

Khor reports' Palm Oil

South Asia's need

11 million tonne predominance of imported palm oil

Feature: South Asia competition, tariff impacts & local India palm oil. Non-dairy ice cream.

Wilmar-Unilever supply-chain jolt, biodiesel stuttering start

Sustainability: TFT-Greenpeace principles lead

Science: remote-sensing & extreme transparency

Spreads narrow, PO exports to dip & demand shift?

Khor Reports' Palm Oil

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Founder & editor: Yu Leng, Khor Associates & contributors: R Wong.

Enquiries

Email: khorreports@gmail.com
Telephone: +6593830428

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1 Claymore Drive #08-14
Singapore 229594

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We also focus on supply-chains, sustainability and reputational risks.

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Forex rates used in this issue: 1 USD = 3.29 RM, 1 USD = 12,170 IDR, 1 USD = 62.17 INR, 1 USD = 1.27 SGD, 1 GBP = 1.642 USD, 1 EUR = 1.360 USD

New challenge for the supply chain

Wilmar, the largest trader of palm oil in the world, has come out to change its supply chain promise, signing a deal to secure its position supplying to Unilever. The Anglo-Dutch consumer goods behemoth, ranked #2 in the world after Nestle, had weeks earlier promised to accelerate its sustainability push. Unilever has taken a lead in promoting the principle of sustainability in its materials sourcing via a top role at the RSPO from its inception nearly 10 years ago. Unilever has a "Sustainable Living Plan" strategy and it is active in the sustainable sourcing of over 12 agri-products. Wilmar has faced NGO grumblings for not practicing sustainable sourcing for its third-party purchases (which is several times bigger than its own internal production). With its new promise, the giant trader is challenged to rationalize and simplify its supply chain; to achieve this without downsizing its business. In general, traceability with high level promises is tougher for large traders with complex supply chains. Industry talk in recent weeks has centered on top producers being asked to sign on to a new RSPO++ manifesto (characterized by multiple additional criteria), building on TFT-Greenpeace principles (they have become de facto new leaders of palm oil sustainability, seizing power from the WWF-driven RSPO). If the key palm oil producers accede, it could be business-as-usual for Wilmar but its cost structure may shift. Its promises can be fulfilled by tough action by its trade partners. Thus, we await information from other industry players on the manner of their support of Wilmar-Unilever. In the meantime, several brands including Kellogg, have stepped up their procurement requirements for sustainability and traceability.

Questions of impact abound. Could this bring on faster unit cost convergence for large-scale corporate SE Asia palm oil vs Brazil soybean oil? For the industry at large, policy makers should be concerned with: a) how a traceable, no-peat, no deforestation, GHG-reducing palm oil supply chain will look like; b) who will be the winners and the losers; and c) how the transition will be effected, and with what effort to mitigate the impact on the losers. Politics may even be a factor given the size of the smallholder sector, rural development programs and promises. How will the new TFT-Greenpeace-driven principles be operationalized? Khor Report thinks that each palm oil mill will need to be supply-chain risk categorized. Could this segment different production zones with discounting factors? Will a November 1995 baseline apply and will high carbon stock measurement become essential? In this regard, the Golden Agri/Sinar Mas pilot done by TFT-Greenpeace is important. What requirements will Africa face even as it remains a net importer for years and has great hopes for rural development?

Various tropical and other commodities face pressures from an ascendant and increasingly well-funded international green movement. The key to its penetration is in promoting new global voluntary standards that have strong staying power. In taking on technical consulting roles NGOs can become self-funding and perpetuating in these sectors. In relative terms, the corporate sector has been scrabbling for footing amidst this structural change, while the independent and smallholder sectors are adrift with little voice. The largest plantation companies (especially those with European assets and market exposure) have been moving ahead. The swing from WWF to TFT-Greenpeace leadership in sustainability is happening just as developed markets think twice about biofuels policies and bumper oilseed crops are anticipated. The falling price ceiling of vegetable oil substitutes is crushing the palm oil price discount differential while big growers (i) face a new cost component at newly acquired estates via the RSPO compensation procedure (in "staged implementation" with a launch target of Nov 2014) and (ii) plan how to step up to the TFT-Wilmar policies. This new cost and opportunity cost intensive phase of the sustainability push proves its strategic importance on the entire palm oil supply-chain, if ever there were any doubt.



Yu Leng, Khor; 5 Jan 2014 (updated)

PS: This e-newsletter will be on a temporary break; please do read our [Blog](#) in the meantime.

