

September 23, 2019

FAIR VALUE: 92

CURRENT PRICE: 100

Bairaha Farms PLC (BFL)

Price target	LKR 92.0
Current Price	LKR 100.0
52-week range	LKR131.8-93.3
Market capitalization	LKR 1.6bn
Public float	c.50%
Average daily turnover	LKR 0.1m

YTD Performance

ASPI	-4.7%
Sector	-11.2%
BFL	-20.0%

Year End 31-Mar	FY18	FY19	FY20e	FY21e
EPS (Rs)	25.3	25.8	5.8	10.6
DPS (Rs)	6.0	8.0	4.0	5.0
NAVPS (Rs)	222.5	241.6	239.4	245.0
P/E (x)	4.0	3.9	17.3	9.4
P/BV (x)	0.4	0.4	0.4	0.4
Div. Yield (%)	6.0	8.0	4.0	5.0
Div. Payout (%)	23.7	31.0	69.1	47.1
ROE (%)	11.4	10.7	2.4	4.3
EBITDA margin (%)	17.4	15.9	8.2	8.9

BFL: 52-week price/volume chart



Source: Bloomberg, Taprobane Research

Price ahead of valuation

BFL is an integrated poultry producer specialising in broiler production, with footprint in key segments of the poultry value chain. Through its joint venture (JV) entity, Fortune G-P Farms, BFL operates a broiler Grand Parent breeding farm and has 3 Broiler Parent breeding farms. BFL is one of the largest suppliers of Day-Old Chicks (DOC) to broiler rearing farms in Sri Lanka. In addition, BFL also produces chicken feed, through another JV operation, Fortune Agro Industries with was further strengthened with the recent acquisition of two grain silos. The poultry industry is currently facing headwind from sluggish demand largely due to poor tourism sector performance and limited availability of maize for feed production. In addition, the industry is also saddled with excess capacity and facing further tailwind from soft chicken meat prices. Nevertheless, DOC prices have increased over the last few months and we expect prices to hold over the medium term. With c.30-40% of direct costs denominated in USD, LKR depreciation should adverse impact margins and drag earnings. We expect BFL's FY2020E revenue to decrease by c.8% YoY but recover in FY2021-24E period. We expect significant margin erosion in FY2020-21E period driven by soft market prices for chicken meat, higher feed cost and LKR depreciation. We expect GP margin to average in the mid double digit levels over FY2020-24E cf. c.25% level seen over the past 5 years. We expect EBITDA margins to erode to the high single digit levels in the FY2020-24E period cf. the mid double-digit levels seen in the past. We expect NPAT to decrease in FY2020E and recover in FY2021-24E on the back of topline growth and uptick in margins. Our DCF based 12M target price is Rs.92, which is a c.8% downside to the current market price. SELL

Excess capacity and soft demand dampen topline growth: With the industry facing excess capacity and soft pricing power, BFL's topline growth should remain in the mid-single digit levels over the FY2020-24E forecast period. Continued investment in capacity buttressed by positive government incentives has seen capacity improve rapidly over past decade. This coupled with the current slowdown in the economy should drag topline growth down.

Margin drag from higher feed costs and adverse FX impact: Cost of feed which makes up c.70% of production cost has gradually increased over the past 18 months. Moreover, BFL should face margin pressure from LKR depreciation as c.30-40% of direct costs are FX denominated.

Valuation: BFL is trading at a c.8% premium to our DCF based 12-month target price of Rs.92 (CoE 22%, TG 2%, Beta 1.5). Moreover, BFL is trading at FY20E PE of c.17x and FY21E PE of c.9x which are significantly above the 5-year average trailing PE of c.4x. SELL.

