October 8, 2019

FAIR VALUE: 9.3

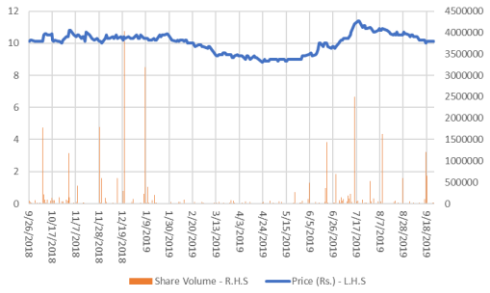
CURRENT PRICE: 10.20

Richard Pieris Group PLC (RICH)

Price target	LKR 9.3
Current Price	LKR 10.2
52-week range	LKR11.4-8.8
Market capitalization	LKR 20.8bn
Public float	15%
Average daily turnover	LKR 1.4m
YTD Performance	
ASPI	-5.8%
Sector	-7.5%
RICH	-0.1%

Year End 31-Mar	FY18	FY19	FY20e	FY21e
EPS (Rs)	1.3	1.0	1.0	0.9
DPS (Rs)	1.1	0.9	0.9	0.9
NAVPS (Rs)	6.5	6.5	6.6	6.7
P/E (x)	7.7	10.3	10.7	11.5
P/BV (x)	1.6	1.6	1.5	1.5
Div. Yield (%)	10.8	8.3	8.3	8.3
Div. Payout (%)	83.3	85.9	89.0	96.1
ROE (%)	20.2	15.2	14.4	13.3
EBITDA margin (%)	12.2	11.1	11.3	10.9

RICH: 52-week price/volume chart



Source: CSE, Taprobane Research

RICHly priced

Richard Pieris Group PLC (RICH) is a diversified conglomerate with key exposure to the retail, plantations and export sectors. In the retail segment, RICH focusses on the hyper market model, with average store sizes in excess of c.10,000-15,000 sq ft. We expect the retail segment, which currently makes up c.50% of group revenue to be the key topline driver. We expect retail segment topline growth to average at c.6% over the next 2-3 years with EBITDA margins of c.8%. Nevertheless, we expect margins to erode as competition increases from traditional and online retailers. We expect the plantation segment to be a mixed bag as margin expansion is the palm oil segment is eroded by weak performance in the Tea and Rubber segments. We expect segment EBITDA margins to hover in low double-digit levels. A key assumption is that RICH would not engage in any significant Tea or Rubber replanting over the forecast period. We also assume that the current impasse over oil palm planting would be resolved in favour of the plantation industry. Namunukula Plantations (NAMU) which is RICH's palm oil exposure has substantial extent of cultivable oil palm land. This gives us extended revenue visibility as oil palms remain mature over a 30-40-year period. We believe that the export sector is the key value driver for RICH. Richard Pieris Exports PLC (REXP) should see topline grow by high single to low double-digit levels over the forecast period. We expect EBITDA margins to hover in the 18-20% range. Based on our SOTP model, we derive a 12-month TP of Rs.9.3 which is a c.9% downside to the current price. We recommend SELL.

Modest topline growth: Whilst RICH is an interesting portfolio of segments, we believe that topline growth from the Retail and Rubber Export segments would be diluted by challenging conditions experienced by the Plantations segment as Tea and Rubber which account for c.70-80% of segment topline see continued decline. We also expect weak topline contribution from the Tyre and Plastics segments.

Stagnant margins: We believe that superior margins from the Rubber Export and Retail segments would be eroded by poor margins from the Plantations, Tyre and Plastics segment would. In the plantation sector, Tea and Rubber gross margins have thinned and are expected to remain weak as input costs rise and prices remain weak.

Valuation: We have valued RICH using a SOTP model which yields a 12-month TP of Rs.9.3. This is a downside of c.9% to the current share price. Our view is further supported by RICH's FY2020E PE of 10.7x and FY2021E PE of 11.0x. We believe that RICH should re-rate down further to make an attractive addition. We recommend SELL.

