

# When Slipping Up Is Good

## Malaysian palm oil prices seem set to increase

*By Steven K.C. Poh / Malaysia*

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**P**RICES FOR CRUDE PALM oil are expected to rise over the next few months, which should help producers from the world's largest palm oil exporter, Malaysia. Stock analysts in Kuala Lumpur who follow the industry say demand for the oil, which is used in cooking and as an ingredient in household items like soap, should increase from buyers in India, Pakistan and, especially, China. At the same time, Malaysia's production growth rate is slowing -- from 8.1% in 1995 to 3.2% in 1996. And analysts point out that the competition has recently taken some hits: higher export taxes on Indonesian palm oil make that country's exports less competitive, and firmer prices for soybeans reduces rivalry from that quarter.

In Malaysia there are several palm oil producers for investors to choose from. One favorite of Vincent Khoo, an analyst for Crosby Research in Kuala Lumpur, is Austral Enterprise. Khoo likes the fact that Austral made money even when the price for palm oil was depressed. Prices have improved in recent months and look set to go up more. Khoo also likes Hap Seng Consolidated (formerly East Asiatic Company). "Its earnings will be boosted by growth in production," he says. Not just that: "It is the only cheap, big-cap stock in the sector." A large company in such an industry has an advantage because, Khoo told Asiaweek, its managers are frequently more seasoned traders and better able to navigate price volatility.

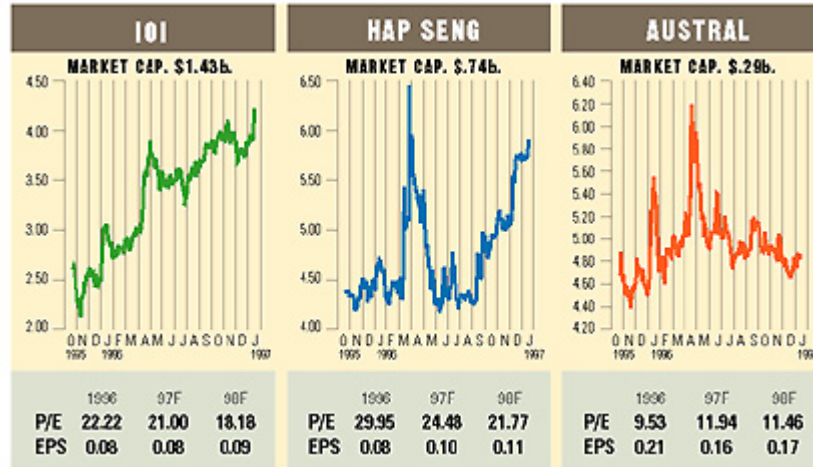
Increased production is especially desirable so long as prices stay high. But, warns Ivan Wong, executive director of Palm Intelligence Services, a private palm oil investment house, "The market is volatile." Lau Wee Sin, an analyst for Kuala Lumpur's Peregrine Research says the company is trading at a relatively low 18 times estimated 1997 earnings. And it owns a quarter of Carlsberg Malaysia, which trades at a price/earnings ratio of 26. Thus, Hap Seng looks like an inexpensive way to buy into the brewer. (Price/earnings estimates in the chart below are consensus figures and may differ from individual analysts'.)

Outside of Hap Seng, there is less unanimity. Ng Eng Hou of Singapore's Keppel Securities likes Kuala Lumpur Kepong (KLK), which he considers a core holding in the plantation sector. Says Ng: "KLK is the most efficient palm oil producer in Malaysia. Its crops have surpassed the industry's average yield." The company's production cost per ton is less than the industry average -- \$263 per ton -- at \$243 per ton. And, at a p/e ratio of 17 times expected 1998 earnings, says Ng, KLK is a "buy on weakness." But Victor Wan of South Johor Securities believes KLK is already valued fairly: "Even though palm oil prices are expected to increase, the upside is limited."

Kwantas has attracted the attention of Lo Chok Ping of Phileo-Allied Securities. "Small and sexy" is how he describes the company. "Strong profit growth will be driven by production from maturing palm acreage within the next three years and by expansion of the company's palm oil mill," he says. Such production growth should help protect the company from price volatility. "The growth of Kwantas is head and shoulders above the rest of the plantation sector." Lo also likes the fact that the company's trees are generally young, with their best years of production ahead. The average useful life of a palm tree is seven to 12 years.

Like Hap Seng, some analysts like IOI Corp. as much for its proxy value for a completely different sector as for its desirability as a palm oil producer. Andrew Chow of ING Baring Research says

IOI, trading at 20 times 1997 earnings, stands in well for a subsidiary, IOI Properties, as a real estate play. At less than \$1.60 per share, the company represents a discount of more than 15% to the plantation sector's average p/e. Chow expects IOI's production to grow as new acreage in Sabah matures.



All money values in U.S. dollars except share prices, which are in Malaysian ringit. (Sources: Datastream, The Estimate Directory)