Shariah Compliant

12 August 2024

Agriculture | Plantation

Sarawak Oil Palms (SOP MK)

Buy (Maintained)

Strong EBIT/ha and Inexpensive Valuation; Still BUY

Target Price (Return):	MYR3.25 (+17%)
Price (Market Cap):	MYR2.79 (USD553m)
ESG score:	2.3 (out of 4)
Avg Daily Turnover (MYR/USD)	0.43m/0.09m

- **Stay BUY, with new MYR3.25 TP from MYR3.30, 17% upside and c.4% FY25F yield.** The plantation industry is at a crossroads. With rising costs, falling yields, little chance for landbank expansion, where can growth come from? As Sarawak Oil Palms' EBIT/ha is already better than its peers, it may be able to improve this by expanding further downstream and raising its ESG credentials. We continue to like the company for its attractive valuation of 8x P/E, at the lower-end of its peer range of 6-10x.
- **Face the hard facts and adapt.** With all the headwinds facing the industry in the form of lower yields, older trees, environmental pressures, higher costs, labour issues and reducing profitability, the plantation industry needs to find ways to circumvent this. Although CPO prices have risen to highs unseen in the last 10 years, there is always a risk that extenuating circumstances can push prices down to below breakeven cost levels. Going forward, we expect long term CPO prices to trade at higher levels of MYR3,000-3,500/tonne and above, but prices are likely to continue to be volatile. As prices are not within the planters' control, they will need to pay closer attention to revenue growth, cost control and potential diversification efforts.
- **Diversification may be the name of the game going forward.** Historically, some planters have already diversified into other industries like property, fruit farming, gloves and dairy farming, amongst others. In recent times, we have seen more ESG-friendly diversification in the form of producing wood, fertiliser, etc using palm oil waste. However, other than ventures that take advantage of their landbank like land sales and property development, none of these have moved the needle in terms of earnings contributions. With landbank monetisation like data centres or renewable energy ventures like solar farms now being a feasible diversification, this may change going forward should more planters opt to engage. We estimate profitability/ha/year for solar is 26x more than oil palm.
- **Besides earnings diversification,** planters also need to improve mechanisation to raise efficiency and reduce reliance on labour; spend more on R&D to produce better breeds of seedlings with higher yields and lower maintenance costs; and boost emphasis on ESG to get a higher ESG premium.
- **For SOP, we raise its ESG score to 2.3 (from 2.2),** coming from a 6-8% reduction in water intensity and greenhouse gas emissions. This, in turn, has increased its "Environment" rating. We believe the sector is also moving in the right direction in terms of ESG standards, with more disclosure and more targets being set. Our overall average sector ESG score has improved this year to 2.6 (from 2.5).
- **Maintain BUY, with a slightly lower MYR3.25 TP,** after raising FY25F earnings by 3%, following a slight reduction in operating expenses. We roll forward our valuation target to 2025, raising our P/E to 11x from 10x, in line with its historical valuation average. Our TP also imputes a lower 14% ESG discount (from 16%), given its ESG score of 2.3.

Forecasts and Valuation	Dec-22	Dec-23	Dec-24F	Dec-25F	Dec-26F
Total turnover (MYRm)	5,308	5,124	4,591	4,521	4,616
Recurring net profit (MYRm)	501	302	347	304	312
Recurring net profit growth (%)	8.9	(39.8)	15.1	(12.4)	2.5
Recurring P/E (x)	4.90	8.23	7.16	8.17	7.97
P/B (x)	0.7	0.7	0.7	0.6	0.6
P/CF (x)	3.29	6.74	4.08	5.00	4.99
Dividend Yield (%)	3.3	1.7	3.6	3.6	3.6
EV/EBITDA (x)	2.49	4.64	3.82	3.93	3.57
Return on average equity (%)	15.7	8.8	9.5	7.8	7.6
Net debt to equity (%)	net cash	1.8	net cash	net cash	net cash

Source: Company data, RHB

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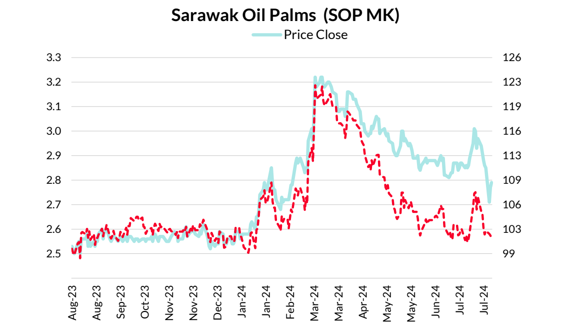
Share Performance (%)

	YTD	1m	3m	6m	12m
Absolute	7.7	(2.8)	(6.7)	2.2	11.6
Relative	(1.7)	(1.6)	(5.8)	(3.0)	1.5
52-wk Price low/high (MYR)					2.50 –3.22



Source: Bloomberg

Overall ESG Score: 2.3 (out of 4)

E: GOOD

While SOP 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

SOP 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

33% of SOP's board members are independent, and 44% 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.

