Issue #2 May / Jun 2013

Khor reports' Palm Oil

The Carbon Conundrum

Palm producers push for biodiesel mandates

Carbon thresholds on deforestation & peat?
Natural: Red palm oil and the organic frontier
Fat standards & fat targets
Chocolate campaigns, Norway's realignment

Khor Reports' Palm Oil

May / June 2013 ISSUE 2

Founder & editor: Yu Leng, Khor
Associates & contributors:
V Mavroeidi, H Varkkey & R Wong.

Enquiries
Email: khorreports@gmail.com
Telephone: +6593830428

Khor Reports' Palm Oil is published by
Segi Enam Advisors Pte Ltd
1 Claymore Drive #08-14
Singapore 229594

Khor Reports is a provider of market intelligence. We specialise in customized industry research and strategic analysis on agribusiness in Southeast Asia and frontier markets. We also focus on supply-chains, sustainability and reputational risks.

Supply problems & sustainability standards

Key players in the palm oil industry seem to think that the weakness in palm oil prices needs to be addressed. There's just too much crop coming in and export markets are not having an easy time absorbing supply. Core producers, Indonesia and Malaysia have dusted off their near-dormant domestic biodiesel programs. Headlines in Malaysia focus on its biodiesel gambit. Indonesia also has a few ideas to handle expanding supply and stocks. They differ in philosophies on subsidies, and strategems cater to the different stages of industry development. Both countries have legions of smallholder farmers. Malaysia just had its general elections and Indonesians will be going to the polls in 2014. Farmers are a key voting bloc in many rural constituencies. Khor Report's checks indicate that Indonesian smallholders have faced at least a 30% drop in monthly net earnings (on a year-on-year basis), mainly due to falling prices. Plantation earnings have also been troubled.

Indonesia talks of getting 3 million MT of palm oil converted to biodiesel. So far, it has allocated a subsidy of up to USD 279 million each year, but local consumption in 2010 was 223,041 kiloliters versus the target of 1.73 million. Instead, Indonesia biodiesel exports in 2011 exceeded 1.4 million MT, particularly to the EU, where accusations of dumping are being challenged. Indonesia likes to see the palm oil industry "enlarge the capacity of its storage tanks from around 2.5 million MT… to hold a one-month stock supply, to 8 million MT to save three-month stocks" (10 January 2013, Jakartapost.com). Malaysia has a new push on replanting, and subsidies for big biodiesel. The latter effort is led by the giants, Sime Darby and Felda Global. Malaysia has said it will subsidise this to offset CPO costs. It may have to pay up to Ringgit 1.1 billion or USD 355 million annually (29 March 2013, thestar.com).

On sustainability, the inclusion of greenhouse gas (GHG) or carbon accounting will trouble growers. It is in the RSPO's new revised standard, which got a high 97% "yes" vote. This means that the usually conservative growers wanted to show support for it (if they voted "no" as a block, we would have seen at most 85%). Strategists find this a debatable move. Looking at the stringent definitions in the Annex of the new standards, it appears that a carbon ceiling is inevitable. This is fundamental to arresting deforestation, allowing regrowth and stopping peatland use. Golden Agri / Sinar Mas has accepted an above ground 35 tonnes carbon per hectare ceiling; surprisingly, working hand-in-hand with Greenpeace (mostly typecast as a "business-unfriendly" NGO). A carbon threshold could severely limit the usability of plantation land banks, possibly to 50% or less (net of plasma or smallholder allocation), even in so-called "degraded" areas. RSPO growers have to negotiate the final definitions that will apply in the new National Interpretation documents. Will they put in the budget for a joint, well-resourced secretariat with full-time staffers (including trade negotiators)? This seems a non-competitive and strategic need. NGOs have a significant group of full-time experts working on palm oil sustainability policy and advocacy. An alternative to real engagement is disengagement. The Malaysian Palm Oil Association is mulling a withdrawal from the RSPO. Indonesia did so in September 2011, but it hardly seems to have affected the enthusiasm of its grower members.

The rest of our line up: Indonesia's recent talk 100,000ha ownership limit; fat standards and Australia's aim to remove over 3 million kg of saturated fat from its food supply; niche natural products: red palm oil and organic; linkages with "palm oil free" but Ferrero fights back.

