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21 August 2017

Sri Lanka

Manufacturing

Key Highlights

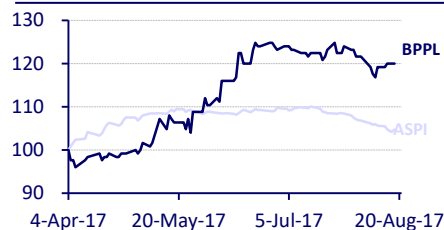
1Q18 Results Summary

- 1Q18 EPS of Rs.0.3 (unchanged YoY), below our expectations, largely due to wage escalation as a result of non-availability of labour and disruption of timber supplies owing to the floods witnessed during the month of May 2017
- FY18E Net Profit forecast maintained at Rs.505mn (+16% YoY) largely due to proposed income tax changes being postponed until FY19E, cushioning the slowdown in 1Q18. Further, a full year's impact of cost savings from the commissioning of BPPL's solar and bio mass plants and continuing currency depreciation is expected to aid margin expansion, despite rising raw material prices. Meanwhile, FY19E Net Profit forecast at Rs.620mn (+23% YoY), amid ramping up of the synthetic yarn project and further penetration into the local and Southeast Asian market
- The BPPL share witnessed positive investor sentiment and outperformed the market, appreciating +25% (vs. broader market performance of +5%), trading above the IPO price of Rs.12.0 since its listing on 04 Apr 2017. During the past 3M the share gained +13% vs. broader market decline of -4%
- The share currently trades at forward PER multiples of 9.1X for FY18E and 7.4X for FY19E and providing attractive ROEs of ~23-24% with a ~3-4% dividend yield
- BPPL is expected to be under pressure in the near term from rising raw material costs; especially petroleum and timber. Further, local currency depreciation will affect imports of select fibers and other raw materials. BPPL is also taking on a large amount of debt (~Rs.500mn) to fund the synthetic yarn project albeit under favorable terms. Further, potential supply and labour shocks in the event of adverse weather conditions is also an area of concern
- We expect positive investor sentiment to continue on the share due to continued double digit growth expected in the mature professional segment and the infant own branded sales coupled with the net benefit of currency depreciation working in BPPLs favour. The synthetic yarn project is also expected to be an additional growth catalyst once online in FY19E

Key Trading Information

Shares in Issue (mn)	306.8
Market Cap (US\$ mn)	30.0
Estimated Free Float (%)	10.0
3M Avg Daily Volume	382,142
3M Avg Daily Turnover (US\$)	37,097
3M High / Low (Rs)	15.6 / 13.0
3M Price Change (%)	13.0

Relative Share Price Movement (%)



BPPL: Valuation Ratios

Financials - Year to 31 March	FY14	FY15	FY16	FY17	FY18E	FY19E
Net Revenue (Rs mn)	1,766	1,931	2,088	2,424	2,655	3,234
Net Profit (Rs mn)	203	148	307	435	505	620
Earnings per Share (Rs)	0.7	0.5	1.0	1.4	1.6	2.0
Earnings per Share Growth (%)	8.5	-27.0	> +100.0	41.8	16.2	22.7
Price / Earnings Ratio (X)	N/A	N/A	N/A	8.8	9.1	7.4
Price / Earnings Growth (X)	N/A	N/A	N/A	0.2	0.6	0.3
Gross Dividend per Share (Rs)	0.1	0.2	0.4	0.4	0.5	0.6
Gross Dividend Yield (%)	N/A	N/A	N/A	3.4	3.3	4.0
Net Book Value per Share (Rs)	3.7	4.1	5.5	6.5	7.7	9.1
Price / Book Value (X)	N/A	N/A	N/A	1.9	1.9	1.6
Return on Equity (%)	19.3	12.4	20.8	23.5	23.1	24.0
Market Price per Share (Rs)	N/A	N/A	N/A	12.4	15.0	15.0