Financial Exhibits

Asia
Malaysia
Agriculture
Sarawak Oil Palms
SOP MK
Buy

Valuation basis

We apply a target P/E of 11x on Dec-2025F 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.

Key drivers

i. CPO price movement;
ii. FFB production output;
iii. Competitiveness of its downstream processing division vs peers.

Key risks

i. CPO price movement;
ii. Weather risks;
iii. Demand and supply dynamics of the global vegetable oil industry.

Company Profile

Sarawak Oil Palms is involved in oil palm cultivation and CPO refining in the state of Sarawak.

Financial summary (MYR)	Dec-22	Dec-23	Dec-24F	Dec-25F	Dec-26F
Recurring EPS	0.57	0.34	0.39	0.34	0.35
DPS	0.09	0.05	0.10	0.10	0.10
BVPS	3.75	3.95	4.24	4.48	4.73
Return on average equity (%)	15.7	8.8	9.5	7.8	7.6

Valuation metrics	Dec-22	Dec-23	Dec-24F	Dec-25F	Dec-26F
Recurring P/E (x)	4.90	8.23	7.16	8.17	7.97
P/B (x)	0.7	0.7	0.7	0.6	0.6
FCF Yield (%)	25.2	8.9	16.3	11.2	10.7
Dividend Yield (%)	3.3	1.7	3.6	3.6	3.6
EV/EBITDA (x)	2.49	4.64	3.82	3.93	3.57
EV/EBIT (x)	3.14	6.70	5.18	5.66	5.21

Income statement (MYRm)	Dec-22	Dec-23	Dec-24F	Dec-25F	Dec-26F
Total turnover	5,308	5,124	4,591	4,521	4,616
Gross profit	1,048	744	483	471	488
EBITDA	847	583	631	567	578
Depreciation and amortisation	(174)	(179)	(167)	(173)	(182)
Operating profit	674	404	464	394	396
Net interest	(2)	14	9	20	28
Pre-tax profit	669	421	476	417	427
Taxation	(165)	(106)	(114)	(100)	(103)
Reported net profit	480	301	347	304	312
Recurring net profit	501	302	347	304	312

Cash flow (MYRm)	Dec-22	Dec-23	Dec-24F	Dec-25F	Dec-26F
Change in working capital	20	(113)	81	7	(9)
Cash flow from operations	746	368	609	497	498
Capex	(127)	(148)	(205)	(217)	(232)
Cash flow from investing activities	6	(832)	(205)	(217)	(232)
Dividends paid	(80)	(42)	(89)	(89)	(89)
Cash flow from financing activities	(296)	(12)	(380)	(380)	(380)
Cash at beginning of period	797	1,254	779	804	704
Net change in cash	456	(475)	25	(101)	(113)
Ending balance cash	1,254	779	804	704	591

Balance sheet (MYRm)	Dec-22	Dec-23	Dec-24F	Dec-25F	Dec-26F
Total cash and equivalents	1,254	779	804	704	591
Tangible fixed assets	2,519	2,485	2,523	2,567	2,617
Total assets	4,894	5,213	5,172	5,105	5,055
Short-term debt	315	622	477	331	186
Total long-term debt	446	223	78	(68)	(213)
Total liabilities	1,447	1,541	1,227	933	647
Total equity	3,447	3,672	3,945	4,172	4,408
Total liabilities & equity	4,894	5,213	5,172	5,105	5,055

Key metrics	Dec-22	Dec-23	Dec-24F	Dec-25F	Dec-26F
Revenue growth (%)	19.8	(3.5)	(10.4)	(1.5)	2.1
Recurrent EPS growth (%)	8.9	(40.5)	15.1	(12.4)	2.5
Gross margin (%)	19.7	14.5	10.5	10.4	10.6
Operating EBITDA margin (%)	16.0	11.4	13.7	12.5	12.5
Net profit margin (%)	9.0	5.9	7.6	6.7	6.8
Dividend payout ratio (%)	16.7	14.0	25.6	29.3	28.6
Capex/sales (%)	2.4	2.9	4.5	4.8	5.0
Interest cover (x)	23.0	12.1	16.6	24.1	83.6

Source: Company data, RHB

Figure 1: SOP's progress on ESG factors

		2021	2022	2023
ENVIRONMENT				
GHG emissions	**Emissions (tCO2e)**	269,290	320,497	294,437
GHG emissions	**Intensity (tCO2e per tonne of palm product)**	0.57	0.72	0.58
Waste treatment	**Recycling/ Repurposing of waste**	Yes	Yes	Yes
Energy efficiency (water)	**Water usage (m3) and intensity (m3/tonne of palm product)**	3,540,000	3,960,000	Not disclosed
Energy efficiency	**Energy consumption and intensity**	1,239,302	1,323,629	1,489,872
Certifications	**RSPO/MSPO/ISPO 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 (%)**	44.3%	45.0%	45.0%
Fire accidents	**Number of accidents**	None	None	None
Usage of renewable energy	**% of renewable energy used**	45.7%	59.8%	63.2%
Traceability	**Traceable to mills (%)**	100.00%	100.00%	100.00%
Traceability	**Traceable to plantation (%)**	41.00%	47.20%	45.00%
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**	3/10 are independent	3/10 are independent	3/9 are independent
Limiting to nine years (for independent directors)	**Limitation of tenure to nine years (for independent directors)**	No	Yes	Yes
Gender inclusivity	**Female representation in the board**	25.0%	50.0%	44.4%
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

