tons. Therefore, decrease in tariff from 54% slipping to 50% will drive Indonesian PO RBD exports amounted to 96.5 thousand tons.

Exhibit 04. India Reduces Tariffs

	Old Rates (%)			New Rates (%)			Change (%)
Malaysia	Duty	Social Welfare	Effective Duty	Duty	Social Welfare	Effective Duty	
CPO	44.00	10.00	48.40	40.00	10.00	44.00	**-4.40**
RBD Palm Olein	54.00	10.00	59.40	50.00	10.00	49.5	**-9.9**
Indonesia							
CPO	44.00	10.00	48.40	40.00	10.00	49.00	**-4.40**
RBD Palm Olein	54.00	10.00	59.40	50.00	10.00	55.00	**-4.40**

Source : *palmoilanalytics.com*

Exhibit 05. Volume of Imports of Indian RBD Palm Olein in 11M17-11M18



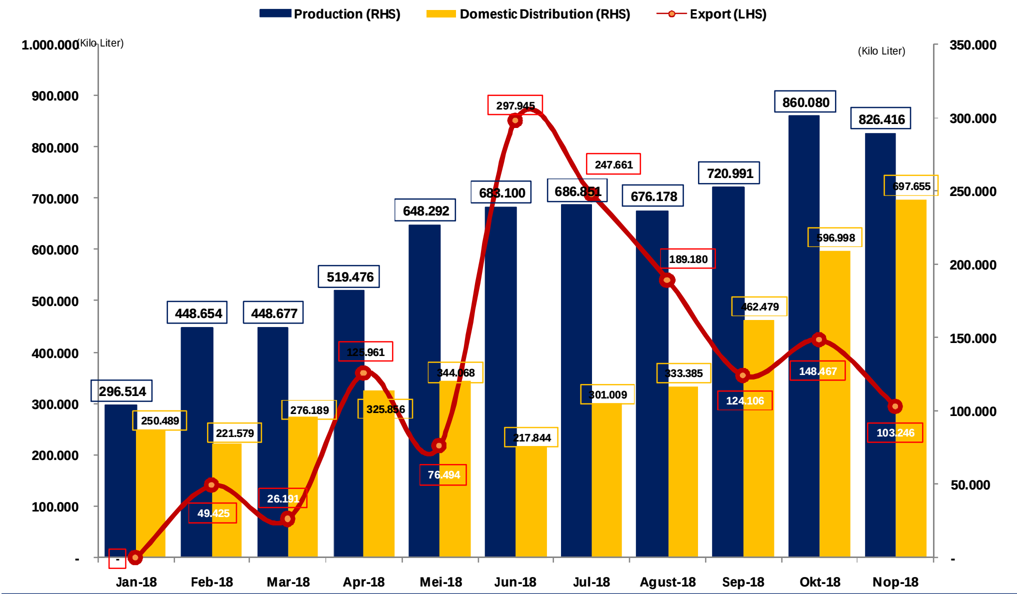
Source : *palmoilanalytics.com*

Zero Export Tariff and B20 Implementation are Expected to Support CPO Growth

Ministry of Finance, through PMK No.23/PMK.05/2019, extends a regulation about the implementation of new levies, based on the boundaries of the CPO price value, where export levies of CPO products and derivatives will be zeroed (0%) when CPO prices or derivatives drop below USD570 per metric ton and will be subject to export levies when CPO prices are above USD570 per metric ton with rates ranging from USD5-USD25 per ton. Zero CPO export levy rates are only valid temporarily, because as of June 1, 2019, the government will re-impose CPO export tariffs with a new mechanism. We see the elimination of export levies as a short-term solution to increase absorption by the domestic market and expand exports. This is an opportunity for AALI to market their CPO to other countries such as India, China, Korea and Pakistan.

In addition, the government seeks to increase domestic CPO consumption through expansion of B20, by setting a volume allocation for the procurement of 6.20 million kiloliters (kl) of biodiesel in FY19E. The expansion of B20 to B30 is estimated to be able to absorb up to 6 million tons of CPO (in the form of biodiesel) consisting of: 1) Potential use of CPO in PLN, and PJKA as a substitute for diesel fuel; 2) The potential of substituting petroleum-based gasoline with green gasoline from palm oil. We believe that the mandatory B20 expansion program is effective, as evidenced by 3.8 million tons of biodiesel uptake in FY18, increasing by 72% YoY (vs. 2.22 million tons in FY17).