YE 31 March (Rs m)	FY17	FY18	FY19	FY20e	FY21e	FY22e
Revenue	49,149	52,973	55,045	58,214	61,716	65,591
+/- YoY%	14.3	7.8	3.9	5.8	6.0	6.3
EBITDA	6,214	6,452	6,131	6,589	6,700	7,201
PBT	4,801	4,632	3,354	3,252	3,046	3,129
PAT	3,559	3,077	2,342	2,277	2,132	2,190
+/- YoY%	57.6	-13.5	-23.9	-2.8	-6.3	2.7
EPS (Rs)	1.6	1.3	1.0	1.0	0.9	0.9
NAVPS (Rs)	6.4	6.5	6.5	6.6	6.7	6.7
EBITDA margin (%)	12.6	12.2	11.1	11.3	10.9	11.0
PER (x)	6.5	7.7	10.3	10.7	11.5	11.2

Source: Company Data, Taprobane Research

Company Outlook

RICH is a recognisable Brand

Richard Pieris Group PLC (RICH) is a diversified conglomerate with exposure to a range of sectors including, but not limited to Plantations, Exports, Manufacturing, Retail and Finance. RICH carries a well-established brand name and brand presence across Sri Lanka.

NAMU, KGAL and MASK make up the plantation segment

RICH's plantation segment consists of Namunukula Plantations PLC (NAMU), Maskeliya Plantations PLC (MASK) and Kegalle Plantations PLC (KGAL). These are some of the regional plantation companies (RPCs) which were privatised by the Government (GoSL) in the early 1990's. RICH holds controlling interests in these entities, through its subsidiary, RPC Plantation Management Services (Pvt) Ltd. This segment contributes c.15% of group revenue. This segment consists of 53 plantation estates which span c.32,097 hectares. Tea and Rubber account for c.80% of the segment revenue, while Oil Palm accounts for bulk of the balance with small contribution from coconut and cinnamon cultivations. Nevertheless, Oil Palm is the primary margin and value driver for the segment. NAMU has a 33.3% stake in AEN Oil Mills, which is one of only two palm oil processing centres in Sri Lanka. We believe that this investment is an earnings and valuation driver.

REXP brings in USD revenue

The Rubber segment of RICH consists primarily of Richard Pieris Exports PLC (REXP). REXP exports Latex and Hard Rubber based products to markets in the US, Western Europe and the Asia Pacific region. The latex segment product line includes natural latex foam mattresses, toppers, pillows etc. Recently, REXP has entered the Chinese market for mattresses and pillows, where it hopes to brand its products using its own brand names. REXP's hard rubber products include food grade jar sealing rings, crutch tips, rubber shoe soles, rubber mats etc. In addition to the above, REXP also exports shoe soles through Arpitalian Compact Soles (Pvt) Ltd is a joint venture with Davos SPA, a globally reputed Italian manufacturer of shoe soles and soling sheets.

Imported Tyres have dented local growth prospects

RICH's tyre segment consists of re-treading of tyres, the manufacture of solid tyres and the materials for the Tyre industry. The Tyre sector consists of Richard Pieris Tyre Company Ltd, Arpidag International (Pvt) Ltd, Richard Pieris Rubber Compounds Ltd and BGN Industrial Pvt Ltd. In flux of cheap imported tyres from China and India have dampened topline growth for RICH's tyre sector. In a move to adapt, RICH has entered the Tyre trading business acting as the sole agent for Nexen Tyre of South Korea and Birla Tyre of India.

The product range of the Plastics, Furniture and Electronics segment spans Mattresses, Electronics, Furniture, Water tanks, Rigifoam products, PVC pipes and fittings, Rubber products Vinyl mats and other Consumer durable items. The growth of this segment is correlated with growth in the construction sector, especially the construction of domestic dwelling and residential apartments. We believe that this segment may be hard pressed for growth in the current economic conditions.

