



RICHARD PIERIS AND COMPANY PLC

CSE: RICH.N0000

Bloomberg: RICH SL

SELL

Dec 2017

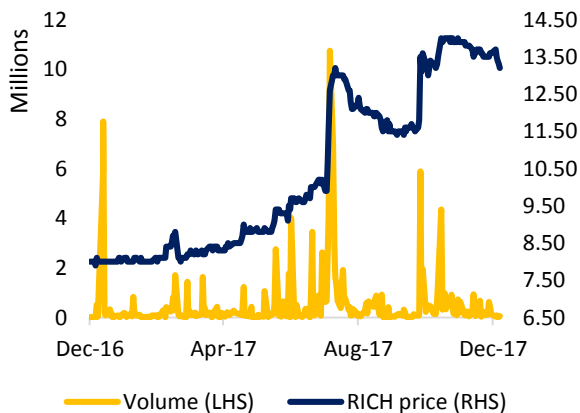
Current Price – LKR 13.50

Fair value [FY19E] – LKR 14.00

2QFY18 Reported Earnings ↑ 2%YoY

KEY DATA			
Share Price (LKR)	13.50		
52w High/Low (LKR)	14/ 8		
Average Daily Volume (Shares)	536,449		
Average Daily Turnover (LKR)	5,948,544		
Issued Share Capital (Shares Mn)	2,035		
Market Capitalisation (LKR mn)	27,473		
Price Performance (%)	1 mth	3 mths	12mths
RICH	0%	17%	69%
ASPI	-2%	0%	1%
Major Shareholders as at 30th Sep 2017			
Skyworld Overseas Holdings Ltd	25.37%		
Camille Consulting Corp.	16.10%		
HSBC--SSBT- Deutsche Bank	11.05%		
Sezeka Limited	9.02%		
Employees Provident Fund	8.35%		
Estimated Free Float	42.15%		

Price – Volume Chart



ANALYST CERTIFICATIONS AND REQUIRED DISCLOSURES BEGIN ON PAGE 7.

“Previous target prices achieved as returns marginalize”

P/E 31 March	FY16	FY17	FY18E	FY19E	FY20E
Revenue (LKR Mn)	43,019	49,149	53,517	58,687	68,362
YoY % Growth	14%	14%	9%	10%	16%
Net Profit (LKR Mn) ¹	2,148	3,170	3,052	3,318	3,956
EPS	1.05	1.56	1.50	1.63	1.94
YoY % Growth	28%	49%	-4%	9%	19%
Valuations					
PER (x)	12.9	8.7	9.0	8.3	6.9
PBV (x)	2.5	1.8	1.5	1.4	1.2
Dividend yield (%)	3.7%	8.1%	5.0%	5.4%	6.5%
NAVPS	5.3	7.6	8.7	10.0	11.4
DPS	0.5	1.1	0.7	0.7	0.9
Payout ratio	48%	71%	45%	45%	45%

1. Attributable to equity holders

LKR (Mn)	2QFY18	2QFY17	YoY	FY16	FY17	YoY
Revenue	13,016	12,194	↑ 7%	43,019	49,149	↑ 14%
Gross profit	3,372	3,231	↑ 4%	10,591	12,776	↑ 21%
Operating profit	1,349	1,401	↓ -4%	3,955	5,290	↑ 34%
PBT	1,198	1,304	↓ -8%	3,399	4,801	↑ 41%
Net profit	978	939	↑ 4%	2,258	3,559	↑ 58%
NP - equity	868	852	↑ 2%	2,148	3,170	↑ 48%

LKR (Mn)	3QFY17	4QFY17	1QFY18	2QFY18	QoQ
Revenue	12,786	12,822	12,945	13,016	↑ 1%
Gross profit	3,409	3,334	3,303	3,372	↑ 2%
Gross margin	27%	26%	26%	26%	↑ 0%
Operating profit	1,402	1,455	1,306	1,349	↑ 3%
Operating margin	11%	11%	10%	10%	↑ 0%
PBT	1,264	1,361	1,162	1,198	↑ 3%
Net profit - equity	846	890	615	868	↑ 41%
Net margin	7%	7%	5%	7%	↑ 2%

Disclosure on Shareholding:

First Capital Group and its affiliates do not hold shares of RICH and will not trade in this share for the three trading days following the issue of this document.