Exhibit 06. Indonesian Biodiesel Production and Distribution Volume: January - November 2018

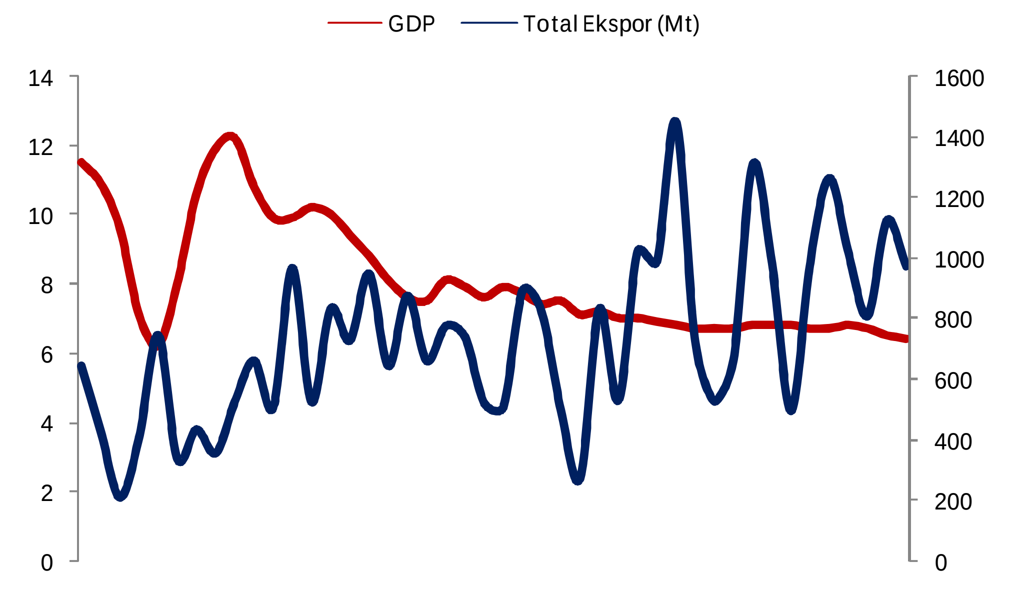


Source : APROBI

Weakening Chinese Economy Potentially Crimps Indonesian Exports

The impact of the US (US) trade war with China is predicted to continue and overshadow world trade in 2019. In FY18, China is Indonesia's largest non-oil and gas export destination with a share reaching 15% of total exports. In 2018, China's economic growth slowed to 6.6%. We assess the economic downturn and the decline in China's manufacturing production activities as potentially threatening Indonesia's exports, including those of crude palm oil (CPO). This can be seen from the increase in Indonesia's CPO exports, which marked 1,263.59 Mt when China's GDP was at a level of 6.7% in 4Q17, while CPO exports declined 22.97% to 973.31 Mt, when China's GDP dipped to a level of 6.4% at the end of FY18. The weakening of the Chinese economy is expected to continue to FY19E to a level of 6.3% and is expected to have a direct impact on falling commodity prices.

Exhibit 07. Chinese GDP per Quarterly vs. Total Chinese CPO Imports from Indonesia



Source : Bloomberg

Renewable Energy Directive (RED) II becomes a Threat

In February 2019, the European Union (EU) will declare a Delegated Act which signifies the readiness of the EU to use environmentally friendly fuels (biofuels) or often referred to as the Renewable Energy Directive (RED) II which will take effect in 2020. In implementing RED II, Uni Europe has an obligation to fulfill 32% of biofuel needs for energy from renewable sources in the next 2030. However, the EU stipulates that CPO is a category of high-risk food crops, so the EU will limit the use of palm oil and remove CPO gradually from the EU biofuels market. Throughout 2018, the EU imported palm oil from Indonesia as much as 4.36 million tons, of which 75% of the use of palm oil was used for biodiesel raw materials and 25% for food. We assess that with the enactment of RED II, it will have a negative impact on the decline in the CPO export market for Indonesia, which can be seen from Indonesia's CPO exports to the EU which decreased by -21.20% MoM in November 2018.