Note: Valuations are based on recurring EPS, Adj. for Capital Issues. Historic Ratios are based on Period End MPS

Source: CT CLSA

The Business

Established in 1991, **BPPL Holdings PLC (BPPL)** is a leading manufacturer and exporter of cleaning tools and janitorial products for the household and commercial markets. It is one of the largest backwardly integrated brush manufacturers in Southeast Asia, exporting to blue chip customers such as Oates, Carrefour, Rubbermaid, Home Depot, Tesco amongst others

Exports account for ~98% of total revenue with the remainder generated through local sales. BPPL exports a variety of products under three main segments; Professional, Direct Sales and Branded. BPPL **caters mainly to the professional cleaning tools** market (~78% of reported revenue), which is estimated to account for 10-15% of global net imports of cleaning tools

BPPL distributes its finished goods to leading players such as United Stationers and Bunzl in the janitorial sector, Grainger, Fastenal in the industrial sector, Home Depot, Lowe's and Tesco in the retail sector and Burger King, McDonalds and Starbucks through Century Products for the restaurant and food services sector

In pursuit of more growth opportunities, **BPPL is expanding into new markets under its own brands, "Tip Top" and "Jab"**. "Tip Top" was launched in Sri Lanka in 2015 with products marketed at leading supermarket chains. "Jab" was launched in Indonesia in 2016 with plans to expand into Malaysia in FY19E

Recent Financial Performance

BPPL reported a Net Profit (NP) of Rs.79mn for 1Q18 (unchanged YoY), below our expectations, largely due to gross margin contraction owing to wage escalation and disruption of timber supplies owing to the floods witnessed during the month of May 2017

Key Figures & Ratios	1Q17	1Q18	% YoY	% QoQ	FY16	FY17	% YoY
Revenue (Rs mn)	513	552	7.6	-15.0	2,088	2,424	16.1
EBIT (Rs mn)	100	91	-8.5	-31.7	361	511	41.5
Net Finance Expense (Rs mn)	-7	-5	-23.4	20.0	-31	-20	-34.8
Profit Before Tax (Rs mn)	93	86	-7.5	-33.4	331	491	48.5
Profit After Tax (Rs mn)	78	79	0.1	-43.2	307	435	41.8
Net Profit (Rs mn)	78	79	0.1	-43.2	307	435	41.8
Earnings per Share (Rs)	0.3	0.3	0.1	-43.2	1.0	1.4	41.8
GP Margin (%)	39.8	36.9	-2.9	-2.5	36.6	39.7	3.1
EBIT Margin (%)	19.5	16.6	-2.9	-4.1	17.3	21.1	3.8
PBT Margin (%)	18.2	15.6	-2.6	-4.3	15.8	20.3	4.4
Effective Tax Rate (%)	16.0	9.1	-6.9	15.6	7.3	11.5	4.2
Net Debt (Rs mn)	N/A	378	N/A	10.1	396	344	-13.2
Capex (Rs mn)	4	91	>+100.0	N/A	52	219	>+100.0

Note: Valuations and ratios on a recurring basis; Adjusted for capital issues (if any)

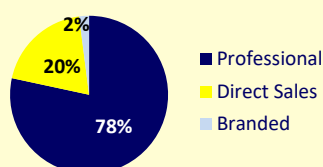
Source: Company financials

Quarterly Highlights

- BPPL reported revenue of Rs.552mn for 1Q18 (+8% YoY), largely driven by continued demand and depreciation of the LKR, with BPPL being a net beneficiary of currency depreciation. Sales were stymied by floods with some orders being delayed
 - Professional segment revenue (~78% of reported revenue) grew +6% YoY in 1Q18 owing to increased demand from the food services, janitorial and oil and gas sectors in the United States
 - Direct sales to retailers (~20% of reported revenue) grew +16% YoY during 1Q18 owing to client inventory adjustments and new product launches driving increased orders
 - Branded segment revenue (~2% of reported revenue) which consists of BPPL's own branded brushes, grew +22% YoY in 1Q18 (off a low base), owing to the favorable uptake of the product portfolio in the Indonesian and Sri Lankan markets
 - On a geographical basis, United States continues to be the single largest export growth market (~77% of reported revenue) growing +7% YoY in 1Q18
- BPPL's GP margin came under pressure during the quarter owing to a temporary wage escalation due to non-availability of labour and disruption of timber supplies owing to the floods, despite BPPL's facilities not being affected by the floods. As a result, 1Q18 GP margin contracted -288bps YoY to 36.9%

