Management Discussion and Analysis

Overview of the Oil Palm Industry

Key Global Megatrends

Megatrends are transformative global forces that may have profound impact on businesses in the short and longer term. The Group proactively strategises to harness on opportunities and mitigate potential threats that may arise from these drivers of change.

Increased Uncertainties in the Market

The business environment is becoming increasingly complex with economic growth rates becoming less foreseeable. The volatilities in commodity prices and currencies are intertwingly driven by a host of multiple factors including changes in weather patterns, financial speculation, currency exchange rates, stock market dynamics, protectionism by consuming countries in the form of import duties and uncertainties in governmental policies. These volatilities are expected to remain and continue to pose significant risks and challenges to businesses in the forthcoming years. Businesses must be able to adapt and innovate to face this challenging environment while continue to ensure cost efficiency and effectiveness in its operations.

Population Growth and Diminishing Arable Land

The current world population of 7.7 billion is expected to reach 8.5 billion by 2030, 9.7 billion in 2050 and 11.2 billion in 2100 (UN DESA). Significant demographic changes are likely to unfold over the coming years, as well as the challenges and opportunities that they present to achieve sustainable development and food security. The food demand is robust with limited arable land available. Palm oil commands 55% of the global oils and fats exports for consumption. The world needs to rely on biologically high yielding crops like oil palm to address sustainable food security. Palm oil is also renowned for its health and nutritional benefits and its competitive prices vis-à-vis other edible oils and fats. Removing palm oil out of the global food supply equation will not help to address the long term global demand.

Increasing Awareness on Sustainability Aspects

Recognising that agriculture can have repercussion on the environment, best management practices and other proactive initiatives must be implemented to mitigate potential negative impacts on the environment. The palm oil industry, having embraced sustainability must continue to enhance its sustainability scorecard by implementing best practices while strengthening dialogues and managing effective stakeholder engagements. However, sustainability indicators must adopt level playing field consideration and with time-tested scientific evidence which are also reflective of the goals for sustainable development. Sustainability issues must be considered objectively and balanced with recognition of the importance of palm oil in ensuring that supply is adequate in the global food equation.

Reimagining Plantations with Innovative Technologies

Many businesses today are leveraging on innovative technologies. The plantation industry can potentially ‘jump the curve’ embracing applicable technologies within its resource effectiveness. Precision agriculture with geospatial technologies, unmanned aerial vehicles and drones have already found its way into the agriculture landscape while Internet of Things, supported by cloud computing, can possibly be game changers for the agriculture sector. Leveraging on technological advancements in automation, R&D such as in exoskeletons or discerniments on more effective site-specific mechanisation can help in selected operations. However, investments in telecommunication and internet connectivity are prerequisite, especially in rural areas where plantations are mainly located.
GLOBAL OILS & FATS SUPPLY & DEMAND REVIEW

Global production of 17 oils and fats is expected to rise at a slower rate of 2.2% to 234.72m tonnes in Oct/Sep 2019. This is due mainly to the slowdown in production growth of palm oil to 75.4m tonnes (+4.8%) in Oct/Sep 19F due to lower new mature areas coming on stream and high production base in 2018. Indonesia and Malaysia are expected to retain their position as the top two largest producers of palm oil, making up 84% of global palm oil output. India and China are expected to increase palm oil imports in 2019 due to the current attractive pricing of palm oil against other edible oil substitutes.

Overall consumption for oils and fats in 2019 is forecasted at 234.5m tonnes, with palm oil consumption making up 32% of the total consumption. Overall, global edible oil stocks are projected to remain flattish at 31.7m tonnes while global edible oils stock/usage ratio is expected to fall from 14.07% to 13.52% in 2019F due to higher consumption.

<table>
<thead>
<tr>
<th>('000 T)</th>
<th>2014/15</th>
<th>2015/16</th>
<th>2016/17</th>
<th>2017/18</th>
<th>2018/19F</th>
</tr>
</thead>
<tbody>
<tr>
<td>Opening Stock</td>
<td>30,210</td>
<td>32,060</td>
<td>27,060</td>
<td>27,960</td>
<td>31,770</td>
</tr>
<tr>
<td>Production</td>
<td>206,430</td>
<td>204,950</td>
<td>218,950</td>
<td>230,120</td>
<td>234,720</td>
</tr>
<tr>
<td>Import</td>
<td>81,020</td>
<td>81,780</td>
<td>86,290</td>
<td>86,480</td>
<td>92,100</td>
</tr>
<tr>
<td>Export</td>
<td>82,130</td>
<td>81,160</td>
<td>87,170</td>
<td>86,980</td>
<td>92,370</td>
</tr>
<tr>
<td>Consumption</td>
<td>203,470</td>
<td>210,570</td>
<td>217,170</td>
<td>225,810</td>
<td>234,520</td>
</tr>
<tr>
<td>Ending Stock</td>
<td>32,060</td>
<td>27,060</td>
<td>27,960</td>
<td>31,770</td>
<td>31,700</td>
</tr>
<tr>
<td>Stock Usage Ratio</td>
<td>15.76%</td>
<td>12.85%</td>
<td>12.87%</td>
<td>14.07%</td>
<td>13.52%</td>
</tr>
</tbody>
</table>

Ref: MPOC’s 2019F Global Edible Oil Supply and Demand Scenario

After taking into consideration the bearish and bullish factors affecting the CPO prices, industry experts are of the view that the CPO price may have bottomed out.

