October 2023
Equity Research
Sri Lanka

Hayleys PLC

HAYL

Target price (12M. LKR) 108.00

Buy

Recent quarterly results for the largely export oriented Group are disappointing on the back of LKR appreciation YTD, base-effect from past non-recurring earnings and external headwinds; as such we don't expect immediate respite. However, investor rotation to domestic consumption-based counters may prove to be a Pavlovian response in the current economic context. HAYL with its dollarized portfolio of globally competitive businesses should continue to outperform peers in the medium term.

Capital Goods | Initiation Report

Acuity: Stock Ratings Scale

Acuity rating	**Strong Sell**	**Sell**	**Hold**	**Buy**	**Strong Buy**
Equivalent ratings	Strong Sell	Underperform Underweight Weak Hold Reduce Moderate Sell	Hold	Outperform Overweight Accumulate Add Moderate Buy	Strong Buy

Acuity: Industry View

Industry outlook	**Cautious**	**In-Line**	**Attractive**
	We view the performance of the industry coverage universe over the next 12-18 months with caution vs. the relevant broad market benchmark, as indicated below.	We expect the performance of the industry coverage universe over the next 12-18 months to be in line with the relevant broad market benchmark, as indicated below.	We expect the performance of the industry coverage universe over the next 12-18 months to be attractive vs. the relevant broad market benchmark, as indicated below.

Table of Contents

HAYL is one of Sri Lanka's largest value-added exporters

CMP as at 6th Oct 2023	LKR 89.50
Bloomberg and Ticker	HAYL SL Equity I HAYL.N
Market Cap (LKR Bn I USD Mn)	LKR 67.1 Bn I USD 207.4 Mn
Issued Quantity (Shares Mn)	750.0
Estimated free float	37.1%
Average daily volume (Last 3M)	762,086
52-week High and Low (LKR)	99.8 I 63.5
Industry & Year end	Materials I 31st March
Beta and Sharpe ratio	1.50 I 0.10

Chart 1.1: HAYL Technical Chart (Trailing 90 days)

Source: Bloomberg

Hayleys PLC	HAYL
Rating	Buy
12M Target Price	LKR 108.00
Potential Upside/ (Downside)	21%
Industry View: Capital Goods	In-Line

Hayleys PLC ("HAYL" or "the Group") reported significantly higher consolidated profitability in FY2021/22 and FY 2022/23 supported by both robust growth in its export SBUs and favorable exchange rate movements. Profitability in the current year is expected to be substantially reduced on account of weaker external demand, lower foreign currency gains and lagging effects of higher interest costs and taxation. However, based on our expectations of a recovery in the export SBUs and the transportation segment, we reiterate the stock as a "Buy" with a 12m price target of LKR 108.00 per share based on the current discount to its intrinsic value and a relevant multiple (in-line with historical/ market multiples) applied to forward earnings. Stock may warrant a re-rating on its valuation premium given that HAYL is overall less correlated with domestic economic conditions and is a hedge against further economic and currency risk. The current market price is at the oversold / undervalued end of the RSI scale. Investors could benefit from accumulating at these price levels and adding to their holdings on any further pullbacks in the stock price.

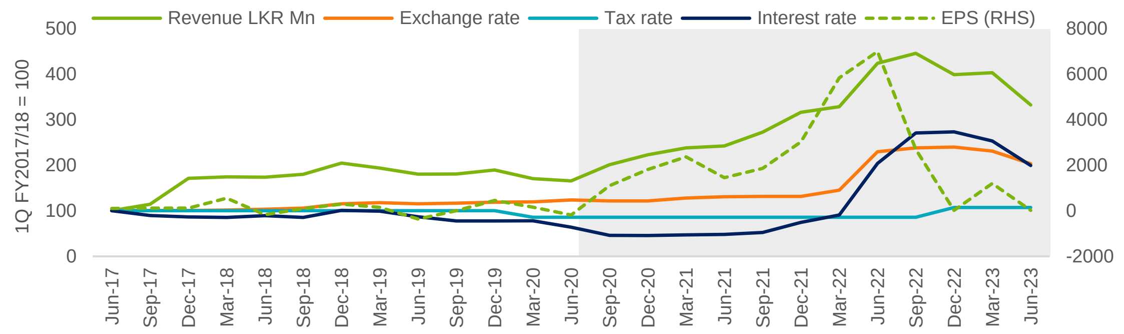
FY ended March 31	FY2020/21	FY2021/22	FY2022/23	1Q 2022/23	1Q 2023/24
Revenue (LKR Mn)	241,276	338,010	487,431	123,641	96,938
YoY Growth (%)	*15%*	*40%*	*44%*	*75%*	*-22%*
Operating profit (LKR Mn)	25,954	33,594	61,073	18,154	8,327
YoY Growth (%)	*58%*	*29%*	*82%*	*179%*	*-54%*
EPS (LKR)	10.18	24.34	21.80	13.99	0.04
DPS (LKR)	1.30	4.00	5.35	-	-
TTM PER (x)	*5.97*	*3.16*	*3.30*	*1.80*	*9.86*

Key revenue and earnings drivers of HAYL group

Table 1.1: Correlation of Business Performance & Economic Variables (2011-21)

+1 = perfect positive correlation, -1 = perfect negative correlation, 0 = no correlation	*Revenue*	*Gross profit*	*Profit attributable to shareholders*
Exchange Rate (LKR/USD)	0.96	0.98	0.64
REER	-0.88	-0.88	-0.71
Nominal GDP growth (%)	-0.39	-0.44	-0.05
Real GDP growth (%)	-0.61	-0.67	-0.25
Interest rates (%)	-0.18	-0.24	-0.32
Taxes CIT (%)	-0.33	-0.35	-0.40
OECD economy growth	0.08	0	0.21

Chart 1.2: HAYL Quarterly Revenue/ Earnings cf. Exchange Rate, Tax Rate and Interest Rate



HAYL is the most diversified conglomerate listed on the with 13 distinct business segments. The Group is a multinational corporation with offices and production sites in 17 countries and is one of Sri Lanka's largest exporters accounting for c. 5.5% of total national exports. Over >60% of Group's consolidated revenues are either directly or indirectly foreign currency denominated on account of its export activities.

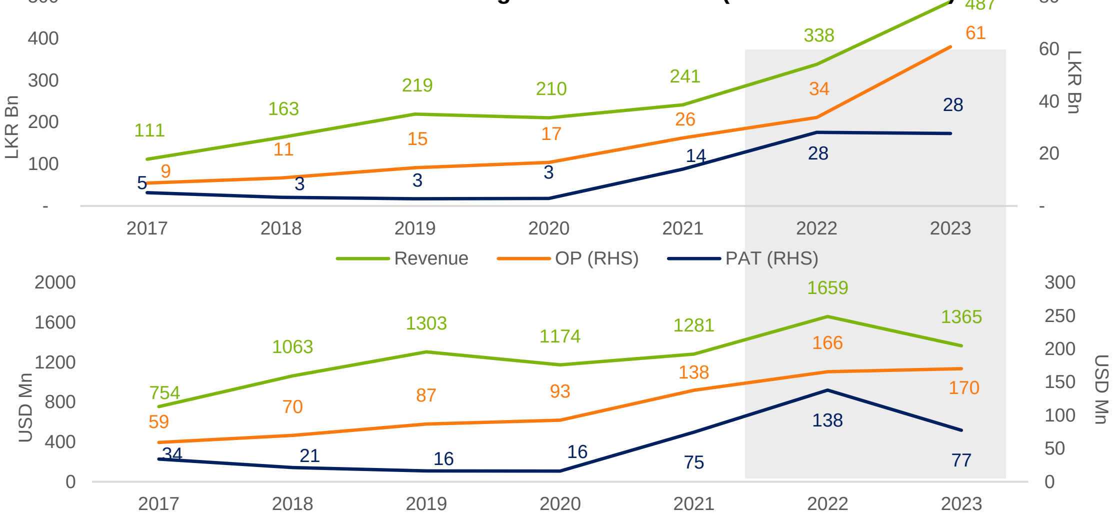
For FY2022/23, HAYL reported consolidated revenues of LKR 487 Bn (+44% YoY) and operating profits of LKR 61 Bn (+82% YoY). Historically, the nominal LKR/ USD exchange rate pair (comprising the reporting currency and the functional currency for the Group's export SBU's) had the highest correlation with HAYL's revenue and earnings followed by the LKR Real Effective Exchange Rate ("REER") (refer Table 1.1 and Chart 1.2).

The c. 70% LKR devaluation against the USD at the height of the economic crisis in 2022 led to substantial revenue growth and non-recurring income for HAYL through foreign currency exchange gains. In FY2022/23 despite lower revenue and earnings in USD terms, the favorable exchange rate impact translated to higher LKR revenue and operating profits for HAYL for the financial year (see Chart 1.3). Whilst similar exchange gains cannot be expected in the short-term with the LKR stabilizing against the USD and other currencies, the REER is currently at record lows post the devaluation. We expect the REER to remain at levels conducive for export industries as inflation normalizes to its target range whilst the LKR despite pairing back some losses following the overshooting in the prior year, is expected to remain weak in the medium term given the low level of foreign reserves in the country amidst ongoing domestic economic challenges.

Secondary drivers of HAYL's earnings growth are interest rates and taxes, both of which have moderate negative correlation with earnings. We expect declining interest rates in the current year on the back of falling inflation coupled with stable tax rates following the steep escalation in the prior year to support a recovery in earnings in 2H 2022/23 and beyond.

Since 2Q FY2022/23 revenue and earnings of HAYL are on a downward trend, with 1Q FY2023/24 showing a sharp deterioration as reflected in revenue contraction of -22% YoY to LKR 97 Bn and operating profit coming in at LKR 8 Bn (-54% YoY) against the backdrop of a c. 10% appreciation in the value of the LKR.

Chart 1.3: HAYL Revenue & Earnings in USD and LKR (FY ended 31 March)



Note: USD values based on avg. exchange rate during the FY

Source: CBSL

Latest quarters show weaker USD revenues/ earnings, but recovery is expected in 2H 2023 and beyond

Table 1.2: HAYL Summarised Annual P&L

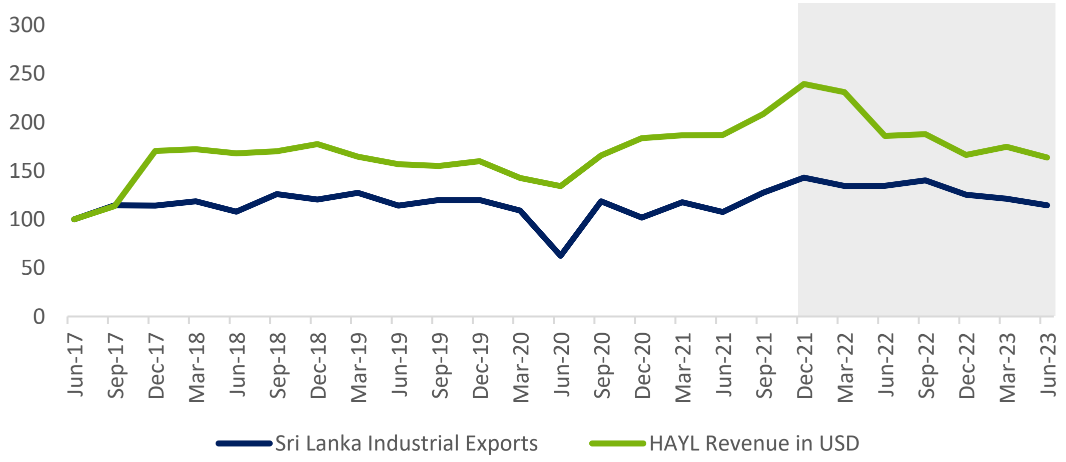
USD Mn	FY 2019/20	FY 2020/21	FY2021/22	FY 2022/23
Revenue (LKR Mn)	210,307	241,276	338,010	487,431
YoY (%)	*-4%*	*15%*	*40%*	*44%*
Revenue (USD Mn)	1,174	1,281	1,659	1,365
YoY (%)	*-10%*	*9%*	*29%*	*-18%*
Gross Profit (USD Mn)	280	325	380	334
GP margin	*24%*	*25%*	*23%*	*24%*
Operating Profit (USD Mn)	93	138	166	170
OP margin	*8%*	*11%*	*10%*	*13%*
PBT (USD Mn)	31	102	175	120
PBT margin	*3%*	*8%*	*11%*	*9%*
PAT (USD Mn)	16	75	138	77
PAT margin	*1%*	*6%*	*8%*	*6%*
EPS (LKR)	0.5	10.2	24.3	21.8
YOY (%)	*40%*	*1948%*	*139%*	*-10%*
EPS (USD)	0.002	0.054	0.119	0.061
YoY (%)	*33%*	*1832%*	*121%*	*-49%*

Table 1.3: HAYL Summarised Quarterly P&L

USD Mn	2Q FY2022/23	3Q FY2022/23	4Q FY2022/23	1Q FY2023/24
Revenue (LKR Mn)	129,932	116,351	117,507	96,938
YoY (%)	*64%*	*26%*	*23%*	*-22%*
Revenue (USD Mn)	358	318	334	313
YoY (%)	*-10%*	*-31%*	*-24%*	*-12%*
Gross Profit (USD Mn)	82	78	81	73
GP margin	*23%*	*25%*	*24%*	*23%*
Operating Profit (USD Mn)	44	37	38	27
OP margin	*12%*	*12%*	*11%*	*9%*
PBT (USD Mn)	28	18	18	7
PBT margin	*8%*	*6%*	*5%*	*2%*
PAT (USD Mn)	20	2	10	4
PAT margin	*6%*	*1%*	*3%*	*1%*
EPS (LKR)	5.4	0.03	2.4	0.04
YOY (%)	*45%*	*-100%*	*-79%*	*-100%*
EPS (USD)	0.015	0.0001	0.007	0.0001
YoY (%)	*-20%*	*-100%*	*-87%*	*-100%*

In addition to the adverse exchange rate impact YTD, the negative financial trend also reflects lower revenue in USD terms since its peak of USD 457 Mn in 3Q FY2021/22, leading up to the latest quarter in which revenue and operating profits declined by c. -12% and -48% YoY to USD 313 Mn and USD 27 Mn respectively, on account of multiple headwinds for key export SBU's. The decline in HAYL's USD equivalent revenue coincides with tapering off the country's industrial exports from 4Q 2021 after a period of strong growth (see Chart 1.4). The latest data on Sri Lanka's industrial exports show that the decline in exports values seem to be bottoming out as reflected in positive movements in the rate of change and higher MoM export values since mid 2023. Much of the weakness in exports is directly attributable to weaker textile & apparel exports (although exports of textiles faired better than apparel) and continuing softness in rubber goods exports. Exports of other industrial exports seem to be fairing better and have largely surpassed pre-covid levels YTD. We anticipate export activities will gradually recover supported by both a more competitive REER and improving economic prospects in OECD and other export markets in 2024 and beyond. It should be noted that HAYL's quarterly USD equivalent revenue whilst mirroring Sri Lanka's overall industrial exports has tended to rise at a faster rate during expansionary periods. Given that HAYL's USD equivalent revenue in the last quarter is c. -32% off its peak in 3Q FY2020/21 (see Chart 1.5a), there is significant scope for revenue expansion going forward with a normalization in external demand conditions.

Chart 1.4: HAYL Quarterly Consolidated Revenue in USD Equivalent cf. Sri Lanka Industrial Exports (2Q 2017 = 100)



Export slowdown seems to be bottoming out and could support a recovery in HAYL topline growth

Table 1.4a: HAYL Annual Segmental Revenue in USD Equivalent

USD Mn	FY 2019/20	FY 2020/21	FY2021/22	FY 2022/23
Hand Protection	100	161	186	144
YoY (%)	*-2%*	*62%*	*15%*	*-23%*
Purification	127	135	163	171
YoY (%)	*2%*	*6%*	*20%*	*5%*
Textiles	68	77	160	173
YoY (%)	*-4%*	*15%*	*107%*	*8%*
Transportation & logistics	243	200	352	377
YoY (%)	*-11%*	*-18%*	*76%*	*7%*
Others	652	733	846	532
YoY (%)	*-13%*	*12%*	*15%*	*-37%*

Table 1.4b: HAYL Quarterly Segmental Revenue in USD Equivalent

USD Mn	2Q FY2022/23	3Q FY2022/23	4Q FY2022/23	1Q FY2023/24
Hand Protection	39	35	32	34
YoY (%)	*-16%*	*-20%*	*-9%*	*-11%*
Purification	51	40	36	33
YoY (%)	*36%*	*1%*	*-23%*	*-24%*
Textiles	47	41	41	46
YoY (%)	*13%*	*-2%*	*-11%*	*5%*
Transportation & logistics	103	77	94	66
YoY (%)	*32%*	*-22%*	*-14%*	*-36%*
Others	122	134	140	144
YoY (%)	*-35%*	*-42%*	*-43%*	*6%*

Chart 1.5a: HAYL Quarterly Consolidated Revenue in USD Equivalent

Chart 1.5b: HAYL Quarterly Revenue in USD Equivalent (YoY Change)

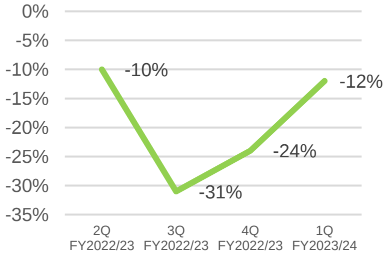


Chart 1.6a: Sri Lanka Industrial Exports (USD Mn)

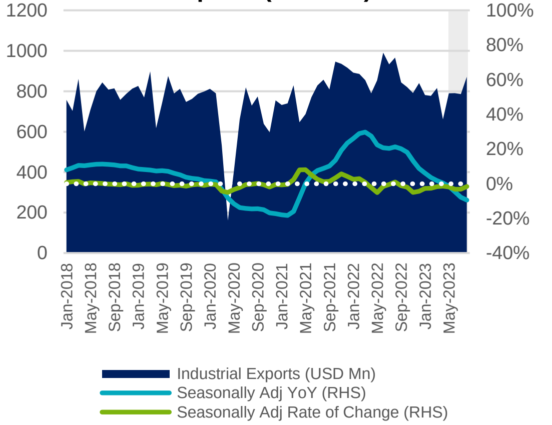
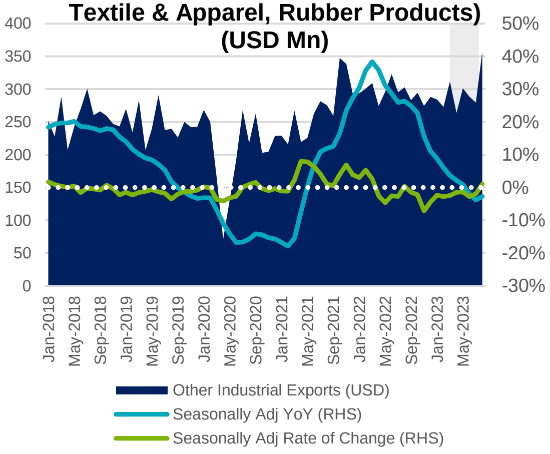


Chart 1.6b: Industrial Exports (excl. Textile & Apparel, Rubber Products) (USD Mn)

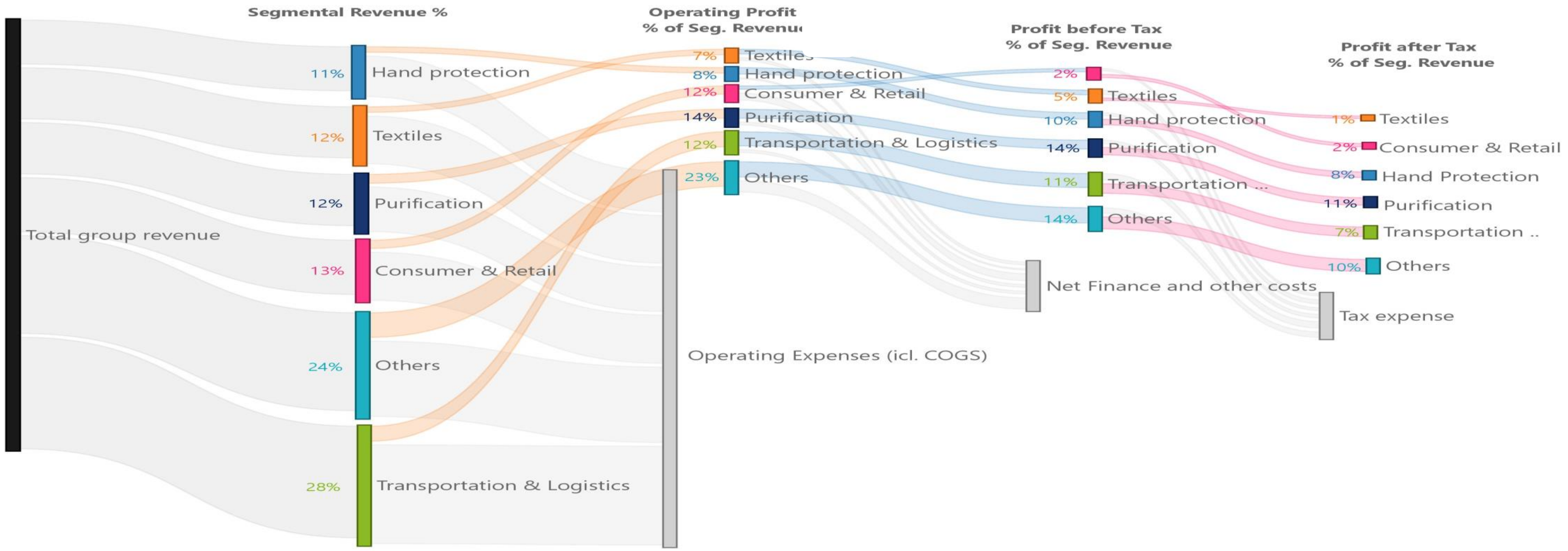


HAYL's last four quarters segmental revenue breakdowns show quarterly revenues of most sectors stabilizing and some showing signs of growth on a QoQ basis (see Table 1.4b). The overall decline in quarterly Group revenues on a USD equivalent basis show signs of bottoming out with possibility of a recovery in YoY revenue growth in 2H 2023 (see Chart 1.5b). This prospect is further supported by a gradual recovery in Sri Lanka's monthly industrial export values since mid 2023 see Chart 1.6a and b)

Source: CBSL

Four key sectors account for bulk of group revenue and profitability

Chart 1.7: Sankey Diagram of HAYL Segmental Revenue/ Profitability Contribution in FY2022/23



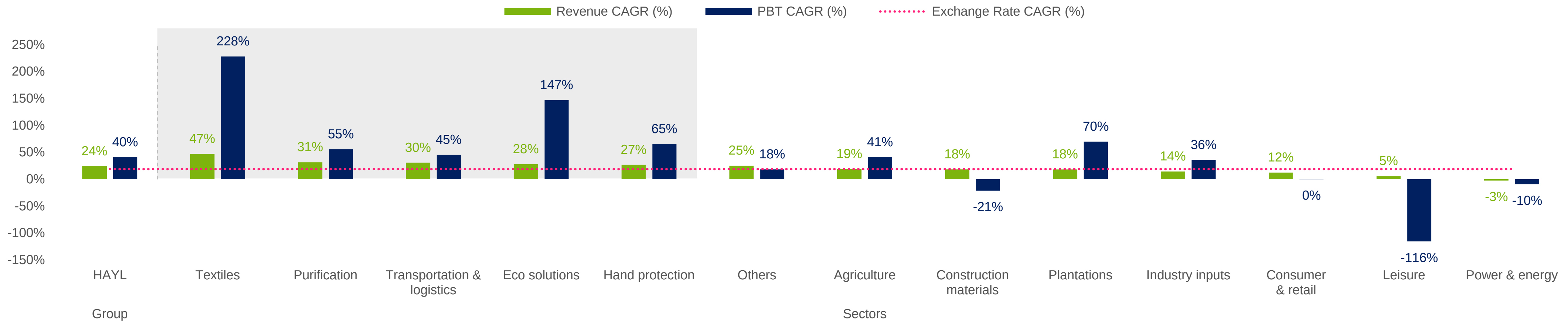
Note 1 ; Percentages of Operating revenue, PBT and PAT are as a % of the respective segmental revenue.
Note 2 : The increase of Hand Protection segment's operating profit to PBT from 8% to 10% is the effect of the inflow of net finance and other income.

