

21 November 2023

Agriculture | Plantation

Sarawak Oil Palms (SOP MK)

Buy (Maintained)

Beneficiary Of Price Upcycle But Weak ESG Score

Target Price (Return): MYR2.80 (+9%)
 Price (Market Cap): MYR2.58 (USD487m)
 ESG score: 2.2 (out of 4)
 Avg Daily Turnover (MYR/USD) 0.48m/0.10m

- **Stay BUY, with new MYR2.80 TP from MYR2.85, 9% upside and c.2% FY24F yield.** Although we downgrade Sarawak Oil Palms' (SOP) ESG score to 2.2 (from 2.3), we believe valuation remains inexpensive – trading at 7.8x, at the lower end of its peer range of 6-12x. SOP should benefit from any price upcycle due to the *El Nino* given its largely pure planter status.
- **The European Union (EU) Deforestation Regulation (EUDR) is not unsurmountable.** While there are a myriad of problems and issues in complying with the EUDR guidelines based on current regulations, we believe there are also numerous solutions. The Malaysian and Indonesian Governments working together with the EU to find solutions is a step in the right direction – especially if Malaysia and Indonesia are classified as “Low Risk”. Aligning definitions are key to achieving compliance and ensuring everyone is on the same page.
- **The EU needs to help, otherwise this problem will be shifted elsewhere.** At the end of the day, if the EU fails to help producing countries like Indonesia and Malaysia in complying with the EUDR, it will push producers to export more of their commodities to countries with weaker environmental regulations, thereby shifting the problem to other regions.
- **A short term solution** would be to ensure that whatever is sold to the EU is produced in segregated mills and refineries and traceable to plantation. This could mean redirecting smallholder crops that are not traceable to other mills to ensure there is no mixing of crops in each plant.
- **Uplifting smallholders means uplifting the sector.** As smallholders manage 40% of plantation areas in Indonesia and Malaysia, this sector will only progress if they are taken care of and well updated with the changes in laws and regulations. As discussed previously, the main hurdle of achieving traceability lies with obtaining data from third-party suppliers, including smallholders. In order to address this, continuous engagement with the smallholders is essential to educate them on the importance of establishing a sustainable business, while the necessary tools must be given to the smallholders to help them to achieve these goals.
- **We believe the sector in general is moving in the right direction** in terms of ESG standards, with more disclosure and targets being set. However, we note that there are some outliers which have yet to make any improvements to ESG disclosures as well as ESG targets.
- **We downgrade our ESG score to 2.2 for SOP.** In 2022, SOP increased GHG emissions and water and energy consumption while its board continues to maintain a composition of <50% Independent Directors.
- **Still, we maintain BUY with a lower MYR2.80 TP** based on an unchanged 10x FY24F P/E. This includes an ESG discount of 16%. Being a pure planter, we believe SOP will benefit from the *El Nino*-led upcycle in prices that we are expecting. The company continues to trade at an inexpensive 7.8x 2024F P/E, at the low end of its peer range of 6-12x 2024F.

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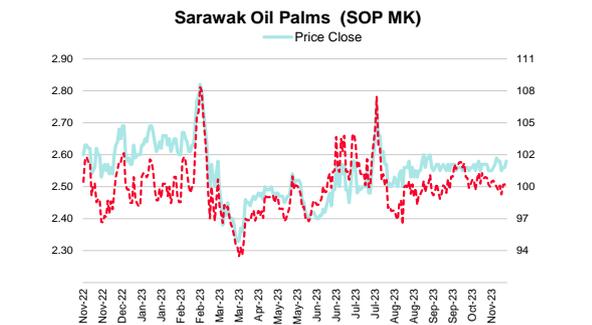


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Share Performance (%)

	YTD	1m	3m	6m	12m
Absolute	(0.8)	0.8	1.6	1.6	(0.8)
Relative	2.1	0.3	2.0	(0.4)	0.0
52-wk Price low/high (MYR)				2.33 – 2.82	



Source: Bloomberg

Overall ESG Score: 2.2 (out of 4)

E: MODERATE

While Sarawak Oil Palms is committed to no further development on peat areas, 45% of its landbank is still planted on peat. The company has reported a reduction in greenhouse gas (GHG) emission intensity since 2017 for its estates but has seen an increase of such from its milling and downstream operations. The company is fully Malaysian Sustainable Palm Oil-certified for its mills and estates.