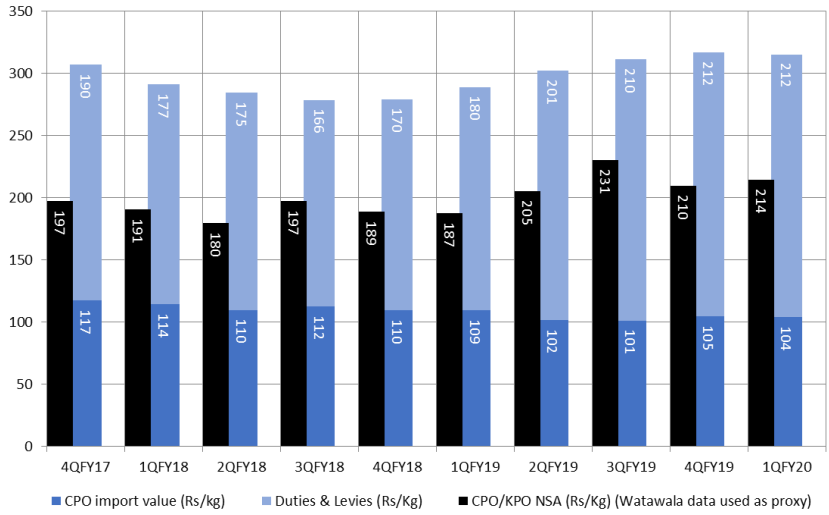
Retail segment is key revenue driver

The retail segment of the business concentrates on the modern retail trade industry. It operates using the overarching brand name of "Arpico". Nevertheless, based on product specialisation and store format, sub brands such as Supercentres, Superstores, Daily, Showrooms and Furniture are used. The retail segment makes up c.50% of group revenue. Key competitors include, Keells, Cargills, SPAR and Glomark. We expect retail to be the primary topline driver over our forecast period. Urbanisation, upgrade in consumer tastes from higher disposable income as well as increased expatriate population are key growth drivers. Moreover, large scale infrastructure projects such as the Western region Megapolis and Port City should also augur well for retail revenue growth. Nevertheless, increased competition from traditional brick and mortar stores and adoption of online retailing by the masses pose significant threats.

The Financial Services segment of RICH is made of primarily Richard Pieris Finance PLC (RPF), Arpico Insurance PLC and Richard Pieris Securities (Pvt) Ltd. The Financial services segment is yet to mature but has the potential to create synergies across other segments, especially Retail.

Protectionist tariff policies are a crucial value driver

Palm oil segment is a beneficiary of GoSL backed protectionism: The GoSL imposes several taxes and levies on the import of palm oil and related products. With palm oil estimated at c.50% of local edible oils consumption, such measures to promote local manufacture benefit both GoSL and the sector. In addition to a raft of import tariffs and levies, GoSL also imposes a Special Commodities Levey (SCL) on the import of palm oil and related products. It is mainly through the SCL which is set administratively, GoSL ensures import of palm oil products remain uncompetitive. For instance, the SCL on CPO has changed over the 2017-18 period from Rs.115/kg in December 2017 to Rs.155/kg in December 2018, taking into account the changes in CPO prices in the global market as well as the depreciation of USD/LKR exchange rate. In addition to protectionist tariffs, GoSL also provides tariff concessions on the import of oil palm seeds and a lower tax rate for plantation companies.



Source: Sri Lanka Customs, Company Data, Taprobane

Land availability is a bonus

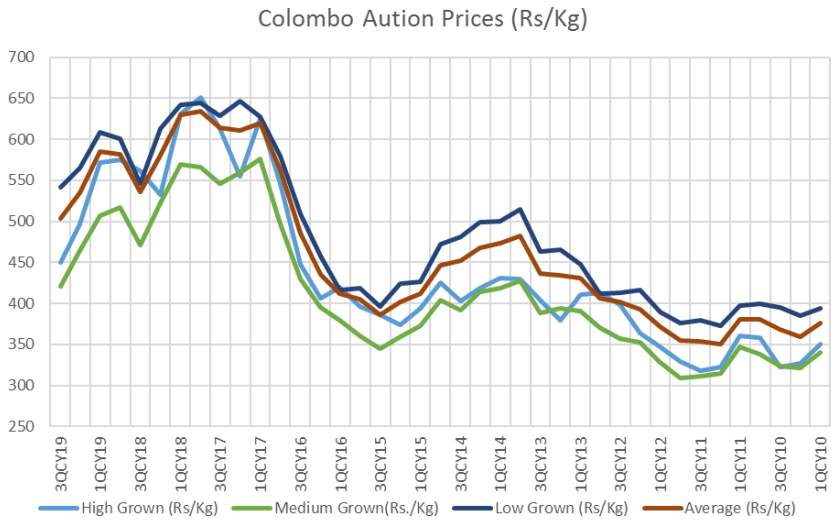
Ample land for palm cultivation: Cultivable land is a key constraint for the palm oil sector. Oil palm cultivation was approved by the GOSL after considering the crop diversification programme in the lease agreements signed between GoSL and the RPCs. Total allowable extent of palm cultivation was limited to maximum of 20,000 ha in the abandoned and economically non-viable lands of the RPCs (e.g. rubber cultivation land over 30 years). Moreover only 20% of the total land area of a plantation can be converted to oil palm. Amongst its peer group, NAMU has the highest availability of land extent eligible for incremental oil palm planting. We the expect current impasse over the ban on the import and planting of palm seedlings to reverse after the end of the current presidential term. Though this should see an increase in sector capex spend in the short term, we expect incremental cashflow to far outweigh capex spend, as oil palm capex is usually much smaller than tea or rubber. Moreover, as oil palm plantations have a much longer replanting cycle, we expect, NAMU's oil palm segment to yield superior cash flows cf. other crops.