Export sectors dominate HAYL's revenues and earnings. Three primary export segments namely, hand protection, textiles and purification account for c. 35% of Group revenues. Combined with the transportation & logistics segment which is both the single largest contributor to Group revenue and largely a dollarized segment, the four largest business verticals account for c. 63% of consolidated revenues and c. 64% of Group operating profit. The purification and transportation & logistics segments had the highest operating profit margins of 14% and 12% respectively based on FY2022/23 financials. Medium to long-term prospects for HAYL's export SBU's and the transportation & logistics segment are favorable on the back of global economic growth and a domestic economic recovery.

Source: Annual Reports

Robust topline growth exceeding dollarisation benefit demonstrates global competitiveness of key SBU's

Chart 1.8: Revenue & PBT 5 year CAGR% (2018 - 2023) of HAYL by Business Segment



Whilst favorable currency movements have boosted topline and bottom-line performance of HAYL and its export SBUs in recent years, the Group's portfolio of export businesses consist of globally competitive entities which have produced robust revenue and earnings CAGRs well exceeding the dollarization benefit arising from devaluation of the reporting currency over the last 5 years. This is evidenced by both Group level and key SBUs revenue/ earnings CAGRs surpassing LKR/ USD exchange rate CAGR over the same period (see Chart 1.8). Whereas underperformance was more evident from the local retailing and domestic economy focused business verticals. The lackluster performance of the leisure segment during the period reflects the one-off impact of the pandemic period travel restriction and is expected to recover quickly.

The textiles segment recorded the highest 5-year PBT CAGR at 228%, followed by eco-solutions (147%), hand protections (65%), purification (55%) and transport & logistics (45%).

Listed diversified companies often trade at a discount ("conglomerate discount") to the sum of their parts or in comparison to more specialized businesses. However, in the Sri Lankan and Asian context, conglomerates are not uncommon. Whilst HAYL may superficially resemble a highly diversified conglomerate with seemingly unrelated business activities, we would argue that that classification can be somewhat misleading.

The Group can trace its origins to businesses that were set up decades ago (in some cases over a century prior) to export Sri Lankan commodities, such as coconut and rubber, in both primary and value-added form. This has led to deep expertise honed over many decades in its core business segments which continue to be focused primarily on adding value to commodities, culminating in products such as activated carbons and rubber gloves which are value added derivatives of coconut and natural rubber respectively, commodities that are prevalent in Sri Lanka. Furthermore, HAYL commands significant global market share in these industries. Other business segments such as textiles and transport & logistics, capitalizes on Sri Lanka's competitive advantage in the international apparel manufacturing space and its strategic geographic location for maritime activities, respectively. The heavy weighting of the Group's portfolio towards these core SBUs which are globally relevant, entail a high degree proprietary expertise and a proven track record of performance supports both the growth narrative and warrants a narrowing of the traditional conglomerate/ peer discount.

Source: Annual Reports

High dollarization cf. peers; provides a hedge against currency risk + exposure to global growth opportunities

Chart 1.9: Revenue, EPS and EBITDA CAGR (2018-23) for HAYL and Peers

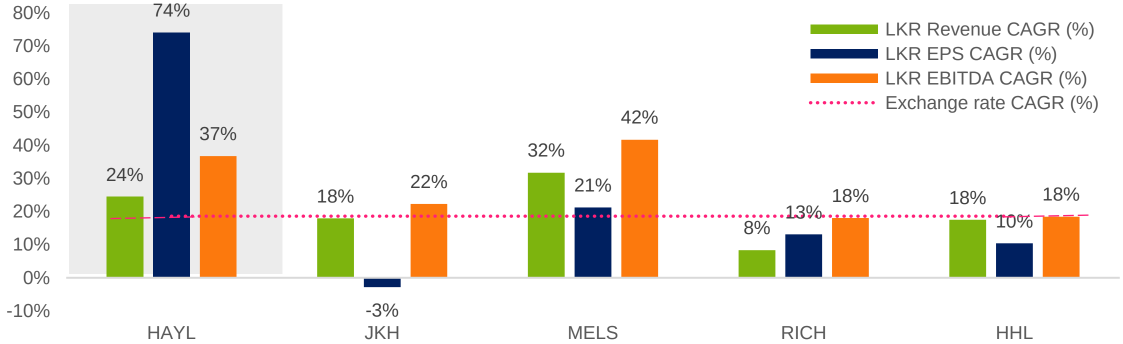
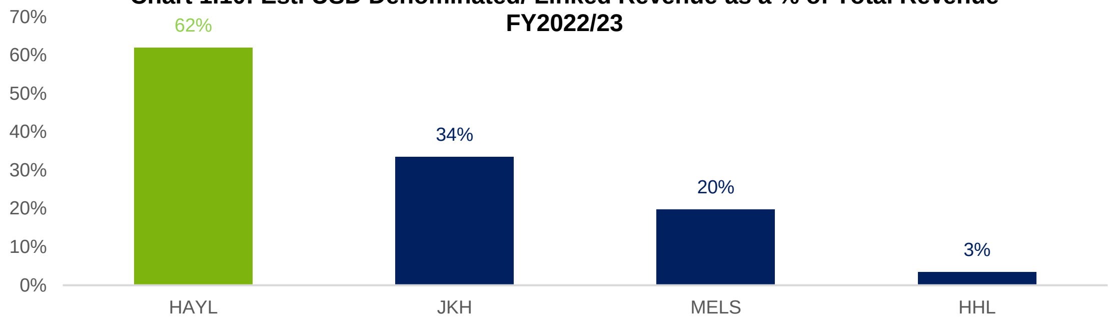


Chart 1.10: Est. USD Denominated/ Linked Revenue as a % of Total Revenue FY2022/23



Note: Based on revenue generated from other geographical segments excluding Sri Lanka.

Table 1.6: Dupont Analysis of HAYL and Peers

DuPont Analysis for FY2022/23: HAYL and peer group	HAYL	JKH	MELS	HHL
Net Profit margin (%)	**5.7%**	4.5%	9.6%	11.8%
Asset Turnover (x)	**1.18**	0.42	0.59	0.80
Financial Leverage (x)	**3.36**	2.07	2.29	3.12
Return on Equity (RoE)	**22.6%**	3.9%	12.9%	29.3%

HAYL's LKR revenue and earnings CAGRs have exceeded its local peer set over the last 5-year period (see Chart 1.9). This is only partly a reflection of the Group's greater degree of dollarization, since as mentioned HAYL's growth has exceeded the dollarization benefit. Outperformance of local peers also reflect the Group's portfolio of internationally competitive key SBUs operating at a global level beyond the constraints of Sri Lanka's limited domestic market.

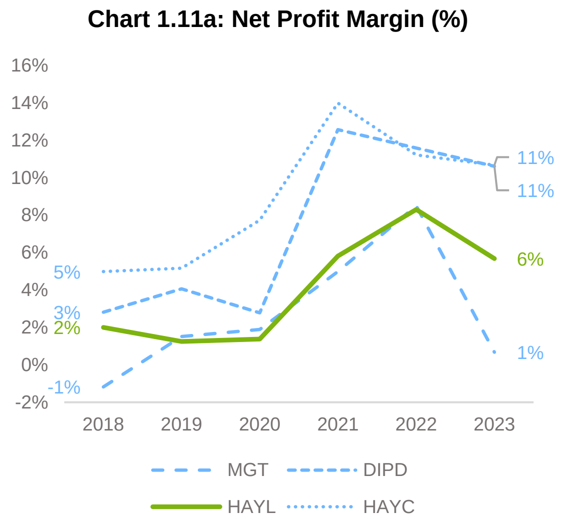
HAYL is by far the most dollarized entity amongst its local peer set when measured as a % of total revenue that is either USD denominated or indirectly linked. The export orientation of HAYL is a hedge for both local investors against further domestic economic stress and/ or a weaker local currency, and for foreign investors as potential revenue streams exceeding the dollarization benefit should translate into higher USD adjusted returns if margins and valuation multiples expand or remain stable.

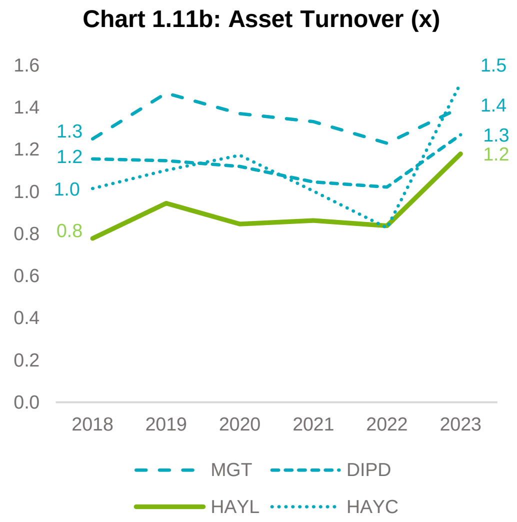
HAYL's capital efficiency metrics have also surpassed its peers in the last few years (see Table 1.6). Whilst the impact on ROA/ ROE from margin expansion arising from elevated non-recurring sources of income in the last few years will be transient, we believe that the Group is poised to experience more sustained improvements in ROA going forward compared with lower capital efficiency in the pre-Covid period.

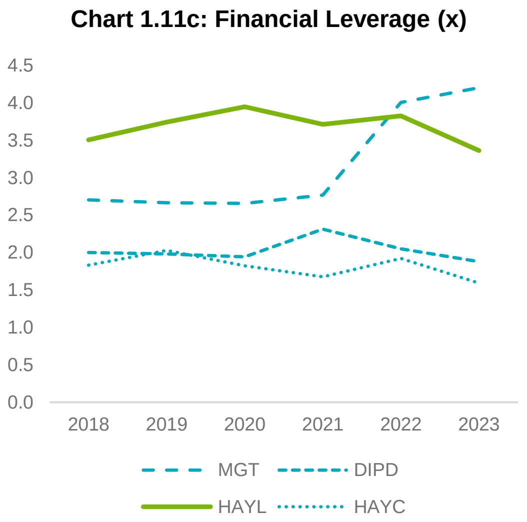
We expect that in the current economic context, HAYL will remain overall better positioned to deliver sustained growth over the medium term compared to its peers that are more exposed to domestic consumption growth. Whilst its probable that domestic consumption will experience a rebound following a severe contraction last year, such a recovery might not be sustained over the medium term. The recovery of the Sri Lankan economy is expected to be gradual and characterized by low to moderate real economic growth for at least the next 1-2 years. Tighter fiscal and monetary policies mandated by the economic crisis will act as a restraint on domestic consumption expenditure during this period with the recovery expected to be primarily investment and export led (both merchandise and service exports).

Source: CBSL, Annual Reports

ROE although lower than FY22 peak, expected to remain above past lows supported by higher asset turnover







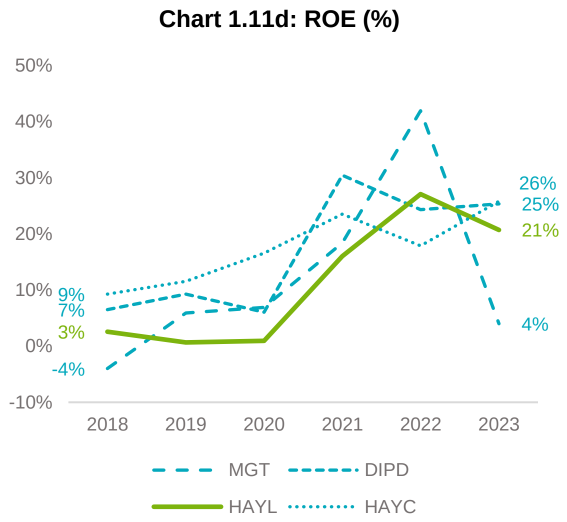
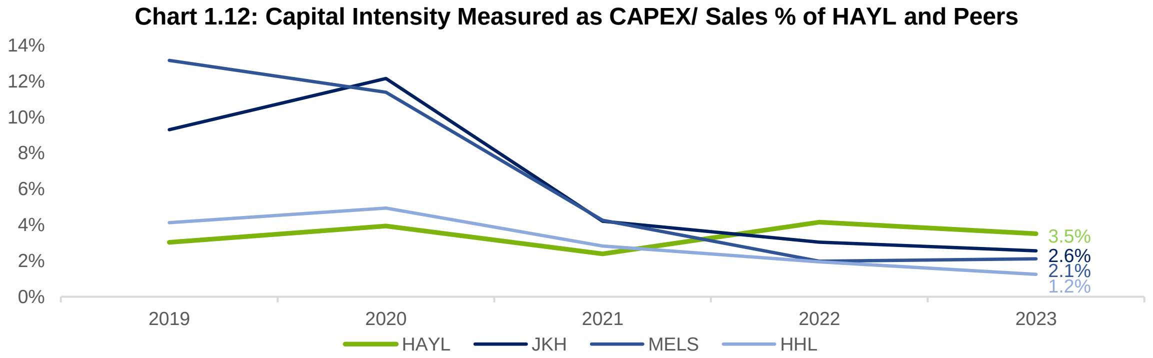


Table 1.7: Dupont Analysis of HAYL and Peers

DuPont Analysis: HAYL and its key subsidiaries	HAYL	HAYC	DIPD	MGT
Net Profit margin (%)	5.7%	10.7%	10.6%	0.7%
Asset Turnover (x)	1.18	1.52	1.27	1.53
Financial Leverage (x)	3.36	1.59	1.88	4.20
Return on Equity (RoE)	22.6%	25.8%	25.4%	4.4%



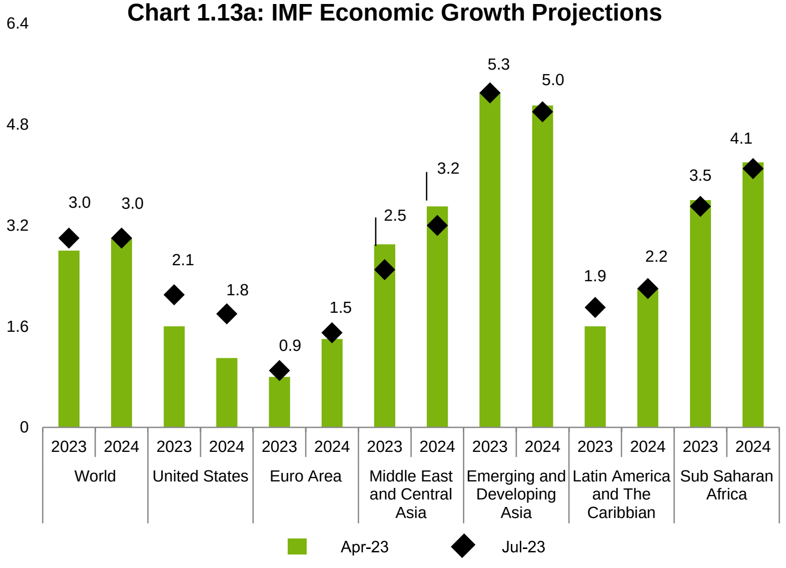
Margins and asset turnover for HAYL and its key SBUs show an upward trend even prior to the significant non-recurring boost to revenue/ earnings in FY2021/22 and FY2022/23 (see Chart 1.11a through d). As an export-oriented entity, the current exchange rate/ REER is more favorable for HAYL to improve the revenue yield from its past investments in fixed assets thus supporting asset/ turnover multiple expansion at its export SBUs and at Group level to enable a more sustained improvement in ROA/ ROE cf. the pre FY2020/21 period.

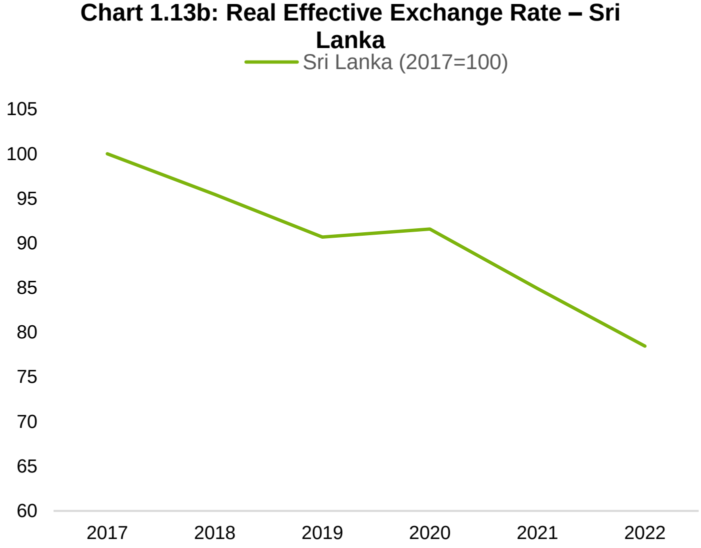
For the Group as a whole, ROE improvement was mainly supported by asset turnover increase and margin expansion as the overall financial leverage has reduced (see Chart 1.11c).

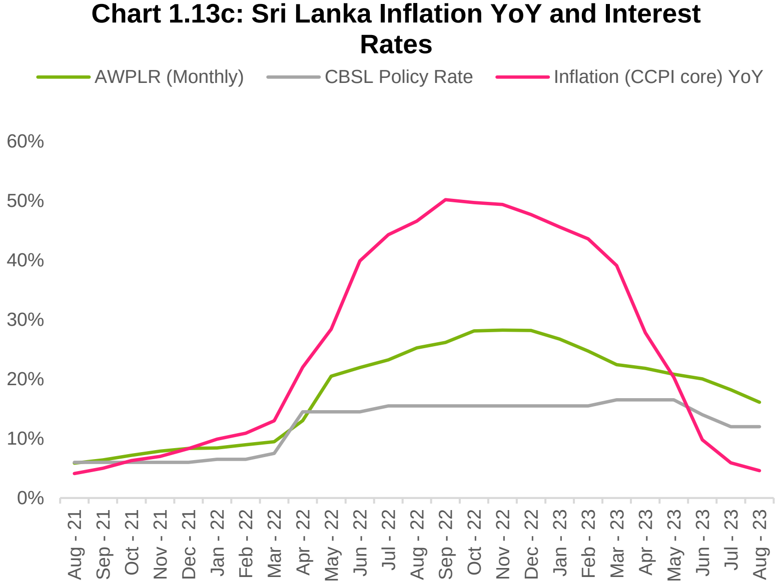
Whilst some of the margin strength seen in the recent past will be transient based on multiple one-off factors in the last few years, we expect that margin compression at HAYL and its key subsidiaries in the current year will be temporary and will revert towards FY2020/21 levels. We expect the temporary dip in MGT margins/ ROE in FY2022/23 due mainly to deferred taxation and other transient factors to recover in the current year.

The Group's capital intensity compared with its peer set is modest and stable despite HAYL's large exposure to manufacturing (see Chart 1.12, some of HAYL's peers have a high exposure to sectors such as hospitality which entail high cyclical capex requirements).

The outlook for growth drivers of HAYL are mostly positive despite challenging global conditions







- Indications of some weakness in major markets in the US and the Eurozone in 2024. Growth in most other regions expected to improve next year.
- Current expectations are for a "soft landing" for the key US economy, with consumer spending still showing resilience amidst a tight labour market.
- Despite global headwinds, outlook is moderately positive for export SBUs of HAYL; incl. **HAYC**, **DIPD**, **MGT** and **Advantis**.