S: MODERATE

Sarawak Oil Palms is committed to free, prior and informed consent for all its employees. Its fatality accident rate has remained low, while the lost time injury frequency rate continues to trend lower. The company has not had any major labour issues in the last two years.

G: GOOD

30% of SOP's board members are independent, and 25% of its members are women. Additionally, it provides full disclosure on director remuneration, which includes salaries and bonuses and on a named basis. The company has an in-house investor relations team and holds briefings regularly, embodying good transparency and disclosure practices.

Note:

Small cap stocks are defined as companies with a market capitalisation of less than USD0.5bn.

Forecasts and Valuation	Dec-21	Dec-22	Dec-23F	Dec-24F	Dec-25F
Total turnover (MYRm)	4,431	5,308	3,574	3,674	3,612
Recurring net profit (MYRm)	460	501	235	291	268
Recurring net profit growth (%)	110.5	8.9	(53.1)	23.8	(7.9)
Recurring P/E (x)	4.93	4.53	9.67	7.81	8.48
P/B (x)	0.8	0.7	0.6	0.6	0.6
P/CF (x)	4.93	3.07	4.15	4.58	4.61
Dividend Yield (%)	2.8	3.5	1.6	1.9	1.9
EV/EBITDA (x)	2.91	2.28	3.32	2.49	2.27
Return on average equity (%)	19.7	15.7	6.9	8.0	6.9
Net debt to equity (%)	7.5	net cash	net cash	net cash	net cash

Source: Company data, RHB

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Financial Exhibits

Asia	Financial summary (MYR)	Dec-21	Dec-22	Dec-23F	Dec-24F	Dec-25F
Malaysia	Recurring EPS	0.52	0.57	0.27	0.33	0.30
Agriculture	DPS	0.07	0.09	0.04	0.05	0.05
Sarawak Oil Palms	BVPS	3.19	3.75	3.97	4.25	4.51
SOP MK	Return on average equity (%)	19.7	15.7	6.9	8.0	6.9
Buy						
	Valuation metrics	Dec-21	Dec-22	Dec-23F	Dec-24F	Dec-25F
Valuation basis	Recurring P/E (x)	4.93	4.53	9.67	7.81	8.48
We apply a target P/E of 10x on Dec-2024F earnings, backed up by an EV/ha of USD10,000/ha, at the mid end of its peer average of USD8,000-15,000/ha.	P/B (x)	0.8	0.7	0.6	0.6	0.6
	FCF Yield (%)	13.6	26.9	14.9	12.3	11.6
	Dividend Yield (%)	2.8	3.5	1.6	1.9	1.9
	EV/EBITDA (x)	2.91	2.28	3.32	2.49	2.27
	EV/EBIT (x)	3.58	2.86	5.30	3.76	3.64
	Income statement (MYRm)	Dec-21	Dec-22	Dec-23F	Dec-24F	Dec-25F
	Total turnover	4,431	5,308	3,574	3,674	3,612
	Gross profit	1,139	1,048	370	459	433
	EBITDA	902	847	493	571	539
	Depreciation and amortisation	(169)	(174)	(184)	(192)	(203)
	Operating profit	733	674	310	378	336
	Net interest	(17)	(2)	12	26	37
	Pre-tax profit	713	669	329	407	374
	Taxation	(171)	(165)	(79)	(98)	(90)
	Reported net profit	510	480	235	291	268
	Recurring net profit	460	501	235	291	268
	Cash flow (MYRm)	Dec-21	Dec-22	Dec-23F	Dec-24F	Dec-25F
	Change in working capital	(273)	20	113	(6)	5
	Cash flow from operations	460	740	546	496	493
	Capex	(152)	(129)	(207)	(216)	(230)
	Cash flow from investing activities	(119)	(7)	(207)	(216)	(230)
	Dividends paid	(64)	(80)	(35)	(44)	(44)
	Cash flow from financing activities	(187)	(294)	(235)	(244)	(244)
	Cash at beginning of period	642	797	1,254	1,357	1,393
	Net change in cash	154	439	104	36	19
	Ending balance cash	797	1,254	1,357	1,393	1,412
	Balance sheet (MYRm)	Dec-21	Dec-22	Dec-23F	Dec-24F	Dec-25F
	Total cash and equivalents	797	1,254	1,357	1,393	1,412
	Tangible fixed assets	2,566	2,519	2,543	2,566	2,593
	Total assets	4,657	4,894	4,849	4,914	4,953
	Short-term debt	496	315	215	115	15
	Total long-term debt	522	446	346	246	146
	Total liabilities	1,718	1,447	1,187	987	785
	Total equity	2,939	3,447	3,662	3,927	4,168
	Total liabilities & equity	4,657	4,894	4,849	4,914	4,953
	Key metrics	Dec-21	Dec-22	Dec-23F	Dec-24F	Dec-25F
	Revenue growth (%)	59.5	19.8	(32.7)	2.8	(1.7)
	Recurrent EPS growth (%)	110.5	8.9	(53.1)	23.8	(7.9)
	Gross margin (%)	25.7	19.7	10.4	12.5	12.0
	Operating EBITDA margin (%)	20.4	16.0	13.8	15.5	14.9
	Net profit margin (%)	11.5	9.0	6.6	7.9	7.4
	Dividend payout ratio (%)	12.6	16.7	15.0	15.1	16.4
	Capex/sales (%)	3.4	2.4	5.8	5.9	6.4
	Interest cover (x)	22.0	23.0	9.4	19.1	32.1