Factors that support higher CPO price are the implementation of B10 biodiesel mandate by the Malaysian government, lower FFB yields due to ageing estates and lower fertiliser applications in 4Q18, reduction in Indonesia’s palm oil export levy to zero, extension of Indonesia’s B20 biodiesel mandate to the non-public sector on 1 September 2019 and higher palm oil imports by India and China.

However, industry experts have also indicated that the downside for the CPO prices will include rising soybean production from Argentina, higher than expected palm oil stocks due to weaker than expected demand and the current high carryover stocks in the US due to the US-China trade tension. Also, the narrowing spread between palm and crude oil prices could reduce discretionary demand for palm oil.
MANAGEMENT DISCUSSION AND ANALYSIS

PALM OIL COMPETITIVENESS AND SUSTAINABILITY

Domestically, the Malaysian Gross Domestic Product ("GDP") was 4.7% in 2018, lower than the 5.9% achieved in 2017 due to the weakening external demand. The Malaysian Government is expected to be very cautious on its capital expenditure especially on major projects in view of anticipated reduction of Government revenue from the narrower scope of Sales and Service Tax ("SST") which replaced the former Goods and Services Tax ("GST").

The oil palm industry continued to encounter multitude of challenges and uncertainties such as the effects arising from the strategies deployed by both the US and China in their on-going trade wars, the effectiveness of the biodiesel programmes to be rolled out by Indonesia and Malaysia, fluctuations in currencies, price levels of crude oil, weather patterns, changes in government policies and increasing threat of protectionism being factors which will continue to have direct impact on the prices of palm products. One significant change in Malaysia which has increased the operating cost in the plantation industry is the implementation of the minimum wage nationwide of RM1,100 per month effective 1 January 2019. The percentage of wage increase was more significant for growers in Sabah as it was a substantial increase of nearly 20% from the earlier wage of RM920 per month.

On the other hand, global food demand remained robust with limited arable land and therefore the world needs to rely on high yielding crops like oil palms to address sustainable food security. Taking palm oil out of the food chain calculation will not help to address the increasing demand, especially when palm oil also offers competitive prices vis-à-vis other edible oils and fats. Palm oil’s dominance can be expected to increase globally and continue to be an attractive long term choice commodity for both producers and consumers.

Moving forward, the sustainability of the oil palm industry is very dependent on continuous improvements to improve and sustain high productivity, continued availability of skilled workers, adopting best management practices, generating innovations in exploring cost-effective and fitting technologies, raising the floor and ceiling on sustainability-related assurance. However, the debate relating to sustainability and climate change impact must be deliberated more objectively along with appreciation of the importance and competitiveness of palm oil to ensure adequate supply in the food equation for the world now and the future.

KEY FINANCIAL AND OPERATIONAL RISKS AFFECTING THE GROUP PERFORMANCE

<table>
<thead>
<tr>
<th>KEY RISKS IDENTIFIED</th>
<th>MANAGING THE RISKS</th>
</tr>
</thead>
</table>
| Fluctuations in CPO Prices | • CPO is a commodity. As such producers are fundamentally “price takers” and not “price makers”.
| Weather Related ie. El Nino | • The Group continues to take proactive steps to locate additional and suitable sites to serve as supplementary water catchment ponds.
| Shortage of workers | • Additional ponds are also progressively constructed and existing ponds are deepened especially to meet the requirements of the FFB processing mills.
| Volatility in Currency Exchange Rates | • Water canals are also desilted when needed and bunds are constructed for better water retention when the need arises.

Borrowings in the Group are denominated in US Dollar and Japanese Yen. Exchange rate movement against the Ringgit and the Rupiah has been very volatile. The Group monitors closely these movements in addition to having restructured its borrowing facilities.

KEY FINANCIAL AND OPERATIONAL RISKS AFFECTING THE GROUP PERFORMANCE

<table>
<thead>
<tr>
<th>KEY RISKS IDENTIFIED</th>
<th>MANAGING THE RISKS</th>
</tr>
</thead>
</table>
| Fluctuations in CPO Prices | • CPO is a commodity. As such producers are fundamentally “price takers” and not “price makers”.
| Weather Related ie. El Nino | • The Group continues to take proactive steps to locate additional and suitable sites to serve as supplementary water catchment ponds.
| Shortage of workers | • Additional ponds are also progressively constructed and existing ponds are deepened especially to meet the requirements of the FFB processing mills.
| Volatility in Currency Exchange Rates | • Water canals are also desilted when needed and bunds are constructed for better water retention when the need arises.

Borrowings in the Group are denominated in US Dollar and Japanese Yen. Exchange rate movement against the Ringgit and the Rupiah has been very volatile. The Group monitors closely these movements in addition to having restructured its borrowing facilities.