Yu Leng, Khor

In this issue

3 briefing Indonesia 100,000 ha ceiling? East Malaysia factors. Frontiers grow organic.
4 food watch EU transfat and Australia SAFA cuts target. Natural claims red palm oil.
5 sustainability US & UK choc campaigns. Norway repositions. Ferrero fights back.
6-7 feature The carbon conundrum: deforestation & peat, Indonesia's moratorium and detecting deforestation. Malaysia producers push for biodiesel.
8 prices & data Key vegetable oils. Weather outlook. CPO technical view. Price charts.

Indonesia

100,000 ha limit revisit

Indonesia's Agriculture Ministry is currently revising the 2007 Ministerial Regulation on Plantation Permits, which will limit the total plantation area a company can own to 100,000 hectares. "Through the revised regulation, the ministry will also oblige companies owning at least 250 hectares of plantation to establish a plasma plantation outside their area to benefit local residents. The size of the plasma plantation should be at least 20 percent of the company's plantation area. "The revision is our move to forestall any land monopoly. The revised regulation will be announced in late April and is expected to be effective in May," (said) Deputy Agriculture Minister Rusman Heriawan… He, however, said that the cap would not affect existing plantation areas that already exceed 100,000 hectares." The concern seems to be on the principle of equity and fairness. He goes on to say, "Look at how land conflicts between local people and big companies have increasingly occurred in various provinces, especially because most provincial administrations have not completed their spatial master plans." (4 April 2013, jakartapost.com)

The deadline has passed as of our publication, without the promised update. Large plantations are obviously resistant to such a move. "This revisits a similar policy included in the bill on plantations that was proposed in 2003. However, the articles that set the maximum plot of land for a plantation company at 20,000 ha in one province and 100,000 ha nationwide were removed from the final draft passed in mid-2004. The government, therefore, should act decisively when setting the land ownership limit. The new policy measure, therefore, should be designed to empower smallholders and protect the interests of tribal-land owners from greedy investors and corrupt officials."
(8 April 2013, editorial, Jakartapost.com)

If passed, this will affect new land acquisitions, and it may not be applied to existing land bank of unplanted areas. It would add a hurdle for newcomers joining the industry, and affect the speed of expansion. A key question is whether the cap will apply at a group or subsidiary level. Earlier versions point to a group landownership limit, and this would mean that big companies cannot expand in Indonesia anymore. All this could means that Indonesian land prices might come down. In the short term, such a move would be bad for companies if they have planted to the limit of their land bank. Longer term, this might be good for CPO prices, as supply growth of palm oil would be constrained.

Malaysia

East Malaysia factors

In Sabah, a security crisis started in February 2013 and erupted in violence in early March. This resulted in risk concerns for the palm oil supply chain in Sabah, which is the biggest producer of palm oil in Malaysia. A group of over 100 heavily armed Suluks, from the southern Philippines, landed in the vicinity of Felda Global's largest estate, the Sahabat Complex. It resulted in the closure of some refineries for several days in the Lahad Datu area. Malaysian security forces brought a resolution and established new security measures. While there was almost no impact on the supply-chain, the risk profile of the area has been raised, given the apparent ethno-political roots of the fracas. So long as there are no further untoward incidents, this will abate.

In Sarawak, long-time Chief Minister Taib Mahmud, has agreed to debate Global Witness, a corruption-busting and Noble Prize-nominated pro-environment UK NGO. It recently released a video sting on Sarawak oil palm land deals. Malaysia has regulations on foreign-ownership limits, and real property gains tax. Sarawak is Malaysia's last major frontier with large areas under native customary rights. A turning point was the landmark IOI Pelita case in 2010, which favoured native claimants. Any major new land development will have to overcome past shortcomings and be more socially inclusive in order to succeed.

Frontiers

Growing organic

It is interesting to find organic palm oil, a niche product, mostly in frontier regions in Africa on a small scale and in some commercial estates in Latin America. Southeast Asian agro-industrialists seem to find it a no-go because the rigorous requirements for organic certification do not allow the use of chemicals and it requires a lot more manpower. Anecdotally, we hear that some planters looking at organic production estimated that big drops in yields would not be sufficiently compensated by the premium. Also, you need segregation in processing i.e. smaller mills, a controlled supply-chain.