- The REER is expected to remain at competitive levels in 2024, despite some nominal appreciation against the USD in 2023, recovering from the overshooting of the exchange rate during the currency collapse in 2022.
- REER levels are supportive for the exports SBUs of HAYL; incl. **HAYC**, **DIPD** and **MGT**.

- Borrowing costs on LKR debt expected to edge lower as inflation and interest rates normalise to pre-crisis/ target levels.
- Falling inflation/ interest rates are supportive for a resumption of domestic economic activity, including consumption, and for reducing the overall financial cost burden across Group companies; supporting the outlook SBU's incl. **SINS** and **Advantis**.

Source: IMF, CBSL

SOTP valuation of HAYL indicates a discount to intrinsic value of c. 49%

Table 1.8: Sum of the Parts Valuation of HAYL

Segment	Valuation method	Valuation summary	
		Firm value / Enterprise value	% contribution to EV
Purification	DCF	36,133	15%
Hand Protection & Plantations	DCF	30,940	12%
Textiles	DCF	44,633	18%
Transport & Logistics	DCF	42,431	17%
Eco Solutions	DCF	3,686	1%
Agriculture	DCF	19,747	8%
Consumer & Retail	DCF (SINS Company)	19,995	8%
Finance & Manufacturing	Multiple (SFIN), NAV (REG & SINI)	5,351	2%
Leisure	Multiple (EV/EBIT of 10.0x)	7,209	3%
Others	Multiple (EV/EBIT of 10.0x)	38,253	15%
Firm value / Enterprise value		**248,379**	**100%**
- Debt		149,782	
+ Cash		42,855	
- NCI		41,734	
Equity value / Fair value		**99,718**	
No of shares (Mn)		750	
Equity value / Fair value (net) per share (LKR)		**132.96**	
12M Target Price @ probable (historical / estimated) PER (8.0x) on estimated TTM EPS of LKR 13.6 in Sept 2024		**108.00**	
CMP of HAYL as of 06 Oct 2023 (LKR)		89.50	
Potential Upside / downside (%)		**21% upside to price target, 49% to intrinsic value**	

HAYL forecast indicates a gradual recovery and normalisation in earnings by FY25E…

Table 1.9: HAYL Summarised Consolidated P&L Forecast

Income statement For the year ended 31-March (LKR Mn)	Actual					Forecast	
	FY2019	FY2020	FY2021	FY2022	FY2023	FY2024E	FY2025E
Revenue	**219,182**	**210,307**	**241,276**	**338,010**	**487,431**	**416,563**	**448,372**
Revenue YoY Growth	*34.3%*	*-4.0%*	*14.7%*	*40.1%*	*44.2%*	*-14.5%*	*7.6%*
Results from operating activities / EBIT	**14,630**	**16,628**	**25,944**	**33,766**	**60,807**	**36,452**	**42,475**
EBIT YoY Growth	*36.6%*	*13.7%*	*56.0%*	*30.1%*	*80.1%*	*-40.1%*	*16.5%*
EBIT margins	*6.7%*	*7.9%*	*10.8%*	*10.0%*	*12.5%*	*8.8%*	*9.5%*
Net finance cost	**13,077**	**10,943**	**7,736**	**9,032**	**27,613**	**15,223**	**9,067**
Profit before tax	**5,476**	**5,504**	**19,234**	**35,717**	**42,749**	**22,230**	**34,408**
PBT margins	*2.5%*	*2.6%*	*8.0%*	*10.6%*	*8.8%*	*5.3%*	*7.7%*
Profit after tax	**2,750**	**2,895**	**14,046**	**28,099**	**27,672**	**15,315**	**24,472**
PAT YoY Growth	*-16.0%*	*5.3%*	*385.2%*	*100.0%*	*-1.5%*	*-44.7%*	*59.8%*
PAT margins	*1.3%*	*1.4%*	*5.8%*	*8.3%*	*5.7%*	*3.7%*	*5.5%*
Profit attributable to the SH (Recurrent earnings)	**265**	**372**	**7,637**	**18,257**	**16,352**	**6,892**	**13,460**
Recurrent EPS (LKR)	**0.35**	**0.50**	**10.18**	**24.34**	**21.80**	**9.19**	**17.95**
Market Price per Share (LKR) *	16.80	12.36	60.80	76.90	72.00	**89.50**	**89.50**
Price / Book Value (X) *	**1.34**	**1.36**	**1.13**	**0.80**	**0.68**	**0.79**	**0.71**
Price / Earnings Ratio (X) *	**47.46**	**24.87**	**5.97**	**3.16**	**3.30**	**9.74**	**4.99**

* For historical period ratio / price is based on FY end price and forecast period ratio is based on CMP as of 06 Oct 2023.

For FY2023/24E, based on our forecasts for the individual SBUs of HAYL, we expect consolidated turnover of the Group to reduce to c. LKR 416 Bn (-15% YoY) on account of multiple headwinds across almost all major business verticals. Refer the individual commentaries with associated forecast and valuations for the key listed and unlisted SBU's of HAYL elsewhere herein.

Three primary export SBUs namely, DIPD, MGT and HAYC is estimated to account for c. 45% of FY2023/24E consolidated Group revenue, and coupled with the transportation & logistics segment, the four core business verticals will account for c. 66% of consolidated revenue as per our projections for the current year.

FY2023/24E EPS based on recurring earnings is forecast to be c. LKR 9.19 (-58% YoY) due to revenue and margin contraction across business verticals, elevated but declining interest costs and higher taxation levels. We expect a gradual recovery in topline and bottom-line growth in FY2024/25E with EBIT margins settling closer to historical levels, well below the elevated margins from non-recurring windfalls during the pandemic economy.

HAYL is trading at a discount to peers; overall investment thesis supports a rerating

Chart 1.14a: P/E Ratio of HAYL and other Listed Peers

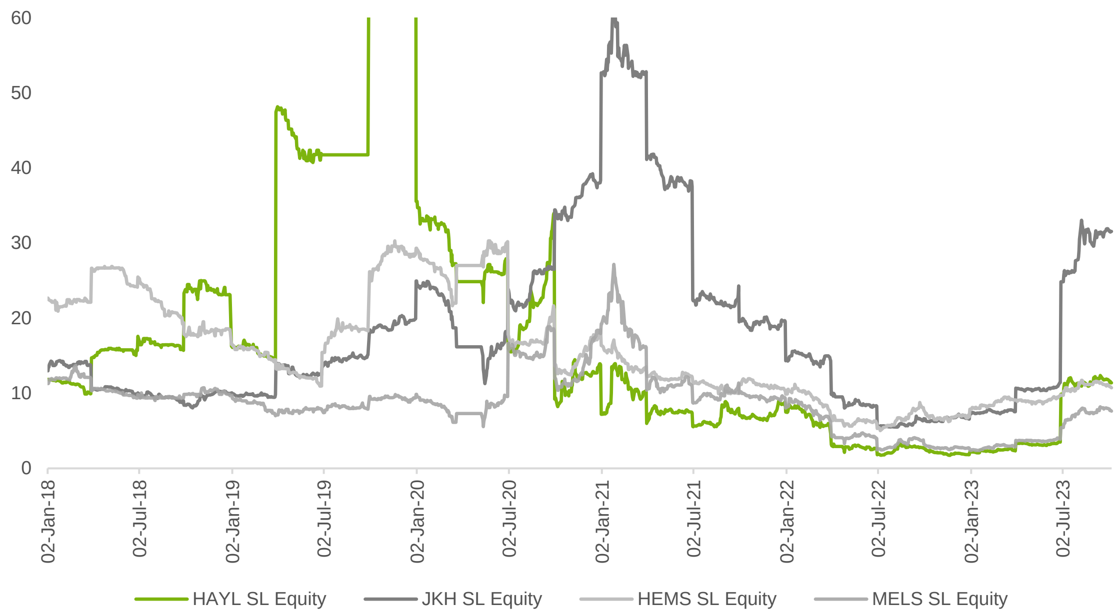
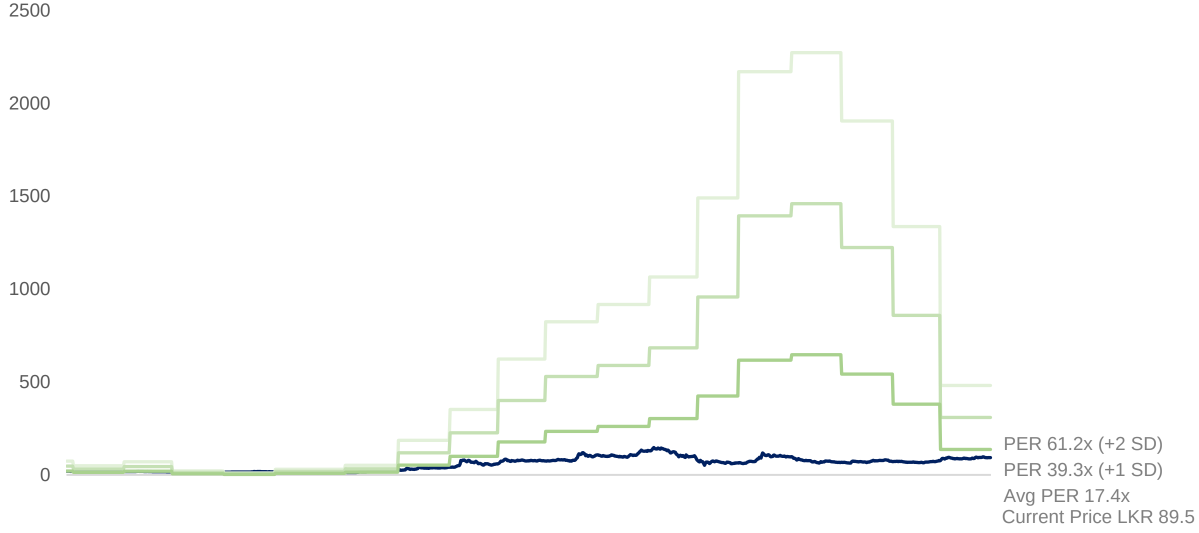


Chart 1.14b: Price and PER Bands



Source: , Bloomberg

Table 1.10: Comparative Valuations of HAYL and Peers

	HAYL	JKH	MELS	HHL
EV to FCF (x) (FY2022/23)	5.65	16.20	7.49	N/A
Average Historical P/E (x)	14.90	18.50	8.80	14.83
Current P/E (x) ttm	12.36	31.46	8.07	11.42
Current P/E Standard Deviation (Z)	-0.19	1.56	0.18	-0.58
Current Discount to Highest Peer	61%	-	74%	64%
5 Year Revenue CAGR %	24%	18%	32%	18%
5 Year EPS CAGR %	73%	-3%	25%	10%
5 Year average ROE %	15%	5%	10%	10%
5 Year average Net Operating Cash Flow / Net Earnings	0.56	1.01	2.95	0.62

HAYL investment thesis

- High degree of dollarization provides is a hedge against currency risks and local economic challenges.

- Portfolio of several globally relevant and competitive SBUs provides exposure to growth opportunities that are not constrained by Sri Lanka's limited market size.

- Buying into specific listed SBU's might offer the same dollarization benefit and allow for more sectoral focus. However, many of the listed export SBUs are more fairly valued at current prices whilst HAYL at a larger discount to both intrinsic value and peer comparatives.

- Significant part of HAYL's valuation discount to SOTP arises from its unlisted transport & logistics vertical. Whilst the transport & logistics segment will report lower profits in current year after multiple one-off gains in the previous years, the sector will nevertheless respond well to domestic and regional economic growth. The outlook for the sector is highly attractive with the expectation that it will continue to deliver higher than average growth based on past track record and future catalysts.

- Whilst conglomerates are out of favor with some classes of international investors, they continue to play an important role in the local and regional bourses. Arguably the "conglomerate discount" is less warranted in the case of HAYL as seemingly disparate businesses that account for c. 70% of revenue are mostly focused on value adding to domestic resources, an area in which HAYL has decades of expertise and a high degree of in-house expertise.

- Weaker LKR exchange rate positions the Group to increase yield on its past investments, supporting a higher asset/turnover ratio and boosting ROA/ ROE on a more sustainable basis in the medium term.

- Given HAYL's recent past performance coupled with future expectations, HAYL possibly warrants a rerating in its comparative valuation relative to its peers in the diversified conglomerate sector.

- HAYL is at a reasonable discount to its intrinsic valuation. Valuations may continue to benefit from falling benchmark interest rates imputed in our WACC calculations and overall market rerating of trading comparatives.

Risk factors impacting our rating of HAYL

Table 1.11: Risk Factors that Impact our Rating of HAYL

Risk Factors	Likelihood of Risks Negatively Impacting Ratings in Next 1-2 years	Negative Impact on Ratings	Positive Impact on Ratings
Risk to Group level Consolidated Earnings	Moderate to High	Apart from the risk factors relating to core SBU's as detailed elsewhere herein, there is a risk that Group level consolidated profitability will be negatively impacted by higher losses or lacklustre performance of non-core sectors, particularly the construction materials.	Faster recovery/ lower losses at retailing and non-core SBU's including construction materials.
Global Economic/ Market Conditions	Moderate	Prolonged deterioration in global economic conditions in key markets and/ or prolonged adverse conditions impacting key export SBU's.	Sustained improvement in global economic conditions in key markets and/ or prolonged favourable conditions in the global markets impacting key export SBU's.
Market Share	Moderate	Sustained loss of global market share in the medium term of key export SBU's.	Sustained gain in global market share in the medium term of key SBU's.
Revenue Growth	Moderate	Sustained decline in USD revenue growth rates below the growth rates assumed in our forecast for export SBU's and lower revenue growth/ declining revenue at non-core SBU's.	Sustained increase in USD revenue growth rates above the growth rates assumed in our forecast for export SBU's and higher revenue growth at non-core SBU's.
Margins	Moderate	Prolonged blended margin compression from unfavourable economic/ industry conditions or company specific factors across the Group portfolio.	Sustained blended margin expansion from favourable economic/ industry conditions or company specific factors across the Group portfolio.
Capital Expenditure/ ROIC	Moderate	Increase in capital intensity of the businesses or decline in ROIC from adverse competitive forces or company specific factors.	Decrease in capital intensity of the businesses or increase in ROIC from favourable competitive forces or company specific factors.
Inflation/ Cost Pressures	Moderate	Increase in localised inflationary pressures which cannot be passed on to end customers.	Decrease in localised inflationary pressures possibly leading to margin expansion.
Devaluation of Reporting Currency	Low	Sustained appreciation of the reporting currency against the functional currency of the export SBU's can lower reported revenue/ earnings and our valuations/ price targets in LKR.	Devaluation of the reporting currency against the functional currency of the export SBU's surpassing our forecast assumption of on avg. 5% p.a. can increase reported revenue/ earnings and our valuations/ price targets in LKR.
Changes to WACC	Moderate	Increase in market interest rates/ equity risk premium or beta values and accordingly the cost of capital or decreases in market valuation multiples can negatively impact our valuations and ratings.	Decrease in market interest rates/ equity risk premium or beta values and accordingly the cost of capital or higher market valuation multiples can positively impact our valuations and ratings.
Regulatory & Taxation	Low	Adverse regulatory or taxation changes which impact the long-term viability/ competitiveness of the business.	Positive regulatory or taxation changes including in the ease of doing business which favourably impact the long-term viability of the business.

ACUITY
A joint venture of DFCC Bank and HNB

October 2023
Equity Research
Sri Lanka

Haycarb PLC

Following on from a period of healthy topline growth, HAYC's recent quarterly results show a reduction in its revenue run rate; most likely the result of inventory levels normalising after pandemic related excess stocking coupled with recessionary conditions impacting certain buyers. We believe that the dip in topline with potential margin contraction in the short-term will be temporary. HAYC is a globally relevant player in its industry and potentially a secular growth story as it expands its product offerings to new verticals and novel uses cases emerge for activated carbons and its applications.

Materials | Reiterate Rating

HAYC

Target price (12M. LKR) 81.82

Buy

HAYC has potential to become a more secular growth story going forward

CMP as at 6th Oct 2023	LKR 68.10
Bloomberg and CSE Ticker	HAYC SL Equity I HAYC.N
Market Cap (LKR Bn I USD Mn)	LKR 20.2 Bn I USD 62.5 Mn
Issued Quantity (Shares Mn)	297.1
Estimated free float	31.4%
Average daily volume (Last 3M)	106,608
52-week High and Low (LKR)	76.5 I 50.0
Industry & Year end	Materials I 31st March
Beta and Sharpe ratio	0.77 I 0.19

Chart 2.1: HAYC Technical Chart (Trailing 90 days)

Source: Bloomberg

Haycarb PLC	HAYC
Rating	Buy
12M Target Price	LKR 81.82
Potential Upside/ (Downside)	20%
Industry View: Materials	In-Line

HAYC's revenue CAGR has historically far exceeded the economic growth in the OECD economies. In the current year, the dip in revenues is mostly explained through lower order volumes from buyers who overstocked during the pandemic normalizing their inventory levels and more carbon supply coming to market at a time of generally weaker demand in developed markets. HAYC has potential to become a more secular growth play in the medium-term with its increasing product offering to a diverse range of both mature and emerging end-users. Historically stable margin profile, sizeable global market share and favorable industry characteristics are further plus points. We expect revenue expansion to resume from 2024 onwards with normalization of inventory levels and gradual recovery in the global economy. We re-iterate the stock as a "Buy" with a 12m price target of LKR 81.82 /- per share based on the current discount to its intrinsic value and expected market rerating. The current market price is at the neutral end of the RSI scale. Investors could benefit from accumulating at these price levels and adding to their holdings on any pullbacks in the stock price.

Financial year ended 31 March	FY2021	FY2022	FY2023
Revenue (LKR Mn)	25,485	33,160	60,943
YoY Growth (%)	*12%*	*30%*	*84%*
Operating profit (LKR Mn)	4,436	3,079	8,274
YoY Growth (%)	*77%*	*-31%*	*169%*
EPS (LKR)	10.25	11.06	19.60
DPS (LKR)	3.70	2.80	5.65
TTM PER (x)	*9.1*	*4.5*	*2.9*

Favourable exchange rates/ economic conditions in export markets have driven HAYC's past earnings

Haycarb PLC ("HAYC") is a leading global manufacturer primarily of coconut shell based activated carbons accounting for a global market share of approximately 16% of the world's coconut shell activated carbon market by volume and having a portfolio of over 1,500 products. HAYC manufactures a range of washed carbons, impregnated carbons, powders, granules and fines, pellets and high purity products for a full spectrum of applications in water treatment, air treatment, gold recovery, food & beverages industry, energy storage and specialty applications. HAYC also offers turnkey "environmental engineering solutions" for advanced water and air purification requirements.

HAYC revenues have historically shown strong positive correlations with OECD economic growth and national coconut production. Strongest correlations impacting both topline growth and earnings is with the LKR/ USD exchange rate pair (and inversely with the REER) as the LKR constitutes the reporting currency whilst the USD is the transactional currency for the bulk of HAYC's revenues. Gross profit margins show a moderate negative correlation with coconut prices. However, HAYC has traditionally maintained stable margins by passing on higher input costs in the longer term despite temporary variations in margins based on raw material and input cost escalations.

Table 2.1: HAYC Margins/ Cost as a % of USD Revenue

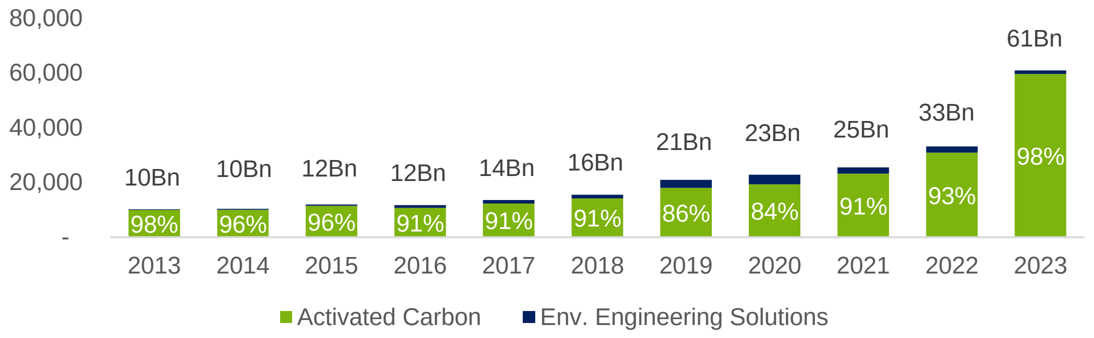
FY ended 31 March	2019	2020	2021	2022	2023
Gross Profit	19%	24%	30%	22%	24%
Operating Profit	7%	11%	17%	9%	14%
Interest Cost	1%	1%	1%	1%	3%
Net Interest Cost	1%	1%	-0.2%	-5%	0%
Tax Expense	1%	2%	4%	3%	3%
Net Profit	5%	8%	14%	11%	11%

Table 2.2: Correlation of Business Performance & Economic Variables (2011-21)

	Revenue	*Gross profit Margin*	*Profit attributable to Shareholders*
Exchange Rate (LKR/USD)	1.0	0.0	0.8
REER	-0.9	0.0	-0.9
Real GDP growth (%)	-0.6	-0.4	-0.4
Tax rate (%)	0.5	-0.4	0.2
OECD economic growth	0.8	-0.4	0.9
Coconut Prices	0.8	-0.5	0.6
National Coconut Production (Mn nuts)	0.7	0.3	0.5
Energy Prices	-0.6	0.1	-0.4

Out of its two operating segments, "activated carbon" is the highest contributor accounting for more than 90% of revenues over the past years. The segment contributed 98% of total revenues in FY2022/23 with a YoY growth rate of 93% owing to strong demand growth across HAYC's portfolio in water purification, gold mining and other applications, as well the impact of favorable exchange rate movements stemming from the steep depreciation of the reporting currency against the transactional currency.