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Indonesia

A tepid tender

Indonesia's biodiesel program is getting off to a slow start. Palm oil biodiesel players do not seem to like the "below gas oil benchmark" and the depot-delivered price offered. Below benchmark pricing means that palm oil prices may end up being higher than the selling price of biodiesel and sellers pay (often high) transport costs to the depots (interviews, Nov 2013). Thus, "Pertamina (the national oil company) received bids representing only 18% of the biodiesel tender target of 6.6 million kiloliters (for two years supply)." Most producers were unable to bid competitively, with the "price below MOPS (Mean of Platts Singapore) – or MOPS minus alpha – although data over the past four years revealed that biodiesel price has mostly traded above MOPS... (Thus, DBS says) expect the participation rate to remain low for the next biodiesel tender" (Kontan & DBS Research, 2 Jan 2014). Depending on spreads of palm with gas oil prices, exports may prove more attractive.

Dorab Mistry said that Indonesia's move to increase blending (alongside Malaysia and Brazil; while the USA and the EU balks) will be a "game changer" for palm oil demand. Indonesia upped its biodiesel blend in subsidized fuel from 7.5 to 10% in September 2013 and expanded its 2014 mandate to non-subsidized fuel and industrial users. Biodiesel capacity may jump to 8.8 (by end-2015) from 5.6 million kiloliters (in 2013; Biofuel Producers Association). Mistry says "domestic mandates for biodiesel in Indonesia and Malaysia will work as long as palm prices remain competitive with Brent crude... Between July and October, the spread between palm and gas oil was enough to create an additional monthly biodiesel demand of 100,000 to 150,000 tonnes." About 6.34 million tonnes of palm oil may be processed into fuel in 2013 (Oil World; Bloomberg.com, 14 Nov 2013).

While Indonesia's expanding biodiesel program offers new demand for its rising production, the road is not smooth with an unfavourable price formula. We reiterate our concern that

key producer economies may lack the fiscal room to sufficiently subsidize biofuels, while political will vacillates.

EU biofuels update: Its governments failed to agree on the level of biodiesel usage. In September 2013, the European Parliament voted for a 6% cap on biodiesel to prevent an EU requirement that at least 10% renewables in transportation energy in 2020. (Bloomberg cited in AmResearch, 16 Dec 2013). Also, "EU policy makers rejected plans to push biofuel suppliers to report increased greenhouse-gas emissions" so there is now an "indefinite delay on ILUC (indirect landuse change)" (Bloomberg.com, 12 Dec 2013).

Malaysia

Seeking workers

Bangladesh migrant workers are now available to key Malaysia sectors (including plantations) on a government-to-government or G2G arrangement basis. The employment of Bangladesh workers in Malaysian plantations is not new. It is thought that the very first batch was recruited in the early 1990s by IOI Corp. Application submission have been made by many companies. The G2G method bypasses the current private broker network for migrant workers, hopefully eliminating the so-called unfair broker fees paid by the migrant workers (a worry to anti-"forced labour" campaigners). However, hirers note that the G2G method isn't exactly a cheap process. Bangladesh is a possible diversification from the Indonesia worker base, which Malaysia has become startlingly reliant upon.

Plantations have put in the numbers sought; for now the larger ones seem to apply for 300-500 workers. Some have got the first 40-50 or so workers approved, and early submitters may have some 300 approved each. Questions include: (i) whether the levy goes to the Ministry of Primary Industries and Commodities (ii) whether the G2G arrangement can be extended to Sabah (now only for the Peninsula), (iii) how to accelerate and streamline the approval process, including allowing two or more simultaneous applications (interviews with 6 companies, Dec 2013).

Health

US transfats demise

Palm oil sits about mid-point in fatty acid composition; it is semi-solid or half solid and half liquid and 1 in 6 food products uses it. Food labelling is on the rise while health issues re-emerge, after being laid to rest in the 1990s. Saturated fat is a worry, but large medical studies find no / no significant association fat with heart diseases (Siri-Tarino et al 2010, Mozaffarian et al 2010). Previously, studies found that palm oil / olein reduces or does not raise cholesterol (Wood et al 1993, Choudhury et al 1995). Health and sustainability may be combined in campaigning; with notable negative effect in the Francophone world.

Hydrogenation takes a liquid oil, including soybean, to make it solid, creating transfats in the process. Post-World War Two, Unilever and others put this in margarine. In the 1980s, food industries reformulated to avoid palm oil and key developed markets were affected by transfats. Mensink & Katan (New England Journal of Medicine, 1990) showed that margarines were not healthy as transfats increase the risk of heart disease. Harvard Medical School work also challenged hydrogenated oils in the 1990s and the US Food and Drug Administration (FDA) concurred. Manufacturers reformulated to reduce transfats. The FDA sought evidence for the promotion of palm oil on non-transfats grounds. Studies have shown that it is safer to eat saturated fats than transfats (Sundram 2001 and others). US palm oil use rose to exceed 1.2 million tonnes. The only reliable substitute was (still is) palm oil.

