CIC Holdings PLC [CIC.N: LKR 51.70, CIC.X: LKR 43.90]

Likely revisit of import ban on chemical fertilizer to provide strong tailwinds for CIC

Recommendation: BUY | Target Price: LKR 60.43/LKR 51.31 | Sector: Material

CIC Holdings PLC-one of Sri Lanka's leading conglomerates- ventures in businesses ranging from agriculture, chemicals, medicine to household products. CIC Group recorded a stellar performance for the year 2021 notwithstanding continued economic headwinds and the devastating impact of COVID-19 pandemic. Group's profits for FY21 grew by a notable 276%YoY to LKR 3.1Bn helped mainly by its crop solution segment (34% of revenue) which mainly represents agro chemicals and fertilizer jumping by 49% YoY. Groups second largest contributor to the revenue- livestock solutions- which is in to feeds, poultry, vetcare and dairy breeding jumped by 29%YoY while health care solutions (herbal care, medical devices, personal care, pharmaceuticals) that contributes to 23% of revenue grew by 3%YoY. The other two segments – Industrial and agri produce meanwhile contributed to 10% and 9% of the revenue respectively.

In terms of profit contribution, crop solutions contributed to 42% of equity holders' profits for FY21 followed by industrial solutions which represents construction material, industrial raw material and packaging contributing to 26% of the bottom-line. The Health and Personal care segment represented by Link Naturals continued to make strong headway in overseas markets too contributing to 22% of the group profits. Livestock segment meanwhile contributed to 17% of profits while agri produce which is mainly in to rice, dairy and fresh produce ("Fresheez") recorded a loss of LKR 223Mn for the year under review.

The possible shortage that would potentially be created in the fertilizer market could prompt Government to revisit some of the rigid decisions taken: We believe the gazette published on 6th May 2021, banning the importation of chemical fertilizers including mixtures and agrochemicals and biopesticides in order to move completely to organic fertilizer to create a significant shortage in fertilizer market in the coming months.

Despite, many discussions, and debate on this matter, GOSL still stand on its grounds to continue with the ban of chemical fertilizer, however, has also taken some efforts to increase the local production.

The experts have also estimated, to meet the same yield, the country must manufacture many folds of organic fertilizer compared to 952,000 MT of chemical fertilizer imported in 2020. This in our view could be an uphill task given that Sri Lanka currently produce only 2-3 tons of organic fertilizer a year amongst 27 licensed local organic manufacturers. The recent steps taken by the government which are yet in preliminary stages to bridge the gap like launching 35 large scale projects in the North Central Province to provide 300,000 metric tons of organic fertilizer, create 15,000 smallholder fertilizer producers to add another 10,000 kg of compost per month and proposing to pay LKR 12,500 per hectare to encourage the farmers to produce and use organic fertilizer for cultivation, however may not be sufficient to bridge the gap specially following the recent ban of importation of organic fertilizer too.

Although some of the other motives behind the ban could be to save money spent on chemical fertilizer imports (Government spent around USD 259 Mn on importation) and cushion the fiscal front (as fertilizer subsidy accounts to LKR 36.7Bn), we believe there could still be two main reasons for the government to revoke/ revisit decision taken to ban import chemical or organic fertilizer. (i) The possible food shortage that would arise through low yields specially in paddy (yields could come down by 30-35%) and vegetable (30%-50%) which could even fuel the inflation in the country. This could even provoke government to import the basic food items which will again go against the main goal as the items been imported could end up been inorganic. (ii) due to direct impact on the export income through low yields specially in tea (lose up to 50%) and other main crops (cinnamon 25%) which in this juncture is something government cannot afford.