	FY22	FY23	FY24F	FY25F	FY26F
FFB production, tonnes	1,193,846	1,226,566	1,316,494	1,366,423	1,403,712
% change	-4.2%	2.7%	7.3%	3.8%	2.7%
Effective CPO price (MYR)	5,136	3,832	3,900	3,800	3,800

Source: Company data, RHB

Emissions And ESG

Trend analysis
In 2023, Scope 1 emissions decreased to 269k tonnes of CO_2 equivalents (2022: 282k tonnes of CO_2 equivalents) and Scope 2 emissions also decreased to 24.5k tonnes of CO_2 equivalents (2022: 38.7k tonnes of CO_2 equivalents)

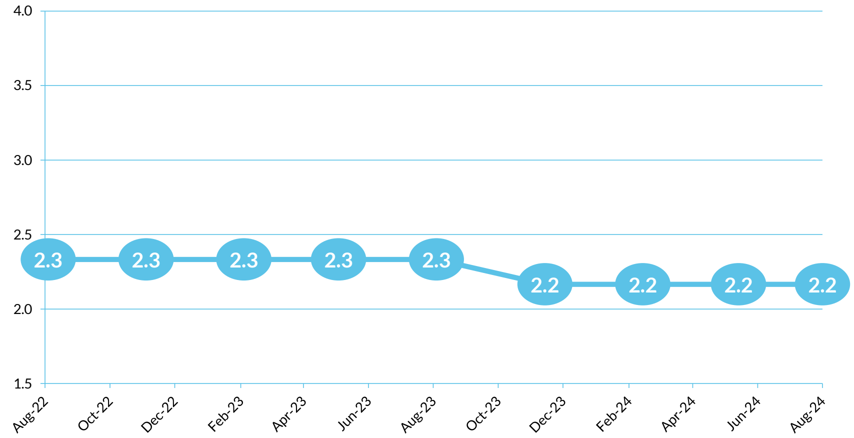
Emissions (tCO_2e)	Dec-21	Dec-22	Dec-23
Scope 1	237,413	281,756	269,481
Scope 2	31,877	38,742	24,956
Scope 3	na	na	-
Total emissions	269,290	320,498	294,437

Source: Company data, RHB

Latest ESG-Related Developments

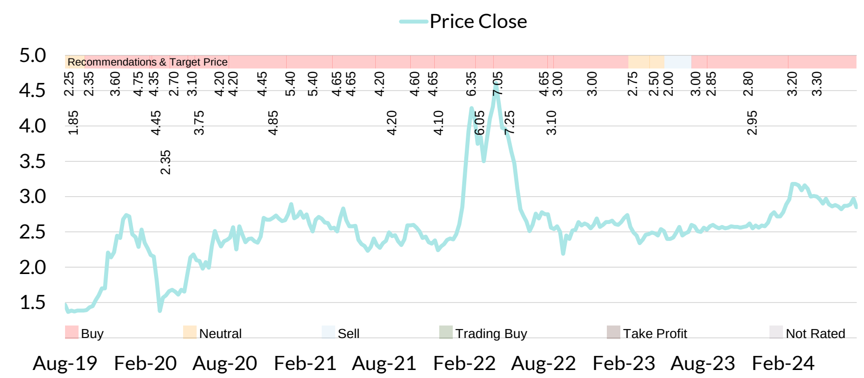
- **Sustainability certification:** As of end 2023, 100% of SOP's operations are MSPO certified.
- **Traceability:** as of end-2023, SOP managed to achieve 45.0% traceability to plantation for CPO and 47.0% for PK and getting all their POMs ISCC re-certified.
- **Reducing GHG emissions:** SOP commits to reduce GHG emissions with the installation of methane capture facilities (five more to be completed from 2024 onwards) to reduce emissions at all mills.

ESG Rating History



Source: RHB

Recommendation Chart



Source: RHB, Bloomberg

Date	Recommendation	Target Price	Price
2024-05-19	Buy	3.30	2.90
2024-02-29	Buy	3.20	2.84
2023-11-29	Buy	2.95	2.58
2023-11-20	Buy	2.80	2.59
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

Source: RHB, Bloomberg

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Buy:	Share price may exceed 10% over the next 12 months
Trading Buy:	Share price may exceed 15% over the next 3 months, however longer-term outlook remains uncertain
Neutral:	Share price may fall within the range of +/- 10% over the next 12 months
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Not Rated:	Stock is not within regular research coverage

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