In November 2013, challenged by a legal suit the US FDA removed its "generally regarded as safe" / GRAS status for transfats. In a single serving food manufacturers were allowed 0.49 grams of transfats (serving sizes were cut to comply). Transfats is now regarded as an additive and not a food ingredient. Palm oil demand can rise modestly. Most switching has already been done with 15% hydrogenated product left in edible soy oil use (Reuters, 8 Nov 2013). When will others move on transfats?

Remote sensing

New transparency

The use of remote-sensing technologies in the industry are in its early stages while some NGOs are among its advanced users. Aerial sensor technologies use images from satellites and drones, to detect and classify objects on the surface; saving the need to be on the ground. Given the importance of its applications, expanding availability of cost-effective data sets, equipment and services, it is set to grow. We look at three usages: one informs biofuels policy and two that may have significant future impact.

1. Setting biofuels policy

To help set biofuels policy, the International Council on Clean Transportation or ICCT needed to know and project how much oil palm is developed on peat. Satellite images were used to estimate the area of expansion 1990-2010: Data sets used include 1990 GeoCover with 28.5 m spatial resolution, 2007 Satellite Pour l'Observation de la Terre (SPOT) satellite images with high spatial resolution (10–20 m)¹. Spatial resolution refers to how close two features can be within an image and still be recorded as distinct.

Four maps presenting the extent and distribution of industrial oil palm plantations on peatland in 1990, 2000, 2007, and 2010 in Peninsular Malaysia, Sumatra, and Borneo were produced from the high resolution data sets with visual interpretation. The reported producer's and user's accuracies of 96% to 97%, suggest "high reliability" of the maps produced by this approach. For 2007 through 2010, the area on peat increased 190,000 ha/year and "taking Indonesia and Malaysia together, the linear projections imply a 32% rate of palm expansion onto peat soils." This is

¹ "Historical Analysis and Projection of Oil Palm Plantation Expansion on Peatland in Southeast Asia" by J Miettinen et al. White Paper Number 17 | February 2012. Indirect Effects of Biofuel Production. www.theicct.org.

a key data point for biofuels policies in various developed markets. It is contested by the palm oil industry which: i) argues against the use of a simple projection from past to future, ii) points to the need for updated peatland area maps, iii) laments the poor scientific basis for voluntary policies against shallow peatland use, and the general lack of tropical peat studies. Why is less than 50 cm peat not considered by some voluntary standards? This is the depth set by the US Department of Agriculture to classify organic soils versus peat soils [1].

2. Upstream planning & management

Satellite images are often used in due diligence studies on acquisitions. Plantations can also use satellite or drone-acquired images for topographic mapping, to help in planning for drainage, planting terraces, and planting patterns on slopes. RSPO also asks companies to produce accurate maps to identify areas with slope over 25 degrees and 300 m above sea level. Interestingly, there is work to establish spectrum responses for early detection of chlorophyll and moisture stress for better management. Can a narrow band even pick up on certain diseases? Previously, 4-5 bands were available and now 300 bands of specific wavelengths can detect variations [1].

3. NGOs bring "radical transparency"

Technical NGOs are actively using imagery from satellites to monitor plantation activity. The WWF has also started to use drones in conservation projects. External monitoring of peat smog fire hot spots were speedily done with accuracy in the 2013 record-breaking Sumatran peat smog season. Back in n 1997 hot spots could be 1km out and a hot zinc roof might also be mistaken for a fire [1]. Now, high resolutions including 2.5 meter resolution can pinpoint with confidence.

World Resources Institute (WRI) has its Global Forest Watch (GFW) initiative that is seeking palm oil supply chain clients. "(Using) near real-time satellite monitoring technology, forest management, and company concession maps, protected areas maps, mobile technology, crowd-sourced data, and

on-the-ground networks to promote transparency in forests around the world (15 Nov 2013, csrwire.com). Similarly, The Forest Trust (TFT) plans "To bring more transparency to a complicated forestry supply chain... (it) developed a monitoring tool that allows companies to convey real-time radical transparency in supply chains." TFT's tool is piloted for Asia Pulp and Paper (APP), with a dashboard that "allows the company to display detailed data going beyond compliance and displaying implementation of sustainability commitments (on 2.6 million hectares)." "In February 2013, after working closely with leading NGOs, APP launched a new Forest Conservation Policy... with a range of stakeholders" (15 Nov 2013, csrwire.com). As TFT also leads Wilmar, the above appears possible for Wilmar's new policies and approach for palm oil.