Source: Company data, RHB

Figure 1: SOP's progress on ESG factors

		2020	2021	2022
ENVIRONMENT				
GHG emissions	Emissions (tCO2e)	278,710	269,290	320,497
GHG emissions	Intensity (tCO2e per tonne of palm product)	0.65	0.57	0.72
Waste treatment	Recycling/ Repurposing of waste	Yes	Yes	Yes
Energy efficiency (water)	Water usage (m3) and intensity (m3/tonne of palm product)	3,190,000	3,540,000	3,960,000
Energy efficiency	Energy consumption and intensity	1,584,859	1,239,302	1,323,629
Certifications	RSPO/MSPO/SPO certified (%)	RSPO: Nil MSPO: 100% ISPO: N/A	RSPO: Nil MSPO: 100% ISPO: N/A	RSPO: Nil MSPO: 100% ISPO: N/A
Use of peat land	Peat land (%)	Not disclosed	44.3%	45.0%
Fire accidents	Number of accidents	None	None	None
Usage of renewable energy	% of renewable energy used	53.5%	45.7%	59.8%
Traceability	Traceable to mills (%)	100.00%	100.00%	100.00%
Traceability	Traceable to plantation (%)	Not disclosed	41.00%	47.20%
SOCIAL				
Channels for workers to raise concerns	Existence of grievance channels to raise concerns	Yes	Yes	Yes
Whistleblowing policy	Policies to protect whistleblowers	Yes	Yes	Yes
Employees' professional/personal development	Provision of training and education	Yes	Yes	Yes
Policy for smallholders*	Policy in place for training, yield improvement and RSPO certification	Yes	Yes	Yes
Employees' welfare	Accommodation and amenities provided	Yes	Yes	Yes
GOVERNANCE				
Board composition	At least half of the board being independent directors	4/10 are independent	3/10 are independent	3/10 are independent
Limiting to nine years (for independent directors)	Limitation of tenure to nine years (for independent directors)	No	No	Yes
Gender inclusivity	Female representation in the board	20.0%	25.0%	50.0%
Emphasis of sustainability at board level	Formation of a sustainability group	Yes	Yes	Yes
Remuneration transparency	Full disclosure of fees and benefits on named basis	Yes	Yes	Yes

