

Lanka Milk Foods (CWE) PLC [LMF.N: LKR 174.50]

Higher demand for fresh milk and ongoing capacity expansion to steer LMF's topline

Recommendation: BUY

Target Price: LKR 237.80

Sector: Food Beverage & Tobacco

Lanka Milk Foods group consists of five companies engaged in importing, manufacturing, producing, packaging marketing and distributing dairy and beverage products under Lakspray, Ambewela Daily, My Juicee and BLU brands. The powdered milk and liquid milk segments accounts to 32% and 58% of LMF's topline respectively. The agriculture segment which is in to rearing of cattle, contributes to 9% of the revenue. In FY21, LMF recorded the highest ever revenue and profit of LKR 7.5Bn and LKR 842Mn respectively. This stellar performance was backed by the 19%YoY revenue growth in liquid milk segment, higher capacity utilization, cost efficiencies and capturing new customer segments through strengthened distribution network amid the pandemic.

Consumer shift towards liquid milk and expansion plans to drive LMF's topline: We expect the revenue contribution from liquid milk segment to increase to >65% (from current 58% of revenue) in FY22E backed by (i) capacity expansion (ii) consumers shifting to liquid milk due to health concerns and likely milk powder shortage. Over the years consumer have been moving away from powdered milk to fresh milk with the increased awareness of harmful effects of powdered milk and health benefits of liquid milk. Hence, along with the industry LMF has also been in the process of increasing the milk production. With the completion of LKR 3.7Bn dairy farm by the end of 2021, LMF intends to increase the herd and cater to the excess demand as 60% of the annual milk demand was fulfilled through imported milk powder. According to the management, the expansion should increase the average production to 55,000 liters per day over the next three years from current 35,000 liters per day, indicating a 60% growth in volumes. This would also reduce the pressure on cost as LMF procures approximately 7.3Mn liters annually from external parties while paying a premium of 35%.

Furthermore, LMF is in a position to benefit from the prevailing milk powder shortage in the market which arose as a result of 27%YoY increase in global milk powder prices, higher freight rates and sharp LKR depreciation. Over the past few months LMF and other producers have kept lobbying the government to increase the price of 1Kg milk powder by LKR 350. Although, GOSL provided a tax relief of LKR 35 (includes 5% PAL and 15% duty) and agreed to increase the price of milk powder by LKR 200/Kg, importers are still unable to break even, let alone make a profit due to the maximum retail price imposed and continuous rise in costs. Currently, only the companies of which milk powder is the sole business is importing at a loss. Hence, LMF halted milk powder imports for the past six months and intends to continue until the price is revised, reducing its exposure to low margin milk powder segment. Further, the domestic milk production has grown by a CAGR of 6% with the amount of imported milk remaining stable over the past five years, indicating the demand for milk is continuously on the rise. Therefore, we expect consumers to shift to liquid milk due to likely milk powder shortage although it is not the most cost-effective option for consumers.

Likely increase in product prices to mitigate the pressure on margins in FY22E: We believe that LMF would continue to maintain its GP margin at 14%-16% level as the adverse impact from further depreciation of LKR and continuous rise in animal feed, other raw material costs and packaging costs (accounts to 17% of total cost), could be mitigated with volume growth in liquid milk segment, improved fixed cost absorption through the new farm, increase in sales of high margin products and likely increase in product prices during the year.

LMF's target to increase monthly yoghurt sales from 4Mn cups to 6Mn cups in FY21 as the company doubled the production capacity of yoghurt in the previous year was unattainable due to the extended periods of lockdown. However, we expect sales of high margin products (yoghurt, yoghurt drink) to grow with the economic recovery, strengthened distribution network amid the pandemic and addition of new products.