Key Statistics
CIC Holdings PLC

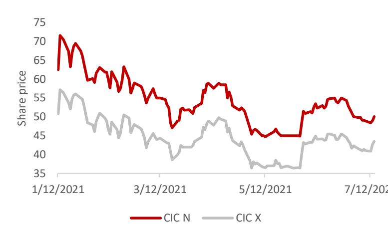
Market Cap (LKR Bn) - Voting	14.6
Market Cap (LKR Bn) - Non Voting	3.8
Market Cap (USD Mn) - Voting	73.09
Market Cap (USD Mn) - Non Voting	19.04
Issued Quantity (Mn) - Voting	291.60
Issued Quantity (Mn) - Non Voting	87.50
Current Trading Range - Voting	49.50-51.00
Current Trading Range - Non Voting	43.80-44.00
52 week High/Low - Voting	71.60/13.25
52 week High/Low - Non Voting	57.20/10.25
YTD High/Low - Voting	71.40/44.70
YTD High/Low - Non Voting	57.20/36.40
Valuation	
Market PE (x)	10.3
Market PBV (x)	1.0
PE (x) - Voting	6.1
PE (x) - Non Voting	5.3
PBV (x) - Voting	1.4
PBV (x) - Non Voting	1.2
Bloomberg Ticker	CIC SL
GICS Industry Group	Materials

Note: Prices as at 15.07.201 and adjusted for the share split of 1:4 which came into effect on 11.01.2021

Main shareholders as at 31.03.2021

	%
Paints & General Industries Limited	53.31
Employees Provident Fund	9.06
Chacra Capital Holdings (Private) Limited	4.49
Seylan Bank PLC/ ARRC Capital (Private) Limited	2.13
Hotel International (Private) Limited	1.34

Share Price Performance



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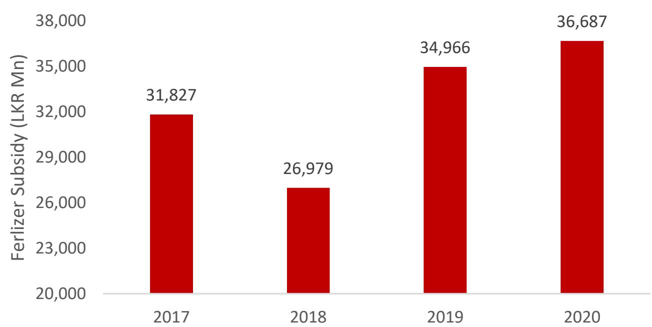
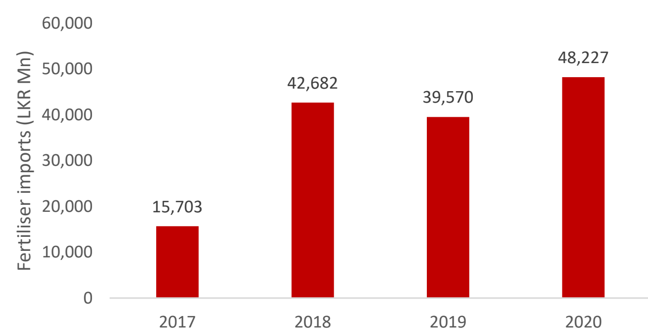
Sri Lanka spends LKR 36.7Bn on fertilizer subsidy and LKR 48.2Bn on importation of chemical fertilizer