YE 31 March (Rs m)	FY18	FY19	FY20e	FY21e	FY22e	FY23e	FY24e
Revenue	4,215	4,724	4,322	4,584	4,808	5,058	5,322
+/- YoY%	-3.4	12.1	-8.5	6.1	4.9	5.2	5.2
EBITDA	735	750	355	409	650	705	770
PBT	465	456	70	150	372	391	429
PAT	404	413	93	170	361	377	410
+/- YoY%	-42.4	2.1	-77.6	83.3	112.5	4.6	8.7
EPS (Rs)	25.3	25.8	5.8	10.6	22.5	23.6	25.6
NAVPS (Rs)	222.5	241.6	239.4	245.0	259.6	275.1	292.8
EBITDA margin (%)	17.4	15.9	8.2	8.9	13.5	13.9	14.5
EV/EBITDA (x)	3.6	3.6	7.5	6.5	4.1	3.8	3.5
PER (x)	4.0	3.9	17.3	9.4	4.4	4.2	3.9

Source: Company Data, Taprobane Research

Company Outlook

BFL is a vertically integrated poultry operation

BFL is a vertically integrated poultry farming and chicken processing company. Its core business activities include:

- Breeding poultry and operating of hatcheries for the production and sale of both parent and commercial broiler day-old chicks.
- Processing, distributing and selling of whole broiler chicken and broiler chicken portions.
- Operating hundreds of out-grower farms as well as a few large-scale own broiler farms.
- Manufacturing, distributing and selling of pre-cooked meats and marinated chicken.
- Marketing poultry related hygiene and nutritional products and poultry by-products.

JVs have helped improve vertical integration

In addition to these, BFL also operates a Broiler Grand Parent breeding farm and a chicken feed manufacturing operation through its JV investments. Fortune G-P Farms uses the “Cobb 500” variety of Broiler GP birds. This operation produces c.55% of the local poultry industry’s broiler grand-parent stock demand. It also exports to Bangladesh and Nepal. Though BFL does not disclose precise production and market share data, we estimate that BFL holds c.10-20% share of annual DOC production and under c.5% market share of annual chicken meat production.

Industry has grown rapidly over the past 3 decades

The domestic poultry sector has shown significant development after 1977 with economic reforms in Sri Lanka. Since 1980 the poultry population has grown from 6.3 million to 40.6 million in 2018, amid greater affordability vis-a-vis other meat products, rising income levels and religious preferences. Accordingly, the current per capita consumption of chicken is c.9.3 kg and current per capita consumption of egg is c.133 eggs. Moreover, the poultry industry is the most developed sub-segment within livestock sector in Sri Lanka and accounts for c.0.5% of GDP in 2018. Per capita consumption of poultry meat is much higher than other forms of meat protein. This is largely attributable to ethno-religious beliefs which adversely affect consumption of other meats such as beef and pork.

GoSL supports sector profitability

The Government of Sri Lanka (GoSL) has identified the need for quality animal feed for the poultry sector, and taxes only a nominal amount of Rs10/Kg on imported maize as special commodity levy. This is due to the realisation that local maize production would not be sufficient to meet the demand of the poultry industry.

Poultry meat is firmly established in local dietary habits

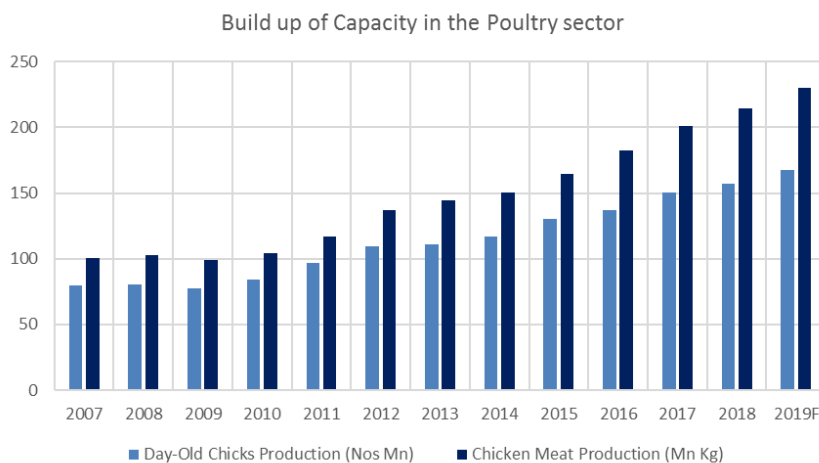
According to the latest (2017) statistics available from the Department of Animal Production and Health (DAPH), per capita consumption of poultry meat has increased from c.5.0Kg in 2008 to c.10.0Kg in 2018 and per capita consumption of eggs has increased from c.94 in 2008 to c.133 in 2018. Some of the key drivers of poultry demand are increasing urbanisation and increase in urban income levels, resulting change in dietary habits as well as tourism growth. It is widely believed that poultry sector growth in 2019 would however be impacted due to the expected drop in tourism activity stemming from the Easter attacks. In addition, the industry has also had to face an over-supply, even before the Easter attacks and the resultant impact on tourism.