Separately, we hear from NGO specialists they NGOs are ready to report on plantation impacts (Khor Reports interview, Nov 2013). This could mean that there will soon be contested reports in this vein: Plantation A has cleared an estimated X hectares and Y tonnes of high carbon stock since a cut of date, e.g. Nov 2005; with a breakdown by estimated non-peat and peat land area, HCV vs non-HCV etc. NGOs lacked accurate concession boundaries data. However, at the recent RSPO General Assembly, a resolution for growers to submit soft copies of their geovector boundaries was passed. These may be posted on the RSPO website for public access and use. While new corporate-ready technical NGOs such as TFT and WRI seek to provide radical transparency solutions for plantations, there will be others who may use the same data and approach for campaigning purposes. There are many possible users and usages, once technology costs have fallen as they have, and the necessary crucial private data is released. Eyes wide open!

[1] Khor Reports interview with Applied Agricultural Resources Sdn Bhd, 10 Dec 2013, We talked about various technical updates, so look out for our future articles: carbon measurements, pests & diseases, genome prospects, and the politics of peat science.

Supply-chain

Wilmar's strong pledges

On 5 Dec 2013, Wilmar introduced its 'No Deforestation, No Peat, No Exploitation' policy. This adds on many new criteria to the RSPO standard. Noteworthy additions include: (i) the non-use of peat of any depth; (ii) apparent agreement to the controversial 35 tonnes carbon per hectare ceiling (implied by the statement: "HCS will be protected. (Only) Young Scrub and Cleared/Open Land areas may be developed"); (iii) progressive greenhouse gas reductions (likely to affect palm oil waste management and the cultivation of existing peatlands); (iv) the restoration and enrichment of forest and peatlands (at what cost and on whose determination?); and on labour, Wilmar pledges on (v) no forced labour, (vi) a 60-hour work week with 1 day off (i.e. average maximum 10 hour work day inclusive of overtime), (vii) 3.8 square meters / 32 square feet of individual living space, and (viii) trade unions with collective bargaining.

These broad and strong new socio-environmental commitments will apply immediately to Wilmar's own plantations (it has adhered to the RSPO standard, but it now needs to add numerous new criteria). Wilmar will also apply this to other companies who supply the palm oil, sugar, soy and other commodities that it trades. Thus, this pledge should have big impact, especially on palm oil where it is frequently said to control around half the world trade. Here, Wilmar can use the power of its position as key trader.

Such a move by a dominant company has long been the strategic goal of NGOs pushing for strong palm oil sustainability. WWF targets 15 commodities with its "roundtables" voluntary standards program which targets the "big brands" to effect more rapid change². Csrwire.com (15 Nov 2013) explains that "corporations can

leverage their supply chain power to achieve systemic solutions to social and environmental challenges." Power or size is a curious thing: big can be a strength as well as a risk.

Wilmar's policy was launched just after its deal with Unilever, the #2 FMCG giant. Unilever also recently upgraded its own target to only use traceable palm oil by end 2014; together with a plan collapse its supplier roster from over 100 to under 20. Multinationals are under pressure to use "ethical" ingredients. NGO commentators note that "the commercial benefits to Wilmar of appearing to be an environmental leader are clear." At the same time, they are watchful of how Wilmar will implement its policy.

"RSPO+9", new TFT / Climate Advisers-led policies for Wilmar include:

(i) non-use of peat land of any depth; (ii) likely 35 tonnes carbon per hectare ceiling for land development; (iii) progressive GHG reductions; (iv) restoration and enrichment of forest and peatlands (similar to RSPO HCV compensation?); (v) no forced labour, (vi) 60-hour work week with 1 day off inclusive of overtime, (vii) 3.8 square meters / 32 square feet of individual living space, (viii) trade unions and collective bargaining; (ix) grievance procedure where advisers and stakeholders have a say in banning suppliers

Note: Summarised from Wilmar's "No Deforestation, No Peat, No Exploitation Policy,"

Wilmar's existing suppliers have until the end of 2015 to comply. Wilmar plans to semi-outsource key parts of its supplier management, notably: "Wilmar will cease to do business with any suppliers who our independent advisors (TFT and Climate Advisers) or other stakeholders find are in serious violation of this policy, and who do not take immediate remedial action to correct those violations." It promises that a banned list of suppliers will be created.

NGOs seem interested to see how Wilmar's new policy will affect the Ganda Group, a palm oil company closely connected to Wilmar (reports by Friends of the Earth, 2007 and Greenpeace, 22 Oct 2013). Awasmiffee.potager.org (11 Dec 2013) writes that "Wilmar has a special relationship with Ganda Group, which is owned by Ganda Sitorus, the younger

brother of Wilmar founder Martua Sitorus. In recent years the Ganda Group has taken over plantations which do not meet Wilmar's previous ethical commitments to the RSPO and IFC... (e.g. Wilmar) sold its subsidiary PT Asiatic Persada to the Ganda Group."

