

Sunshine Holdings PLC [SUN.N: LKR 35.20]
SUN poised to reap benefits from the latest ventures. Focus on core business activities to drive up the topline

Recommendation: BUY

Target Price: LKR 48.90

Sector: Food Beverage & Tobacco

Sunshine Holdings PLC - one of the leading conglomerates - ventures in businesses ranging from healthcare, consumer goods and agri business. SUN's merger with Akbar Pharmaceuticals in 4Q'FY21, opened the path forward to become Sri Lanka's first fully integrated healthcare company engaged in research and development, manufacturing, importation, distribution and retail activities. SUN's healthcare segment which consists of pharmaceuticals, medical devices and Healthguard pharmacies now together with Akbar merger contributes to a significant 54% of Group's topline.

The agri business segment which is in to palm oil plantation and dairy, through the group's subsidiary- Watawala plantations PLC- meanwhile contributes to 24% of SUN's revenue. The consumer goods segment meanwhile operates under the brands Watawala, Zesta, and Ran Kahata, the market leaders in the branded tea segment. With the acquisition of Daintee Ltd->40% controlled domestic confectionary manufacturer- in 2Q'FY21, the group also diverted to confectionary business under the brands- Daintee, Milady, Bensons, Chito, Chix, X-tra, and Mr Bitz, pushing consumer segment contribution to 22% of SUN's revenue.

Growth in pharmaceutical industry and step-up revenue from strategic merger with Akbar Brothers to boost healthcare sector revenue further: We expect the demand for pharmaceutical industry to continuously rise on the back of: (i) ageing population and harmful habits of consumers leading to the rise in non-communicable diseases (ii) increased health consciousness of people due to the pandemic. Consequently, we believe the biggest contributor to healthcare segment - pharma distribution (contributes to 60% of healthcare) which holds the No.1 position in cardiac care and Insulin distribution in Sri Lanka will benefit in the long term. Further, according to the recent market trends; the hospital occupancy, number of lab tests and surgeries were higher during the lockdown periods during which higher number of Covid patients were reported. With the emergence of new variants which are not responsive to the vaccines, we expect this trend to continue. Hence, the demand for medical devices segment (contributes to 20% of healthcare) which represents surgical items, blood test kits and PCR kits is also expected to grow in the medium term.

The recent venture (4Q'FY21), Akbar pharmaceuticals consists of agency business and manufacturing, contributing to 67% and 33% of Akbar pharmaceuticals revenue respectively. SUN expects the manufacturing segment to be the major revenue contributor to Akbar pharmaceuticals, adding approximately LKR 1.7Bn to the topline by FY24. The ambitious target is expected to be through manufacturing segment- Lina Manufacturing (manufactures respiratory pharmaceuticals and devices) which has an annual capacity of 1.6Bn units and Lina Spiro which is planning to commence operations in the near term as Sri Lanka's first and only metered dose inhaler manufacturing plant with an annual capacity of 2Mn units which is equal to the annual demand of the country. Lina Manufacturing is also an oligopoly specialized in dry powder inhaler manufacturing and currently operates at 35% capacity utilization level. Hence, SUN is in a position to benefit from 'National Competitive Bidding' (which was extended till 2024 by GOSL) due to SUN's potential to increase capacity utilization and less competition for the products. Thus, the revenue contribution from healthcare segment could increase to >58% by FY24, maintaining the position as SUN's major revenue contributor.

Moreover, of the pharma distribution segment, contribution from price-controlled molecules under a gazette which was passed in 2019 is 40%. During 2Q'FY22, GOSL increased the prices of these molecules by ~9% which is yet to be reflected in SUN's performance. SUN also increased the prices of other molecules (which are not included on the gazette) by lobbying to the government along with other pharmaceutical manufacturers. Hence, we expect the margins to expand from 8% recorded in 2Q'FY22 to 9% in FY22 with price increase of gazette molecules getting reflected in the coming quarters given that it was effective only from 19th of August'21.

Key Statistics

Market Cap (LKR Bn)	15.79
Market Cap (USD Mn)	77.79
Issued Quantity (Mn)	448.70
Current Trading Range	33.40-37.50
52 week High/Low	35.20/22.00
YTD High/Low	35.20/22.60
Valuation	
Market PE (x)	13.3
Market PBV (x)	1.5
SUN PE (x)	8.8
SUN PBV (x)	1.4
Bloomberg Ticker	SUN SL
GICS Industry Group	Food Beverage & Tobacco

Note: Prices as at 17.11.2021 and adjusted for the share split of 1:3 which came into effect on 31.03.2021.