Key subsidiaries and Joint Venture investments of BFL

Bairaha Foods (Pvt) Ltd.	Manufacturing of pre-cooked meat products	100%
Siyane Farms Ltd.	Breeder farming	100%
Nature’s Best Industry Ltd.	Breeder farming	100%
Hill County Farms Ltd.	Breeder farming	100%
Bairaha Trading (Private) Ltd.	Importing and selling poultry products	100%
Joint ventures		
Fortune G-P Farms (Lanka) Ltd.	Grandparent Breeder Farming	50%
Fortune Agro Industries (Pvt) Ltd.	Feed milling operation	50%

Sluggish volume growth coupled with soft prices

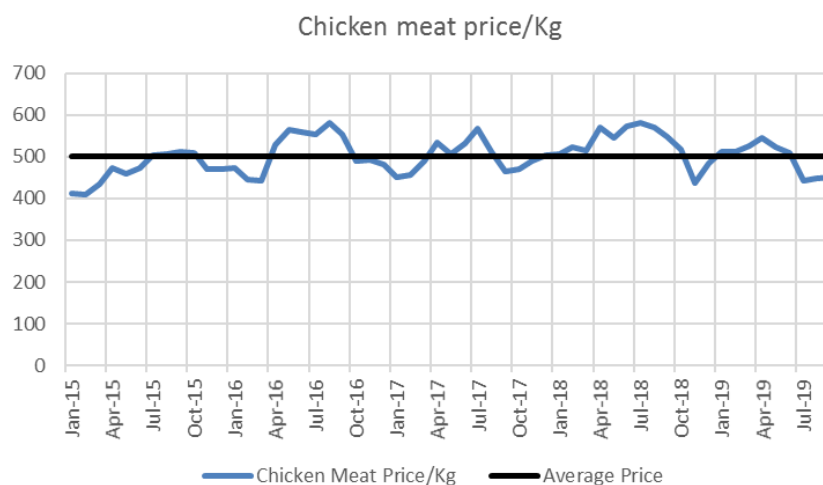
Tailwind from excess capacity in the medium term: Tailwind from excess capacity in medium term: Fresh investment has steadily flowed into the poultry sector over the decade buttressed by positive government policies and fiscal incentives. At present there are 3 Broiler Grand Parent breeder farms, 34 broiler parent breeder farms and 11 Layer Parent breeder farms. In addition to this there are hundreds of broiler and layer rearing farms that procure DOCs and produce poultry meat and eggs. This is a significant increase over the position 10 years ago. DOC production of broiler and layer chicks has increased by a CAGR of c.6% over the past 10 years and production of poultry meat too has increased by a CAGR of c.7% over the same period. While this has doubled per capita poultry meat consumption and increased per capita egg consumption by c.50% over the past decade, we feel that currently the industry is facing excess capacity. As such we expect prices for poultry meat and eggs to remain soft and expect this trend to continue over the medium term.