It appears that Wilmar is in the curious position of pushing rather strongly with pledges that may prove challenging to implement. Judging from the tone of NGO reactions, their scrutiny of Wilmar's moves could remain pretty tight. Can it hit its KPIs and timelines? Will enough NGOs regard Wilmar's move as satisfactory or will some NGOs see opportunity to bargain for more? Such shifts can attract more change-makers seeking tipping points across several tropical and other commodities.

Along with TFT and Climate Advisers, Greenpeace now sits atop palm oil sustainability (by virtue of its groundbreaking move with TFT at Golden Agri/Sinar Mas on the new high carbon stock criteria). Greenpeace views the move as "Wilmar (caving) to public pressure." it promises that it "will be closely monitoring how Wilmar will put these words into action..." and asks "will it now immediately stop buying from companies such as the Ganda Group" (5 Dec 2013). Rainforest Action Network calls this "only the beginning" (ran.org, 5 Dec 2013).

How will other dominant players react (see page 2)? While it looks like they may need to rely on the same imaginative independent advisers (TFT and Climate Advisers lead Wilmar), it is possible that at the industry level there is need to hedge risk via some "home grown" national, regional or multilateral programs. If there is perceived or actual weakness in negotiation strategies and tactics - industry and companies can become "soft targets" for pressure groups. Indeed, some professionals worry that marketing is making the call rather than science. If so, we would not be surprised to see stringent interpretation and implementation of Wilmar's pledges and/or even more criteria added in years to come. But only time will tell.

² Jason Clay explains WWF's 15 commodity-big brands strategy in this video:

http://www.ted.com/talks/jason_clay_how_big_brands_can_save_biodiversity.html

South Asia

A core net-importer reliant on palm oil.
Price sensitivity drives market share shifts.
India's local palm oil program.

Demand in South Asia is driven by growing young populations, urbanization and middle-class expansion. A widening gap between domestic demand and supply of edible oils necessitates rising imports. Palm oil dominates imports, meeting the needs of a price-conscious region. We review here the key markets of India, Pakistan and Bangladesh which now import over 11 million tonnes of palm oil each year.

India to be a top 5 consumer market

Economictimes.com describes India's demand for palm oil in India as "fantastic... (India is a) palm oil or its refined version – palm olein-dependent nation" (6 May 2010). "Indians love their food when it is deep fried in oil, be it their favorite samosa (cover picture of this newsletter), vada, jalebi or gulabjamun. But the source of this oil is seldom known. Probability is more than half that these are being fried in imported oils (which) has contributed to widening the current account deficit" (17 Jan 2013). 43% of current Indian population consume palm oil in their home (Basu, British Medical Journal/BMJ 2013). "India has emerged as one of the largest importers of vegetable oils in recent times. The country imports about 60 percent of its vegetable oil needs of

18 million tonnes. Palm oil makes up nearly 80 percent of that. In 2011-12 the country imported in excess of 10 million tonnes of vegetable oil... This has left policy makers concerned" the Malaysia Palm Oil Council (MPOC) notes (MPOC Fortune, Mar 2013). As per capita consumption should rise, more demand is expected. Increase in disposable incomes will likely drive total demand to 20.6-22.0

Oils & fats with palm oil (PO) indicators, 2012
India: pop'n 1,258 million; consumption of oils & fats 18.9 mill tonnes (47:53 domestic vs imports); 15 kg/head; imports 10.4 mill tonnes with PO 7.8 mill tonnes (75%); Indonesia PO mkt share 68%.
Pakistan: pop'n 180 million; consumption of oils & fats 3.9 million tonnes (44:56 domestic vs imports); 21.6 kg/head; imports 2.2 mill with PO 2.0 mill tonnes (91%); Indonesia PO 35% mkt share.
Bangladesh: pop'n 152 million; consumption of oils & fats 1.8 mill tonnes (14:86 domestic vs imports); 11.5kg/head; imports 1.4 mill with PO 1.0 million tonnes (71%); Indonesia PO 75% mkt share.
Total for 3 countries: pop'n 1,590 million; PO imports 10.8 million tonnes
<small>Data: Oil World projections</small>

million tonnes by 2016, if per capita usage rises to 15.5-16.5kg. New Delhi tries to encourage domestic oilseed production, partly by guaranteeing minimum prices to farmers, but has had limited success. Output of oilseeds has not kept pace so import dependence has increased from 3% to 50% over 20 years (MPOC Fortune, Mar 2013). The middle-income group is expected to grow from 50 to to 583 million (2011 to 2025). Of the income spent on food items, 7% was on oils and fats. India's consumer market, currently ranked 12th, is expected to rise to top 5 by 2025 alongside the United States, Japan, China and the UK. (MPOC Fortune, Oct 2012).