	NAMU	WATA	ELPL	AGAL
Cultivable land (Palm) Ha	3,377.6	4,373.2	2,409.2	2,580.4
Current land usage (Palm) Ha	2,337.6	3,535.8	1,930.7	1,312
% used	69%	81%	80%	51%
Palm segment revenue (Rs 000) FY19	957.8	2,468.5	731.9	349.4
EBIT (Rs 000) FY19	478.9	1,114.1	492.7	138.1

Source: Company Data, Taprobane Research

Tea segment in decline

Tea segment is a laggard with a weak outlook: A combination of soft end market demand, increased competition from new entrants and geo-political issues in traditional export markets have dented tea industry performance over past decade. In addition to this, local issues such as concerns over the use of certain types of agro-chemicals, trade union actions as a bargaining chip by a unionised workforce, lack of new investment etc. have also played a significant role in dampening the performance of the tea industry. Whilst not making a doomsday prediction, we feel that sans consistent and sustained support by the GoSL, the local tea industry could enter a phase of structural decline. Within this context, we expect RICH's tea segment to post mediocre performance over the forecast period. A key assumption is that we don't expect RICH to carry out any replanting programs over this period, given prevailing weak prices. We expect, prices across all tea categories to remain weak, though prices low-grown tea should see marginally better performance over the forecast period.

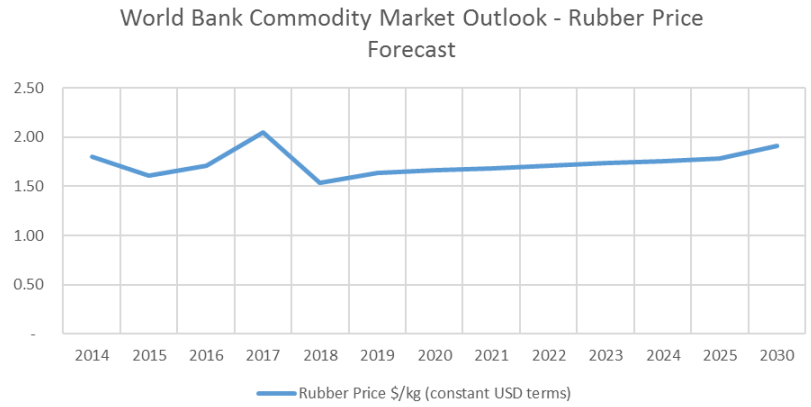


Source: Forbes & Walker, Taprobane Research

Rubber is not too far behind

Rubber segment should perform marginally better: We expect the Rubber segment to post weak results, albeit marginally better than Tea. Rubber prices have remained largely flat over the year. Nevertheless, KGAL has key accounts to which it supplies value added rubber materials and should post modest growth. Key factors affecting rubber prices are the current sluggishness in the global economy and the on-going Sino-US trade war. Nevertheless, the substitution of synthetic rubber for natural rubber across most industries is a key underlying factor for a decline in prices globally. The domestic rubber industry has also experienced a slow yet steady decline over the past decade. While the total area under rubber plantation has remained constant, replanting and new cultivation has gradually dropped. This has caused a steady decline in yields with average yield/Ha decreasing to c.774 Kg in 2018 from c.1437 Kg in 2009. More importantly, export of rubber has declined to c.14m Kg in 2018 from c.56m Kg in 2009.

Import of Crude Palm Oil & Olein has increased when local coconut oil production has dipped