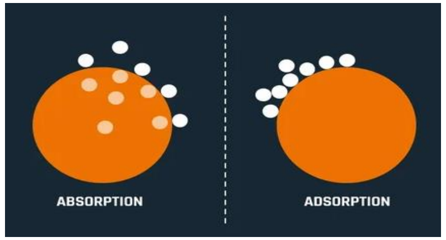
Chart 2.2: Revenue Contribution by Sector



Source: CBSL, Annual Reports

Coconut shell activated carbon is a versatile material with unique properties

Activated carbon, which is also commonly known as activated charcoal, is a highly porous form of carbon that is treated with oxygen or chemicals to create small, low volume pores that increase its surface area. The high surface area makes the activated carbon effective in **adsorbing** various impurities and contaminants from liquids and gases.



Absorption occurs when molecules pass into a bulky material. Here, the particles dissolve into another substance which absorb them and once dissolved, the molecules are hard to be separated from the absorbent.

Adsorption is a process where molecules from a substance adhere to a surface of an adsorbent such as activated carbon.

Raw materials that are widely used for activated carbon are coal, coconut, peat and wood out of which coal and wood accounts for over 60% of the total global output due to its high surface area and low cost.

Coconut shells are mostly produced in the Asia-Pacific region and increasingly preferred for its high adsorption properties and renewability.

Activated carbon is also used for gold mining and extraction processes. This method is known as carbon-in-pulp (CIP) or carbon-in-leach (CIL) processes where activated carbon is used to adsorb and recover the gold from cyanide solutions. The type of activated carbon used in CIP or CIL is typically the granular form because of its larger particle size, diverse range of pore sizes, low attrition rate and regeneration capability.

Activated carbon is used in batteries as a component of the electrode structure or as an additive to improve the battery performance. Activated carbon is used in new Sodium-ion batteries as an anode material for higher capacity and cycling stability. Its also used in Supercapacitors as an electrode material to enable rapid charge and discharge cycles. Powdered, granular, fibrous and carbon nano-tube forms of activated carbon are used In batteries.

Activated carbon is widely used for water treatment that accounts for nearly half of the market share. It is a highly effective tool in water purification to adsorb pollutants, contaminants and chlorine from wastewater.

Both powdered and granular forms of activated carbon are used for water treatment applications.

Source: Industry Research Reports

Activated carbon market to grow at a healthy CAGR and has a favourable industry structure

The global activated carbon market growth is expected to be catalyzed by the rising concerns regarding pollution control. With the overall global activated carbons market growing at a CAGR of 9.5% in USD terms (as per industry reports), the total addressable market for HAYC's coconut shell activated carbons could grow from c. 312,000 MT p.a. at present to c. 400,000 MT p.a. by 2028 (assuming 5% volume CAGR). With the same market share, HAYC's revenue share can be expected to grow up to c. USD 250 Mn by 2028 (or higher if we factor in some market share gains).

The global coconut shell activated carbon industry is identified as a moderately consolidated market dominated by 1-5 major players where Haycarb is among the top players in the industry in terms of revenue and market share. The market has mixed characteristics of both a consolidated and a fragmented market with moderate competition, low threat from new entrants, low threat from substitutes, low power of individual suppliers and customers.

Chart 2.3a: Global Activated Carbon Market share by application

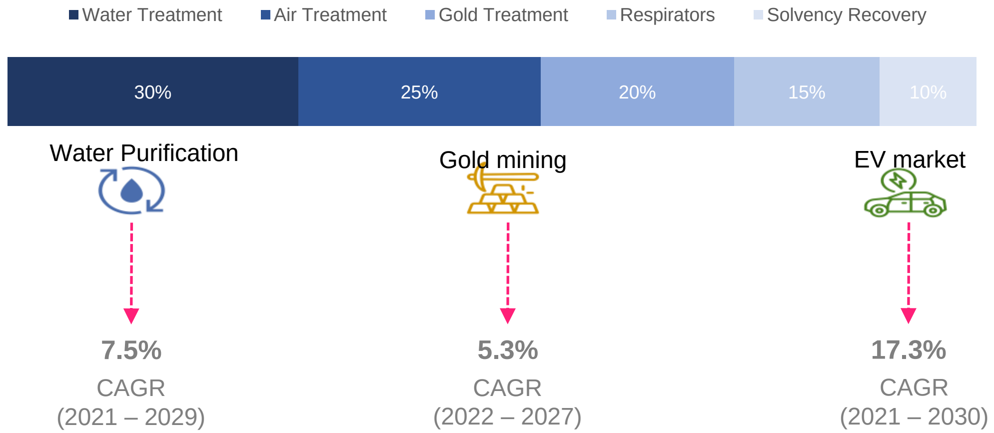
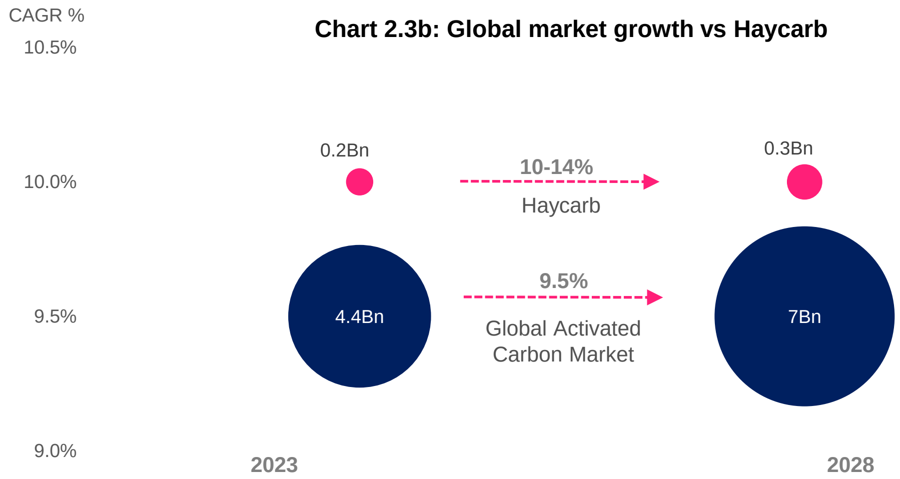


Chart 2.3b: Global market growth vs Haycarb



Top Global Players

Low Competition
The market is less competitive
With a few dominant players as a result, there is less price competition.

Low threat of new entrants
Entrance threat is very low due to the required high initial investment, longstanding customer/ supply chain relationships and necessary technical expertise to compete with the existing players.

Low power of customer
Major players have the power to change the prices but subject to a time lag specially, for less differentiated products.

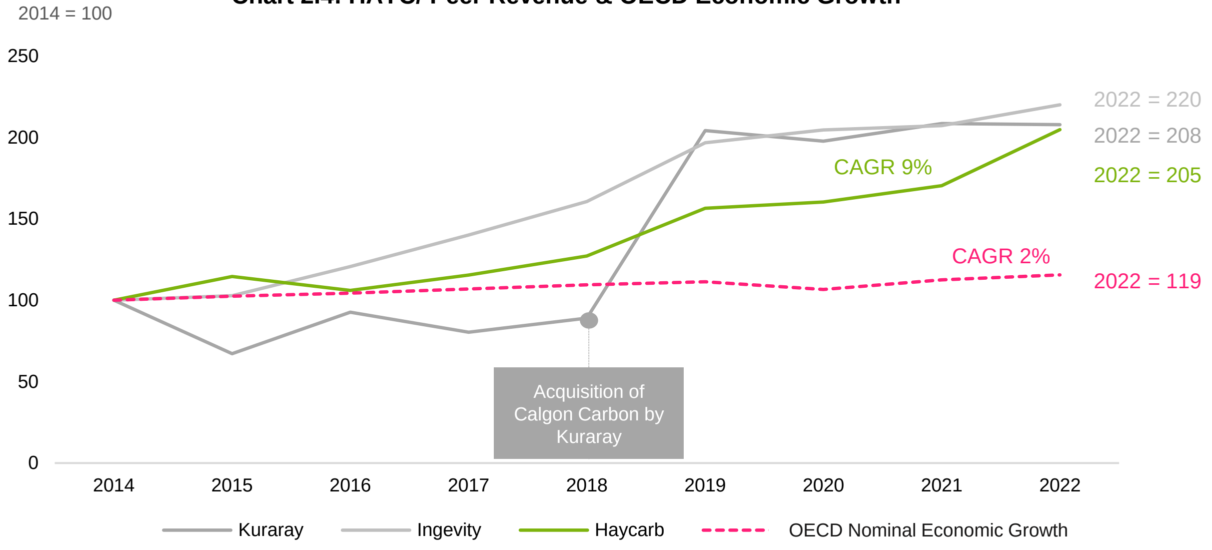
Low threat of substitutes
Coconut shell activated carbons are widely accepted and used renewable products with no immediate threat of viable substitutes.

Low power of suppliers
Most of the industry raw material suppliers are small scale. Market players maintain multiple suppliers to gain competitive pricing which gives suppliers less bargaining power.

Source: Industry Research Reports

HAYC revenue growth CAGR has exceeded OECD growth rate in recent years…

Chart 2.4: HAYC/ Peer Revenue & OECD Economic Growth



HAYC's revenue growth in USD terms is observed to be inline with the other major industry players with CAGRs converging over time. Overall, the growth of the activated carbon industry has surpassed the OECD nominal economic growth rate by a wide margin, possibly indicating increased usage of activated carbons from newer applications. Thus, the industry represents a possible secular growth narrative where demand is growing at a steady pace and is somewhat decoupled from global business cycles.

Source: World Bank, Annual Reports

… as increasing number of applications adds to possibility of a more secular growth narrative

HAYC provides activated carbon solutions for a wide range of applications. Water and air purification can be identified as non-cyclical applications where under normal circumstances the demand does not vary much based business cycles or in response to typical external shocks, which adds to the recession proof growth narrative.


Residential and Municipal water treatment


Industrial wastewater treatment


Industrial air and gas treatment


Precious Metals


Solvent Recovery


Petroleum and Gas


Food & Beverages


Automotive


Energy Storage


Nuclear Industry

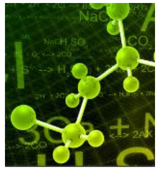

Cigarette Filter


Renewable and Portable water


Personal Protection


Catalyst Support


Chemical Industry


Customized Products

Coconut Shell

Positives

- Renewable and sustainable
- High porosity and surface area
- Low ash content
- Cost Effective

Negatives

- Lower carbon content
- Variable quality
- Limited Availability
- Processing challenges

Coal

Positives

- Abundant and widely available
- High Carbon content
- Well-established industry
- Diverse activated carbon ranges

Negatives

- Environmental concerns
- Higher ash content
- Non-renewable resource
- Regulatory compliance

Palletized Activated Carbon

Positives

- Increased Durability
- Enhanced Handling
- Improved bed density

Negatives

- Lesser surface area
- Limited Accessibility

Impregnated Activated Carbon

Positives

- Enhanced Selectivity
- Targeted Adsorption

Negatives

- Limited Applicability
- Higher cost

Source: Industry Research Reports

Domestic + foreign manufacturing facilities mitigates dependency on suppliers and geographic risk

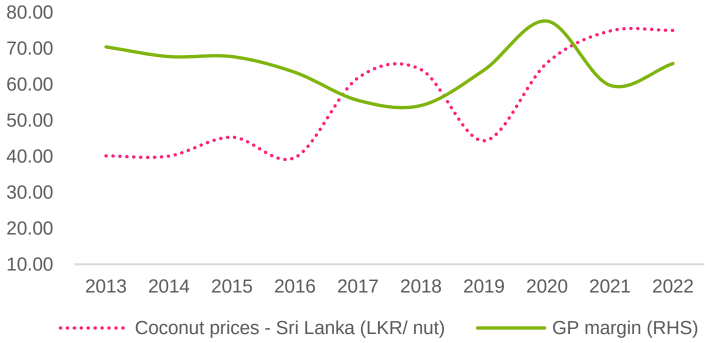


Chart 2.5a: HAYC Margins & Coconut Prices

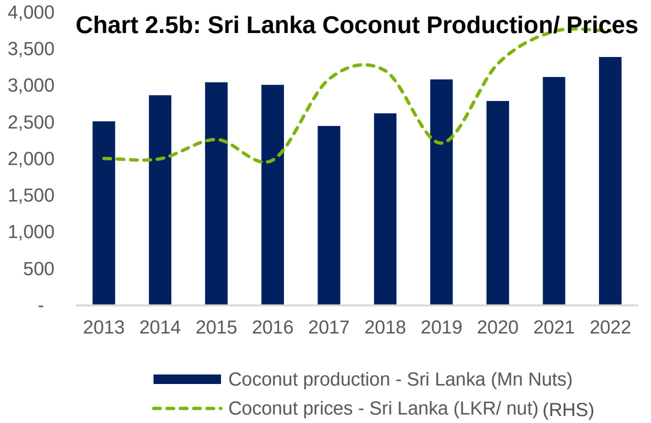


Chart 2.5b: Sri Lanka Coconut Production/ Prices

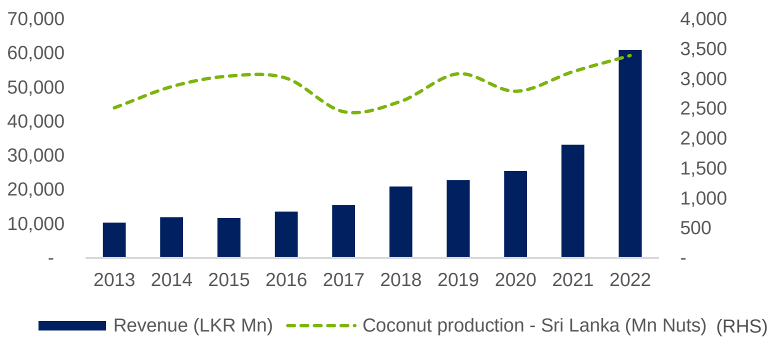


Chart 2.5c: HAYC Revenue & Sri Lanka Coconut Production

Moderate negative correlation is observed between Sri Lankan coconut prices and HAYC's gross margins (correlation of -0.5). Coconut shell charcoal is the primary raw material and c. 85% - 90% of the coconut shells required by HAYC's domestic production sites are is sourced locally. Therefore, any unforeseen localized climatic events such as drought has the potential to impact on the raw material availability, quantity and prices. Given that local production is on average ranging c. 2,500 Mn nuts p.a. for past 10 years (see Chart 2.5c), it raises concerns on the ability to source sizeable additional supplies locally for HAYC to significantly surpass its past revenue milestones. Therefore, the required additional raw materials may have to be sourced through imports, which in turn could reduce the gross margins through higher input costs.

In order mitigate the risk to its supply chains, HAYC has strategically expanded its manufacturing facilities to other coconut producing countries, namely Thailand and Indonesia, which now account for c. 50% of HAYC's total production. HAYC has also initiated measures to import raw materials from India and Philippines. These initiatives should minimize the high-dependency on Sri Lankan coconut production and ensure raw material availability at HAYC's manufacturing facilities to sustain volume growth and sustained margins going forward.

Historically, a high correlation is observed between the revenue growth of HAYC's revenue in USD terms and its capacity expansion, both have grown at a CAGR of 10.6% over the last 7-years (see Chart 2.6). With HAYC's revenue is expected to grow at a 5-year CAGR of c. 10% going forward, assuming a similar expansion in capacity and utilization, HAYC's capacity is expected to reach c. 91,500 MT per annum by 2028. Overall capacity utilization is expected to reach 90% with the increase in utilization in Thailand and Indonesia.

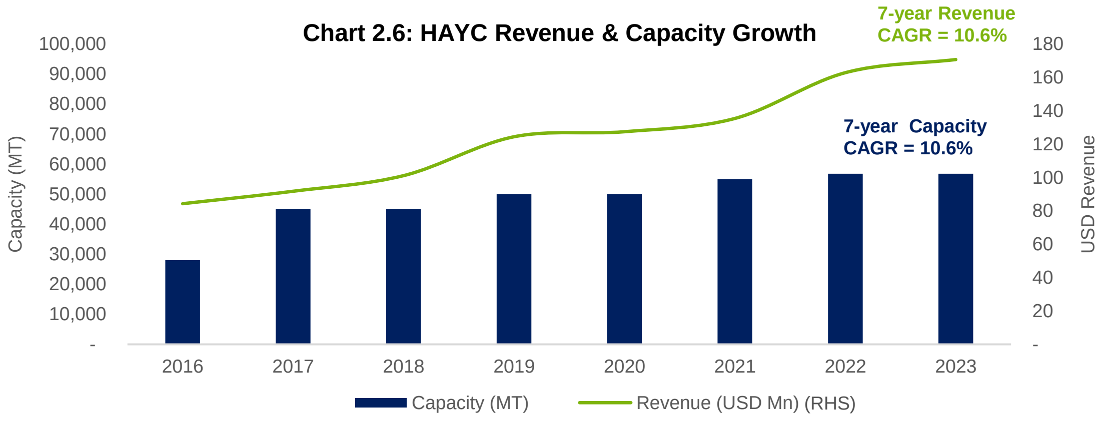


Chart 2.6: HAYC Revenue & Capacity Growth

Source, CBSL, Annual Reports

Favourable unit economics; interest cost burden expected to reduce as interest rates revert to mean

Unit Economics and Margins

Historically, HAYC has demonstrated a stable margin profile with low variance. The standard deviation of its average gross and operating margins have been c. +/- 200 bps (see Chart 2.7a). Furthermore, HAYC's operating margins are competitive compared to its main international peers (see Chart 2.7b). Comfortable gross margins coupled with general & administration expenses constituting by far the largest fixed cost element at c. 13% of sales(see Chart 2.7c) presents opportunities to realize further operating leverage through economies of scale plus other strategic initiatives such as lean/ energy efficient manufacturing and cost rationalization.

HAYC's interest cost to average debt increased from 6% to 18% in FY2022/23 as soaring interest costs (+238% YoY) on account of the higher interest rates prevailing in country in the immediate aftermath of the economic crisis and higher average debt level (+14% YoY) took its toll. We anticipate benchmark interest rates/ AWPLR to gradually decline to pre-crisis levels c.15% and debt levels to remain around the same as FY2022/23. Based on our assumptions its estimated that the interest cost to average debt will reduce to c. 15.1% and as a result the total interest cost burden for FY2023/24 will may reduce by up to c. 14%.

Chart 2.7a: HAYC Margins and Variance 2017-2023

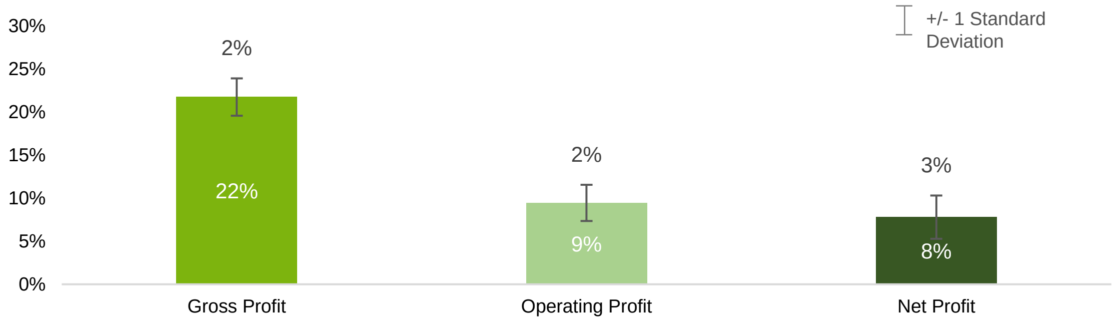


Chart 2.7b: HAYC and Peers Operating Profit Margin Comparison

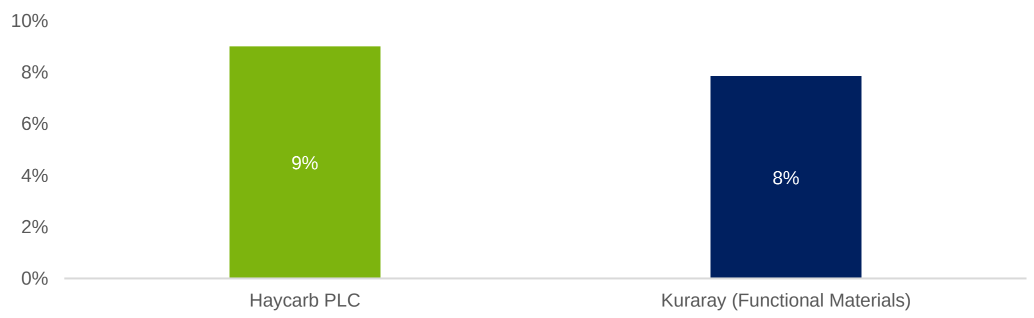


Chart 2.7c: HAYC Avg Margin Analysis 2017-2023

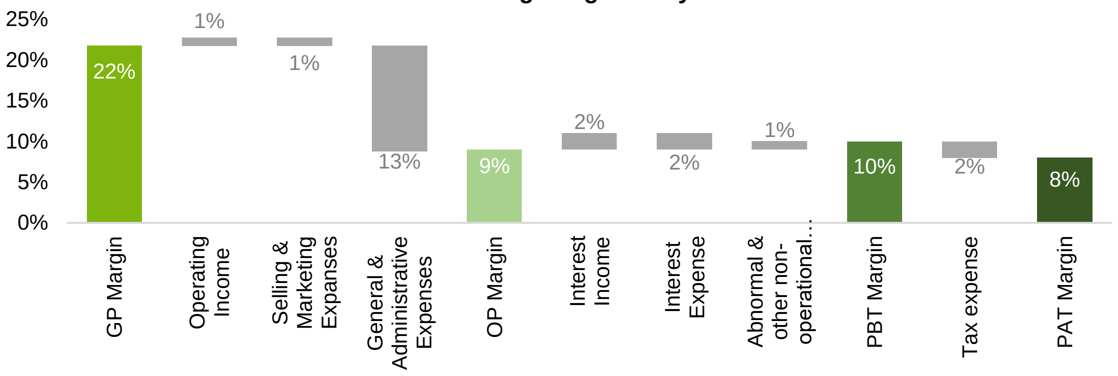
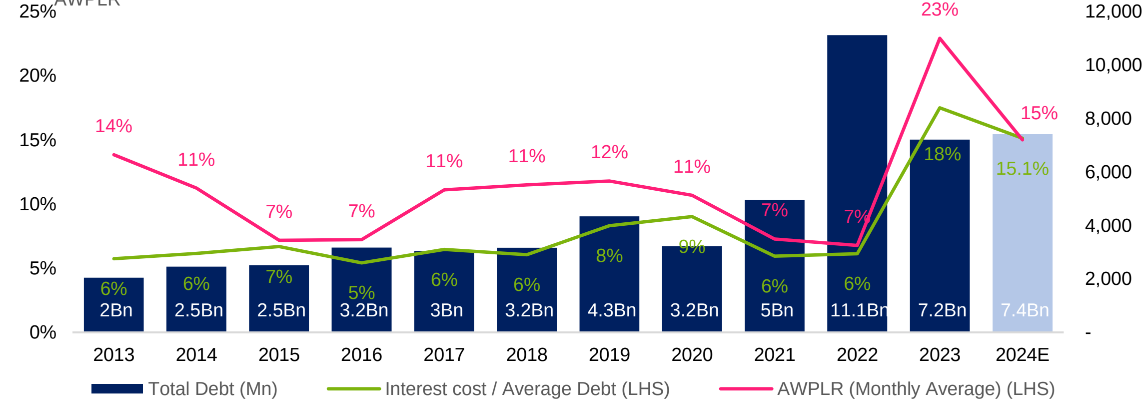


Chart 2.8: HAYC Interest Cost



ACUITY
A joint venture of DFCC Bank and HNB

HAYC revenue and margin assumptions

Historically, USD equivalent revenues grew at a CAGR of c. 11% (see Chart 2.9a). However, FY2021/22 and to a lesser extent FY2022/23 experienced a higher growth attributable customers overstocking during the Covid pandemic in response to supply chain disruptions. HAYC's recent quarterly results shows a reduction in the revenue run rate as inventory levels normalise coupled with higher carbon supply coming to the market whilst demand conditions have softened in the backdrop of recessionary indicators in developed markets. We believe that the dip in the topline with potential margin contraction in the short-term will be a temporary phenomenon and that HAYC's revenue growth will revert to its long-term trend in the coming years as supply/ demand imbalances are ironed out. We are projecting a CAGR of 11.4% over the forecast period which is in line with past trends and slightly above the expected growth rate of the global activated carbon market.