Flat NP owing to increase in cost of production as a result of recent floods

1Q18 Revenue by Segment



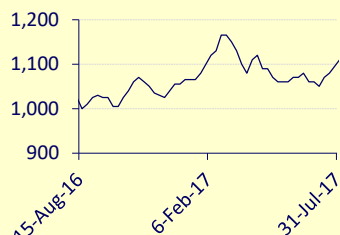
Source: BPPL

Temporary increase in raw material and labour costs impacted gross margins

Quarterly Highlights contd.

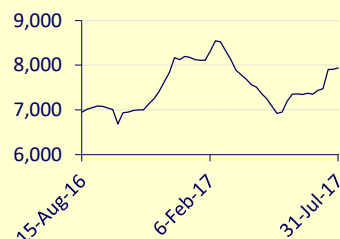
- Raw materials (mainly timber, polypropylene and fibre) amount to ~64% of total cost of sales, of which timber accounts for ~28%. The recent floods impacted the supply of timber, despite BPPL maintaining about four weeks of supply in the factory. As a result, prices paid for timber increased contributing to the contraction in gross margin in 1Q18
 - Prices of other raw materials such as polypropylene (~18-19% of total raw material costs) and PET (~6% of total raw material costs) were gradually picking up in line with rising crude oil prices. The US Energy Information Agency (EIA) forecasts a ~6% rise in Brent spot prices from the current average of US\$48/b in July 2017 to an average of US\$51/b for 2017E
 - Labour costs amount to ~15-17% of total cost of sales. However, due to the recent flooding, many employees were unable to report for work. Consequently, temporary workers were hired at higher wages to fulfil orders
- BPPL's working capital cycle increased to 223 days in 1Q18 (vs. 197 days in 1Q17 and 201 days in 4Q17), largely due to increased receivables turnover of 124 days (vs. 102 days in 1Q17 and 111 days in 4Q17), likely owing to increased credit sales. Consequently, operating cash flow declined -48% YoY
- Lower gross profit margin coupled with relatively higher operating expenses led to BPPL's 1Q18 EBIT margin to decline -293bps YoY and -405bps QoQ to 16.6%. Opex as a % of revenue increased marginally YoY to 20.6% in 1Q18 (vs. 20.3% in 1Q17 and 18.9% in 4Q17)
- Net finance cost declined -23% YoY in 1Q18 to -Rs.5mn (vs. -Rs.7mn in 1Q17) as accumulated profits were used for debt retirement
 - Net debt was recorded at Rs.378mn as at 30 Jun 2017 (vs. Rs.344mn as at 31 Mar 2017)
- The effective income tax rate was reported at 9.1% for 1Q18 (vs. 16.0% in 1Q17), owing to a tax holiday benefit for a subsidiary company, Beira Environmental Solutions (Pvt) Ltd. However, following the new Inland Revenue Act which is yet to be enacted, BPPL is expected to be subject to a corporate tax rate of 14% from FY19E
- On 27 Jul 2017, BPPL announced A first interim dividend of Rs.0.18 per share for FY18 – XD: 08 Aug 2017, PD: 17 Aug 2017. Management indicated that they would maintain a 30-35% payout despite expansion ongoing plans
- On 12 Jul 2017, the Central Environmental Authority (CEA) introduced an action plan with the objective of reducing plastic waste. As part of the action plan, lunch sheets, polystyrene and polythene food containers would be banned from 01 Sep 2017 and a 15% cess tax will be imposed on the importation of plastic raw materials in the mid-term followed by a complete ban on recycled plastic raw material in the long-term. Further, a recommendation to ban PET beverage bottles under 1000ml (excluding water) was also proposed in Mar 2017, which was not implemented
- According to management, CEA's action plans will not affect BPPL's operations as BPPL does not deal with polythene and does not import recycled plastic raw material. However, it is unclear how the 15% cess on imported plastic raw material will affect BPPL as the CEA has not given any additional information pertaining to this matter