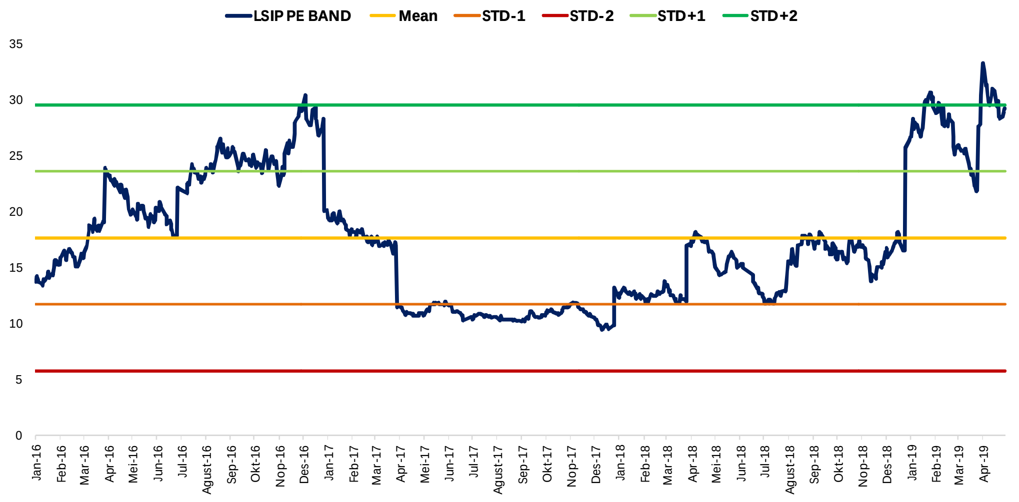
El Nino has the chance to occur in the next 4 months

The World Meteorological Organization (WMO) estimates that weather conditions will be drier with probabilities of 75% -80% in December 2018-February 2019 and will continue in February-April 2019 with a probability of 60%. The Meteorology, Climatology and Geophysics Agency (BMKG) also estimates that weak dry weather conditions will last until July 2019 with a probability of 50% indicating El Niño has a chance to occur in 2019. El Niño has an impact on decreasing production, due to low rainfall resulting in drought. We estimate that with the occurrence of El Niño this year has become a potential for improvement in oversupply and CPO prices in FY19E.

NEUTRAL Recommendation with Selected Stocks: LSIP, AALI

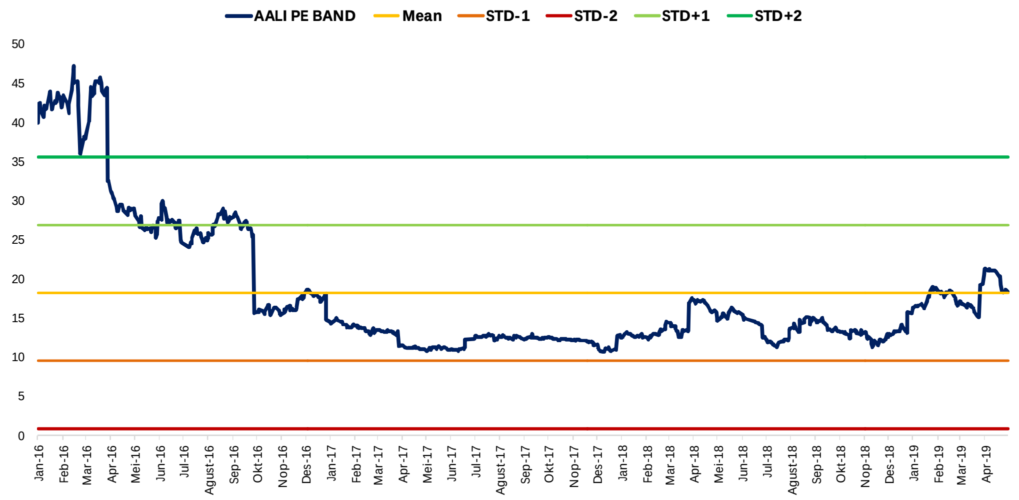
We still maintain the **NEUTRAL** outlook for the plantation sector in FY19F. We predict the plantation sector has the potential to move stagnant until the end of 2019. We believe that positive issues both in terms of increasing domestic demand and decreasing inventories due to weather factors will be an interesting turnaround story going forward. However, we see several factors that are negative catalysts for declining CPO inventories and CPO prices such as: 1) Changes in regulation of importing countries that have the potential to decrease demand; 2) Increased CPO production. We recommend **LSIP (BUY, TP: Rp1,420)** because of a healthy balance sheet condition, and **AALI (BUY, TP: Rp13,825)** because of the chance of increasing CPO demand from the implementation of B20.

Exhibit 08. PE Band LSIP



Source : Bloomberg

Exhibit 09. PE Band AALI



Source : Bloomberg

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MNC Research Investment Ratings Guidance

BUY : Share price may exceed 10% over the next 12 months
HOLD : Share price may fall within the range of +/- 10% of the next 12 months
SELL : Share price may fall by more than 10% over the next 12 months
Not Rated : Stock is not within regular research coverage

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