Historically, HAYC has maintained consistent gross margins (c. 24%) whilst operating and net margins also follow the trend in gross margins. Stable margins demonstrates pricing power as HAYC has passed on cost escalations in a timely manner to maintain overall profitability. Raw materials sourced from Sri Lanka and Thailand show an increase in prices lately due to shortages. However, a longer time-lag in adjusting selling prices on par with the cost increases resulted in only temporarily lower margins for HAYC in FY2017/18 and FY2018/19.

The abnormally high margins seen in FY2020/21 was most likely the result of premium pricing in response to excess stocking by customers during the pandemic period. Based on the past performance of HAYC, we have assumed in our forecasts that the profitability margins would be maintained at around historic levels through cost-reflective price adjustment strategies going forward.

Chart 2.9a: HAYC Revenue Projections

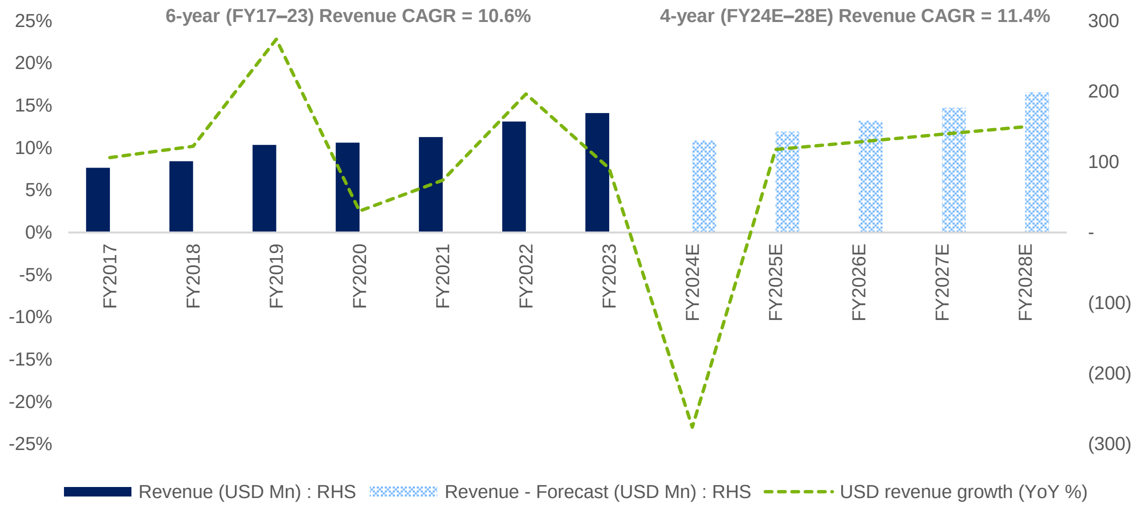
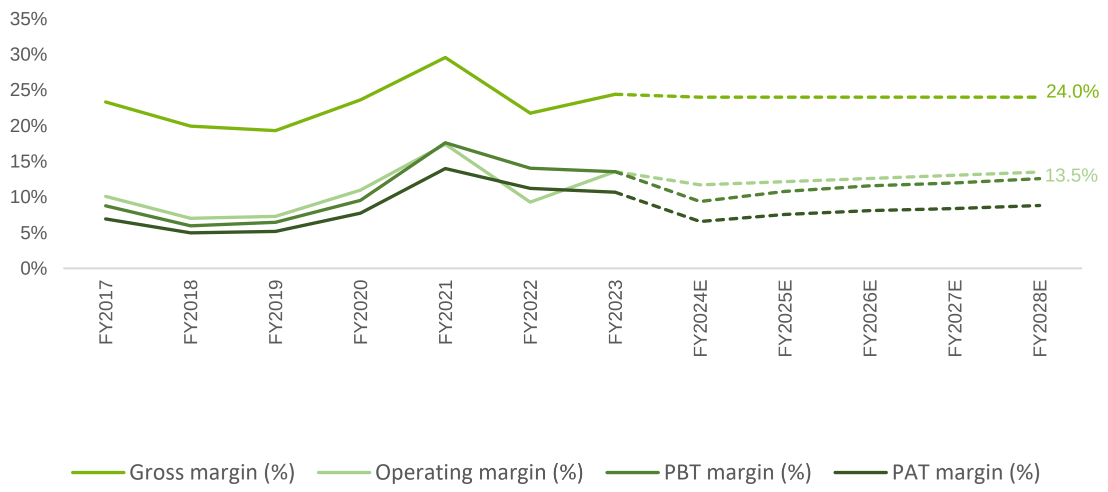


Chart 2.9b: HAYC Margin Forecast



HAYC: story behind the numbers

Key performance indicator	Assumption			
	Base year	Years 1 – 5 (FY24 – FY28)	Beyond 5 years	Link to story
Revenue	USD 169.2 Mn (FY23)	11.1 % (4yr CAGR)	2.0%	Global activated carbon market is to grow at a CAGR of c. 9% in the forecast period. We expect a slightly higher CAGR of 11.1% for HAYC (from FY25 to FY28) and for capacity expansion to grow in line with revenue growth.
Operating margin	13.6 % / 12.6% (FY23 / Q1 FY24)	11.7 % - 13.5 %	13.5 %	Cost-reflective price adjustments in the past have maintained margins at relatively stable levels. Overall, favorable pricing power in the industry despite lack of major product differentiation or brand image associated with HAYC products, and preference for coconut shell-based carbons which are more renewable is expected to keep margins in-line with past levels.
Tax rate	30.0 %	30.0 %	30.0 %	Currently applicable 30.0% (revised) corporate tax is expected to continue in the forecast period.
Reinvestment (CAPEX as a % of sales)	5.0 %	1.5 – 2.0%	2.0 %	1.5% - 2.0% of the sales is expected to be incurred as CAPEX, over the period of next five years, to be in line with the revenue growth expected over the same period. Also, additional CAPEX of 2.0% of sales is predicted for the terminal year and beyond.
Return on capital	22.0 %	10.8 % - 23.0 %	12.0 %	This is to range between 10.0% - 21.0% over the next five years in-line with projected growth and profitability metrics. However, with no major product differentiation or brand image associated with HAYC products, in long run (beyond terminal period), ROC is expected to settle around 12.0%.
Cost of capital (WACC)	17.0 %	17.4 %	17.4 %	Assuming the (long term) risk-free rate to settle at around 15.0% and average cost of borrowings on foreign + local currency debt to be around 12.6% (with D/E of 70:30 and the levered beta of 0.77), WACC assumed to be at 17.4% over the forecast period.
Exchange rate (USD / LKR)	325.00	320.00 – 415.00	420.00	On average, LKR is expected to depreciate c. 5% each year, over the next five years and expected to reach an exchange rate of (USD/LKR) 420.00 in the terminal year.

HAYC valuation indicates a upside of > c. 20% based on intrinsic and target prices

For the year ended 31-March	Actual					Forecast				
	FY2019	FY2020	FY2021	FY2022	FY2023	FY2024E	FY2025E	FY2026E	FY2027E	FY2028E
Revenue (USD Mn)	124.18	127.32	135.18	157.30	169.21	130.29	143.06	158.37	176.74	198.83
Recurring Net Profit (USD Mn)	5.67	8.69	16.16	17.65	18.06	7.66	9.66	11.48	13.27	15.67
Earnings per Share (LKR)	3.22	5.25	10.25	11.06	19.60	8.80	11.66	14.53	17.64	21.88
Earnings per Share Growth (%)	42.1%	63.3%	95.2%	7.9%	77.2%	-55.1%	32.4%	24.7%	21.4%	24.0%
Price / Earnings Ratio (X) *	3.95	3.05	9.07	4.54	2.87	7.74	5.84	4.69	3.86	3.11
Gross Dividend per Share (LKR)	0.80	1.50	3.70	2.80	5.65	2.00	3.00	4.00	4.00	5.00
Gross Dividend Yield (%) *	6.3%	9.4%	4.0%	5.6%	10.0%	2.9%	4.4%	5.9%	5.9%	7.3%
Net Book Value per Share (LKR)	27.77	31.40	45.10	60.80	74.52	81.32	89.98	100.51	114.14	131.02
Price / Book Value (X) *	0.46	0.51	2.06	0.83	0.76	0.84	0.76	0.68	0.60	0.52
Return on Equity (%)	115.8%	16.7%	22.7%	17.9%	25.8%	10.8%	13.0%	14.5%	15.5%	16.7%
Market Price per Share (LKR) *	12.70	16.00	93.00	50.20	56.30	68.10	68.10	68.10	68.10	68.10

* For historical period ratio / price is based on FY end price and forecast period ratio is based on CMP as of 06 Oct 2023.

We have estimated HAYC's revenue to grow at a 4-year CAGR of 11.4% to achieve a topline of USD 198.0 Mn by FY2027/28E in-line with expected industry and past growth rates.

FY2023/24E EPS is forecast at LKR 8.80 (-55% YoY) due to negative impact of appreciation of the LKR, lower sales on the back of normalization of inventory levels, temporary supply/ demand imbalances and associated margin pressure. Furthermore, average dividend payout ratio of 20.0% is assumed over the forecast period. Based on our DCF based valuation using a WACC of 17.4% and a terminal growth rate of 2% and expected gradual market rerating, we assigns a 12M forward price target of LKR 81.82 per share for HAYC.

DCF Valuation					
LKR Mn	FY2024E	FY2025E	FY2026E	FY2027E	FY2028E
EBIT	5,202	6,228	7,507	9,111	11,134
FCFF	2,871	3,597	4,295	5,168	6,266
Terminal value					44,825
Discounted FCFF (WACC @ 17.4%)	2,650	2,828	2,877	2,949	3,045
Enterprise value					36,133
Net debt					1,082
Equity value					35,051
Equity value (net of NCI)					31,980
# of shares (Mn)					297
DCF based intrinsic value (LKR)					107.63
12M Target Price based on probable (historical / estimated) PER (8.0x) on estimated TTM EPS of LKR 10.2 in Sept 2024					81.82
CMP as of 06 Oct 2023 (LKR)					68.10
Potential Upside / (downside) to 12M Target Price					20%

ACUITY

A joint venture of DFCC Bank and HNB

HAYC forecast and WACC sensitivity

Income statement For the year ended 31-March (LKR Mn)	Actual		Forecast				
	FY2022	FY2023	FY2024E	FY2025E	FY2026E	FY2027E	FY2028E
Revenue	**33,160**	**60,943**	**44,462**	**51,260**	**59,582**	**69,819**	**82,473**
Revenue YoY Growth	*30.1%*	*83.8%*	*-27.0%*	*15.3%*	*16.2%*	*17.2%*	*18.1%*
Results from operating activities / EBIT	**3,079**	**8,274**	**5,202**	**6,228**	**7,507**	**9,111**	**11,134**
EBIT YoY Growth	*-30.6%*	*168.7%*	*-28.3%*	*19.7%*	*20.5%*	*21.4%*	*22.2%*
EBIT margins	*9.3%*	*13.6%*	*11.7%*	*12.2%*	*12.6%*	*13.1%*	*13.5%*
Net finance cost/ (income)	**(1,598)**	**19**	**1,029**	**701**	**617**	**747**	**759**
Profit before tax / PBT	**4,677**	**8,256**	**4,173**	**5,527**	**6,890**	**8,364**	**10,375**
PBT margins	*14.1%*	*13.5%*	*9.4%*	*10.8%*	*11.6%*	*12.0%*	*12.6%*
Profit after tax / PAT	**3,721**	**6,505**	**2,921**	**3,869**	**4,823**	**5,855**	**7,262**
PAT YoY Growth	*4.3%*	*74.8%*	*-55.1%*	*32.4%*	*24.7%*	*21.4%*	*24.0%*
PAT margins	*11.2%*	*10.7%*	*6.6%*	*7.5%*	*8.1%*	*8.4%*	*8.8%*
Profit attributable to the SH / Recurrent earnings	**3,288**	**5,823**	**2,615**	**3,463**	**4,317**	**5,241**	**6,501**
Recurrent EPS (LKR)	**11.06**	**19.60**	**8.80**	**11.66**	**14.53**	**17.64**	**21.88**

Weighted average cost of capital	
Cost of equity (Ke)	
Risk free rate	15.0%
Market risk premium	7.0%
Levered beta	0.77
Cost of equity (Ke)	20.4%
Cost of debt (Kd)	
Average cost of borrowings	12.6%
Tax adjusted Kd	8.8%
Weighted average cost of capital (WACC)	17.4%

		WACC				
		16.4%	16.9%	17.4%	17.9%	18.4%
Terminal growth	1.0%	118.38	113.69	109.30	105.18	101.31
	1.5%	117.68	112.94	108.51	104.36	100.47
	2.0%	116.88	112.10	107.63	103.46	99.55
	2.5%	115.98	111.16	106.66	102.46	98.53
	3.0%	114.98	110.11	105.58	101.36	97.42

Intrinsic value of LKR 107.63 compared against the CMP of LKR 68.10 as of 06 Oct 2023 represents a discount of > 58%.

Risk factors impacting our rating of HAYC

Table 2.3: Risk Factors that Impact our Rating of HAYC

Risk Factors	Likelihood of Risks Negatively Impacting Ratings in Next 1-2 years	Negative Impact on Ratings	Positive Impact on Ratings
Global Economic/ Market Conditions	Moderate	Prolonged deterioration in global economic conditions in key markets and/ or prolonged adverse conditions in the global market for activated carbon.	Sustained improvement in global economic conditions in key markets and/ or prolonged favourable conditions in the global market for activated carbon.
Market Share	Moderate	Sustained loss of global market share in the medium term.	Sustained gain in global market share in the medium term.
Revenue Growth	Moderate	Sustained decline in USD revenue growth rates below the growth rates assumed in our forecast.	Sustained increase in USD revenue growth rates above the growth rates assumed in our forecast.
Margins	Moderate	Prolonged margin compression from unfavourable economic/ industry conditions or company specific factors.	Sustained margin expansion from favourable economic/ industry conditions or company specific factors.
Capital Expenditure/ ROIC	Moderate	Increase in capital intensity of the business or decline in ROIC from adverse competitive forces or company specific factors.	Decrease in capital intensity of the business or increase in ROIC from favourable competitive forces or company specific factors.
Inflation/ Cost Pressures	Moderate	Increase in localised inflationary pressures which cannot be passed on to end customers.	Decrease in localised inflationary pressures possibly leading to margin expansion.
Devaluation of Reporting Currency	Low	Sustained appreciation of the reporting currency against the functional currency of the export SBU's can lower reported revenue/ earnings and our valuations/ price targets in LKR.	Devaluation of the reporting currency against the functional currency of the export SBU's surpassing our forecast assumption of on avg. 5% p.a. can increase reported revenue/ earnings and our valuations/ price targets in LKR.
Changes to WACC	Moderate	Increase in market interest rates/ equity risk premium or beta values and accordingly the cost of capital or lower market valuation multiples can negatively impact our valuations and ratings.	Decrease in market interest rates/ equity risk premium or beta values and accordingly the cost of capital or higher market valuation multiples can positively impact our valuations and ratings.
Climatic Events	Low	Localised climatic events/ natural disasters which may have a medium-term negative impact on supply/ prices of raw materials.	N.A.
Loss of Human Capital	Low	Sustained loss in talent/ key personnel.	N.A.
Regulatory & Taxation	Low	Adverse regulatory or taxation changes which impact the long-term viability/ competitiveness of the business.	Positive regulatory or taxation changes including in the ease of doing business which favourably impact the long-term viability of the business.

HAYC's ESG initiatives are a strategic differentiator which appeals to more environmentally aware buyers

Environment

Greening Supply chains
Mitigating the environmental impacts along the supply chain through the propagation of proprietary green charcoaling technology.

- Recogen – Patented green charcoaling technology that generates electricity using waste heat.
- Haritha Angara Initiative (Sri Lanka & Indonesia) – Promoting closed pit charcoaling
- Vertical kiln charcoaling technology (Thailand)



Environmentally conscious product portfolio
A portfolio of products and solutions that minimize the environmental impact of industries.
- 90% of raw material suppliers are from green charcoaling sources

Preserving biodiversity and combating climate change
- Tree planting initiatives - >500 trees planted in FY22/23
- Contributing towards the conservation efforts of endangered sea turtles – LKR1.23Mn invested in conservation of sea turtles at Kumana National Park.


Social

Empowering children through support for education
- "Sisu Divi Pahana" program - providing nutritious mid-day meals to 700 students in 13 schools in 6 districts for 200 schools in Sri Lanka.
- "Going Beyond" book donation program – over 3500 students benefiting from the program carried out in 14 schools in Sri Lanka.
- Donation of schoolbooks to over 650 school children residing in proximity to Haycrab operations.



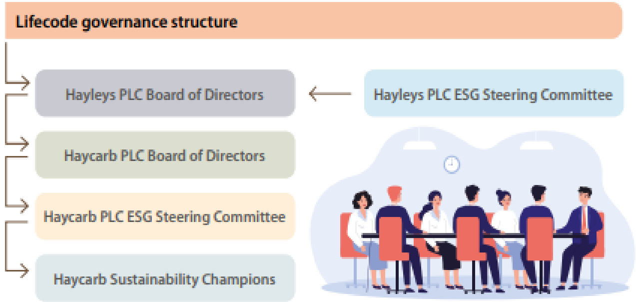
Well-being of communities and employees
- Hospital refurbishment and donation of medical supplies.
- Addressing food security related concerns of community through the donation of dry ration packs.
- Supply of purified drinking water to communities living in areas affected by chronic kidney disease.
- Addressing food security related concerns among employees through the provision of subsidized meals and promoting home gardening.



Empowering Communities
Group contributes to the socio-economic empowerment of the communities it operates in by,
- Supporting the livelihood of over 200 micro-entrepreneurs in Sri Lanka.
- Empowerment of youth, women and uplifting domestic entrepreneurship.

Governance

Adhering to 'Hayleys Lifecode'
- ESG steering committee was established at the company board level to assist the board in rolling out ESG agenda.



Favorable engagement with Government, Industry, Regulatory bodies and Media
The group ensures,
- Compliance with all regulatory requirements.
- Timely and accurate disclosures
- Timely payment of taxes, levies, licensing fees and other government payments.
- Maintaining governance and risk mitigation frameworks, responsible and non-partisan employment and career progression opportunities.

HAYC price and PER bands

The share price of HAYC is currently trading at approximately one standard deviation below its historical valuation multiples based on a trailing earnings basis. Although on a forward earnings basis, the stock is around one standard deviation above its historical average valuation multiple, we believe the indicated upside to our target price is achievable with the expected earnings growth in the forecast period and rerating of the overall market trading comps.