DAABON has 2,500 ha of organic estates while developing another 2,000 ha with small farmers in Colombia. We found some interesting insights into organic production. First of all, decent yields are possible. Conventional Colombian yields average 19 MT FFB/ha/year and DAABON's organic palm yields (including smallholders) are currently 26 MT FFB/ha/year. Organic is driven by supply rather than demand as it is tough to find suitable areas: a) which are not influenced directly by conventional planting or contaminants (locations near rivers are problematic), b) soil recovery from conventional farming to remove chemical residuals may be an issue, c) organic palm needs an area without too much rain, in order to control pest outbreaks, which are very dependent on moisture. Cost of production per MT for organic is at least 20% higher.

"Going organic gives you the opportunity to switch from a monoculture to an integral farm. This style of crop must be driven by conviction. That is why interested players have failed in the past. Organic means detail and audits and commitments that conventional does not require," concludes Felipe Guerrero of DAABON. In principle, palm oil is more "organic ready" than others, as there is no genetically modified or GMO palm oil yet. Food for thought?

Fat standards

EU transfats and Australia saturated fats

In March 2013, the EU margarine industry set stricter transfat standards. Foodnavigator.com reported on 19 March 2013 that "Its initial 1995 standards recommended that all margarines and vegetable fat spreads, whether sold at retail or as ingredients, should contain less than 5% transfat – about the level of butter. The Code of Conduct was updated in 2003 and again in 2007, and now recommends that spreads and margarines should contain no more than 2% trans fatty acids (TFA) on a fat basis, at retail." Also, "It added that food companies should ensure saturated fat levels do not rise as a result of reformulation."

Palm oil's use is very important in industrial margarine products, possibly more so than in retail ones. Palm oil is blended with other vegetable oils to achieve the right balance between fatty acid profile and functionality. Because of its fatty acid composition, palm oil does not need hydrogenation.

The negative health issues surrounding transfats have been known for many years and most manufacturers have moved away from partial hydrogenation of soft oils (primarily soy and rapeseed) which results in transfats. Thus processors prefer palm oil. This is seen in the increase in imports by the USA since 2006 on transfats regulations.

Until there is a major technological breakthrough to improve the shelf life of soft oil based products, manufacturers will have to depend on palm oil, coconut oil or animal fats. Thus, it appears that the food industry cannot do without palm oil. Its wide discount to other oils is an opportunity for it to gain market share. Most industry experts say that this is palm positive, but they note that the proposed nutrient reference values (NRV), could be a tricky issue.

However, the big debate has shifted from transfats to saturated fats. Which is more harmful? Foodnavigator.com reports that the "current scientific consensus suggests that trans fatty acids are worse than saturated fatty acids (SAFA) in terms of effect on lipoproteins."

Palm oil experts think the EU margarine industry move will increase the consumption/usage of palm oil in industrial margarines rather than retail. However, since transfat in margarines sold to manufacturers is already at 1.7%, the upside seems limited. In retail products, you need to disclose the amount of fats (i.e. TFA, SAFA and other). Under the proposed NRV, this could be a tricky issue on labelling. Come 2015, under the EU's rules, you need to disclose the ingredient list. Palm oil cannot just come under a general "vegetable oils" label.

EU margarine industry standards
Voluntary measures to reduce trans fat in margarines sold to food manufacturers already have led to an average 76% reduction since 2004, from 7.1% to 1.7%.
To reduce levels of TFA in retail products to no more than 2% TFA on a fat basis, but concern remains over the higher levels of TFAs in other foods.
Supports mandatory labelling of both SAFA and TFA from all sources in all retail food products.

More fundamentally, there are emerging moves to cut saturated fats in foods. Australia wants to cut this by 25% by 2015. Foodnavigator-asia.com reported in October 2012 that "Some of Australia's biggest food companies have joined forces via the Australian Food and Grocery Council (AFGC) to launch an initiative to significantly reduce fat, sodium and calories from diets in the country. Under the terms of this voluntary agreement, named the Healthier Australia Commitment, companies representing more than a quarter of the domestic food and grocery industry have agreed on a series of reduction targets… Unilever, Nestlé, Coca-Cola and Campbell Arnotts, will set out to reduce saturated fat in products… equivalent of over 3 million kg (3,000 MT) of saturated fat (will be) removed from the food supply." This could slightly impact palm oil. It is up to palm oil marketers to explain to users and consumers the difference in its saturated fat (less unhealthy), compared to others.