Main shareholders as at 30.09.2021

Lamurep Investments Limited	59.48%
Deepcar Limited	10.00%
SBI Ven Holdings Pte Ltd	5.60%
Ceylon Property Development Limited	2.04%
Phoenix Ventures Private Limited	2.00%

Share Price Performance


Analyst: Nisali Ranaweera

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Expected pick up in economic activities and introduction of new items to the confectionary portfolio to drive consumer segment's topline: SUN caters to approximately 48% of the market share in branded tea market, attracting different consumer segments with Zesta (caters to local and export market), Watawala (caters to middle income) and Ran Kahata (caters to low income). We expect the revenue contribution from tea to be increased to 77% levels of consumer goods segment (from 75% in FY21) as the lockdown enforced during the year will not have a significant impact due to stocking up by consumers. Moreover, as a solution for the impending fertilizer shortage, SUN increased the stocks of tea and purchased tea at a higher cost in order to maintain the quality of the product and to sustain their market leadership.

In terms of the confectionary segment (contributes to 25% of the segment's revenue with the acquisition of Daintee Ltd which is the market leader in the hard-boiled candies category catering to 43% of market share), SUN intends to introduce consumer packs to reach modern trade consumers as 'Daintee' is yet a strong brand only among general trade consumers. Despite the closure of general trade outlets during the lockdown which is likely to impact the confectionary segment, we expect the sales to increase further in the medium term with SUN's focus on expansions and expected economic normalization backed by reopening of the country and 61% of the Sri Lankan population being fully vaccinated.

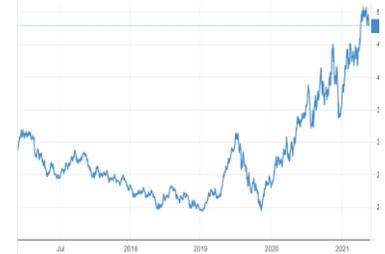
Further, in Oct'21 SUN also settled the debt of LKR 1.1Bn obtained for the acquisition of Daintee Limited with the recent funding lines from IFC of USD 5Mn for a tenor period of 7 years (including 2 years grace period). The management expects SUN to benefit as the interest rate of the funding line are on fixed terms compared to the previous loan which was on floating rate, that would have had a direct impact with rising interest rates.

Stronger global palm oil prices and expansions in dairy production to increase the revenue contribution from agri business: Palm oil contributes to 22% of SUN's revenue due to its 92% contribution to Watawala plantation (WATA). WATA's operating margins from palm oil increased exceptionally from 50% in FY21 to 63% in 1H'FY22, mainly due to higher global palm oil prices and increased import duties imposed on imported palm oil, which enabled local producers like WATA to fetch higher NSA (net selling average). Although, palm oil prices have declined by 4%MoM in Nov'21, prices still remain 36%YoY higher compared to FY21. We expect the prices to remain above pre pandemic levels with labour shortages, production disruptions due to the pandemic and higher demand in the global market. Thus, we expect the revenue contribution to increase to 24% in FY22.

Moreover, although new planting of palm oil is already banned, the government's plan to uproot 10% of the existing palm oil plantations and replace with an eco-friendly cultivation is still under discussion. However, till 2027-2028 SUN does not see the need to cultivate new plants as 50% of WATA's palm oil plants are in the young stage. WATA also plans to replace the 10% of existing palm oil which has to be uprooted annually, with cinnamon, coconut and tea if the regulation comes into effect. Further, according to the management the impact on palm oil from the fertilizer ban will be evident within next two years and WATA is currently using waste collected from dairy farms as a substitute. Hence, we believe that these events would exert some pressure on palm oil segment's gross profit margins in the long term.

Furthermore, in terms of the dairy segment, SUN intends to increase the daily milk production by 11% to 20,000 liters per day (from current 18,000 liters per day) through the increase in number of milking cows to 1000 (from current 800 cows). With the capital infusion of USD 2Mn by SBI Ven Holdings Pte. Ltd., SUN plans to import 250 cows (127 cows are to be imported before the end of 3Q'FY22) and to enhance capital infrastructure.