Key Statistics

Market Cap (LKR Bn)	6.9
Market Cap (USD Mn)	34.1
Issued Quantity (Mn)	40.0
Current Trading Range	170.00-175.00
52 week High/Low	100.10/197.50
YTD High/Low	139.00/197.50
Valuation	
Market PE (x)	10.6
Market PBV (x)	1.2
PE (x)	5.4
PBV (x)	0.6
Bloomberg Ticker	LMF SL
GICS Industry Group	Food Beverage & Tobacco

Main shareholders as at 30.06.2021

Milford Exports (Ceylon) (Pvt) Ltd	33.57%
Melstacorp Plc	16.79%
Mills Enterprises Ltd	15.30%
W. M. C. H. Umayanga	1.20%
Pershing Llc S/A Averbach Grauson & Co.	1.16%

Share Price Performance



Analyst: Nisali Ranaweera

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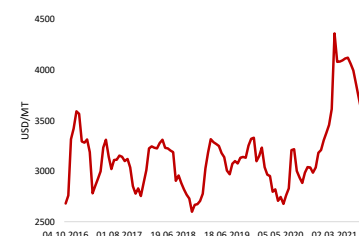
Sector: Food Beverage & Tobacco

Further, LMF increased the prices of liquid milk by 8%YTD to LKR 280/1L and yoghurt by 13%YoY to LKR 45/cup to cushion the impact of rising costs and we believe that the prices will be increased further during the 2H'FY22.

LMF's equity investments to drive the growth of other income: During the FY21, LMF's dividend income grew by 16%YoY mainly through the investments in MELS (13%) and DIST (1%) which have an average dividend payout of 96% and 74% respectively. MELS and DIST are mainly engaged in liquor and tourism segments which look promising with the anticipated revival in tourism, relaxation in travel restrictions and high consumption. The other listed companies in LMF's equity portfolio are BBH (1%), DOCK (0.3%) and COMB (0.2%). Hence, we expect this trend to continue driven by the healthy performance and high dividend payout from these entities.

Valuation: We estimate LMF's net profit to reach LKR 1.0Bn (23%YoY) in FY22E supported by increased demand for liquid milk and government policies to make the country self-sufficient in dairy milk production. In FY23E we estimate a revenue jump of 18%YoY to LKR 10.3Bn backed by the volume growth in liquid milk segment through the fully operational farm which is under construction at the moment. Hence, we believe LMF be able to increase its market share further and to continue its growth momentum. Based on DCF valuation method we estimated a 12M target price of LKR 237.80, a upside of 36%, and along with a dividend yield of 3% LMF should generate a total return of >39%. Thus, we recommend BUY.

Whole milk powder prices increased by 27%YoY


Earnings Forecast

YE 31 March	FY18	FY19	FY20	FY21	FY22E	FY23E	FY24E
Income Statement							
Revenue (LKR Mn)	5,279	5,385	6,704	7,597	8,730	10,300	11,831
YoY growth (%)	-1%	2%	24%	13%	15%	18%	15%
Net Profit (LKR Mn)	581	(127)	291	842	1,001	1,273	1,474
YoY growth (%)	3%	-122%	-328%	190%	19%	27%	16%
EPS (LKR)	14.5	-3.2	7.3	21.0	25.0	31.8	36.9
DPS (LKR)	2.5	1.3	2.5	5.0	4.0	5.1	5.9
BVPS (LKR)	311.5	222.7	260.3	281.2	301.5	328.3	359.2
Balance Sheet							
Property, Plant & Equipment (LKR Mn)	1,473	1,281	2,027	3,062	3,124	3,227	3,367
Total Assets (LKR Mn)	13,792	10,613	12,954	14,521	15,773	16,508	17,480
Total Equity (LKR Mn)	12,470	8,918	10,413	11,249	12,061	13,130	14,368
Total Liabilities (LKR Mn)	1,323	1,696	2,541	3,273	3,712	3,378	3,112
Ratios (%)							
GP Margin	15%	9%	10%	14%	16%	16%	16%
EBIT Margin	13%	2%	8%	12%	15%	15%	15%
NP Margin	11%	-2%	4%	11%	11%	12%	12%
Dividend Payout(%)	17%	-39%	34%	24%	16%	16%	16%
Dividend Yield (%)	1.5%	0.7%	1.5%	2.9%	2.4%	3.0%	3.5%
ROE (%)	5%	-1%	3%	7%	8%	10%	10%
PE (x)	12.0	(54.8)	24.0	8.3	7.0	5.5	4.7
PBV (x)	0.6	0.8	0.7	0.6	0.6	0.5	0.5

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