

Wednesday, 04 December 2019

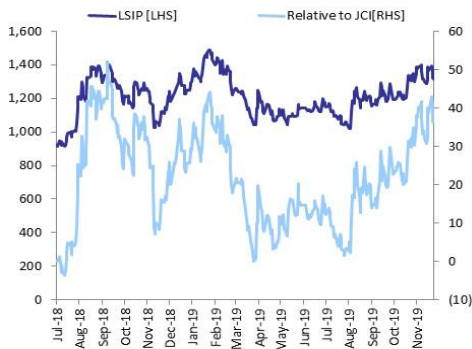
OVERWEIGHT

Maintain

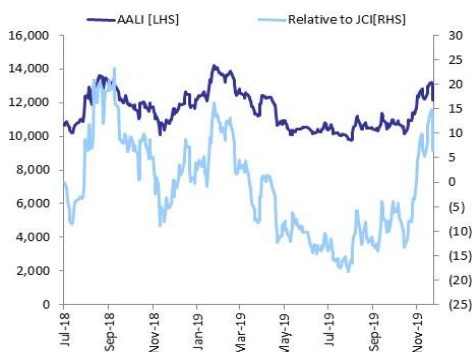
Plantation

Dry and Feverish is Good For CPO Price

LSIP relative to JCI Index



AALI relative to JCI Index



Source : Bloomberg

Dryness as indicated in the Southern Oscillation Index (SOI) has been negative for 11 consecutive months in 2019, i.e. not yet confirmation of an El-Niño event. In China, meanwhile, African Swine Fever (ASF) continues to put pressure on the pig population. While restocking of the parent stock is now taking place, prices have more than doubled and pig data is still deep in negative territory YoY. In our view, these two developments will cushion CPO prices on both the supply and demand sides with more demand coming from China. We maintain our Overweight rating and BUY calls on both LSIP (TP of IDR1,650) and AALI (TP of IDR14,000) as a CPO price of only c.MYR2,200/ton is priced in by the market vs the current spot price north of MYR2,600/ton.

Dry weather has lingered for 11 months. This is indicated by the SOI being negative for more than 11 months straight in 2019 with the index clipping a level of -10.0. Another Indicator is the Indian Ocean Dipole (IOD) which gauges the temperature difference in the Indian Ocean in Indonesia as opposed to the African side of the equation. In this respect, the IOD has been positive since April 2019, which also means lower convection and equates to less rainfall in Indonesia.

The dryness will put pressure on next year's FFB production, which will create supply side tightening, especially when Indonesia implements the B-30 program which will take up to 8.5mn tons of CPO.

ASF continues to haunt pigs in China. Tensions between China and the US have led to less export – import transactions. As a consequence, China is sourcing more of its soybeans from Brazil (compared to predominantly US sources previously). At the same time, the African Swine Fever epidemic - which threatens the lives of up to 200mn pigs - means less soybean is required and c.2.0mn tons less soy oil produced leading to lesser supply to keep soybean and its derivative prices at reasonable level.

This should therefore pave the way for more CPO imports to China this year and next year as the Oct19 data shows a 41.4% decrease in pig stocks and 37.8% lower ability to breed sows on a YoY basis. On a monthly basis, the ability to breed sows ticked up by +0.6% due to restocking done by more corporations rather than small farmers, while pig stocks fell by 0.6% in October 2019.

A CPO price of only MYR2,200/ton is currently priced in. Working back to our implied PE of 30.4x for the 2020 earnings of AALI and LSIP of 28.8x, we note that the market has only priced in a CPO price of MYR2,197/ton and MYR2,236/ton using yesterday's closing prices. What this means is that there is still significant headroom to catch up with the current spot price ranging from MYR2,500-2,600/ton of late. We believe concerns over price sustainability are rather overdone as the supply-demand dynamics are highly supportive for the current price range up to at least 1H20.

Maintain OVERWEIGHT. We believe the supply demand dynamics in the veg oils market indicate further tightness due to less supply of both CPO and soybeans, while demand will increase from biofuel programs. We maintain our 2020 average CPO price assumptions of MYR2,400 and BUY recommendations on both LSIP (TP of IDR1,650) and AALI (TP of IDR14,000).