Source: DAPH, DCS, Taprobane Research

Oil sector growth does not necessarily translate to margin expansion

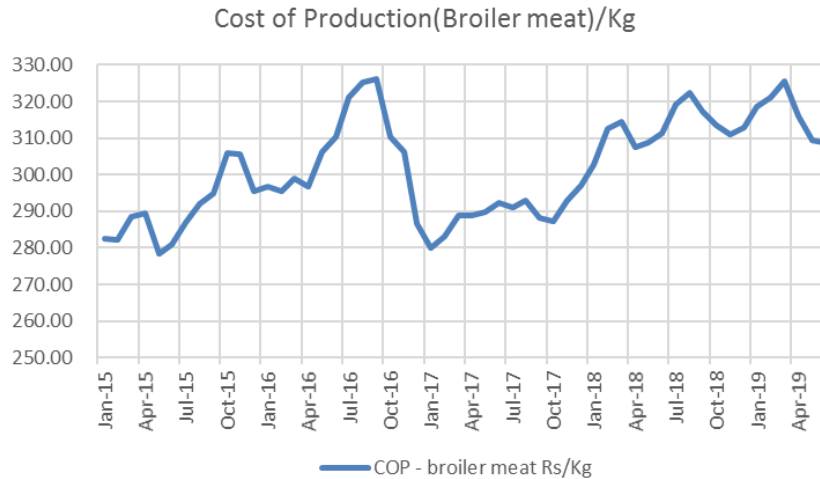
Soft pricing due to sluggish demand: Slowdown in consumption from stunted macroeconomic growth and expected drop in the tourism sector due to the Easter terror attacks have dented demand for poultry meat consumption. This coupled with excess capacity in poultry sector has contributed to the prevailing soft pricing environment. We expect soft pricing regime to continue over our the FY2020-21E period with modest price increases in the FY2022-24E period.



Source: DAPH, DCS, Taprobane Research

Feed price consistency is critical

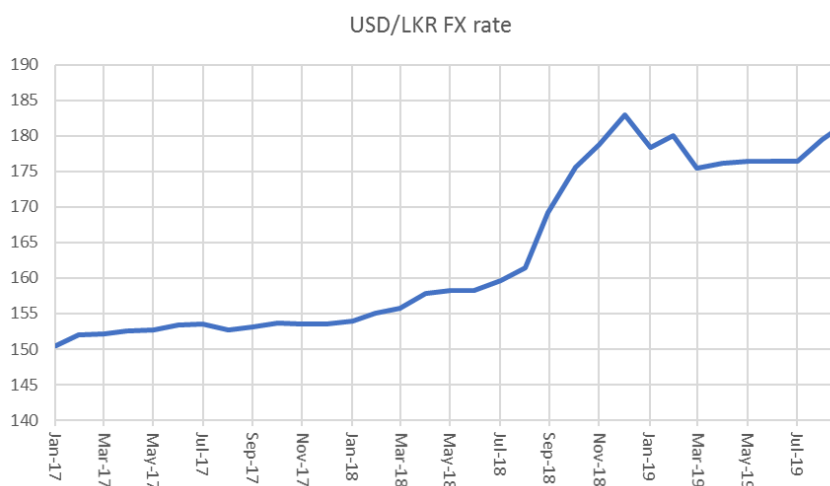
Margin drag from feed price variability: Feed costs make up to c.70% of production cost of poultry meat. Feed prices have gradually increased by c.10-15% over the past 18 months with feed prices averaging c.115/Kg. This is due to a combination of short supply in maize due to drop in local production and projected increase in maize and soya bean prices in the global markets. Nevertheless, the recent acquisition of two additional grain silos by Fortune Agro, which is a JV of BFL should help partially cushion this impact. Feed cost variability also adversely affects the pricing decision of DOC and meat producers as they inadvertently build in buffers in their prices for anticipated feed price increases, thereby distorting market price predictability.



Source: DAPH, Taprobane Research

FX woes are a margin drag

FX woes should linger over our forecast period: We estimate that up to 30-40% of production cost is FX denominated. As such, we believe LKR depreciation should erode margins over the forecast period. Some of the crucial ingredients denominated in FX are Soya Beans (c.30% of typical feed composition), and Fish Meal (c.4-5% of feed composition). In addition to this several types of poultry nutrients mixed in poultry feed as well as poultry medicine are also imported. Moreover, since Maize requirement (c.50% of typical feed composition) of the poultry industry is only partially (c.40%) met by domestic production, the balance should be imported.



Source: Bloomberg, Taprobane Research

It's SELL, but only by a sliver.