SELL as price appreciation has outweighed earnings outlook: FC Research forecasted a fair value of LKR 9.80 for FY18E and LKR 13.80 for FY19E, both of which have been achieved. Within the last 12 months, ASPI has increased only 1% whereas RICH has seen a price appreciation of 69%. 2QFY18E results do not hold a surprise that justifies a further upgrade in FY18E and FY19E earnings therefore we maintain FY18E and FY19E earnings unchanged at LKR 3Bn and LKR 3.3Bn. Further, plastics and furniture segment which contributed 21% to profitability in FY17 (35% in FY16) continued to slow down in 1HFY18 with a dip in profits by -45%YoY. Thus we expect a slow-growth phase for RICH earnings over the next 2 years where earnings surprise seen in FY17 (FC forecast: LKR 2.7Bn vs Actual LKR 3.2Bn, +17% variance) will be absent. However, we believe RICH will return to a higher growth phase beyond FY19E, with the construction sector recovering from the current slowdown and favourable macroeconomic conditions returning in 2020E which is expected to spark a robust growth in plastics and retail segments. As such we estimate the fair value at LKR 14.0 for FY19E which provides a marginalized return of 11% and recommend a **SELL** for RICH.

Earnings performance: Plastics drags operating results down, despite plantations improving

2QFY18 reported earnings up by 2% due to reduction in tax expenses: RICH recorded profit attributable to equity holders of LKR 868Mn in 2QFY18, a 2% growth from 2QFY17. This was primarily driven by reduction in tax expenses by LKR 144Mn which offset the dip in profit before tax by -8% to LKR 1,198Mn owing to the reduction in operating profits and profits from associate companies (-92%).

Operating results down by -4% as slowdown in plastics segment offsets growth in plantation: Operating profit saw declining to LKR 1,349Mn in 2QFY18 from 1,401Mn (-8%YoY) primarily due to the



lower profits in Plastics segment (-36%YoY) despite improved profitability of the plantations segment's profits (119%YoY). Further, lower profits in Rubber (-25%YoY) and Tyre (-37%YoY) also added to the decline in operating profits.

Retail segment operating profits dipped -1% as revenue growth slows to 5%: Retail segment's operating profits dipped to LKR 409Mn in 2QFY18 (30% of op. profits) from LKR 415Mn in 2QFY17. Segment's revenue growth of 5% in 2QFY18 and 9% in 1QFY18 is notably below the double-digit growth maintained at an average 16%-17% consecutively in all 4 quarters of FY16 and FY17. The operating margins slightly dipped to 6.55% in 1HFY18 from 6.58% in 1HFY17. We believe the slowdown in revenue is attributable to the floods and other natural disasters as well as low consumer confidence resultant to the tight monetary conditions maintained by the Central Bank of Sri Lanka.

Plantations overtake retail to become the top contributor to profitability: Plantations segment recorded 119% growth in operating profit to LKR 422Mn in 2QFY18, occupying 31% of operating profit, ahead of retail segment for the second consecutive quarter. The higher average prices of tea (+38%YoY), rubber (+20%YoY) and palm oil (+2%YoY) in 1HFY18 can be attributed to the outperformance of the segment. MASK contributed significantly to plantation segment in 1HFY18 driven by higher tea prices, turning around to profits of LKR 176Mn from a loss of same amount (+200% growth). KGAL profits grew 167% to LKR 199Mn while NAMU profits grew 28% to LKR 306Mn in 1HFY18.

Plastics segment's profit notably dropped by -36% in 2QFY18: Segment's profits dipped to LKR 208Mn in 2QFY18 from LKR 327Mn in 2QFY17. We believe this is attributable to temporary slowdown in construction sector which was affected by heavy floods in May 2017 coupled with tight monetary policy maintained. The 1HFY18 operating profits of the segment saw dipping by -45%.