Palm oil is the most consumed oil in India, with a share of 37%, up from just 9% (1995-2011); increasing from 700,000 tonnes to almost 7 million tonnes. Despite its market dominance, palm oil is still consumed as a commodity and marketed mostly in loose form. The northern regions of India prefer solid fats, either ghee or vanaspati. Palm oil is mostly consumed in the southern region, with a 70% share of total vegetable oils and fats. In other regions, palm oil's share is 30-40% (MPOC Fortune, Nov 2012).

India's largest contract farming program

India palm oil refiners have faced worsening margins and they have pressed for the reinstatement of import duties. "What would be the likely outcome if a scenario of 10% import duty on CPO and 20% import duty on RBD oil were imposed? Based on past experience, this would not any significant impact on the domestic production of oilseeds" (MPOC Fortune, Mar 2013). India has long been concerned about its rising edible oils import bill. Attracted by higher oil yields for palm oil versus its traditional oilseed crops, India has an oil palm contract farming program initiated in 1991-92. The Oil Palm Development Programme (OPDP) identified 800,000 hectares of land might suit its planting in its sub-tropical zone, notably in parts of coastal Andhra Pradesh and in Karnataka (latitude range 12-19 degrees north with a combined 80% of the potential area; MPOC Fortune, Jun 2009). Newer estimates even place it at 2 million hectares (Directorate of Oil Palm Research, cited in economictimes.com 17 Jan 2013).

Economictimes.com (6 May 2010) describes the current business model in some detail. "Surveys showed India could potentially grow oil palms on a million hectares and get 3.5 million tonnes oil - enough to halve annual palm oil imports. Bureaucrats figured it was cheaper to finance farmers for those first four years than shopping abroad. Energy security would be a bonus...States demarcated areas where palm would be encouraged. Each farmer that planted palms got cash subsidy for three years. These areas were then parceled to companies, who got monopoly rights to buy all fruit at a government-fixed price (based on wholesale crude palm oil rates), and process it in their own local mill. In return, they supplied saplings and extension services. If CPO sells for Rs 40 per kilo (USD 889/MT), an Andhra farmer with seven-year-old trees can make Rs 50,000/ha net (USD1,111/ha). That beats profits from sugarcane and tobacco. He needs to worry only if palm oil falls below Rs 35/kg (USD 778/MT)...Companies are equally excited. At the same CPO price, they buy one tonne of palm fruit for Rs 4900 / USD109 (according to the government formula), and spend Rs 1500 / USD 33 on freight and processing. The oil and meal they get is together worth Rs 7500 / USD167. Or 15% gross margin. In edible oils that feel lucky with 2%. That's why more than 30 companies are now nurturing palms on 200,000 ha spread over seven states. It's India's largest contract farming programme" (in early May 2010, USD 1 = Rs. 45).

Economictimes.com (6 May 2010) warned: "Yet the business is flawed. Any model where the government shares cost, fixes location, and allocates profit has to be... When political risk

exceeds market risk, you are better off playing Farmville.” Indeed, thehindu.com just reported on 16 Dec 2013 that the Oil Palm Developers and Processors Association in Andhra Pradesh (OPDPA) is upset at a change in the pricing formula which it says will make processing unviable. OPDPA said, “The government has yielded to the farmers’ lobby and hiked the price by Rs. 609 / USD 9.82 per tonne but failed to factor in the Rs. 440/ USD7 (field) lifting cost borne by processors... the Commissioner for Agriculture Costs & Prices (CACP) has fixed the cost ratio between farmers and processors at 75.25:24.75. The poll driven government is in a hurry to please the farmers but the processors are marginalised.”

India domestic palm oil production

India oil palm total cultivation area: 150,000 hectares; Andhra Pradesh has 70% of domestic oil palm cultivation, on 110,000 hectares

India total production of FFB: 800,000 tonnes per annum (5.3 FFB/hectare by total area; no maturity info) worth Rs. 800 crore (Rs8 billion/ USD129 million)

Ruchi Soya: Merged Mac Oil Palm Limited and Palm Tech India Limited into Ruchi Soya Industries Limited. It is the leading oil palm processor with 0.52 million tonnes annual capacity and land access to over 200,000 hectares of potential oil palm area in Andhra Pradesh, Karnataka, Mizoram, Gujarat, Odisha, Tamil Nadu and Chhattisgarh.

Godrej Agrovet: Largest producer of palm oil. Over the years, it has developed 35,000 hectares of oil palm in Andhra Pradesh, Goa, Karnataka, Gujarat, Tamil Nadu, Orissa, Maharashtra, Chattisgarh and Mizoram.

Source: oil palm area and FFB output reported in thehindu.com, 16 Dec 2013 and extracts from company websites accessed 22 Dec 2013.