Natural

Red palm oil

Palm oil is well known to contain carotenoids and tocotrienols or vitamin E, which have been found to be good for health. In the 1980s, in-lab processing developed red palm oil to retain these nutrients in greater concentration, and processing was commercialised in the early 1990s by Golden Jomolina. The processing involves a pre-treatment, and low temperature deodorization or deacidification. With conventional processing, at higher temperatures, the carotene (red colour) breaks down, to produce regular golden-coloured palm oil. Thus, red palm oil is natural and not synthesized. It is a virgin palm oil that is free of chemical additives. Jomolina and Carotino are among the bigger producers of this product.

The applications are numerous, including direct consumption in margarine (which would apparently be grey without the colourant). In frying it gives a golden colour to the food, and it would be better used at lower temperature and with shorter cooking times, so as not to lose the properties. Some red palm oil products guarantee minimum 550 ppm carotenes.

While its superior nutritional values are lauded and used in products like the Carotino Biscuit program to fight vitamin A deficiency among children in Africa (with positive documented results); for food manufacturers it is mainly used for colouring purposes. Europe is at the forefront of a growing trend to drop artificial "E number" ingredients. Its natural anti-oxidants also have a positive influence on product shelf-life. Red palm oil is an all-in-one substitute (with no transfat and a natural colouring), that has a price advantage over many alternatives. Marketers of red palm oil see good immediate prospects in niche and high-end market applications especially in Japan, Korea, Europe and the US.

Ethical ratings

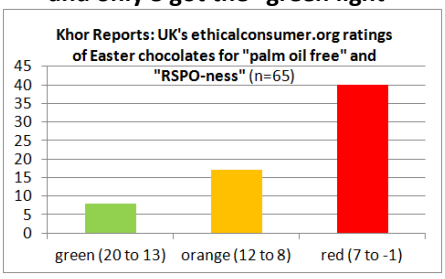
Chocolate campaigns

Back in February, the US saw a bout of campaigning over Valentine's Day chocolates. NGOs tackled the likes of Mars and Hershey on their sourcing of palm oil. More recently, sustainable palm oil has again been linked to the rise of "palm oil free." In an "ethical rating" of palm oil usage in consumer products: UK's Easter chocolates get a high score by various degrees of effort or "RSPO-ness."

The methodology: "Products are ranked on a scoring system of 1-20....Companies that do not use palm oil or their derivatives score 20 (best score). Companies that use it but make no substantial policy statements and are not members of the Roundtable on Sustainable Palm Oil score 0." In addition, there are negative marks for missing or inconsistent information provided (ethicalconsumer.org, 26 March 2013).

RSPO's Annual Communication on Progress (ACOP) was greatly strengthened last year but it has been hampered by significant non-responses and non-disclosures. This move in consumer product ratings highlights these issues and marks down companies for their lack of full disclosure.

65 Easter chocolate products were rated and only 8 got the "green light"



In a poll by Retail Active in Easter of 2010, UK children were estimated to indulge in more than 2.5 kg of chocolate over the Easter holiday on average; consuming nearly 13,000 calories and 650 grams of fat (2 April 2010, telegraph.co.uk). In the USA, Easter is the second most important candy-eating occasion of the year. Americans consumed 7 billion pounds (3.2 million MT) of candy in 2011, according to the National Confectioner's Association. In 2012, Americans spent nearly USD 2.1 billion on Easter candy (rising to the top position by sales), while Halloween sales were over USD 2 billion; Christmas, more than USD 1.4 billion; and Valentine's Day, over USD 1 billion (reported in infoplease.com of Pearson Education).

Chocolate makers buy specialty fats from palm oil providers in the form of cocoa butter equivalent and cocoa butter substitutes. To be rated high by ethicalconsumer.org a chocolate manufacturer using palm needs to do the following: be a RSPO member; for all group companies buy segregated sources for all CPO, PKO and palm derivatives used; disclose all relevant data to RSPO, disclose all suppliers and label palm oil in ingredients. The do-nots: provide incomplete or inconsistent information. The alternative for a top score is to simply go "palm oil free" (and never mind the attributes of the ingredient you substitute it with i.e. sustainability, transfat and so forth). Thus, the slightly startling conclusion from ethicalconsumer.org is this: the best sustainable palm oil is no palm oil.