Global palm oil prices spiked up by 36%YoY



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Currently, the farmgate milk price is also on the rise with the higher demand for liquid milk as consumers are shifting to liquid milk due to health concerns and likely milk powder shortage. Although the higher feed cost could dampen the margins of this sector, we expect the impact to be minimum with the increased demand and major players of the dairy segment (Lanka Milk Foods, Pelwatte dairy, Cargills Ceylon and Fonterra Brands Lanka) being WATA's customers. Hence, we expect the revenue contribution from agri business to increase to 26% in FY22 compared to 24% in 1H'FY22.

SUN's focus on core business sectors to drive the topline in the long term : SUN exited from the power segment (which had a capacity of 8.3MW and contributed to 2% of group's revenue) with the disposal of Sky Solar (Pvt) Ltd (solar power generation through 8 rooftop solar plants) for LKR 265Mn and Waltrim Energy Ltd (hydro power generation through 3 mini plants) for LKR 900Mn. Given that SUN's gearing ratio is also at healthy levels (20% in 2Q'FY22), the group could comfortably invest the cash balance in consolidating the business and focusing on Healthcare (by increasing local pharmaceutical production) and Consumer segments (through product diversification).

SUN's SOTP valuation indicates a BUY: We estimate SUN's profits to reach to LKR 2.2Bn (47%YoY) in FY22E supported by higher margins from Agri and step up revenue contribution from Daintee Ltd and Akbar Pharmaceuticals. From FY23E onwards we have taken a conservative approach when arriving at margins. Healthcare segment specifically may see some short term margin pressure in our view, with impact from 3% tax imposed on turnover (it was proposed to charge a tax of 3% for companies exceeding annual turnover of LKR 120Mn on turnover from budget 2022) taking some time to be passed down. The rest of the segments however we believe could maintain margins specially with additional burden been able to pass down comfortably.

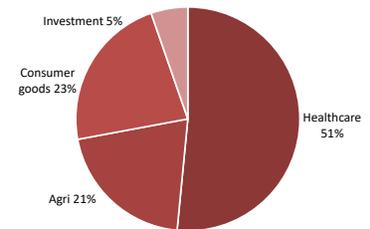
Based on the SOTP, we value the counter at LKR 48.90 (healthcare valued on DCF, consumer on PER and Agri on market based), derive an upside of 39% to the CMP of LKR 35.20. Moreover, the share trades at a forward PE of 5.2x on FY22E earnings which is still 50% discount to the 5Yr average PE. Thus, we recommend BUY.

Earnings Forecast

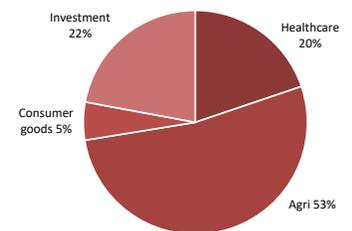
YE 31 March	FY18	FY19	FY20	FY21	FY22E	FY23E	FY24E
Revenue (LKR Mn)	21,181	22,642	20,875	24,339	32,252	36,499	41,719
YoY growth (%)	10%	7%	-8%	17%	33%	13%	14%
Equity Holder's Profit (LKR Mn)	829	647	1,147	1,522	2,236	2,418	2,625
YoY growth (%)	47%	-22%	77%	33%	47%	8%	9%
Reported EPS (LKR)	6.1	4.4	7.7	3.4	5.0	5.4	5.9
EPS on current no. of shares(LKR)	1.8	1.4	2.6	3.4	5.0	5.4	5.9
DPS (LKR)	0.5	0.4	0.8	0.8	1.2	1.3	1.4
BVPS (LKR)	14.2	16.8	18.8	23.5	27.2	31.3	35.7
Ratios (%)							
Dividend Payout(%)	27%	29%	29%	24%	24%	24%	24%
Dividend Yield (%)	1.9%	1.6%	2.9%	3.2%	4.7%	5.1%	5.5%
ROE (%)	13%	9%	14%	14%	18%	17%	16%
PE (x)	14.1	18.0	10.2	7.7	5.2	4.8	4.4
PBV (x)	1.8	1.6	1.4	1.1	1.0	0.8	0.7

Source: CSE & company reports

Health sector was the biggest contributor to revenue in 1H'FY22



Agri sector contributed the most to EBIT in 1H'FY22



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