Pakistan & Bangladesh: PO serves half of needs

Pakistan and even more so Bangladesh are also in edible oils and fats deficit situations. The latter can only produce about 14% of its needs while Pakistan has a higher per capita consumption rate than India and it is more reliant on palm oil (50% of total needs) and buys more from Malaysia as a top 5 buyer, given the 10-15% margin of preference Malaysia palm oil enjoys via a Jan 2008 FTA. Malaysia-Pakistan joint-venture efforts also helped position palm oil and Malaysia imports with a bulking installation, refinery and liquid cargo terminal at Port Qasim. “Similar to its neighbouring countries, Pakistan is also a price-sensitive market... Indonesian palm oil is mostly sold at a discount to Malaysian palm oil – and this competition will become stiffer with the implementation of the Pakistan-Indonesia preferential trade agreement (1 Sep 2013).” (MPOC Fortune, Dec 2012).

Palm and soybean oils are the top two consumed for India and Bangladesh. Coming next are butter fat and rapeseed oil for India (which has a more diverse range of oils and fats consumed in larger quantities), rapeseed oil is distant third for Bangladesh. Pakistan’s consumption is heavily skewed toward palm oil followed by butter fat and cotton oil. Palm oil leads in Bangladesh with import volume of 1 million tonnes, likely to reach 1.4 million tonnes by 2017. In 2012, the import of refined palm oil and crude palm oil was in the ratio 60:40. The higher import of refined product served Malaysia exporters well (MPOC Fortune, Aug 2012). During the early 2000s, Bangladesh buyers “started to shift their source to Singapore based trading houses who mainly offered Indonesia palm oil with lucrative terms and conditions with competitive pricing” while Malaysia vendors were lacking of an active presence (MPOC Fortune, Jul 2013).

Frozen treats & Magnum

Ice cream is a big business for Unilever. “With almost USD13 billion in sales across brands such as (Magnum), Cornetto, Breyers, Klondike, and Ben & Jerry’s, ice cream is Unilever’s single biggest category, accounting for about 15% of total revenue, according to researcher Euromonitor. London and Rotterdam-based Unilever is also the world’s biggest maker of ice cream, with about 20% of the USD85 billion market, ahead of Vevey, Switzerland-based Nestle... Magnum’s sales, which have doubled since 2006, top EUR 1 billion (USD1.24 billion) worldwide this year, making ice cream a standout in Unilever’s sluggish food unit. Sold in 50 countries, Magnum is Europe’s top ice cream brand” (Bloomberg.com, 5 Aug 2012).

The key markets differ. Parthenon research says that “The USD12 billion US ice cream market is unique because more than half of total sales come from packaged tubs sold in supermarkets and eaten at home... In Europe, more consumption takes place outside the home in single-serve, more-profitable portions... (not surprisingly) major players.. “are increasingly shifting their focus to so-called frozen novelties -- single-serve treats on sticks or in cones... (which) command 21.2% of the US market” How is Magnum positioned in Asian emerging markets? “Magnum costs about three times as much as locally produced ice cream bars, lending it cachet among the emerging middle class, a group projected to increase from 500 million people to more than 3 billion across Asia by 2030” (Bloomberg.com, 5 Aug 2012).

Taste / fat is back!

Mintel: “Taste has come back... that’s where Magnum comes in. Introduced in 1989 and made with Belgian chocolate, Magnum’s flavors include Double Caramel and Mochaccino. A typical Magnum has 240 calories and 16 grams of fat, compared with 100 calories and 1 fat gram in a (Nestle) Skinny Cow fudge bar. Magnum’s success derives from its appeal as a tasty yet affordable treat, as well as its racy marketing... The focus on the diet brands had dragged the market down. Magnum could change this stagnation and boost the emerging premium end of the market, which is not particularly crowded.” Source: Cited in Bloomberg.com, 5 Aug 2012.

In India, the biggest dairy producer is losing ground in the booming frozen treats market. Gujarat Co-Operative Milk Marketing Federation Ltd advertises that real ice cream contains milk, in a campaign seeking to highlight the lack of the ingredient in most of its global rival’s Indian products: cream, or any other dairy fat... “One reason producers have developed recipes without cream is that milk fat is about five times as expensive as fats derived from palm oil and coconut oil... Another advantage is that dairy-based frozen desserts tend to melt faster than those made from plant oils, according to Doug Goff, food scientist at the University of Guelph. That’s important in a country as hot as India.... (its) consumers have decided they’re happy with frozen desserts using cheaper fats such as palm oil. In the five years to 2012, Gujarat Co-operative’s share of the market for frozen treats fell to 31% from 35% while Unilever’s rose to 21% from 17%, according to researcher Euromonitor.... Indians eat an average of 200 milliliters of ice cream each year, versus 14 liters in the US and 2.2 liters in China” (bloomberg.com, 26 Sep 2013). In 2010, world consumption was 2.4 liters/head (data includes both dairy- and non-dairy-fat based products).