Source: Company data, RHB

Figure 2: Key assumptions

	FY21F	FY22F	FY23F	FY24F	FY25F
FFB production, tonnes	1,246,249	1,193,846	1,236,424	1,272,135	1,306,883
% change	-8.3%	-4.2%	3.6%	2.9%	2.7%
Effective CPO price (MYR)	4,430	5,136	3,900	3,900	3,800
Refinery utilisation rate	100%	85%	45%	45%	50%

Source: Company data, RHB

Emissions And ESG

Trend analysis

In 2022, Scope 1 emissions increased to 282k tonnes of CO₂ equivalents (tCO₂e) (2021: 237k tCO₂e) while Scope 2 emissions increased to 38.7k tCO₂e (2021: 31.9k tCO₂e)

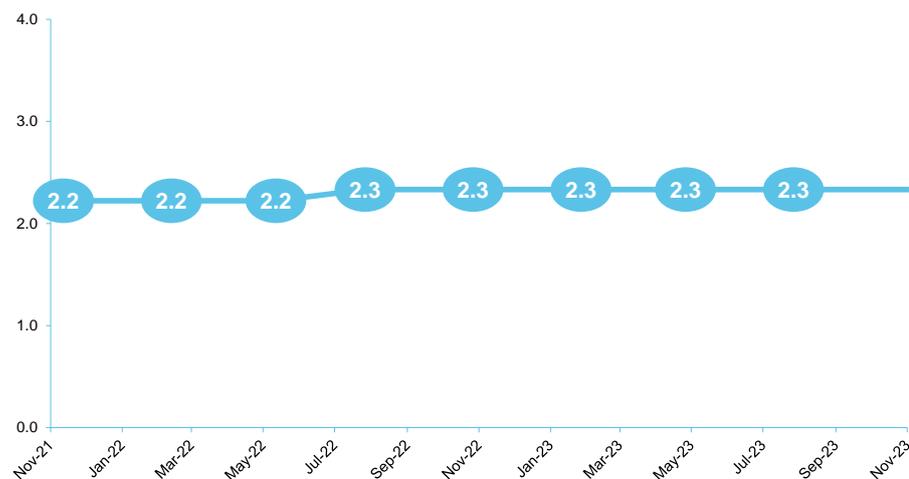
Emissions (tCO ₂ e)	Dec-20	Dec-21	Dec-22
Scope 1	250,283	237,413	281,756
Scope 2	28,427	31,877	38,742
Scope 3	na	na	na
Total emissions	278,710	269,290	320,498

Source: Company data, RHB

Latest ESG-Related Developments

- **Sustainability certification:** As of end 2022, 100% of SOP's operations are MSPO certified
- **Traceability:** as of end-2022, SOP managed to achieve 47.2% traceability to plantation for CPO and 43.5% for PK
- **Reducing GHG emissions:** SOP commits to reduce GHG emissions with the installation of methane capture facilities to reduce emissions at all mills

ESG Rating History



Source: RHB

Recommendation Chart



Source: RHB, Bloomberg

Date	Recommendation	Target Price	Price
2023-08-28	Buy	2.85	2.55
2023-07-23	Buy	3.00	2.60
2023-05-22	Sell	2.00	2.46
2023-04-18	Neutral	2.50	2.46
2023-03-01	Neutral	2.75	2.55
2022-11-28	Buy	3.00	2.60
2022-09-11	Buy	3.00	2.54
2022-08-28	Buy	3.10	2.75
2022-08-10	Buy	4.65	2.68
2022-05-24	Buy	7.25	3.93
2022-04-26	Buy	7.05	4.32
2022-03-16	Buy	6.05	3.65
2022-02-25	Buy	6.35	3.93
2021-12-12	Buy	4.10	2.38
2021-11-29	Buy	4.65	2.35

Source: RHB, Bloomberg

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Trading Buy:	Share price may exceed 15% over the next 3 months, however longer-term outlook remains uncertain
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