ACUITY
A joint venture of DFCC Bank and HNB

October 2023
Equity Research
Sri Lanka

Dipped Products PLC

DIPD

Target price (12M. LKR) 35.62

Hold

With the ending of the Covid bonanza for glove manufacturers, external headwinds in the form of recessionary conditions with softer demand for household and industrial gloves coupled with inventory levels normalising from excess stocking by buyers during the pandemic; DIPD is likely to see continued pressure on revenue and margins in the hand protection segment. The stock is close to fully valued at current prices based on its intrinsic value. However, since our valuations are imputed from current risk-free rates which are at the higher end of their historic range, we rate the stock as a hold based on potential valuation gains in-line with the market.

Materials | Reiterate Rating

DIPD's new product segments could diversify future revenue streams

CMP as at 6th Oct 2023	LKR 32.30
Bloomberg and CSE Ticker	DIPD SL Equity I DIPD.N
Market Cap (LKR Bn I USD Mn)	LKR 19.3 Bn I USD 59.7 Mn
Issued Quantity (Shares Mn)	598.6
Estimated free float	41.0%
Average daily volume (Last 3M)	344,809
52-week High and Low (LKR)	42.8 I 24.5
Industry & Year end	Materials I 31st March
Beta and Sharpe ratio	1.18 I 0.21

Chart 3.1: DIPD Technical Chart (Trailing 90 days)

Source: Bloomberg

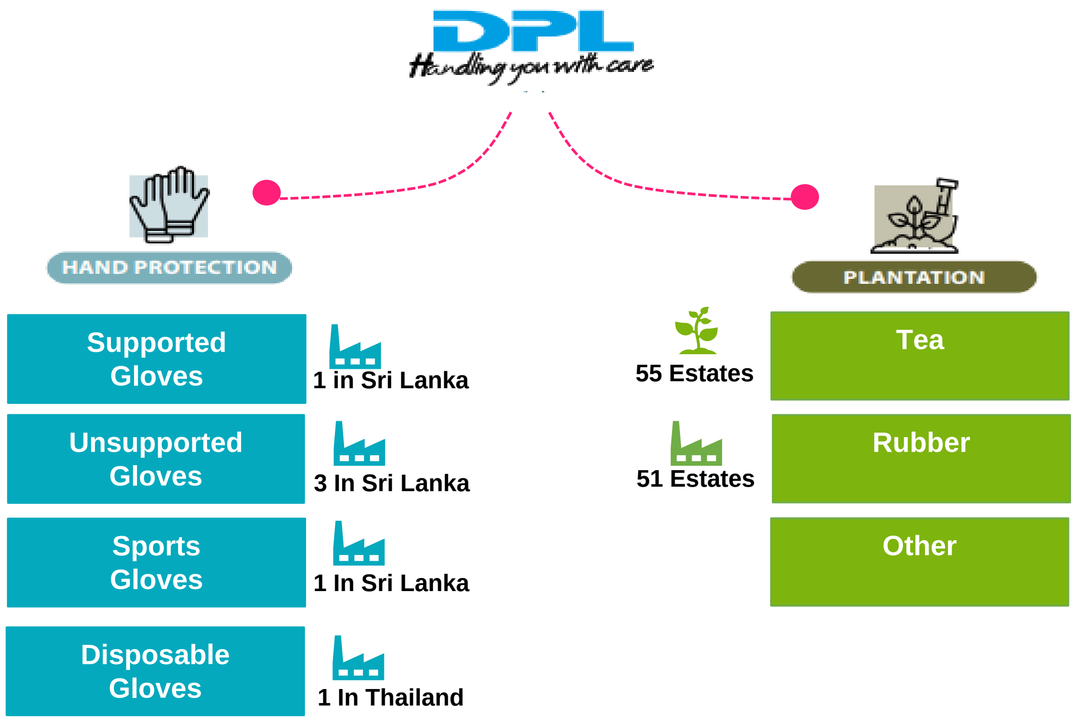
Dipped Products PLC	DIPD
Rating	Hold
12M Target Price	LKR 35.62
Potential Upside/ (Downside)	10%
Industry View: Materials	In-Line

The Covid pandemic was a bonanza for glove manufacturers as demand for all types of personal protective equipment skyrocketed. Although not primarily a medical gloves manufacturer, DIPD also witnessed a marked uptick in revenue and substantial margin expansion during the pandemic period. The end of the Covid-boom and economic weakness in developed markets is likely to pressure revenue and earnings in the current financial year and into FY2024/25. Improving economies of scale and entry into newer segments that offer more scope for product differentiation may support margins in the longer term. We re-iterate the stock as a "Hold" with a 12m price target of LKR 35.62 /- per share based on the current moderate discount to its intrinsic value and potential valuation gains in-line with the market.

Financial year ended 31 March	FY2021	FY2022	FY2023
Revenue (LKR Mn)	46,387	55,294	80,099
YoY Growth (%)	12%	30%	84%
Operating profit (LKR Mn)	7,306	5,383	9,695
YoY Growth (%)	77%	-31%	169%
EPS (LKR)	8.6	9.0	10.9
DPS (LKR)	2.3	2.5	3
TTM PER (x)	5.4	3.6	2.6

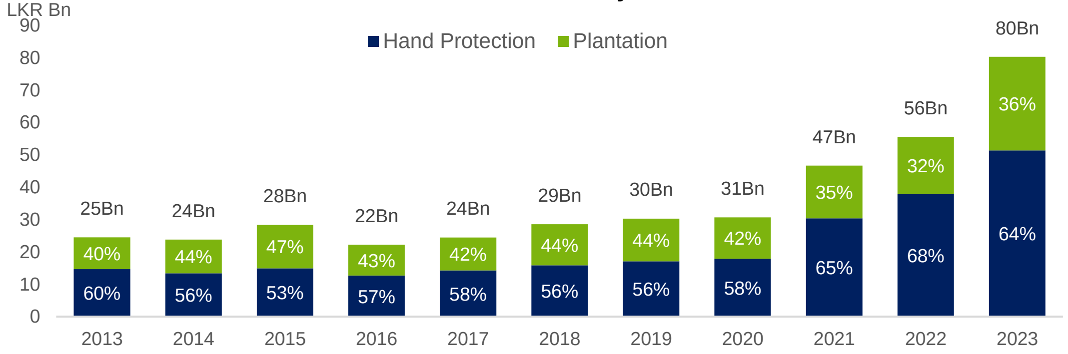
Dipped Products PLC ("DIPD") is one of the largest manufacturing entities in Sri Lanka as a global manufacturer of rubber protective hand-wear. DIPD manufactures and exports synthetic and natural rubber gloves for medical, household, industrial and sports purposes. The company holds 5% of the global market share serving customers in over 70 countries across the globe.

The hand protection segment manufactures and sells high quality, innovative and sustainable natural and synthetic-latex based household and industrial gloves while the plantation segment produces some of the best quality tea and rubber in the country.



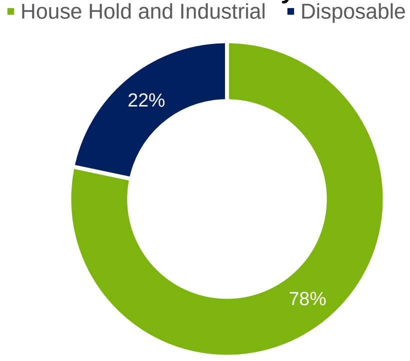
DIPD owns 6 manufacturing facilities in Sri Lanka and Thailand under the hand protection segment while Talawakelle Tea Estates PLC, Kelani Valley Plantations PLC and Horana Plantations PLC are owned under Plantation segment.

Chart 3.2a: Revenue contribution by sectors FY2022/23



The hand protection segment is the highest contributing segment to DIPD revenue, typically accounting for well over 50% across past years. The segment contributed 64% of DIPD total revenue in FY2022/23 with a 36% YoY growth. The inter-segmental revenue is dominated by household and industrial glove sales, amounting to 78% of inter-segmental revenue, the remainder comprising of disposable gloves. DIPD manufactures gloves both under its own brands including "DPL", "Palmrite" and "Linepro" and as a contract manufacturer for private label brands.

Chart 3.2b: Revenue Contribution by Product Type FY2022/23



DIPD at a glance, cont'd

Table 3.2a: DIPD Margins/ Cost as a % of USD Equivalent Revenue

Financial year ended 31 March	FY2019	FY2020	FY2021	FY2022	FY2023
Gross Profit	16%	15%	26%	19%	24%
Operating Profit	6%	5%	16%	10%	12%
Interest Cost	1%	1%	1%	1%	1%
Net Interest Cost	1%	1%	0.3%	-4%	-2%
Tax Expense	1%	1%	3%	2%	3%
Net Profit	4%	3%	13%	12%	11%

DIPD benefitted from substantial margin expansion during the Covid period compared to the immediate pre-pandemic period as demand for all types of personal protective equipment skyrocketed enabling manufacturers to command premium pricing (see Table 3.2a). Historically, DIPD's revenue and earnings had the highest correlations with LKR/ USD exchange rate (and inversely with the REER). Secondary drivers of revenue/ earnings growth were OECD area economic growth and rubber prices through the exposure to the plantation segment (see Table 3.2b). Interest rates have had less impact on the earnings of DIPD given the overall low degree of financial leverage of the company, which reported a net cash position in FY2022/23.

Table 3.2b: Correlation of Business Performance & Economic Variables (2011-21)

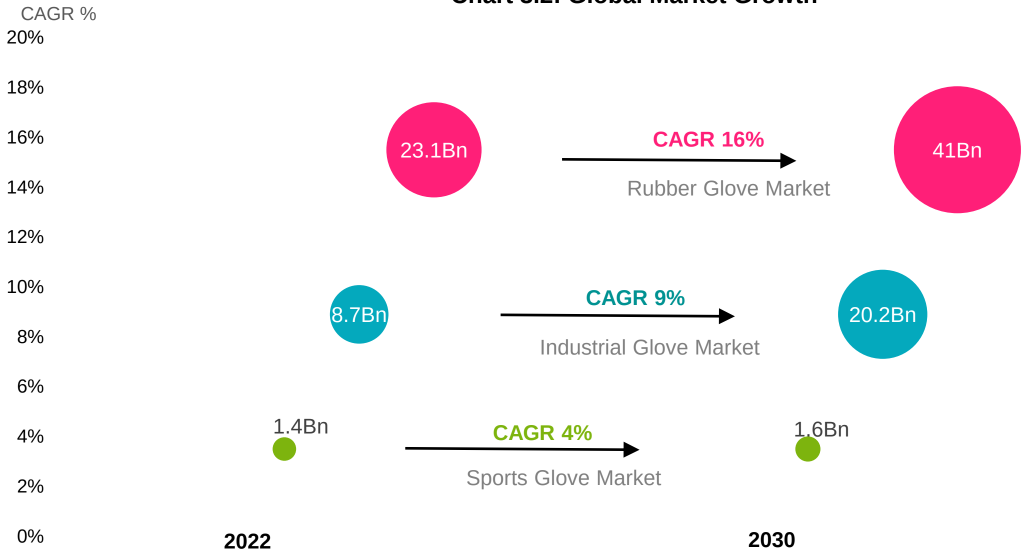
	Revenue	*Gross profit*	*Profit attributable to shareholders*
Exchange Rate (LKR/USD)	0.9	0.8	0.5
REER	-0.9	-0.9	-0.8
Interest rates (%)	-0.1	-0.1	0
Concessionary Tax Rate (%)	0.7	0.6	0.4
OECD economic growth	0.9	0.9	0.9
Rubber Prices (Rs/Kg)	0.7	0.8	0.8
Energy Prices	-0.4	-0.3	-0.1

Source: CBSL, Annual Reports

The revenue mix of hand protection segment is expected to change, with an increasing contribution from household and industrial gloves in coming years. These product segments are expected to contribute more than 85% of revenues by FY2024/25 compared to 78% in FY2021/22, with DIPD increasing focus on the supported glove segment with the introduction of more value-added products with higher margins, such as electrician's gloves. Volume growth across all product segments will be supported by the overall global market growth, including a higher contribution from larger emerging economies which currently have low per capita glove usage.

The disposable glove segment witness a margin erosion with relatively lower demand for medical gloves since the end of the pandemic, but its impact on earnings is anticipated to be less significant and offset by better margins in industrial gloves and through introducing potentially higher margin products (sports gloves and electrician gloves), supported by the recent capacity expansions and expected increase in capacity utilization.

Chart 3.2: Global Market Growth



Source: Industry Research Reports

DIPD's new product segment, sports gloves, is identified as a potentially higher margin, more niche market, growth lever in coming years. This product segment is expected grow with more increasing disposable income in the longer-term, especially in emerging markets, and favorable lifestyle related trends which promote exercise and outdoor recreation activities.

The demand for sports gloves is observed to display a seasonal effect with higher purchasing in the 1st and 4th quarters of a calendar year. Major sporting goods markets who are also the top buyers of sports glove are the US, UK, Spain, and Japan with more demand expected from larger emerging economies going forward.

Glove markets in developing countries shows significant potential to grow over the longer term with an outsized proportion of the global population and significantly lower per capita glove consumption. Compared to developed nations which have per capita usage of 100 – 300 gloves per annum, per capita usage in larger emerging markets is still below 10 gloves per annum (see Chart 3.3a). It's assumed that the annual per capita glove consumption in certain key emerging markets will double over the next decade from a low base, whilst developed countries face stagnant per capita demand. Potentially, the increased volume demand from key emerging economies could conservatively add a CAGR of 1.3% to the global rubber glove market in terms of volume growth, which coupled with price growth of c. 5% p.a, implies that key emerging economies alone could support a 10-year CAGR of 6.3% in the total addressable market (see Chart 3.3b), whilst continued higher population in growth developing countries would offset declining demographics in developed markets further down the line.

Incremental volume contribution from developing economies growing at a CAGR of c. 6%

Chart 3.3a: Population and Per capita Glove Consumption in 2020

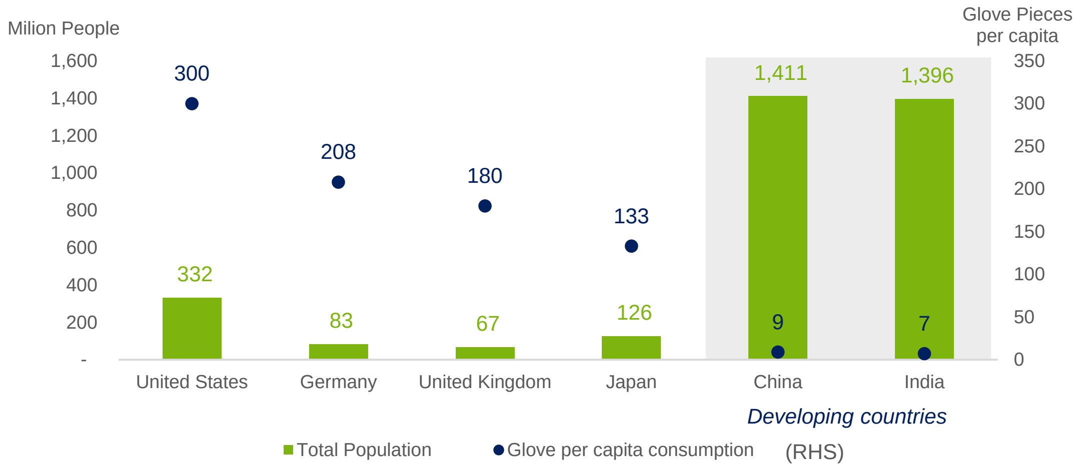
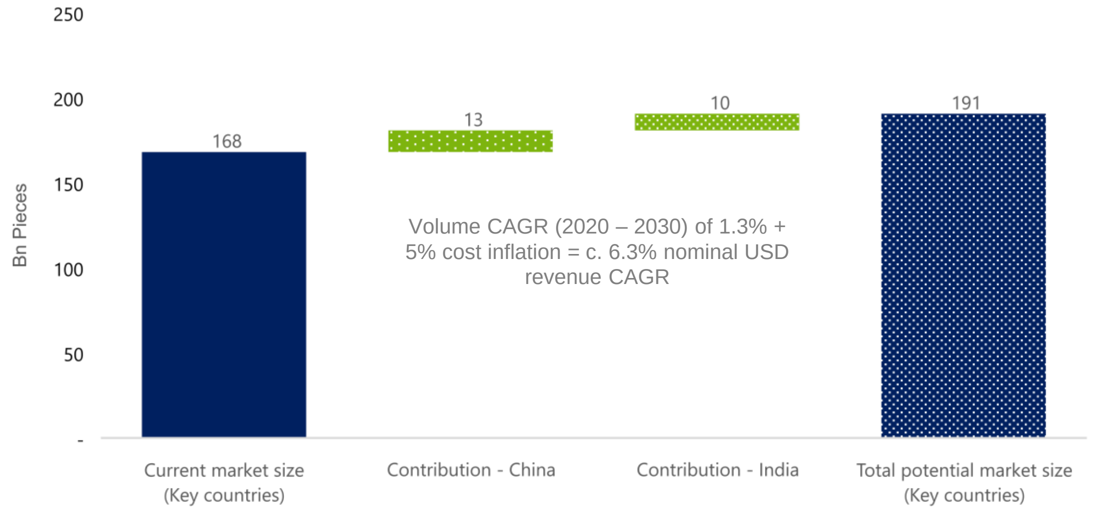


Chart 3.3b: Growth in total glove consumption by 2030



The industrial glove market is identified as a moderately fragmented market that is competitive without too many dominant players. The market consist of few bigger players plus a large number of small and mid sized players that cater to their respective domestic and international markets. Hence, the market has both consolidated and fragmented characteristics including high competition, low threats from new entrants, low threat from substitutes, lower power of individual suppliers and higher power of large customers.

Global Medical Glove Manufacturers

Global Industrial Glove Manufacturers

High Competition
The market has a larger number of players with limited pricing power.
Hence, product differentiation and innovation are identified as the key to improve margins.

Low threat of new entrants
Threat of new entrants is low to due to the requirement for large initial investments and domain expertise to compete with the existing players.

High power of customer
The market has a larger number of players each with limited pricing power over existing large buyers.

Low threat of substitutes
Although there are no direct substitutes for gloves, companies need to keep investing in R&D and manufacturing facilities to remain competitive.

Low power of supplier
Most raw materials are commodities with many suppliers. Manufacturers maintain multiple suppliers to gain competitive pricing which Affords less pricing power to suppliers.

Source: Frost and Sullivan, December 2021, World Bank

DIPD revenue has grown in line with the larger players whilst margins are comparable

Chart 3.4: USD Basis Revenue Comparison of DIPD & TOPG

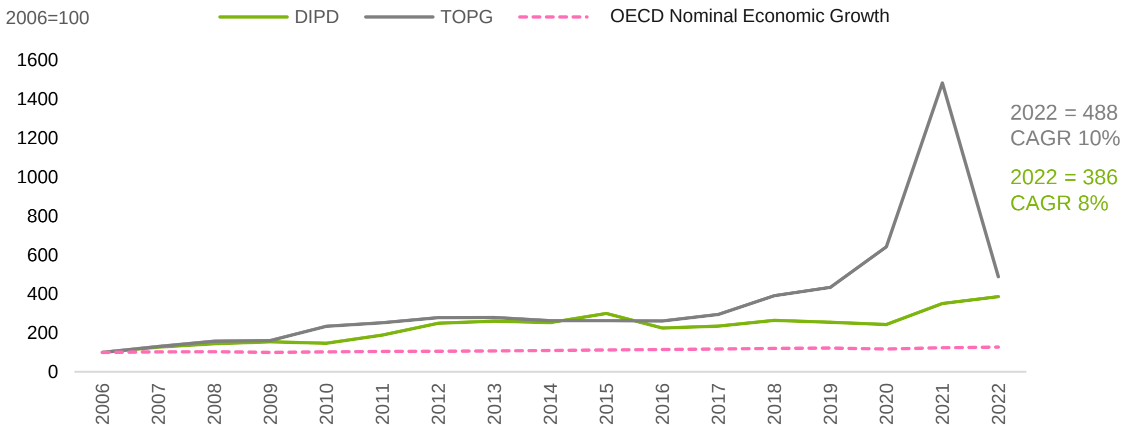
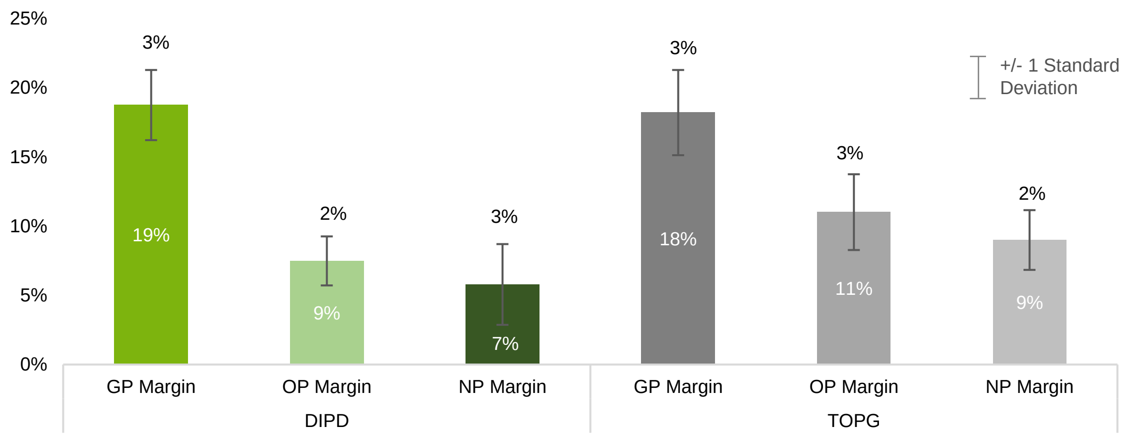


Chart 3.5a: Margin Comparison of DIPD & TOPG



DIPD revenue growth in USD terms has kept up with the larger players in the industry with CAGRs historically moving at the same pace (see Chart 3.4). Ignoring the one-off spike in demand for large medical glove suppliers such as Top Glove ("TOPG") in 2021 due to the Covid-19 pandemic, DIPD is expected to grow broadly inline with the major industry players going forward.