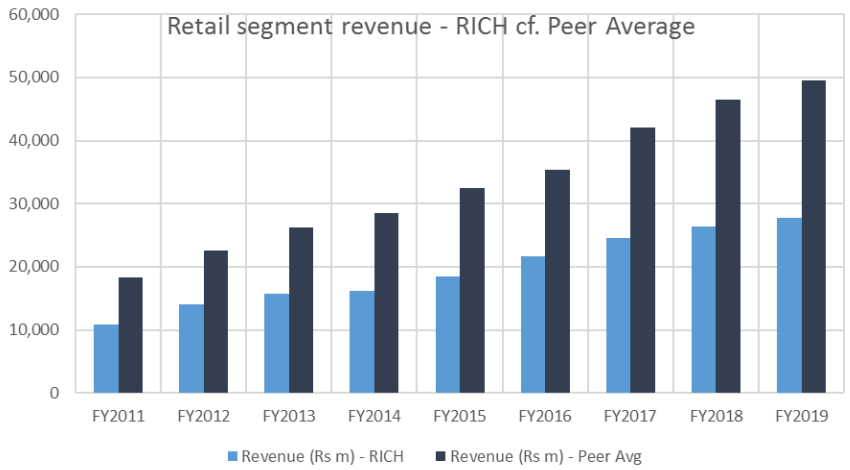
Source: World Bank, Taprobane Research

REXP is a key valuation driver

Export sector provides a crucial lifeline: We expect the Rubber export segment of RICH, largely made up by REXP to be the principal valuation driver. REXP exports soft and hard rubber products such as mattresses, pillows and industrial rubber mats globally. It has an established presence in the Western markets and is now exploring tapping into the Chinese market. REXP has ambitious targets to expand its presence in the mattresses and pillows market in China. China's increasing middle class and purchasing power should augur well for REXP's growth plans. We expect REXP to post high single to low double-digit topline growth over our forecast period; of which we expect LKR depreciation to contribute c.3-4%. We expect REXP to maintain EBITDA margins c.18-20% over the forecast period.

Retail should drive topline growth

Retail sector topline should grow: We expect RICH's retail segment to be its key topline driver over our forecast period. RICH operates on a hyper-market model with large store format in excess of c.15,000 sq. ft, though recent opening have also focused on a c.10,000 sq. ft. format. RICH's retail business focus is slated to remain in the western province, which is the key economic hub of Sri Lanka. Increasing urbanisation, growth in key high density sub-urban towns and projected increase in Sri Lanka's population size over the next decade all augur well for growth in the modern retail industry. We also expect RICH's retail topline to benefit from large scale infrastructure projects such as the Western Region Megapolis and Port City projects. Moreover, growth in the expat population also augurs well for RICH's retail business.



Margin pressure from online and traditional retailers

Tailwind from competition and inability to synergise with Finance Company: With modern retail penetration estimated in the mid-teens cf. to 30-40% seen in regional peers such as Thailand and Malaysia, we expected new competition to enter the market from both existing and new firms. John Keells Holdings (JKH) which is operates the Keells Supermarket brand has ambitious growth plans over the next 2-3 years. Though, Keells store format remain significantly smaller than RICH's (maximum of c.7,000 sq. ft.), Keells along with fellow rival Cargills (CARG) have extended value chain reach through their out-grower programmes, which lower input costs. This should pose a margin challenge to RICH. Moreover, new entrants such as SPAR and Glomark which carry a global brand should attract high spending locals and expats. We believe that online retailing should grow exponentially in Sri Lanka as the country already has access to highspeed internet and well-established electronic payment infrastructure. The lower cost bases of online retailers pose a margin challenge to traditional brick and mortar stores. We also believe RICH's margins maybe impacted by the relatively small size of RICH's finance company, Richard Pieris Finance (RPF). This should make it difficult for RPF to offer any meaningful synergies to the retail segment through credit card and other consumer finance products.

SELL

Valuation: We have valued RICH using a SOTP model which yields a 12-month target price of Rs. 9.3. We believe that RICH is currently over-valued. Though significant pockets of value do exist such as the Palm Oil and

Rubber Export segments, we believe that earnings drag from the Plantation sector which is highly exposed to Tea and Rubber as well as moderation in Retail segment margins pose significant downside risk. We recommend SELL.

Segment	Value (Rs m)	Basis	
Rubber	6,053	EV	WACC=17%
Tyre	1,253	EV	WACC=18%
Plastic, Furniture and Electronics	(170)	EV	WACC=17%
Retail	2,817	EV	WACC=16%
Financial Services	2,119	NBV	0.5X
Plantation	3,307	EV	WACC=19%
Total Enterprise Value	**15,379**		
Net Debt/Other Adjs.	3,598		
Equity Value	**18,977**		

12 month TP	**9.3**

Source: Company Data, Taprobane Research

Key Risks:

- Weather is a key risk for the plantations segment; Tea, Rubber and Oil palms are usually grown in tropical regions with the best yields coming from areas closer to the equator. Moreover, yield of palm oil, which is a key value driver is affected by excess rain and cold weather patterns.
- High exposure to Retail may be counter-productive if expected recovery in economic growth and consumer spending does not materialise soon.
- A key concern is analysts' ability to approach and meet senior management. In the compilation of this report, we were unable to meet senior management and discern important information such as growth strategy, capex plans etc.