Tyre segment's profits dip by -37% while Rubber segment's profits dip by -25%: Tyre segment's profits dipped to LKR

111Mn while Rubber segment's profits dipped to LKR 193Mn in 2QFY18 while a lackluster revenue growth of 2% and -7% were recorded in two segments respectively. Rubber segment's margins saw dropping to 19% in 1HFY18 from 21% in 1HFY17 while Tyre segment's margins significantly dropped to 15% in 1HFY18 from 23% in 1HFY17. Each Tyre and Rubber segments contributed 8% and 14% to operating profit in 2QFY18 (Annex VII).

Investment case: Outperformance in Plantations to be offset by slowing demand in plastics resulting in overall FY18E and FY19E earnings forecast maintained unchanged

Plantation is a star in the making: We estimate a revenue growth of 25% and 10% for plantation segment for FY18E and FY19E respectively (1HFY18 growth = 25%). World Bank estimates price CAGR for tea at 3%, rubber at 13% and palm oil at 2% between 2017-2019. FC Research estimates plantation segment's margins to improve to 15% in FY18E and 13% in FY19E from 9% in FY17 thus achieving an operating profit growth at a CAGR of 40% between FY17-19E. We estimate the plantation segment to contribute 25% to operating profits in FY19E from 15% in FY17 making it a high growth – high market share segment (“Star” in BCG matrix). However, it should be noted that plantation sector is affected by unpredictable adverse weather conditions and wage revision which increase RICH's risk profile.

Retail to continue as a star in the long run despite short-term slow down: FC Research estimated Retail revenues to grow at a CAGR of 9% in FY17-19E. The slowdown in revenue growth from 13% in FY17 is due to the low consumer confidence and slow private credit growth which may affect demand. However as Sri Lanka is moving to the middle income club, we remain positive on the long term growth prospects of retail segment (20% growth in FY20E) and expect it to be a high growth and high-market share segment beyond FY19E (Star in BCG matrix). FC Research estimates a profit CAGR of 10% over the next 2 years (39% in FY20E) with average margins improving to 7.3% from 7% in FY17 due to more store openings resulting in Economies of Scale.

Plastics to continue as a cash cow but next 2 year growth prospects to bleak: FC Research estimates a revenue growth of 6% in FY18E

and improve to 10% in FY19E due to slower consumer demand and tight monetary policy. However, large part of the growth is estimated to come beyond FY19E (FY20E growth 15%) once construction sector recovers from the current slowdown and retail demand picking up, boosting demand for the segment. In addition, rising oil prices put pressure on material cost therefore we estimate the segment's margins to be ~11% in FY18E and FY19E, down from 13% in FY17. Given the market leadership of Arpico, plastics is expected to remain a high market share-low growth (Cash cow in BCG matrix) segment over the next 2 years

Rubber segment earnings growth to delay as global demand growth slows: Rubber segment exports latex and hard rubber based products via Richard Peiris Exports PLC (REXP) to European Union and China. The slower global demand is expected to delay the growth of the segment which has otherwise attractive growth prospects in the long term due to RICH's foray into Chinese market.

Overall FY18E and FY19E profitability unchanged from previous forecasts: The revised assumptions result in the profit for FY18E and FY19E maintained unchanged at LKR 3Bn and LKR 3.3Bn respectively.

Recommendation

For FY19E, FC Research maintains RICH's fair value estimate at LKR 14.0, which has been achieved in Oct-Nov 2017 period. We do not see a further upgrade to FY18E and FY19E earnings due to the lackluster performance of plastics segment in 2QFY18. This gives a total return of 14% (capital gain 4%, dividend yield 10%) for FY19E revised fair value estimate with an annualized return of 11%. **SELL**

Investment risks

- Tight monetary policy and lower consumer confidence may affect slowdown in retail demand
- Volatility in commodity put pressure on costs and margins
- Planation segment is affected by upward wage revisions which almost occurs every 2 year while adverse weather conditions affect the crops and yields



Valuation summary

Expected RICH price	FY19E
Sum-of-the-Parts valuation	19.30
Net debt adjustment	5.30
Target price	14.00
Buy below price	12.00