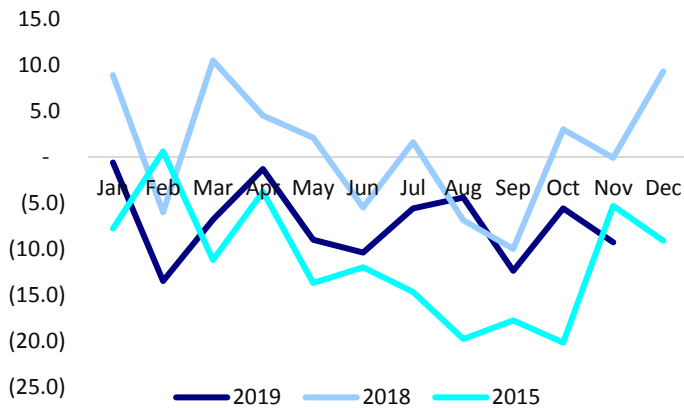
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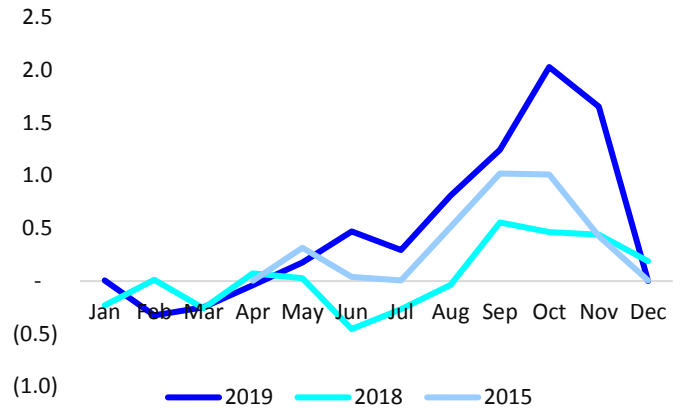
Company	Ticker	Rec	Target	Market	P/E (x)		P/BV (x)		ROE (%)
			Price (Rp)	Cap. (RpBn)	2019F	2020F	2019F	2020F	2020F
London Sumatra	LSIP IJ	BUY	1,650	9,343.4	100.0	23.9	1.1	1.1	4.7
Astra Agro Lestari	AALI IJ	BUY	14,000	24,251.1	155.4	27.3	1.3	1.2	4.6

Exhibit 1. SOI Index



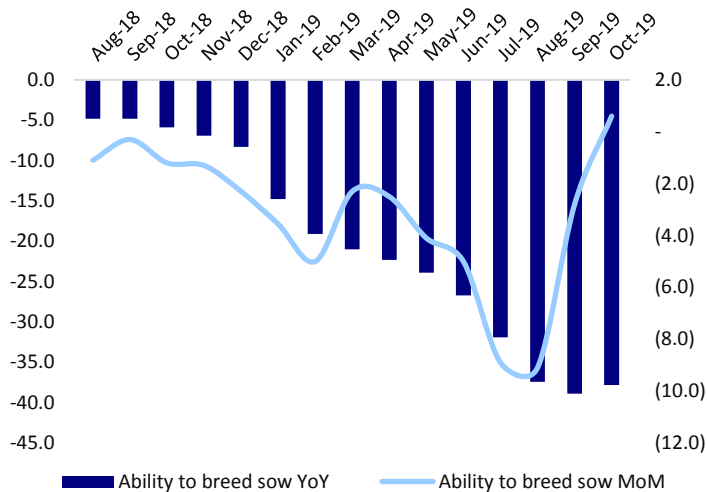
Source: Australian Government Bureau of Meteorology, Danareksa Sekuritas

Exhibit 2. Indian Ocean Dipole (IOD) in °C



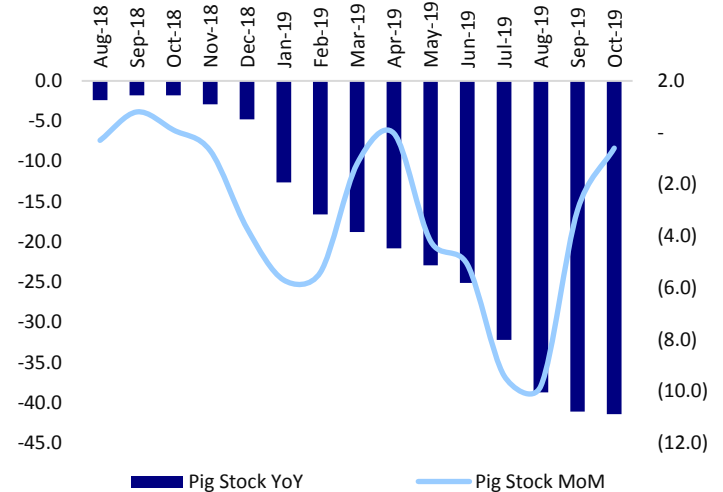
Source: Australian Government Bureau of Meteorology, Danareksa Sekuritas