Branding

Norway repositions

Norway's recent shifts on palm oil include: (i) a key pension fund selling all other plantation equities but greatly boosting its holdings of shares in Sime Darby at end-2012 and (ii) an NGO campaign reducing palm oil consumed by two-thirds for mixed reasons.

There has been a symbolic sell-down of plantation company equity holdings by the Norwegian Government Pension Fund Global. Pressured by activists, the hydrocarbon exporting nation decided to become "more green" by selling off plantation shares. But this selling was reversed by its buying a lot more shares in Sime Darby, by end 2012. This move was stated to be part of the "Fund's policy on risk related to climate change and tropical deforestation" (source: www.regnskog.no). While experts questioned its methodology of selection, some analyst worried about other such funds selling stocks on sustainability concerns. However, few think that this issue moves the overall market.

Secondly, there has been a campaign by Rainforest Foundation to cut by two-thirds, Norway's 2011 level of consumption of palm oil from 3 kg to 1 kg per capita. Norwegian food producers used 15,000 MT of palm oil in 2011. "Producers were asked to disclose details about their use of palm oil… published in a (web-based) "palm oil guide"… (at www.regnskog.no). The guide is worth a look as it gives details on palm oil content in different products (850 food products by October 2012; google for "palmeoljeguiden"). All food producers except for General Mills made disclosures or were compelled to. The US food giant could not be made to do so unlike a Norwegian company. The pressure group reports that they were frustrated to find that journalists and others were often "distracted" (more concerned) by the saturated fat worry than deforestation.

Norway is a limited player in both the global equity markets and the global oils and fats trade. It is advanced in the strategic marketing of its country's branding (which would otherwise be troubled by its hydrocarbon interests). Its shift in stance on palm is not entirely straightforward. Palm oil marketers may take note of key issues and myths that this repositioning has revealed.

RSPO

Ferrero fights back

On deforestation-free palm oil concerns in end markets, Khor Reports notes that the Ferrero Group has for years been carefully sourcing palm oil from Peninsula Malaysia, a long cultivated area i.e. plantations there developed many decades ago. However, it faced a negative marketing blitz in the so-called Nutella Wars in France last year. It is interesting to note that it has lodged a complaint against its fellow RSPO members, Groupe Casino and Systeme U on 2 April 2013 for "undermining the objectives of the RSPO… and breaching the RSPO Code of Conduct..." These companies were key players in the negative advertisements.

The carbon conundrum
– tough thresholds to come?

In a tough revision of its certification standard for growers, the RSPO will require measurement of greenhouse gas (GHG) emissions from operations and new plantings. Other key new criteria are on forced labour and corruption; these definitions will likely follow United Nations conventions. The key bugbear for growers will be GHG and its implied carbon threshold for new land development. Some time will be given to develop the GHG tools, and public reporting will only start 31 Dec 2016. Nevertheless, the implications are obvious and significantly negative for plantation expansion on a business-as-usual basis, using the current high conservation values (HCV) approach. This approach has lacked numeric certainty. Furthermore, some European countries are asking their companies to report on GHG; leading to pressure on their suppliers to do likewise.

Thus, plantation expansion by RSPO growers will have to focus on "low carbon areas" (no deforestation, no peat) and cultivated areas will likely need to have higher areas set aside for conservation. The new Principles & Criteria (P&Cs) will also require changes in carbon stocks to be measured against a baseline of land use in November 2005 (when HCV assessments started). Such retroactive reporting of land developments catches up with those who were less than fulsome in their new planting procedures reporting. This could generate a list of who did the most in reducing carbon stocks.

Low carbon stock areas

RSPO defines low carbon stock areas "as those with (above and below ground) carbon stores, that would be lost by conversion to oil palm, smaller than that which would be sequestered within an oil palm crop and other set-aside areas within the management unit over the period of one rotation." Thus, expansion should only occurr areas with less carbon (forested areas and scrubland) than in a typical mature estate.

Principles overlap and are superseded; and this will mean:

a) Low or no peat land development (negating or superseding Principle 7.4 which allows for non-extensive planting on peat);

b) Usage of a carbon ceiling e.g. 35 tonnes carbon per hectare*. This is the often cited measure of carbon sequestered in a palm tree, which Golden Agri / Sinar Mas has accepted for its pilot scheme. This would supersede Principle 7.3 on non-usage of primary forest from November 2005; and

c) Much higher set-asides (i.e. areas not to be developed).