Return	FY19E
Target price	14.0
Current price (Cum Div)	13.5

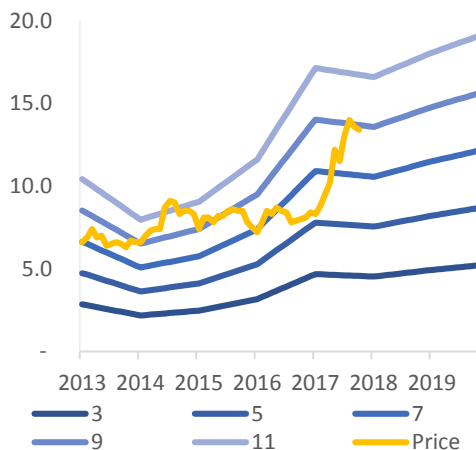
Capital gain	0.5
Dividend FY18E	0.7
Dividend FY19E	0.7

Capital gain %	4%
Dividend yield %	10%

Total return	14%
Total return (annualised)¹	11%

1. Annualised over 474 days

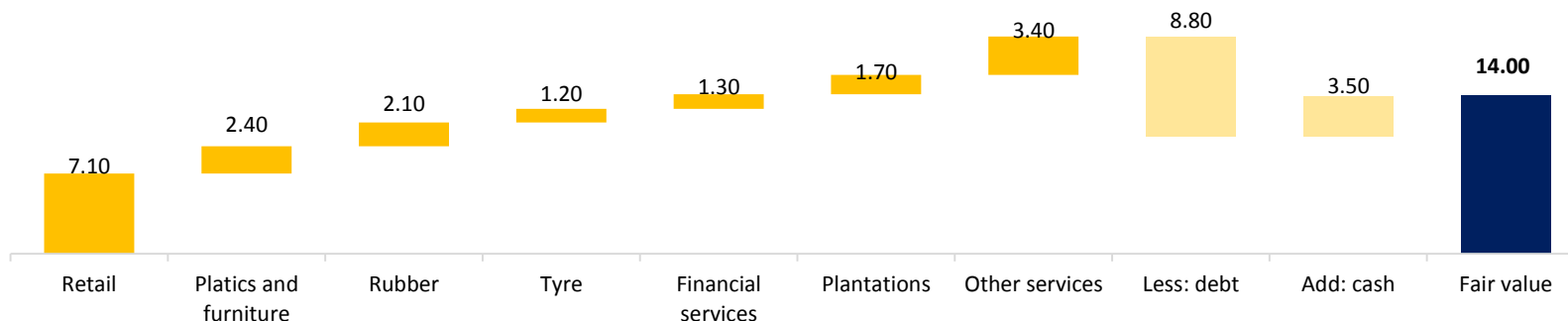
RICH PE band



Sum-of-the-Parts (SOTP) valuation

Segment	Valuation method	Valuation assumptions						Value in LKR Mn		RICH's holding	Value per share	% of total
		D/E	CoE	WACC	Growth	PBV	PER	Firm	Equity			
Retail	FCFF	40/ 60	19%	15%	3%			14,500		100%	7.10	37%
Platics and furniture	FCFF	40/ 60	20%	16%	3%			4,978		100%	2.40	13%
Rubber	FCFF	50/ 50	21%	19%	1%			4,217		80%	2.10	11%
Tyre	FCFF	40/ 60	20%	16%	2%			2,530		100%	1.20	6%
Financial services	Justified PBV		22%		3%	0.68			2,607	82%	1.30	7%
Plantations	Justified Forward PER		24%		3%		3.37		3,413	76%	1.70	9%
Other services	Justified PBV		21%		3%	1.35			7,020	100%	3.40	18%
Fair value before net debt											19.30	100%
Less: debt											8.80	
Add: cash											3.50	
Fair value											14.00	

Note: debt adjustment includes debt for segments with Firm value, i.e. excludes financial services, plantaion and other services