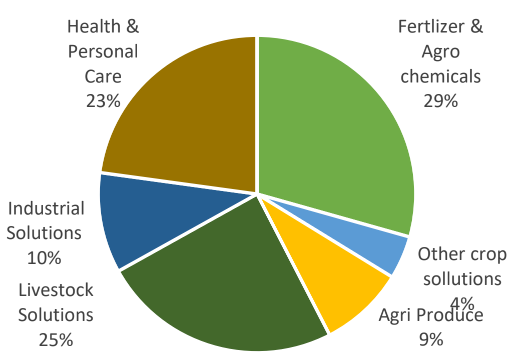


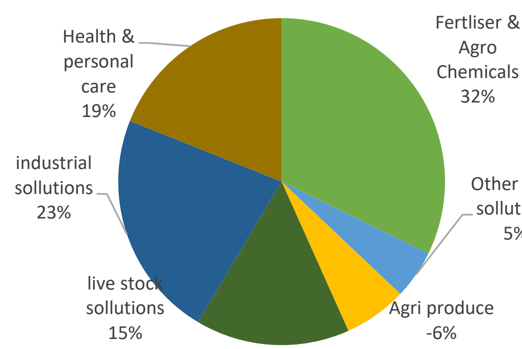


Source: CBSL & MOF

However, despite the surrounding uncertainties CIC – one of the largest importers of chemical fertilizer – have still taken some drastic steps to minimize the impact from fertilizer ban (as contribution from Fertilizer & Agro Chemicals contributed to 29% of revenue (LKR 10.9Bn) and apprx 32% of profits (LKR 1-1.1Bn in 2020). The company has already taken measures to strengthen the capacity in the organic fertilizer area and have ventured into the manufacture and distribution of organic fertilizer to mitigate the impact from chemical fertilizer & agrochemical ban. According to the management, CIC has also acquired an organic fertilizer supplier to fall in line with government policies. Moreover, in the event Government revisit the decision of banning the fertilizer imports, which we believe could be highly likely, CIC would be in a very comfortable position to reap benefits due to the strong relationship it has maintained over the years with fertilizer importers.

Fertilizer & Agro Chemicals contributed to 29% of CIC's revenue and ~32% of profits





Source: Company reports

CIC's other segments should grow along with pent up demand: CIC's industrial sector catering to sale of paints, emulsions, industry related raw materials, chemicals and packaging which is directly linked to country's Construction sector could see an immediate pick up once the economy is open. The low interest rate environment could also help boost this segment in our view with pick up in the home builder's market. The livestock sector and agri segments meanwhile too will continue with its healthy profits due to its essential nature, however we have taken a margin cut of about 100-150bps due to the rising feed cost in the industry. Health & Personal care segment meanwhile could perform on the back of rising demand in the local pharma & medical devices industry.

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Valuation: We estimate CIC's performance to have a temporary hit in FY22E with profits falling by ~22%YoY to LKR 2.4Bn on the back of (i) ban on fertilizer imports and (ii) time lag taken by CIC to showcase results on the newly entered organic fertilizer business. However short-term consolation remains in the books of CIC, as we believe it hold approximately around three months of chemical fertilizer imports. Profits for FY23E however should end at LKR 2.9Bn in our view, especially with some rigid policies taken been revisited by the government and CIC's quick adoption to the same.

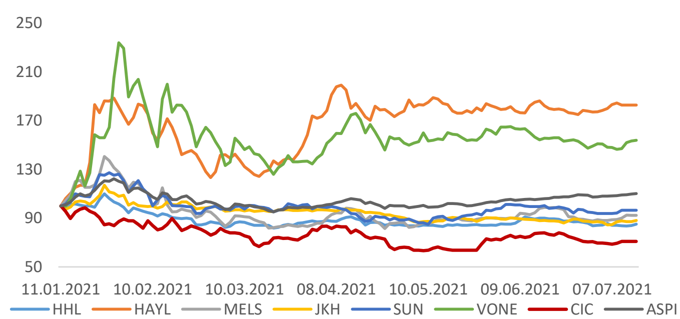
When we look at the market prices too, CIC has responded to the ban and other external factors negatively, dropping by ~30% from its highs of LRK 71.50 levels resulting in one of the most underperformed counters amongst diversified sector. CIC has underperformed by 29% since the share split compared to CSE which performed by 10% , while peers like Hayleys (83%), Vallibel One (54%) and Richard Peiris (16%) performing significantly above the market.

We have thus valued CIC on a relative earnings' multiple basis, taking an average earnings multiple of diversified counters as a yardstick. CIC trades at one year forward PE of 7.8x after an earnings cut, a significant discount to the average diversified sector PE of 12x, which we believe is unwarranted. Therefore, even after applying a discount of 20%-22% on the average diversified sector PE (12x), the counter should still trade at 9.4x PE which should translate to a value of LKR 60.43, a 17% upside to the current market price. With the dividend yield of 3.4%, the counter should derive a total return of >20% while CIC non-voting should trade at LKR 51.31, deriving a total return of 21%. We thus recommend CIC BUY.