Polypropylene Index (USD/mt)



Source: Bloomberg

Polyethylene Terephthalate (PET) Index (USD/mt)



Source: Bloomberg

TTM Valuations of Key Listed Peers

	BPPL	REXP	HEXP	TJL	MGT
MPS (Rs)	15.0	225.0	77.0	40.6	15.5
PER (X)	10.7	5.4	10.0	16.2	155.0
PBV (X)	2.2	2.4	0.8	2.5	1.2
Gross DY (%)	2.8	7.1	2.6	3.4	N/A *
ROE (%)	20.6	44.4	8.3	15.3	0.8

Note : Period ended 30 Jun 2017

* No dividends declared so far

Source : Respective company financials

FY18E segment earnings forecast maintained due to proposed income tax changes being postponed to FY19E

Gross margin expansion due to improved productivity and tighter cost controls

Outlook & Valuations

- Despite flat 1Q18 earnings, FY18E Net Profit forecast maintained at Rs.505mn (+16% YoY) largely due to proposed income tax changes being postponed until FY19E. Further, a full year's impact of cost savings from the commissioning of BPPL's solar and bio mass plants and continuing currency depreciation is expected to aid margin expansion, despite rising raw material prices. Meanwhile, FY19E Net Profit forecast is maintained at Rs.620mn (+23% YoY), amid ramping up of the synthetic yarn project and further penetration into the local and Southeast Asian market
- Revenue forecast maintained at Rs.2,655mn (+10% YoY) for FY18E, stemming from growth in sales in the US and from own-brands in Indonesia and to a smaller extent Sri Lanka. FY19E revenue forecast at Rs.3,234mn (+22% YoY) with growth driven by further penetration of own brands coupled with the revenue addition from the synthetic yarn project commencing operations in FY19E
- FY18E gross margin forecast revised down to 39.5% (-24bps YoY) largely due to the flooding related impact on gross margins despite cost savings from the solar and bio-mass power plants (contributing ~Rs.30mn or 33% of BPPL's total electricity cost, in electricity savings each year) and continuing rupee depreciation against the dollar despite increasing raw material costs. Meanwhile, FY19E gross margin forecast revised down to 39.6% (+13bps YoY) driven by higher margin contribution from synthetic fibre despite increasing raw material costs
- Group operating margins maintained at ~22% levels for FY18-19E (vs. 21.1% in FY17), with the addition of higher margin branded products, process efficiencies aided by continuing local currency depreciation
- Following the 2017 National Budget proposals, BPPL is expected to be subject to a concessionary corporate tax rate of 14% (vs. current rate of 12%) for export oriented companies from FY19E
- The BPPL share witnessed positive investor sentiment and outperformed the market, appreciating +25% (vs. broader market performance of +10%), trading above the IPO price of Rs.12.0, since its listing on 04 Apr 2017
- The share currently trades at forward PER multiples of 9.1X for FY18E and 7.4X for FY19E and providing attractive ROEs of ~23-24% with a ~3-4% dividend yield
- BPPL is expected to be under pressure in the near term from rising raw material costs; especially petroleum and timber. Further, local currency depreciation will affect imports of select fibers and other raw materials. BPPL has taken on a large amount of debt (~Rs.500mn) to fund the synthetic yarn project albeit under favorable terms. Further, potential supply and labour shocks in the event of adverse weather conditions are also an area of concern
- We expect positive investor sentiment to continue on the share due to continued double digit growth expected in the mature professional segment and the infant own branded sales coupled with the net benefit of currency depreciation working in BPPLs favour. The synthetic yarn project is also expected to be an additional growth catalyst once online in FY19E