Income statement

YE 31 March (Rs m)	FY18	FY19	FY20e	FY21e	FY22e	FY23e
Revenue	52,973	55,045	58,214	61,716	65,591	69,905
Operating Profit	5,397	4,879	5,266	5,343	5,796	5,862
Finance costs	-1,291	-2,109	-2,371	-2,683	-3,090	-3,618
Finance income	516	556	329	359	395	445
Associate income	10	28	28	28	28	28
PBT	4,632	3,354	3,252	3,046	3,129	2,716
PAT	3,082	2,347	2,277	2,132	2,190	1,901
EPS (Rs)	1.3	1.0	1.0	0.9	0.9	0.8

Balance Sheet

YE 31 March (Rs m)	FY18	FY19	FY20e	FY21e	FY22e	FY23e
Property, Plant & Equipment	19,449	20,210	20,862	21,589	22,392	23,284
Intangible assets	1,166	1,155	1,144	1,132	1,121	1,110
Other non-current financial ass	1,741	2,317	2,317	2,317	2,317	2,317
Other non current assets	2,610	3,292	3,288	3,284	3,281	3,278
Non Current Assets	24,966	26,974	27,610	28,321	29,110	29,988
Inventories	6,509	6,997	7,568	8,023	8,527	9,088
Trade and other receivables	8,218	10,080	10,479	11,109	11,806	12,583
Loans and advances	10,665	13,719	16,463	19,755	23,706	28,447
Other current assets	1,085	1,583	1,583	1,583	1,583	1,583
Cash and cash equivalents	4,544	5,467	4,155	2,645	1,190	-475
Current Assets	31,020	37,846	40,248	43,115	46,812	51,227
Long Term Borrowings	5,071	5,879	5,879	5,879	5,879	5,879
Deferred Tax Liabilities	855	975	975	975	975	975
Other non current assets	5,080	5,444	5,444	5,444	5,444	5,444
Long term liabilities	11,006	12,298	12,298	12,298	12,298	12,298
Trade and other payables	8,889	9,933	10,479	11,109	11,806	12,583
Customer deposits	5,070	6,680	8,685	11,290	14,677	19,080
Loans and borrowings	14,770	19,422	19,422	19,422	19,422	19,422
Other current liabilities	359	364	364	364	364	364
Current Liabilities	29,088	36,400	38,949	42,185	46,269	51,449
Share Capital	1,973	1,973	1,973	1,973	1,973	1,973
Retained Earnings	11,137	11,085	11,299	11,369	11,496	11,335
Other reserves	170	227	227	227	227	227
Minority Interests	2,613	2,838	3,112	3,385	3,659	3,933
Equity and Reserves	15,892	16,122	16,610	16,954	17,355	17,468
NAVPS	6.5	6.5	6.6	6.7	6.7	6.7

Cash Flow Statement

YE 31 March (Rs m)	FY18	FY19	FY20e	FY21e	FY22e	FY23e
PBT	4,627	3,349	3,252	3,046	3,129	2,716
Depreciation & Amortisation	1,016	1,213	1,322	1,357	1,405	1,459
Changes in working capital	-620	-3,364	-1,164	-1,142	-1,068	-899
interest paid (net)	-742	-1,432	-2,042	-2,325	-2,694	-3,173
taxes paid	-1,102	-1,301	-976	-914	-939	-815
other adjustments	1,498	2,474	2,014	2,297	2,667	3,146
Operating Cash Flow	4,677	940	2,408	2,320	2,500	2,434
Capex	-3,988	-2,078	-1,931	-2,041	-2,167	-2,309
FCFF	**689**	**-1,138**	**477**	**278**	**334**	**124**
net debt issued/repaid	-799	2,193	0	0	0	0
FCFE	**-110**	**1,055**	**477**	**278**	**334**	**124**
Dividends paid	-2,239	-1,730	-1,730	-1,730	-1,730	-1,730
other adjustments	-884	-1,341	-59	-59	-59	-59
Net Cash Flow	**-3,232**	**-2,017**	**-1,312**	**-1,511**	**-1,455**	**-1,664**

Source: Company Data, Taprobane Research

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