outlook & prices

Key vegetable oils

Market in transition

“The structure of the oils & fats market is currently in transition: palm oil supplies are tightening pronouncedly owing to lower stocks and diminishing production growth. The shortage of world palm oil supplies will be magnified by the ambitious Indonesian biodiesel mandate which may contribute to a rare occurrence... the first decline of global palm oil exports since 1997/98 (supplies suffered a severe blow from El Nino)... The market has already started to respond – the competitiveness of palm oil vis-à-vis crude mineral oil deteriorated in recent weeks... (implying) a massive decline of palm oil usage for energy outside the mandates. Given ample oilseeds supplies, seed oils are in a favourable position to offset the temporary disruption,” Oil World (13 Dec 2013).

Dr. James Fry of LMC also notes that price-positive fundamentals for palm is constrained by falling seed oil prices (presentation at PIPOC, Nov 2013). “Soybean oil prices declined to a new low of USD0.3860/pound last Friday. Price discount between CPO and soybean oil is 6% presently or USD51/tonne. There was speculation that rain will boost soybean yields in South America” (AmBank, 6 Jan 2014).

Weather outlook

MY flood risks, then dry

The Australia Bureau of Meteorology reports: “The tropical Pacific has remained neutral with respect to the El Niño-Southern Oscillation (ENSO) since mid-2012. All the main ENSO indicators (and) International climate models... indicate the persistence of this neutral ENSO phase through at least the austral autumn. The Indian Ocean Dipole is currently neutral” (2 Jan 2014).

Jabatan Meteorologi Malaysia (JMM) notes in its “Weather Outlook for January and February 2014” that Malaysia’s northeast monsoon season continues but in January, the rains are expected to begin to subside in the Peninsula area with rainfall in most areas 100-300 mm. Dry weather will be

felt in most parts of the country in February 2014. In Sarawak, heavy rains are forecast for Kuching, Samarahan, Sarikei and Betong with rainfall hitting 700 mm in January with flood risk. In February, rainfall should moderate. Sabah may face rainfall up to 40% above average in January with flood risk, especially in parts of Kudat, West Coast and Sandakan, continuing into February (10 Dec 2013, met.gov.my).

The Indonesian Meteorology Agency (BMKG) reports the rainy season has so far seen 37% of areas with above average rain, 56% average and 6% of areas with below average rainfall (all against 30-year averages). Regions with normal rains for the October through March rainy season are expected to be, “in most of the west coast of the island Sumatra, the island of Borneo to the west and east, west and central regions of Papua” (Sept 2013).

CPO technical view

Neutral then bullish

The technical view by 4-Traders.com points to a neutral short-term outlook with range USD774-826 / RM 2546-2718 and mid and long-term bullish with price range around USD 762-825 / RM2507-2714. Technical analyst, Benny Lee expected price pressure to let up in Jan-Feb 2014, with a price climb toward RM 2,900 (USD 881) by end 2014 (July 2013 at MPOC Pointers).

Chart: Prices & CPO price expectations

Year-end palm oil prices have been stronger, after diminished price expectations entering into the 4Q2013. Production has been below

expectations for various reasons, including two prior years of tree stress, especially in southern Sumatra (Dr. James Fry, PIPOC, Nov 2013). Some Peninsula Malaysia oil palm areas also suffered flooding into end 2013. Palm oil price advanced 8% in 2013, the first annual gain since 2010. Increased demand for food and biofuel faces a drop in Indonesia production. “Prices may advance to RM 3,000 by March as demand climbs, according to Dorab Mistry... Indonesian output will decline by 500,000 tonnes to 27.5 million tonnes (2013), before rebounding to 30.5 million tonnes in 2014 (bloomberg.com, 31 Dec 2013).

“We still think that the firmer CPO price could stay until 1Q2014, though the price upside will be capped by concerns over the rising oilseed supplies” (CIMB, 11 Dec 2013). Some think the biodiesel lift may also be limited, “should Pertamina insist on its pricing formula... a lower-than-expected (Indonesia) biodiesel demand could further pressure CPO prices in the near term; amidst narrowing discount to soybean oil and thin refining margins” (DBS Research, 2 Jan 2014). With the US and the EU recoiling from biofuels plans while 2013 saw production gains, resulting in notable declines in corn (-40% with +30% US production, the worst commodity performer) and about 20% drops in soybean and canola oil prices. Positive for CPO producers is the drop in fertilizer prices (potash prices were expected to drop 25% year-on-year).

Khor Reports’ CPO Price Expectations Survey* found the average at RM 2,298 / USD 725. *Our mini-survey asks “What Malaysia CPO price do you base your expectations on for 2H2013?” Next survey: Feb 2014.