* "The time averaged carbon stock in an oil palm plantation appears to be in the order of 35 tonnes carbon/ha, calculated over... 25-30 years... by various authors using different approaches..." (source: Greenhouse Gas Emissions from Palm Oil Production, Literature review and proposals from the RSPO Working Group on Greenhouse Gases, Final report, 9 October 2009)

Growers go for it?

RSPO's new P&C was voted on and ratified on 25 April 2013 in an Extraordinary General Assembly. 222 members from all stakeholder sectors voted on the new P&Cs. Significantly, the new standards were voted in entirety, and not on a key item-by-item basis. There were 3 spoilt votes and only 6 voted against. On the submissible votes, the votes were 97% in support. Thus, oil palm growers (who are 15% of RSPO members) appear to have come out surprisingly and selflessly in support of future restrictive measures.

Indonesia's Moratorium on Deforestation

"The Indonesian Palm Oil Association (Gapki) has opposed the government's plan to prolong a two-year forest moratorium, slated to end (on 20 May)…. Presidential Instruction No. 10/2011, had set a two-year moratorium to halt the commercial use of a total 65.2 million hectares of primary forests and peat land in an attempt to curtail deforestation and reduce greenhouse gases. The moratorium… resulted from an Indonesia–Norway bilateral agreement with a US$1 billion potential carbon transaction. Forestry Minister Zulkifli Hasan has declared the moratorium a success, saying that the move has slowed the country's deforestation rate to 450 hectares per year during 2010-2011 from 3.5 million hectares per year in the period of 1999-2002."
(24 April 2013, Jakartapost.com)

Detecting deforestation

What will a carbon stocks policy require? Careful monitoring. All the pieces are falling in place for the global monitoring of deforestation, with the year-end launch of a platform promising near-real time satellite data combined with submitted from-the-ground data. Global Forest Watch 2.0 is an initiative of NGO World Resources Institute, Google, University of Maryland and the UN Environment Program.

NGOs started using satellite imagery to good effect, to identify open burning incidents in plantation concessions, notably in Sumatra, Indonesia. Plantations attributed it to third-party burning on their land (not their doing nor by their contractors) and pledged to try to better police the situation. Burning in peat lands has been a key source of the annual haze in Southeast Asia. Various academic studies of satellite imagery have also shed light on deforestation rates in the region, including peat swamp forest deforestation. It has highlighted interesting regional trends, including those in Sarawak and Kalimantan.

Satellite imagery studies for high carbon stocks has also been done by Golden-Agri Resources with the aid of sourcing facilitator The Forest Trust (TFT) and a key NGO, Greenpeace. Importantly, this included the ground-truthing of carbon stocks measures of canopies viewed from satellites. In a nasty surprise for the palm oil industry, it found pretty high carbon stocks in what has been loosely called "degraded areas." Bottom-line: even large areas of degraded scrub lands should not be planted.

Also notable in recent international research and in product marketing is reference to "deforestation-free commodities." Thus, deforestation detection will be negative for oil palm expansion by plantations in higher carbon stock areas. The logical move would be for NGOs to make good use of such information in their campaigns to influence global buyers.

Malaysia producers push for biodiesel to prop-up prices

Palm oil has been trading at an unusually large discount to competitor oils in recent months. The industry also endured the shock of record large end-2012 stocks figure in Malaysia. Together with concerns of large supplies in 2013 and lackadaisical demand, it is no surprise that some Malaysia palm oil producers are again talking of burning palm oil to raise domestic usage of palm oil. This would reduce stocks and it might be price supportive. However, since the launch of Malaysia's National Biofuel Policy in 2006, the lack of will and high cost to implement a subsidised mandate, has resulted in an overhang of unused biodiesel licenses, shuttered plants and shelved projects. Malaysian biodiesel players have struggled with increasingly high feedstock prices and poor export market prospects, while Indonesia gained market share on the back of a more advantageous export duty structure.