Summarised Forecast Financials

Rs mn	FY16	FY17	YoY%	FY18E ^	% YoY	FY18E	YoY%	FY19E ^	% YoY	FY19E	YoY%
Revenue	2,088	2,424	16.1	2,655	9.5	2,655	9.5	3,234	21.8	3,234	21.8
Cost of Sales	-1,323	-1,461	10.4	-1,575	7.8	-1,607	10.0	-1,946	23.5	-1,953	21.5
Gross Profit	764	963	26.0	1,080	12.1	1,048	8.9	1,288	19.3	1,281	22.2
Distribution Costs	-212	-230	8.2	-234	1.8	-242	5.2	-259	10.7	-275	13.8
Administrative Expenses	-203	-222	9.0	-239	7.9	-242	9.1	-285	19.1	-275	13.8
EBIT	361	511	41.5	607	18.8	575	12.5	745	22.7	731	27.2
Net Finance Income/Expenses	-31	-20	-34.8	-21	3.8	-20	-1.2	-25	19.2	-25	25.3
PBT	331	491	48.5	587	19.4	555	13.0	720	22.8	706	27.2
Tax	-24	-56	>+100.0	-82	45.8	-50	-11.3	-101	22.8	-92	83.8
Margins (%)											
Gross Profit Margin	36.6%	39.7%	3.1	40.7%	0.9	39.5%	-0.2	39.8%	-0.8	39.6%	0.1
EBIT Margin	17.3%	21.1%	3.8	22.9%	1.8	21.7%	0.6	23.0%	0.2	22.6%	1.0
Effective Tax Rate	7.3%	11.5%	4.2	14.0%	2.5	9.0%	-2.5	14.0%	0.0	13.0%	4.0

Source: CT CLSA

Major Shareholder Movements

Major Shareholder Movements as at 30 June 2017

	Name	No. of Shares	%	Change (Shares)*	Comment
1	Infinity Capital (Pvt) Ltd.	154,382,777	50.3	-	Related party
2	LOLC Investments Ltd.	80,546,372	26.2	-	Promoter
3	Hirdaramani Investment Holdings (Pvt) Ltd.	41,229,208	13.4	-	Promoter
4	J.B. Cocoshell (Pvt) Ltd.	3,774,816	1.2	-	
5	ARRC Capital (Pvt) Ltd.	3,446,301	1.1	-	
6	Deutsche Bank AG Singapore Branch	2,576,300	0.8	-	
7	Ms. Marianne Mahilmalar Page	1,000,000	0.3	-	
8	Jafferjee Brothers (Exports) Ltd.	772,800	0.3	-	
9	W.D.N.H.Perera	762,567	0.2	-	
10	Mr. Fernando Merrill Joseph	750,000	0.2	-	
11	Mr. Esufally Murtazaali Abidhussen Hassanaly	733,400	0.2	-	
12	Mr. Akshay Anil Hirdaramani	732,100	0.2	-	
13	Mr. Mahesh Lalchand Hirdaramani	732,100	0.2	-	
14	Comtrust Equity Fund	730,000	0.2	-	
15	Lanka Century Investments PLC	645,100	0.2	-	
16	Mr. Samaranyake Nihal Parakrama De Alwis	600,000	0.2	-	
17	Ceylon Knit Trend Ltd.	556,520	0.2	-	
18	GF Capital Global Ltd.	476,600	0.2	-	
19	Katunayake Garments Ltd.	419,200	0.1	-	
20	Mr. Aroon Janak Hirdaramani	412,700	0.1	-	
	Top 20	1,468,759,745	93.0		

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