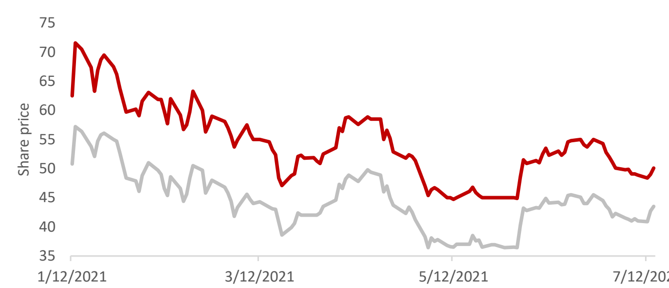
Average PE of diversified counters stands at 12x. CIC trades at one of the lowest despite generating the highest ROE

Counter	Share price (LKR)	Mkt Cap (LKR Bn)	TTM 4Q PE (x)	PBV (x)	ROE (%)	TTM DY (%)
CIC Holdings PLC	50.1	14.6	6.1	1.4	27.5	4.5
John Keells Holdings PLC	136.5	180.1	38.1	0.8	2.1	1.1
Hemas Holdings PLC	80.8	48.2	12.8	1.5	11.9	2.3
Richard Peiris and Company PLC	17.0	34.5	7.4	2.0	26.6	5.9
Renuka Holdings PLC	14.7	2.2	9.7	0.3	3.5	1.7
Hayleys PLC	77.8	58.3	7.6	1.3	17.3	1.3
Vallibel One PLC	53.9	61.3	7.6	1.0	13.0	6.5
Melstacorp PLC	48.2	56.1	11.5	0.7	5.9	10.9
Sunshine Holdings PLC	25.7	11.5	7.6	1.1	14.5	5.8
Aitken Spence PLC	61.9	25.1	-	0.5	-	1.6
Softlgoic Holdings PLC	11.6	13.8	-	2.3	-	-
Average		46.0	12.0	1.2	13.6	4.2

CIC- most underperformed amongst other diversified



CIC's prices slipped by 30% from its YTD highs



Source: CSE & Company reports

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Summary Financial Performance

YE 31 March	FY19	FY20	FY21	FY22E	FY23E
Revenue (LKR Mn)	**30,702**	**30,535**	**37,233**	**34,562**	**41,217**
YoY growth (%)	*4.2%*	*0.5%*	*21.9%*	*-7.2%*	*19.3%*
Revenue Contribution					
Crop Solutions	*31%*	*28%*	*34%*	*20%*	*22%*
Agri Produce	*11%*	*9%*	*9%*	*10%*	*10%*
Livestock Solutions	*19%*	*23%*	*24%*	*29%*	*28%*
Industrial Solutions	*12%*	*13%*	*10%*	*12%*	*11%*
Health & Personal Care	*26%*	*27%*	*23%*	*29%*	*29%*
Operating Profit (LKR Mn)	2,315	3,187	5,394	4,498	5,349
Equity Holders Profit (LKR Mn)	**483**	**833**	**3,132**	**2,438**	**2,951**
YoY growth (%)	*319.5%*	*72.3%*	*276.2%*	*-22.1%*	*21.0%*
Reported EPS	5.1	8.8	8.3	6.4	7.8
EPS (LKR) on current share volume	1.3	2.2	8.3	6.4	7.8
DPS (LKR)	1.0	2.0	2.3	1.7	2.1
BVPS (LKR) on current share volume	24.3	25.3	34.9	39.8	45.7
Ratios (%)					
EBIT margin	8%	10%	14%	13%	13%
NP margin	2%	3%	8%	7%	7%
Dividend Payout	20%	23%	27%	27%	27%
ROE (%)	5%	9%	27%	17%	18%
Voting					
PE (x)	39.3	22.8	6.1	7.8	6.4
PBV (x)	2.1	2.0	1.4	1.3	1.1
Dividend Yield (%)	2.0%	4.0%	4.5%	3.5%	4.2%
Non-Voting					
PE (x)	34.1	19.8	5.3	6.8	5.6
PBV (x)	1.8	1.7	1.2	1.1	1.0
Dividend Yield (%)	2.3%	4.6%	5.2%	4.0%	4.8%

Source: Company annual reports & NLE Research

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