As recently as late 2012, three biodiesel facilities were operational at sub-optimal capacities. However, palm oil biodiesel has offered positive margins recently. With palm oil price slumping to the floor of Brent Crude price, biodiesel makes real commercial sense. Thestar.com reports on 2 April 2013 that "according to sources, the plants of five biodiesel players, namely Carotino, Sime Darby, Kuala Lumpur Kepong, Platinum Biofuels and AM Biofuel, have already been running at full capacity over the past two months." Our sources reckon that Indonesia exporters may be benefiting most from the US $1 per gallon tax credit reinstated in Jan 2013. In the meantime, the EU mulls retroactive implementation of antidumping duties.

GLCs to lead Malaysia to B10?

In a surprise and bold move, Sime Darby and Felda Global, the two large Malaysia plantations giants (they are government-linked corporations) announced a new venture at the end of March 2013. They are going to lead Biodiesel Malaysia Sdn Bhd which was originally set up by the Malaysia Palm Oil Board, a unit of the Ministry of Agriculture. It hopes to be operational by 3Q2013, using Sime Darby's biodiesel plant on Carey Island in Selangor, leasing facilities from non-operational units or via toll processing with others.

The shareholding structure and consortium member has yet to be finalised. The latest news is that Felda Global will take 32% and Sime Darby 23%. The Malaysia Government wants other major plantations, petroleum companies and biodiesel producers take part in the remaining 45% stake in Biodiesel Malaysia. The market awaits news of who will join in.

The plan

In its 17 April 2013 report, UOB Kay Hian reports on details of the Sime Darby-Felda Global proposal. First, they envisage easier implementation by focussing on take-up by non-subsidised commercial vehicles and the fishing boat fleet, while B5 will remain for passenger cars. For the latter, the big stumbling block is no warranty by car makers for B10 usage (Japanese cars warranty B5 and European cars cover up to B7). Furthermore, the size of the subsidy that may be needed for a full roll-out of B10 into subsidised diesel is a burning question.

Secondly, Biodiesel Malaysia plans for a realistic volume. UOBKayhian notes: "Based on the above usage of B5 and B10, an estimated 650,000-700,000 tonnes (about 30% of inventory level in Mar 13) of palm biodiesel are required to meet the target, vs. the earlier projected 1 million MT. Despite the lower volume, this is enough to reduce Malaysian's palm oil inventory.. to 1.5-1.6 million MT, a one-month supply."

Finally, the timeline for implementation and the subsidy structure looks more reasonable. "The B5 programme has been implemented in central Peninsular Malaysia with an estimated usage of 110,000 tonnes of CPO. The same blending facilitates will be used for B10 blending in the central region and the roll-out into the southern, northern and eastern regions will be implemented in stages starting from Jul 13, Oct 13 and Jan 14 respectively," UOBKayhian reports. There will also be capex of Ringgit 300 (USD 97) million for new blending stations (Ringgit 6-10 million per blending station). Ringgit 80 (USD 26) million of capex and subsidies has been spent so far (12 February 2013, thestar.com).

The impact is likely to be felt only from late-4Q2013 onwards when the biodiesel blend is fully implemented in Peninsular Malaysia. However, to sustain this, the government needs to offer subsidies to users and producers. Can Malaysia, with its increasingly limited fiscal flexibility, do this?

We think….

Recently, the differential between diesel and biodiesel is wide enough to make it financially viable. How long will this situation persist? Some point out that biodiesel ventures by plantation companies tend to sour when prices exceed Ringgit 2,500 per MT. Biodiesel is a volatile business, hence the call for subsidies. Do analysts worry that subsidy costs may prove prohibitive? Some who are positive on Biodiesel Malaysia admit that they have not calculated the subsidy. They hope that the subsidy cost may be recovered via higher export tax and potential windfall profit tax on the plantation sector. Furthermore, most agree that the risk of the reversal of biodiesel policies is significant globally.

Natural resistance from petroleum companies should not be discounted. In the US, the Environmental Protection Agency could soon require oil companies to replace E-10 with E-15. On 2 April 2013, industry experts said on National Public Radio:

- "Oil companies say they're absolutely not going to put E-15 into the marketplace, and if they're forced, they'll take their product elsewhere."
- Renewable Fuels Association president, Bob Dinneen, says (about petrol company resistance) "This is about market share. This is about their profitability. It's not any more complicated than that."
- "Even though the EPA says E-15 is safe for any car built after 2001, car companies insist it's not."