Valuation: Based on our DCF based valuation model we estimate BFL's 12-month target price of Rs.92 (CoE 22%, TG 2%, Beta 1.5). This is further supported by the fact that BFL is trading at FY20E PE of c.17x and FY21E PE of c.9x which are significantly above the 5-year average trailing PE of c.4x. Poultry sector earnings have been volatile and share prices of poultry stocks has also reflected this. A key valuation driver would be the rate at which earning recover in FY2020E. A faster than projected recovery would warrant a positive upward revision of our 12M target price. Since the April 2019 terror attacks, BFL's share price has re-rated downwards significantly, but we believe that the share should adjust downward a bit more to be a compelling purchase.

Sensitivity of 12M Target Price to TG and COE assumptions

		Terminal Growth				
		0%	1%	2%	3%	4%
C O E	19%	92	92	92	92	92
	20%	92	92	92	92	92
	21%	92	92	92	92	92
	22%	92	92	92	92	92
	23%	91	91	91	91	91

Source: Company Data, Taprobane Research

Income statement

YE 31 March (Rs m)	FY18	FY19	FY20e	FY21e	FY22e	FY23e	FY24e
Revenue	4,215	4,724	4,322	4,584	4,808	5,058	5,322
Gross Profit	993	1,076	606	729	756	813	872
Operating Profit	552	545	139	229	464	499	544
PBT	465	456	70	150	372	391	429
Share of JV Earnings	34	41	41	41	41	41	41
Net Finance Cost	-87	-76	-69	-80	-93	-108	-115
PAT	465	456	70	150	372	391	429
EPS (Rs)	25.3	25.8	5.8	10.6	22.5	23.6	25.6

Balance Sheet

YE 31 March (Rs m)	FY18	FY19	FY20e	FY21e	FY22e	FY23e	FY24e
Property, Plant & Equipment	2,086	2,185	2,216	2,313	2,513	2,713	2,914
Biological assets	68	51	57	57	57	57	57
Investments in Joint Ventures	913	919	961	1,002	1,043	1,084	1,125
Other non current assets	5	12	29	28	27	25	24
Non Current Assets	3,072	3,168	3,263	3,399	3,639	3,879	4,120

Inventories	166	216	242	253	263	276	289
Biological assets	420	477	483	483	483	483	483
Receivables	491	521	506	538	553	582	612
Other current assets	43	149	158	158	158	158	158
Cash and cash equivalents	438	430	317	346	370	459	516
Current Assets	1,557	1,792	1,707	1,779	1,827	1,958	2,058

Long Term Borrowings	393	298	71	71	71	71	71
Deferred Tax Liabilities	164	164	164	164	164	164	164
Retirement Benefit Liability	72	79	78	78	78	78	78
Long term liabilities	629	541	313	313	313	313	313

Trade and other payables	275	352	335	350	365	382	400
Loans and borrowings	153	187	475	578	619	723	764
other current liabilities	12	14	16	16	16	16	16
Current Liabilities	440	553	826	944	1,000	1,121	1,181

Share Capital	256	256	256	256	256	256	256
Retained Earnings	2,893	3,197	3,162	3,251	3,484	3,733	4,015
Other reserves	410	412	412	412	412	412	412
Equity and Reserves	3,560	3,866	3,830	3,920	4,153	4,402	4,684
NAVPS	223	242	239	245	260	275	293

Cash Flow Statement

YE 31 March (Rs m)	FY18	FY19	FY20e	FY21e	FY22e	FY23e	FY24e
PBT	465	456	70	150	372	391	429
Depreciation & Amortisation	183	205	216	180	186	206	226
Changes in working capital	-42	-93	-46	-28	-11	-24	-25
interest paid	-87	-76	-69	-80	-93	-108	-115
taxes paid	-151	-84	-28	-21	-52	-55	-60
other adjustments	77	67	68	80	93	108	115
Operating Cash Flow	446	476	211	280	495	518	570
Capex	-742	-294	-258	-275	-385	-405	-426
FCFF	-296	182	-47	5	110	113	144
net debt issued/repaid	-84	-80	40	103	41	103	41
FCFE	-380	102	-7	109	152	217	185
Dividends paid	-109	-110	-126	-80	-128	-128	-128
other adjustments	560	-19	-1	0	0	0	0
Net Cash Flow	70	-28	-133	29	24	89	57

Source: Company Data, Taprobane Research

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