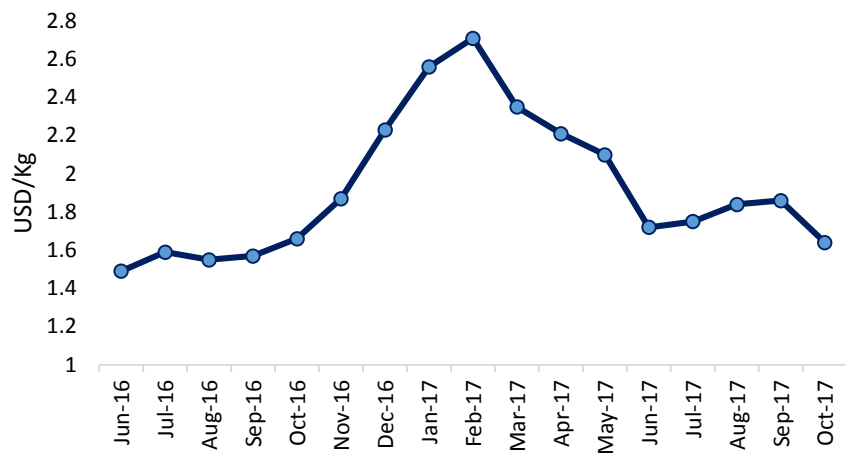


Recommendation criteria

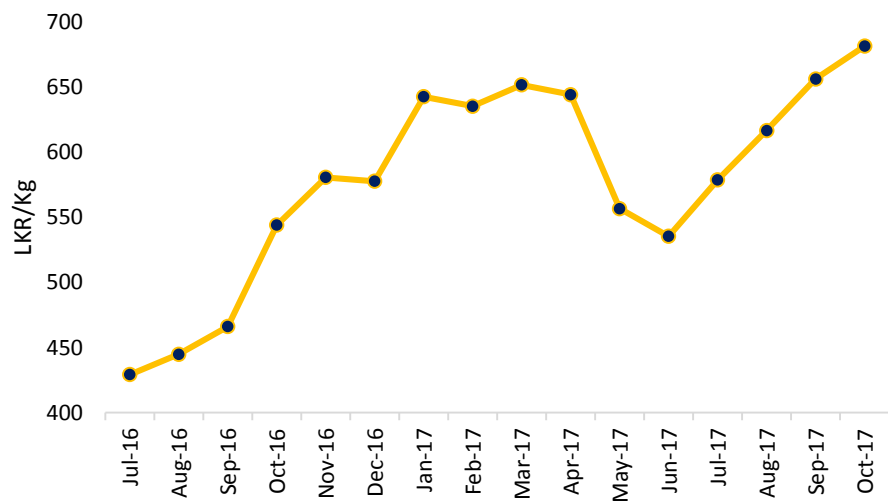
Categorization	Company Category	Strong Buy	Buy	Hold	Sell
Grade A	S&P SL20 Companies	T.Bill + 10% & Above	T.Bill + 5% & Above	T.Bill + 1% & Above	Below T.Bill + 1%
Grade B	Rest of the Companies	T.Bill + 13% & Above	T.Bill + 8% & Above	T.Bill + 3% & Above	Below T.Bill + 3%
Grade C	Companies less than LKR 1Bn Market Cap	T.Bill + 16% & Above	T.Bill + 11% & Above	T.Bill + 6% & Above	Below T.Bill + 6%