Exhibit 3. Ability to breed sows since the ASF outbreak



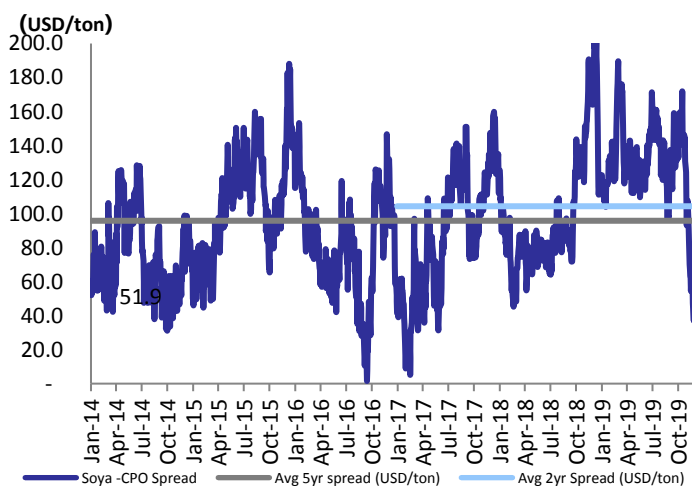
Source: Chinese Ministry of Agriculture and Rural Affairs, Danareksa Sekuritas

Exhibit 4. Pig stocks since the ASF outbreak



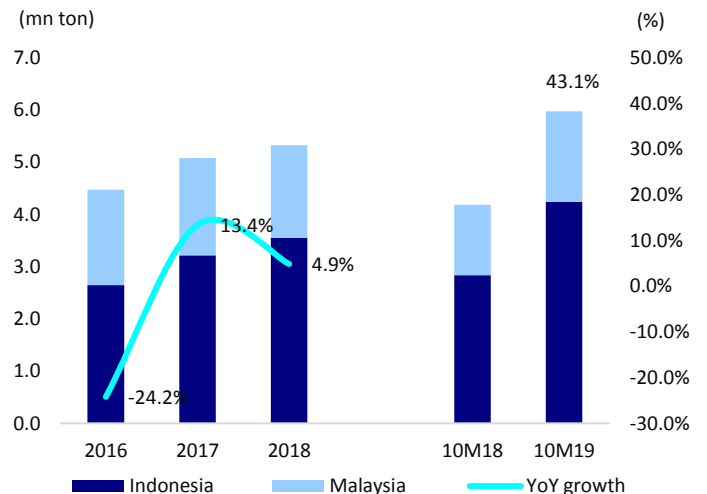
Source: Chinese Ministry of Agriculture and Rural Affairs, Danareksa Sekuritas

Exhibit 5. Soy oil – CPO price gap



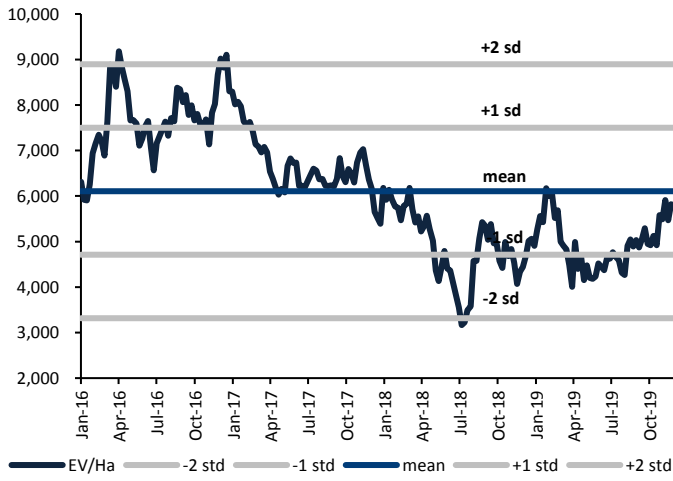
Source: Bloomberg, Danareksa Sekuritas

Exhibit 6. Chinese CPO Imports



Source: Customs General Administration, Bloomberg, Danareksa Sekuritas

Exhibit 7. LSIP historical EV/ha



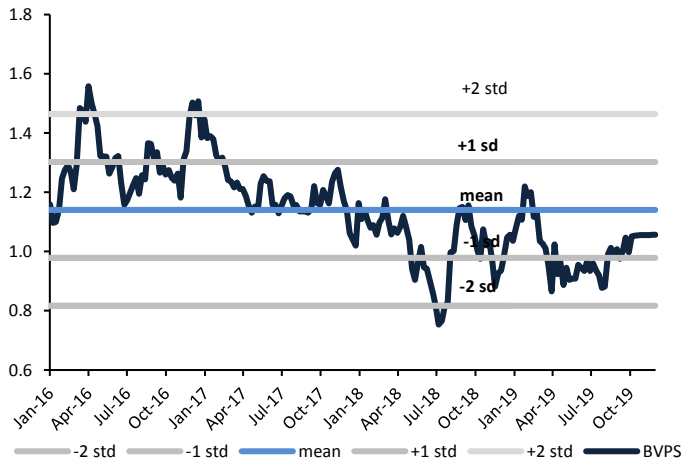
Source: Bloomberg, Danareksa Sekuritas

Exhibit 8. AALI historical EV/ha



Source: Bloomberg, Danareksa Sekuritas

Exhibit 9. LSIP historical PBV



Source: Bloomberg, Danareksa Sekuritas

Exhibit 10. AALI historical PBV



Source: Bloomberg, Danareksa Sekuritas

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