Key vegetable oils

USDA: Larger than expected soybean stocks, prices ease

USDA reported on 12 April 2013 that "global soybean production for 2012/13 is estimated 1.6 million MT higher this month to 269.6 million due to better crop outlooks for Paraguay and Uruguay." Also, it says that "China's cumulative imports (October-March) of soybeans lag last year's trade by 2.6 million MT primarily because of a sharp decline in South American trade (with) shipping delays from the region… China has begun selling more of its reserve stocks.

For China, USDA reports: "To some extent, the tighter availability for soybeans in China this year is being offset by imports of rapeseed, rapeseed oil, and palm oil. A supply source for rapeseed was opened up again by the recent approval of imports from Australia. Since 2009, China had banned rapeseed imports from Australia over concerns of spreading a fungal disease (blackleg). Like an earlier agreement with Canada, China will allow Australian imports for crushing plants in regions where rapeseed is not grown."

Palm oil imports by India "in 2012/13 are forecast 500,000 MT higher this month to 8.5 million MT (compared to 7.5 million for 2011/12) based on impressive gains to date. For October 2012-February 2013, cumulative Indian palm oil imports were up 27 percent from a year earlier. The import growth stems from an expected 13.5-percent increase in Indian palm oil consumption (to 8.4 million MT). In contrast, imports of competing oils… have declined moderately compared to a year ago."

Weather outlook

ENSO neutral, wetter than average in Indon

The Australia Bureau of Meteorology reports on 23 April 2013 that "The tropical Pacific has remained in a neutral El Niño-Southern Oscillation (ENSO) state since mid 2012. Currently, all atmospheric and oceanic indicators of ENSO remain within their neutral range. All climate models surveyed by the Bureau of Meteorology favour ENSO-neutral conditions (neither El Niño nor La Niña) persisting through the southern hemisphere winter (past mid-year)."

Forecasts for rain by BMKG, the Indonesian Metereology Agency, for the month of May 2013, point to well below average rain in Aceh, and 116-150% above average rain in parts of North, West and South Sumatra, as well as Jambi. Likewise in isolated parts of East and South Kalimantan, as well as in Papua. For June 2013, BMKG forecasts rainfall 116-150% of average for most parts of the key growing oil palm areas while the northern tip of Sumatra and much of Sulawesi remain rather dry.

CPO technical view

Short & long term bears?

Technical's point to a mid-term neutral with short and long term bear situation for Malaysia palm oil, according to price chart pattern analysis by 4-Traders.com. However, in the longer term, the expected range is Ringgit 2,080 to Ringgit 2,542 (USD 670-820) per MT. The failure to break resistance of Ringgit 2,600 (USD 838) by end April, may worry Benny Lee of Jupiter Securities who had in February opined that this might result in 2013 prices ranging Ringgit 2,200-2,600 (USD 709-838).

Malaysia stockpiles (the only readily available key reference) have fallen from the shock, record 2.63 million MT hit in December 2012. Prices perked up but they have drifted down again. TheStar.com quotes traders saying "lacklustre demand from China and India in the short term means top producers Malaysia and Indonesia may have to pin their hopes on buyers restocking ahead of Ramadan (starting in July)". Furthermore, the latest news points to speculation that Malaysian shipments may drop after Indonesia just trimmed its export taxes.

Chart: Prices & CPO price expectations

Our 5-year price chart for palm oil watchers (with key indicative prices for NW Europe), shows crude palm oil continuing to trade at a large discount to soybean and rapeseed oils; and near or at Brent crude (the so-called "floor price") for close to five months. Looking ahead, we mark out price outlooks from the key prognosticators: Dorab Mistry of Godrej, an Indian conglomerate, and Dr James Fry of LMC International, a key commodity consultant based in Oxford, England. For mid-2013, Mistry and Fry predict Ringgit 2,550 and Ringgit 2,625 per MT, respectively; thereafter Mistry has a bearish view, with post-August (Bursa Malaysia Derivatives first-position futures) prices falling below Ringgit 2,000 per MT. Khor Reports' CPO Price Expectations Survey in late February found the average at Ringgit 2,580 or about USD 832 per MT. It is noteworthy that some equity analysts have also adjusted down prices too.

Methodology: Our survey asks "What CPO price (and/or range) do you base your expectations on for 2013?" Our next survey will be at end August 2013, prior to the next round of key palm oil conferences.