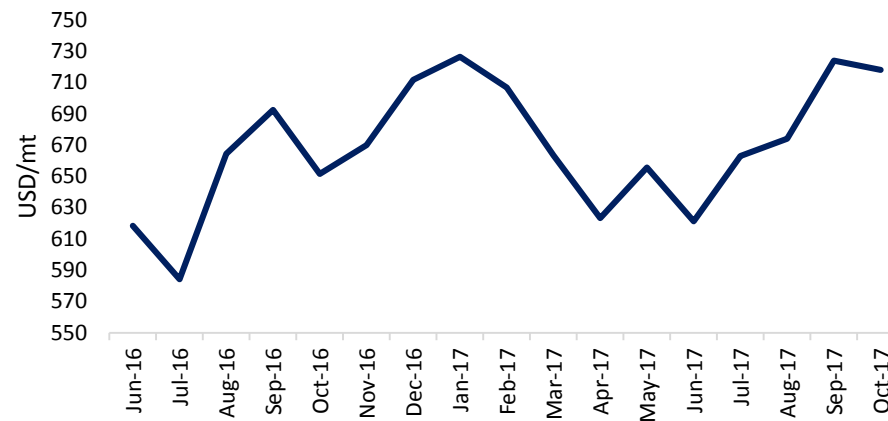
Annex I – Rubber price movement



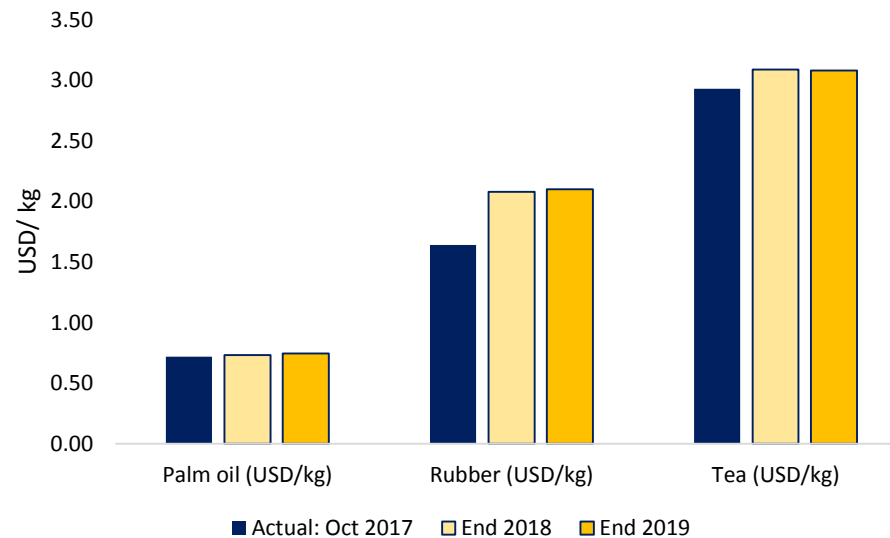
Annex III – Western High tea price movement



Annex II – Palm oil price movement



Annex IV – World Bank commodity price forecast



Source: Company reports, Indexmundi, Sri Lanka Tea Board, FC Research Estimates



Annex III – Income Statement

LKR (Mn)	FY16	FY17	FY18E	FY19E	FY20E
Continuing operations					
Revenue	43,019	49,149	53,517	58,687	68,362
Cost of sales	(32,428)	(36,373)	(39,335)	(42,841)	(49,904)
Gross profit	10,591	12,776	14,182	15,845	18,458
Other operating income	981	1,072	995	1,030	1,061
Selling and distribution expenses	(2,649)	(2,888)	(3,211)	(3,521)	(4,102)
Administrative expenses	(4,929)	(5,614)	(5,739)	(6,868)	(7,886)
Other operating expenses	(38)	(55)	(60)	(66)	(77)
Operating profit	3,955	5,290	6,167	6,420	7,454
Finance cost	(826)	(956)	(1,307)	(1,264)	(1,263)
Finance income	234	384	313	455	498
Share of profit from associate	36	83	100	120	143
Profit before income tax	3,399	4,801	5,272	5,730	6,832
Income tax expense	(1,137)	(1,237)	(1,634)	(1,776)	(2,118)
Profit for the year (continuing)	2,261	3,564	3,638	3,954	4,714
Profit/(loss) from discontinued operations	(4)	(5)	(4)	(4)	(4)
Profit for the year	2,258	3,559	3,634	3,949	4,710
Equityholders	2,148	3,170	3,052	3,318	3,956
NCI	110	389	581	632	754
Segmental revenue					
Rubber	3,629	4,368	4,630	4,955	5,400
Tyre	4,368	4,263	4,306	4,435	4,479
Plastics and furniture	7,830	8,242	8,737	9,610	11,052
Retail	21,927	24,754	26,982	29,410	35,292
Financial services	1,764	2,685	3,759	4,887	6,842
Other services	2,791	2,750	2,805	2,833	2,862
Plantations	7,644	8,807	11,009	12,110	13,563
Inter segmental adjustments	(6,935)	(6,721)	(8,712)	(9,554)	(11,129)
Total	43,019	49,149	53,517	58,687	68,362
Segmental operating profits					
Rubber	648	839	903	979	1,030
Tyre	608	547	563	591	595
Plastics and furniture	1,368	1,096	987	1,061	1,234
Retail	1,540	1,722	1,997	2,103	2,920
Financial services	227	526	736	969	1,229
Other services	1,206	1,307	1,333	1,340	1,328
Plantations	(186)	799	1,651	1,574	1,676
Inter segmental adjustments	(1,458)	(1,546)	(2,003)	(2,197)	(2,559)
Total	3,955	5,290	6,167	6,420	7,454