Unit Economics and Margins

DIPD's margin variance is comparable with international peers with a standard deviation of +/- 300 bps and +/- 200 bps for gross and operating margins, respectively. Whilst DIPD's gross margins are comparable with larger international peers, its operating and net margins are lower on account of significantly higher administration costs. This presents opportunities for margin expansion through greater economies of scale.

Chart 3.5b: DIPD Avg Margin Analysis 2006-23

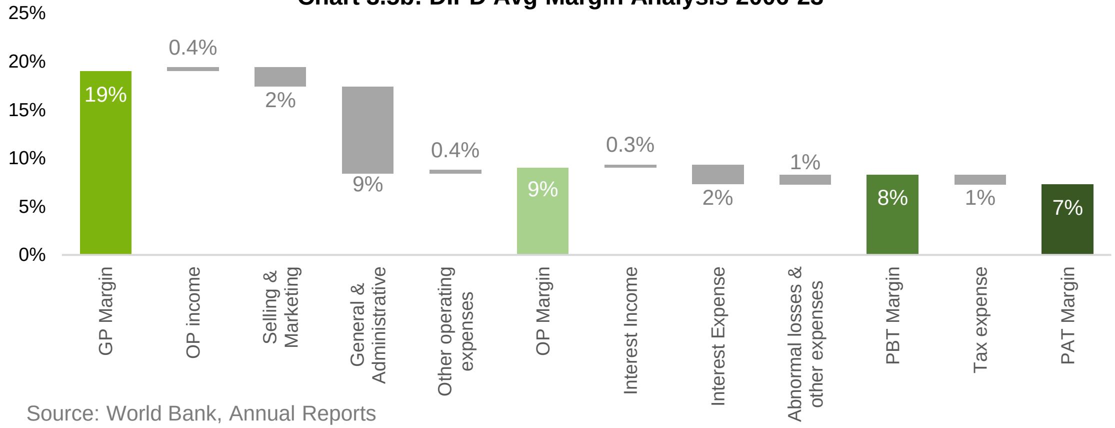
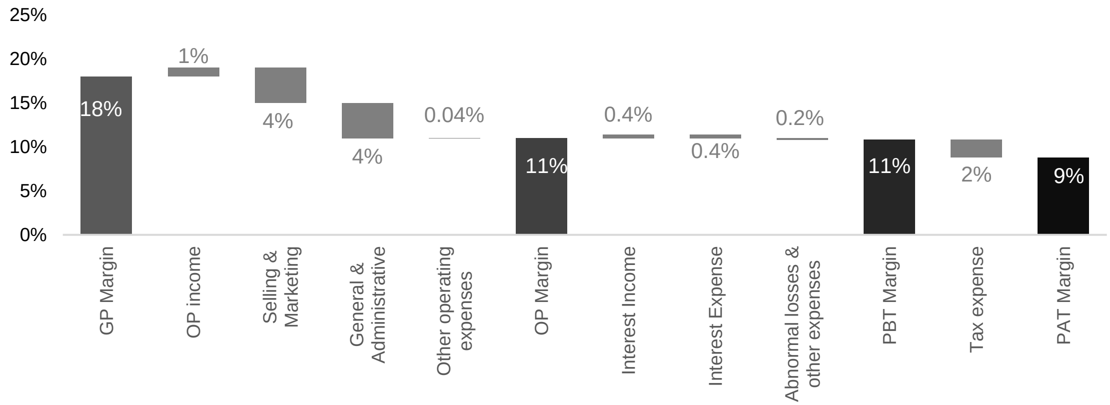


Chart 3.5c: TOPG Avg Margin Analysis 2006-23



Source: World Bank, Annual Reports

Moderating capex cycles and declining interest costs should support net income growth

Further analysis suggests that DIPD incurs comparatively higher admin during stages of its capital expenditure cycle (see Chart 3.6). The upward spikes in admin cost as a percentage of sales have tended to follow major capex cycles, which can be observed in FY2015/2016 (admin costs rise c. 230 bps to 10.3%) and again in FY2022/2023 (+140 bps to 10.1%) following noticeably higher than average capex spending in the preceding years. Admin costs tend to trend lower after each cycle, presumably as production ramps up and economies of scale kick in.

Chart 3.6: Administration Cost movement & Capex Cycles

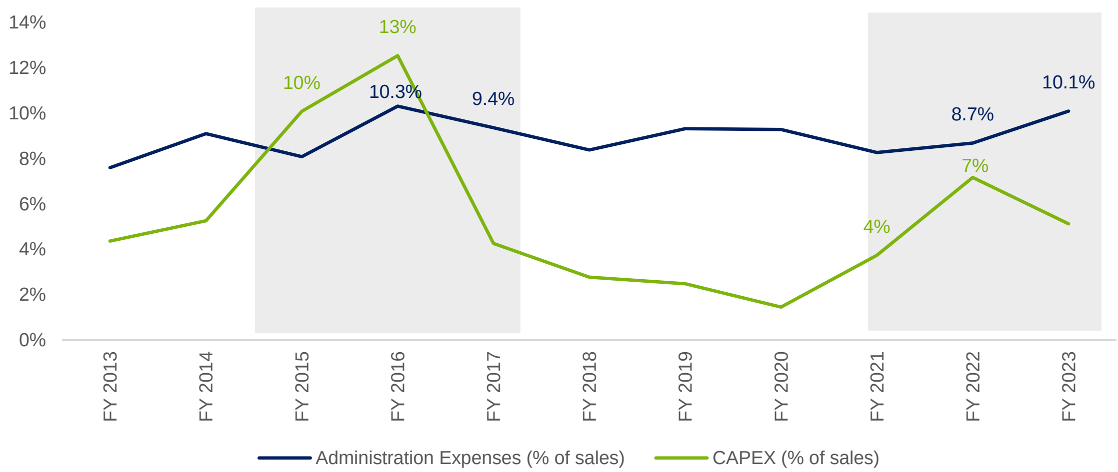
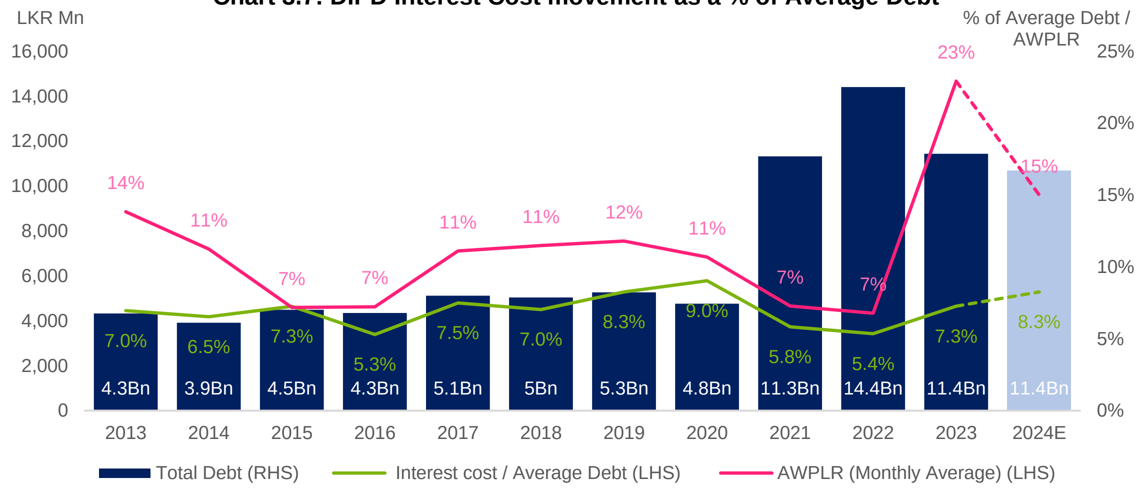


Chart 3.7: DIPD Interest Cost movement as a % of Average Debt



DIPD's net financial costs increased by 49% in FY2022/23 as the sharply higher interest rates which prevailed during the period offset the positive impact from the decline in the value of outstanding debt. We anticipate the benchmark AWPLR interest rates to come down to c.15% p.a. by end 2024 and debt level to remain at LKR 11 Bn. However, interest cost relative average debt may remain elevated on account of foreign currency debt repricing at higher rates with the global escalation in USD interest rates.

Source: Annual Reports, CBSL

Revenue expected to recover whilst economies of scale will allow for stable margins

Chart 3.8a: DIPD Hand Protection Segment Revenue Growth Forecast

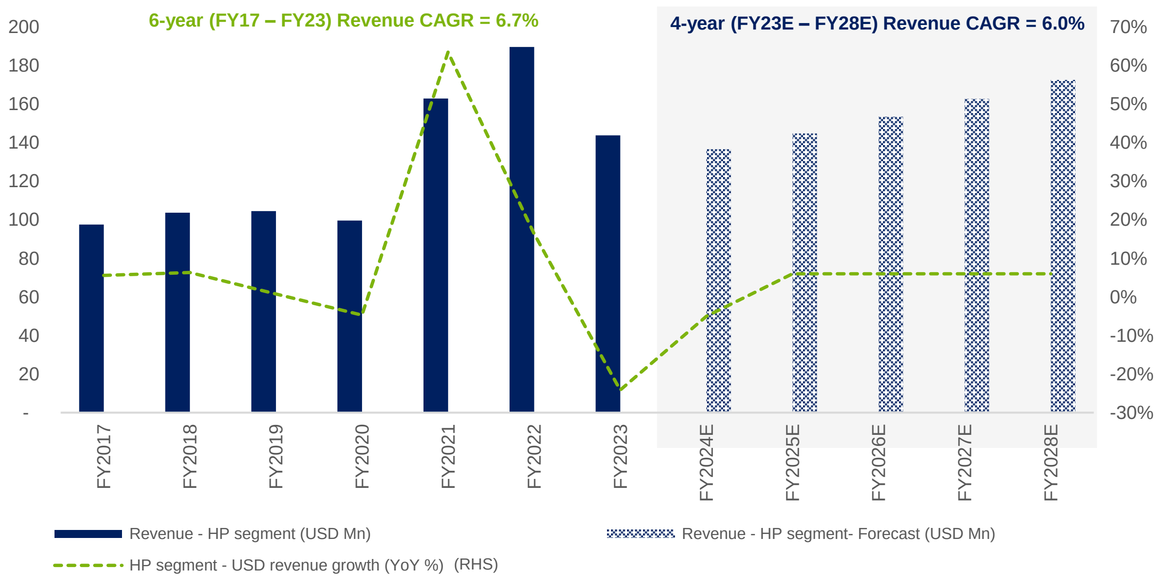
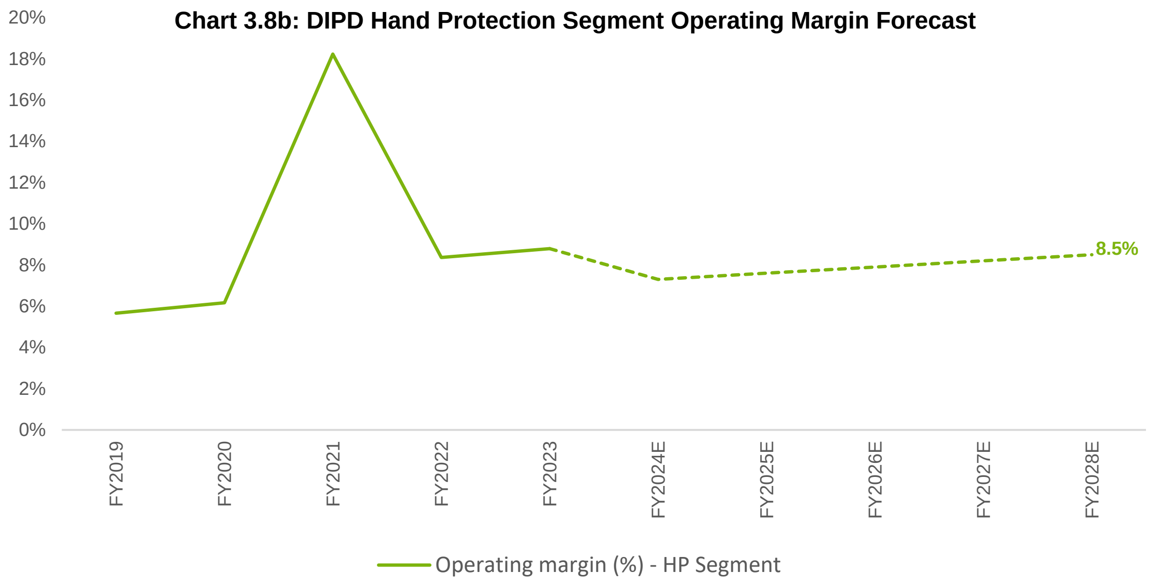


Chart 3.8b: DIPD Hand Protection Segment Operating Margin Forecast



Historically, the hand protection segments' revenue in USD basis has grown at a CAGR of 6.7% (see Chart 3.8a), including robust growth observed in the FY2020/21 with the pandemic stimulus. DIPD as a group in FY2020/21 recorded a notable YoY revenue growth of 52% primarily contributed by one-off growth of 70% observed in hand protection segment from surging global demand for gloves, while the plantation segment also reported a commendable 24% YoY growth. In the current year, continued inventory reduction by customers who overstocked during the pandemic is impacting demand in the hand protection segment.

Given the less favorable demand and supply imbalances in the global glove market, we have assumed that the DIPD's revenue from the hand protection business will grow at a normalized CAGR of 6.5% CAGR in USD over the forecast period (FY2023/24 to F2027/Y28).

DIPD's hand protection segment's profitability is somewhat exposed to supply/demand dynamics in the glove market, fluctuating raw material costs, exchange rates and OECD area economic cyclicals.

DIPD also has continued to invest in capacity expansion in FY2020/21 through FY2022/23 as evidenced by higher capex to sales, including investments in facilities for manufacture of new products, namely sports gloves, and high value niche products such as electrician's gloves.

Given these initiatives, we have forecasted DIPD's stabilized operating margins to marginally improve over time supported by continuous product innovations, better economies of scale from past expansions, cost optimization and focus on higher value-added products (see Chart 3.8b).

Source: Annual Reports

Expectations of higher for longer FED rates could predict short-term declining trend in commodity cycle

Chart 3.9a: CRB Commodity Index

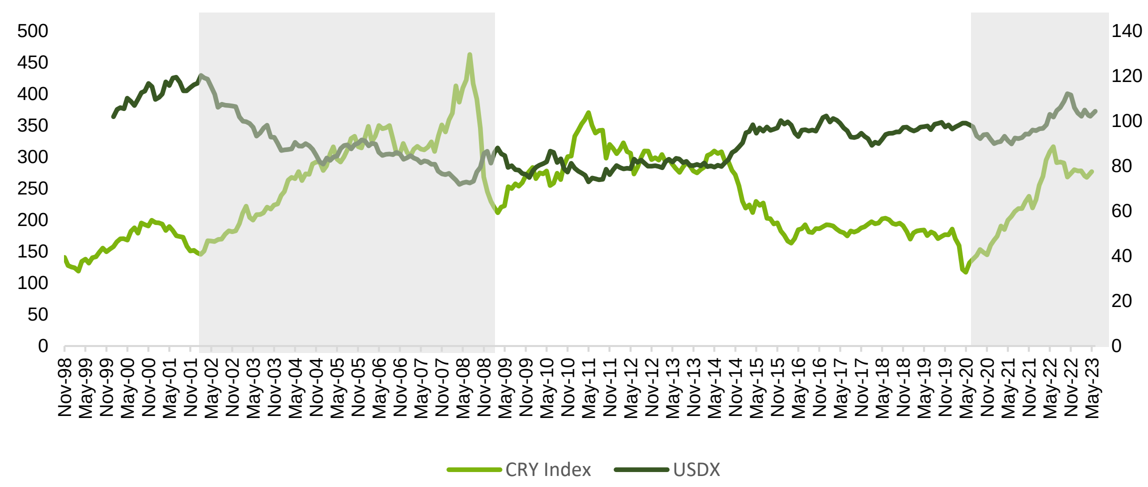
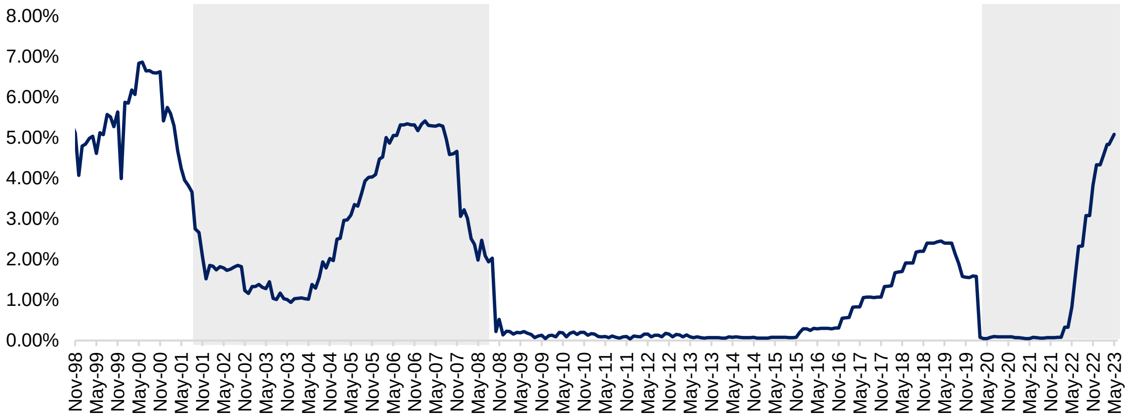


Chart 3.9b: FED Funds Rate



Source: Annual Reports, Bloomberg

Table 3.3: Correlation of Global Commodity Price Index with USD and US Fed Rate

	CRB Commodity index	*US Fed rate*	*INDEX - USDX/ DXY*
CRB Commodity index	1		
US Fed rate	-0.6	1	
INDEX - USDX/ DXY	-0.9	0.6	1

The primary driver of revenue in the plantation segment in addition to LKR/ USD exchange rate is the commodity cycle. Typically, commodities gain in value on a USD basis when the USD currency is weaker against other global currencies. This is evidenced by the high negative correlation of the USD index against the CRB commodity index (see Chart 3.9a and Table 3.3). The USD gains in value during periods when US policy interest rates are higher. In the current global economic context with US Fed rates expected to remain higher for longer to tackle inflation, we can expect the USD to continue to strengthen against other major currencies as fund flows to the greenback increase driven both by higher yields and a flight to safety. This indicates potentially a negative short-term outlook for commodity prices compounded by subdued economic activity in the OECD area and weaker consumer demand. However, weaker USD commodity prices in response to a stronger currency would be compensated for commodity producers by higher devaluation of the local currency against the greenback. Therefore, overall, we expect the plantation segment forecast revenues to closely track our LKR/ USD exchange rate projection over the forecast period.

DIPD hand protection segment: story behind the numbers

Key performance indicator	Assumption			
	Base year	Years 1 – 5 (FY24 – FY28)	Beyond 5 years	Link to story
Revenue	USD 158.3 Mn (FY23)	6.0% (4yr CAGR)	3.0%	Rubber Glove Market to grow at 8-year CAGR of 16% and Industrial Glove Market at 9%. DIPD's hand protection segment is expected grow at a lower CAGR of 6% in the short-term due to temporary supply/ demand imbalances.
Operating margin	12.0% / 6.8% (FY23 / Q1 FY24)	7.6% - 8.3%	8.3%	DIPD's past and ongoing strategic initiatives is expected to result in long-term stabilized operating margins of c. 8.3%, higher than in the pre-Covid period.
Tax rate	30.0%	30.0%	30.0%	The currently applicable 30.0% (revised) corporate tax rate is expected to continue over the forecast period.
Reinvestment (CAPEX as a % of sales)	2.0%	1.3 - 2.0%	1.2%	1.3 – 2.0% of the sales is expected to be incurred as CAPEX, over the period of next five years, to be in line with the revenue growth expected over the same period. Also, additional CAPEX of 1.2% (of sales) is predicted for the terminal year and beyond given the ongoing and potential expansions focusing on premium / niche and differentiated segments of glove market (i.e. Sports Gloves).
Return on capital	31.5 %	13.6 % - 23.0 %	18.2 %	This is to range between 14.0% - 23.0% over the next five years in-line with the growth expected in both Rubber and Industrial glove market. And in long run (beyond terminal period), ROC is expected to settle around cost of capital of 18.2%.
Cost of capital (WACC)	18.0%	18.2%	18.2%	Assuming the (long term) risk-free rate to settle at around 15.0 % and average cost of borrowings including foreign currency debt to be around 8.5% (with D/E of 70:30 and the levered beta of 1.18), WACC assumed to be at 18.2% over the forecast period.
Exchange rate (USD / LKR)	325.00	320.00 – 415.00	420.00	On average, LKR is expected to depreciate c. 5% each year, over the next five years and expected to reach an exchange rate of (USD/LKR) 420.00 on the terminal year.