Source: CSE, Company reports, FC Research Estimates

Annex IV – Balance Sheet

LKR (Mn)	FY16	FY17E	FY18E	FY19E	FY20E
Assets					
Non-Current Assets					
Property, plant and equipment	15,945	17,114	18,655	20,520	21,957
Leasehold property	547	521	489	456	424
Investment properties	165	167	167	167	167
Intangible assets	1,147	1,141	1,118	1,096	1,074
Biological assets	825	866	876	886	896
Investments in subsidiaries	-	-	-	-	-
Investment in associates	241	117	217	336	480
Other non-current financial assets	1,112	1,683	1,683	1,683	1,683
Deferred tax assets	-	76	76	76	76
Total non current assets	19,982	21,685	23,280	25,220	26,755
Current Assets					
Inventories	4,643	5,621	5,494	5,890	6,721
Trade and other Receivables	4,981	6,334	6,378	6,994	8,147
Loans and advances	8,760	11,128	12,628	14,128	15,628
Tax receivables	164	185	185	185	185
Amounts due from subsidiaries	-	-	-	-	-
Other current financial assets	840	508	508	508	508
Cash and cash equivalents	4,206	4,468	6,496	7,110	9,597
Total current assets	23,593	28,244	31,690	34,816	40,787
Total Assets	43,575	49,929	54,970	60,036	67,543
Equity and Liabilities					
Capital and Reserves					
Stated Capital	1,973	1,973	1,973	1,973	1,973
Retained Earnings	8,787	10,807	12,486	14,311	16,487
Reserves	113	151	151	151	151
Equity attributable to equity holders	10,873	12,931	14,610	16,435	18,611
Non-controlling interests	2,413	2,614	3,196	3,828	4,581
Total Equity	13,285	15,545	17,806	20,262	23,192
Non-current Liabilities					
Interest-bearing loans and borrowings	6,272	6,925	6,488	6,331	6,211
Net liability to the lessor	595	584	573	563	552
Insurance provision	502	815	815	815	815
Provisions	105	117	117	117	117
Government grants	551	534	539	544	549
Deferred tax liabilities	277	493	493	493	493
Employee benefit liabilities	2,441	2,426	2,426	2,426	2,426
Total non-current liabilities	10,743	11,894	11,451	11,288	11,164
Current Liabilities					
Trade and other payables	8,008	8,013	9,241	10,065	11,963
Public deposits	3,723	3,935	5,105	6,624	8,600
Current portion of borrowings	2,499	3,433	2,780	2,713	2,662
Current portion of lease	11	12	12	12	12
Amounts due to subsidiaries	-	-	-	-	-
Income tax payable	427	253	253	253	253
Short term borrowings	4,878	6,844	8,322	8,818	9,697
Total current liabilities	19,546	22,490	25,713	28,486	33,187
Total Liabilities	30,290	34,384	37,164	39,774	44,351
Total Equity and Liabilities	43,575	49,929	54,970	60,036	67,543
NAVPS	5.3	7.6	8.7	10.0	11.4



Annex V – Cash Flow Statement

(LKR Mn)	FY16	FY17	FY18E	FY19E	FY20E
Profit/Loss before tax (after disc. Operations)	3,395	4,796	5,268	5,726	6,828
Adjustments for:	-	-	-	-	-
Depreciation	834	885	1,027	1,119	1,231
Amortisation of lease	31	32	32	32	32
Amortisation of intangible assets	11	6	23	22	22
Finance income	(234)	(384)	(313)	(455)	(498)
Finance cost	826	956	1,307	1,264	1,263
Share of profit of an associate	(31)	(83)	(100)	(120)	(143)
Grants amortized	(35)	(30)	(25)	(25)	(25)
Changes in working capital	-	-	-	-	-
(Increase)/ decrease in Receivable	(283)	(1,445)	(44)	(616)	(1,153)
(Increase)/ decrease in inventories	(326)	(1,124)	127	(395)	(831)
Increase/ (decrease) Trade and Other Payabl	1,201	1,018	1,228	824	1,899
Changes in operating assets	(3,527)	(2,452)	(1,500)	(1,500)	(1,500)
Changes in operating liabilities	1,062	212	1,170	1,520	1,975
Increase in insurance provision	195	310	-	-	-
Cash generated from operations	3,877	3,439	8,199	7,397	9,100
Interest paid	(944)	(945)	(1,307)	(1,264)	(1,263)
Gratuity paid	(223)	(323)	-	-	-
Interest received	234	384	313	455	498
Tax paid	(1,496)	(1,293)	(1,634)	(1,776)	(2,118)
Net Cash from operating activities	1,448	1,261	5,571	4,811	6,217
Cash Flow from Investing Activities					
Proceeds from sale of property, plant and eq	13	37	-	-	-
Purchase of property, plant and equipment	(1,511)	(2,053)	(2,567)	(2,985)	(2,668)
Increase in biological assets due to new plan	(11)	(2)	(10)	(10)	(10)
Purchase of financial instruments	(754)	(7)	-	-	-
Acquisition of a subsidiary, net of cash acqui	-	(203)	-	-	-
Net cash used in investing activities	(2,218)	(2,116)	(2,547)	(2,965)	(2,648)
Cash Flow from Financing Activities					
Payment of finance lease liabilities	(11)	(11)	(11)	(11)	(11)
Proceeds from borrowings	2,815	4,633	3,478	2,496	2,879
Repayment of borrowings	(2,522)	(3,130)	(3,089)	(2,224)	(2,171)
Dividends paid to equity holders	-	(2,239)	(1,374)	(1,493)	(1,780)
Dividends paid to non-controlling interests	(239)	(118)	-	-	-
Net Cash Flow from Financing Activities	43	(864)	(995)	(1,232)	(1,082)
Increase/ decrease in cash and cash equiva	(726)	(1,719)	2,028	615	2,487
Movement in Cash and Cash Equivalents					
At the beginning of the year	554	(172)	(1,891)	137	751
Increase/ decrease in cash and cash equiva	(726)	(1,719)	2,028	615	2,487
Cash and cash equivalents at the end of the	(172)	(1,891)	137	751	3,238

Annex VI – Key ratios

P/e 31st Mar		FY16	FY17E	FY18E	FY19E	FY20E
Growth	Revenue	14%	14%	9%	10%	16%
	Cost of Sales	11%	12%	8%	9%	16%
	Gross Profit	22%	21%	11%	12%	16%
	Net Profit (equityholders)	30%	48%	-4%	9%	19%
Margins	GP Margin	25%	26%	27%	27%	27%
	Operating Profit Margin	9%	11%	12%	11%	11%
	NP Margin (Equityholders)	5%	6%	6%	6%	6%

Annex VII – Segmental performance – 2QFY18 and 1HFY18

LKR Mn	2QFY18				1HFY18			
	Revenue	Δ YoY	Op. profit	Δ YoY	Revenue	Δ YoY	Op. profit	Δ YoY
Rubber	1,124	↓ -7%	193	↓ -25%	2,256	↑ 4%	425	↓ -8%
Tyre	759	↑ 2%	111	↓ -37%	1,394	↑ 1%	212	↓ -34%
Platics and furniture	1,872	↑ 11%	208	↓ -36%	3,274	↑ 7%	312	↓ -45%
Retail	6,210	↑ 5%	409	↓ -1%	12,711	↑ 7%	833	↑ 7%
Financial services	812	↑ 26%	47	↓ -46%	1,567	↑ 28%	138	↓ -10%
Other services	13	↓ -6%	264	↑ 8%	23	↓ -1%	431	↓ -5%
Plantations	2,226	↑ 13%	422	↑ 119%	4,735	↑ 25%	859	↑ 252%
Inter segmentals adj.	-		(306)	2%	-		(556)	1%
Total	13,016	↑ 7%	1,349	↓ -4%	25,961	↑ 10%	2,655	↑ 9%

Source: CSE, Company reports, FC Research Estimates

Research Disclosure

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