DIPD valuation indicates a upside of >10% based on intrinsic and target prices

For the year ended 31-March	Actual					Forecast				
	FY2019	FY2020	FY2021	FY2022	FY2023	FY2024E	FY2025E	FY2026E	FY2027E	FY2028E
Revenue (USD Mn)	178.62	170.49	246.05	269.25	223.64	237.54	249.77	262.66	276.24	290.54
Recurring Net Profit (USD Mn)	5.16	4.17	27.39	26.21	18.17	8.81	9.92	11.15	12.38	13.46
Earnings per Share (LKR)	1.45	1.25	8.63	8.99	10.87	5.02	5.94	7.01	8.17	9.33
Earnings per Share Growth (%)	75.2%	-13.9%	590.3%	4.2%	20.9%	-53.8%	18.3%	18.0%	16.5%	14.2%
Price / Earnings Ratio (X) *	3.95	3.05	9.07	4.54	2.87	6.43	5.44	4.61	3.95	3.46
Gross Dividend per Share (LKR)	0.45	0.40	2.30	2.50	3.00	1.50	2.00	2.00	2.00	3.00
Gross Dividend Yield (%) *	3.5%	2.5%	2.5%	5.0%	5.3%	4.6%	6.2%	6.2%	6.2%	9.3%
Net Book Value per Share (LKR)	17.41	18.60	26.14	36.60	45.06	48.08	52.02	57.03	63.20	69.53
Price / Book Value (X) *	0.73	0.86	3.56	1.37	1.25	0.66	0.61	0.56	0.51	0.46
Return on Equity (%)	8.3%	6.7%	33.0%	24.6%	25.4%	10.3%	11.3%	12.2%	12.8%	13.3%
Market Price per Share (LKR) *	12.70	16.00	93.00	50.20	56.30	32.30	32.30	32.30	32.30	32.30

* For historical period ratio / price is based on FY end price and forecast period ratio is based on CMP as of 06 Oct 2023.

We have estimated the hand protection and plantation segments revenue in USD basis to grow at a 4-year CAGR of 6.0% and 4.0% respectively to reach an aggregate topline of USD 291 Mn by FY2027/28E, supported by a recovery in demand for rubber and industrial gloves from 2024 onwards. Notwithstanding headwinds in both business segments in the current year, the plantation vertical's revenue forecast for FY2023/24E is at USD 101 Mn (+25% YoY) primarily due to consolidation of Horana Plantation, which was acquired by DIPD in the latter part of FY2022/23. Furthermore, an average dividend payout ratio of 30.0% is assumed over the forecast period.

Based on our DCF based valuation using a WACC of 18.2% and a terminal growth rate of 3% & 1% for the hand protection and plantation segments respectively, we arrive at an intrinsic value marginally higher than the CMP and assigns a 12M forward target price of LKR 35.62 per share for DIPD.

DCF Valuation					
LKR Mn	FY2024E	FY2025E	FY2026E	FY2027E	FY2028E
EBIT	6,158	6,952	7,848	8,859	9,999
FCFF	2,708	3,701	4,208	4,784	5,436
Terminal value					37,261
Discounted FCFF (WACC @ 18.2%)	2,491	2,880	2,771	2,666	2,563
Enterprise value					30,940
Net debt					-9
Equity value					30,949
Equity value (net of NCI)					24,409
# of shares (Mn)					599
DCF based intrinsic value (LKR)					40.78
12M Target Price based on probable (historical / estimated) PER (6.5x) on estimated 12M TTM EPS of LKR 5.5 in Sept 2024					35.62
CMP as of 06 Oct 2023 (LKR)					32.30
Potential Upside / (downside) to 12M Target Price					10%

DIPD forecast and WACC sensitivity

Income statement For the year ended 31-March (LKR Mn)	Actual		Forecast				
	FY2022	FY2023	FY2024E	FY2025E	FY2026E	FY2027E	FY2028E
Revenue	**55,294**	**80,099**	**81,060**	**89,497**	**98,821**	**109,125**	**120,515**
Revenue YoY Growth	*19.2%*	*44.9%*	*1.2%*	*10.4%*	*10.4%*	*10.4%*	*10.4%*
Results from operating activities / EBIT	**5,360**	**9,628**	**6,158**	**6,952**	**7,848**	**8,859**	**9,999**
EBIT YoY Growth	*-26.8%*	*79.6%*	*-36.0%*	*12.9%*	*12.9%*	*12.9%*	*12.9%*
EBIT margins	*9.7%*	*12.0%*	*7.6%*	*7.8%*	*7.9%*	*8.1%*	*8.3%*
Net finance cost	**2,237**	**1,590**	**(611)**	**(469)**	**(284)**	**(140)**	**(148)**
Profit before tax / PBT	**7,597**	**11,219**	**5,548**	**6,484**	**7,564**	**8,719**	**9,851**
PBT margins	*13.7%*	*14.0%*	*6.8%*	*7.2%*	*7.7%*	*8.0%*	*8.2%*
Profit after tax / PAT	**6,411**	**8,503**	**3,883**	**4,539**	**5,295**	**6,103**	**6,896**
PAT YoY Growth	*9.9%*	*32.6%*	*-54.3%*	*16.9%*	*16.7%*	*15.3%*	*13.0%*
PAT margins	*11.6%*	*10.6%*	*4.8%*	*5.1%*	*5.4%*	*5.6%*	*5.7%*
Profit attributable to the SH / Recurrent earnings	**5,383**	**6,507**	**3,006**	**3,556**	**4,197**	**4,890**	**5,582**
Recurrent EPS (LKR)	**8.99**	**10.87**	**5.02**	**5.94**	**7.01**	**8.17**	**9.33**

Weighted average cost of capital	
Cost of equity (Ke)	
Risk free rate	15.0%
Market risk premium	7.0%
Levered beta	1.18
Cost of equity (Ke)	23.3%
Cost of debt (Kd)	
Average cost of borrowings	8.5%
Tax adjusted Kd	6.0%
Weighted average cost of capital (WACC)	18.2%

		WACC				
		17.2%	17.7%	18.2%	18.7%	19.2%
Terminal growth	2.0%	44.05	42.27	40.59	39.01	37.52
	2.5%	44.15	42.36	40.68	39.10	37.60
	3.0%	44.26	42.46	40.78	39.19	37.69
	3.5%	44.36	42.56	40.87	39.28	37.77
	4.0%	44.46	42.66	40.96	39.37	37.86

Intrinsic value of LKR 40.78 compared against the CMP of LKR 32.30 as of 06 Oct 2023 results in an upside of > 26%.

Risk factors impacting our rating for DIPD

Table 3.4: Risk Factors that Impact our Rating of DIPD

Risk Factors	Likelihood of Risks Negatively Impacting Ratings in Next 1-2 years	Negative Impact on Ratings	Positive Impact on Ratings
Global Economic/ Market Conditions	Moderate	Prolonged deterioration in global economic conditions in key markets and/ or prolonged adverse conditions in the global market for rubber gloves.	Sustained improvement in global economic conditions in key markets and/ or prolonged favourable conditions in the global market for rubber gloves.
Market Share	Moderate	Sustained loss of global market share in the medium term.	Sustained gain in global market share in the medium term.
Revenue Growth	Moderate	Sustained decline in USD revenue growth rates below the growth rates assumed in our forecast.	Sustained increase in USD revenue growth rates above the growth rates assumed in our forecast.
Margins	Moderate	Prolonged margin compression from unfavourable economic/ industry conditions or company specific factors.	Sustained margin expansion from favourable economic/ industry conditions or company specific factors.
Capital Expenditure/ ROIC	Moderate	Increase in capital intensity of the business or decline in ROIC from adverse competitive forces or company specific factors.	Decrease in capital intensity of the business or increase in ROIC from favourable competitive forces or company specific factors.
Inflation/ Cost Pressures	Moderate	Increase in localised inflationary pressures which cannot be passed on to end customers.	Decrease in localised inflationary pressures possibly leading to margin expansion.
Devaluation of Reporting Currency	Low	Sustained appreciation of the reporting currency against the functional currency of the export SBU's can lower reported revenue/ earnings and our valuations/ price targets in LKR.	Devaluation of the reporting currency against the functional currency of the export SBU's surpassing our forecast assumption of on avg. 5% p.a. can increase reported revenue/ earnings and our valuations/ price targets in LKR.
Changes to WACC	Moderate	Increase in market interest rates/ equity risk premium or beta values and accordingly the cost of capital or lower market valuation multiples can negatively impact our valuations and ratings.	Decrease in market interest rates/ equity risk premium or beta values and accordingly the cost of capital or higher market valuation multiples can positively impact our valuations and ratings.
Climatic Events	Low	Localised climatic events/ natural disasters which may have a medium-term negative impact of supply/ prices of raw materials.	N.A.
Loss of Human Capital	Low	Sustained loss in talent/ key personnel.	N.A.
Regulatory & Taxation	Low	Adverse regulatory or taxation changes which impact the long-term viability/ competitiveness of the business.	Positive regulatory or taxation changes including in the ease of doing business which favourably impact the long-term viability of the business.

DIPD's ESG initiatives enhance its appeal amongst more environmentally aware buyers

Environment

DIPD has taken initiatives to improve energy efficiency and dependence on renewable energy sources.

- Shifted to more cost-effective biomass sources such as saw dust.
- Improved processes to enhance efficiency in boilers and heaters.
- Expanded solar generation capacity through additional investment in rooftop solar panels.
- Enhanced water recycling capacity in hand protection by 50% during last two years.
- Invested in expanding rain-water harvesting capacity across both sectors.

Social

DIPD continuously invest in socio-economic wellbeing of communities through infrastructure, training and resources.

- "Home for Every Plantation Worker" Program
- "First Light" supplier development program
- Signed a pledge to take part in "Mother and Child Friendly Seal for Responsible Business".

Also, DIPD ensures a better workplace for employees across the group.

- KVPL certified as a "Great Place to Work" locally and globally while TTE achieved the same in the previous year.
- KVPL ranked among Asia's 30 best workplaces and 15 best workplaces for women.

Governance

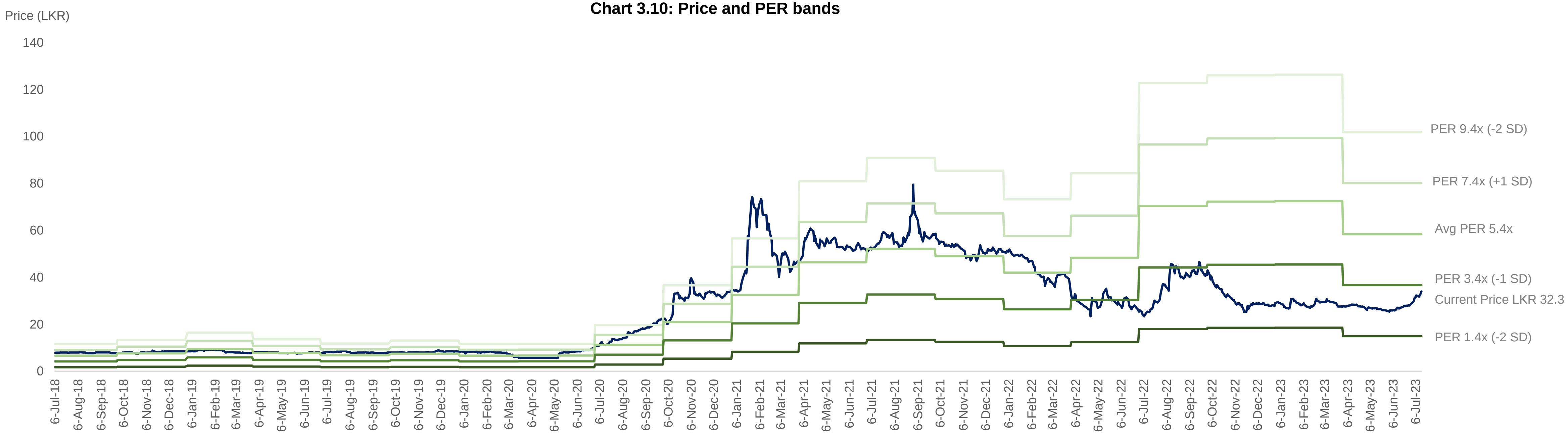
DIPD ensure strict compliance to all relevant laws and regulations.

Introduced policy on Bribery and Anti-Corruption in FY2022/23.

- To ensure zero tolerance of bribery and anti-corruption which is applicable to BODs and employees in all subsidiaries.

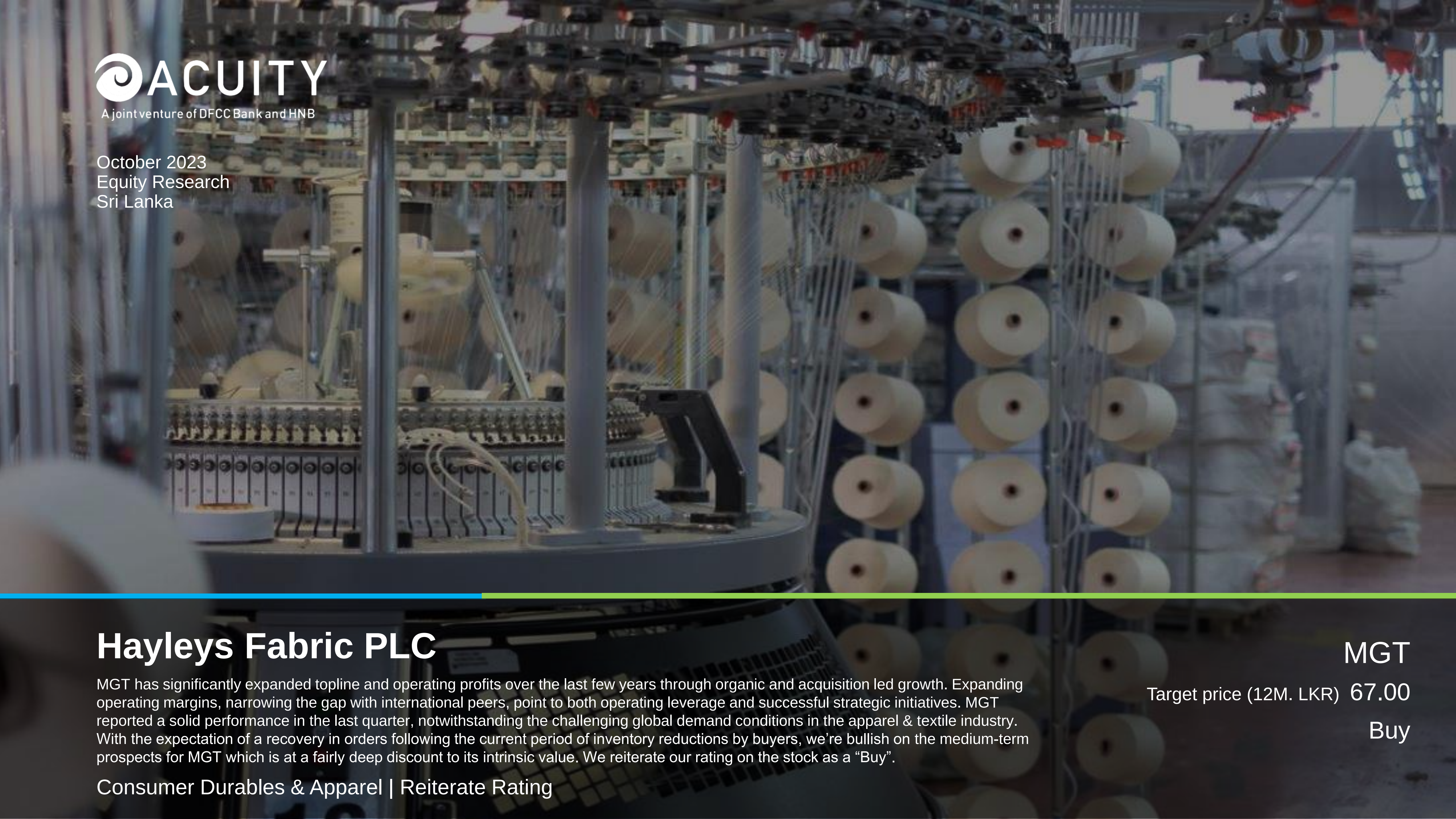
DIPD price and PER bands

Chart 3.10: Price and PER bands



The share price of DIPD is currently trading at approximately one standard deviation below its historical valuation multiples based on a trailing earnings basis. However, on a forward earnings basis, the stock is slightly above its historical average valuation multiple. We believe the indicated upside to our target price may be surpassed if the continued rerating of the overall market trading comps persist going forward.

Source: Bloomberg



ACUITY

A joint venture of DFCC Bank and HNB

October 2023
Equity Research
Sri Lanka

Hayleys Fabric PLC

MGT has significantly expanded topline and operating profits over the last few years through organic and acquisition led growth. Expanding operating margins, narrowing the gap with international peers, point to both operating leverage and successful strategic initiatives. MGT reported a solid performance in the last quarter, notwithstanding the challenging global demand conditions in the apparel & textile industry. With the expectation of a recovery in orders following the current period of inventory reductions by buyers, we're bullish on the medium-term prospects for MGT which is at a fairly deep discount to its intrinsic value. We reiterate our rating on the stock as a "Buy".

Consumer Durables & Apparel | Reiterate Rating

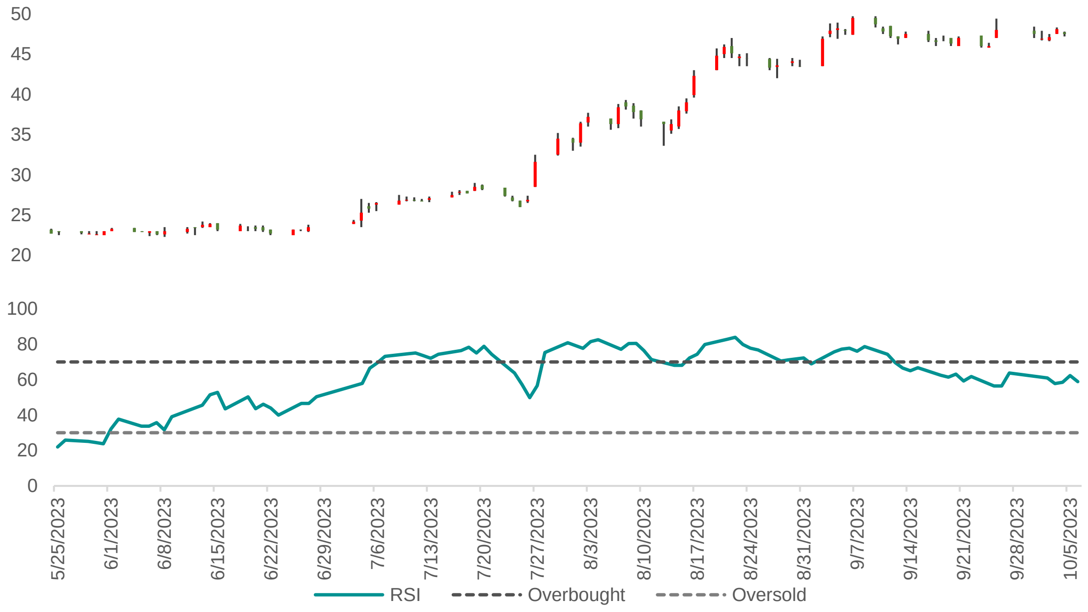
MGT

Target price (12M. LKR) 67.00

Buy

CMP as at 06th Oct 2023	LKR 47.50
Bloomberg and CSE Ticker	MGT SL Equity l MGT.N
Market Cap (LKR Bn l USD Mn)	LKR 19.7 Bn l USD 60.9 Mn
Issued Quantity (Shares Mn)	415
Estimated free float	36.78%
Average daily volume (Last 3M)	1,115,881
52-week High and Low (LKR)	49.70 | 20.00
Industry & Year end	Consumer Durables & Apparel l 31st March
Beta & Sharpe ratio	1.27 | 0.32

Chart 4.1: MGT Technical Chart (Trailing 90 days)



Source: Bloomberg

Hayleys Fabric PLC	MGT
Rating	Buy
12M Target Price	LKR 67.00
Potential Upside/ (Downside)	41%
Industry View: Consumer Durables & Apparels	In-Line

MGT has reported sound top and bottom-line expansion since around 2018 supported by both organic and acquisition led growth. The pandemic economy and fiscal stimulus in the US and EU boosted consumer spending was a significant fillip for global textile & apparel manufacturers enabling Sri Lankan exports from the industry to peak in 2023. MGT bucked the trend of an overall decline in Sri Lankan textile & apparel exports in the current year to report solid YoY and QoQ USD revenue growth in 1Q FY2023/24. The sector is expected to face global headwinds with recessionary conditions and reduced discretionary consumer spending in key markets in the short-term. However, with the expectation that economic conditions in global markets will gradually improve, MGT is poised to continue its growth trajectory benefitting from its strategic business initiatives of the past few years. We re-iterate the stock as a “Buy” with a 12m price target of LKR 67.00 /- per share based on the current discount to its intrinsic value and expected market re-rerating. The current market price is at the overbought end of the RSI scale. Investors would benefit from adding to their holdings on any pullbacks in the stock price.

Financial year ended 31 March	FY2021	FY2022	FY2023
Revenue (LKR Mn)	14,560	30,802	59,632
YoY Growth (%)	*21%*	*112%*	*94%*
Operating profit (LKR Mn)	875	1,730	4,442
YoY Growth (%)	*70%*	*98%*	*157%*
EPS (LKR)	1.70	6.36	1.07
DPS (LKR)	1.2	1.2	2.5
TTM PER (x)	*7.46*	*3.07*	*11.03*

Overview

Hayleys Fabric PLC ("MGT") is engaged in designing and manufacturing textile fabrics since 1994 and manufactures a range of weft knit fabrics. In 2021 MGT acquired a rival fabric mill, South Asia Textiles Ltd ("SAT"), thereby doubling the capacity under its control and consolidating its position as the largest integrated knit fabric manufacturer in the country. MGT boasts a strong tier-1 customer base including prominent global brands such as Nike, Calvin Klein and Victoria's Secret with the US, EU and UK comprising its primary export markets.

In 2014 MGT developed their proprietary "Inno" brand with the strategic objective of providing niche branded fabric to trending fashion innovators. The Inno brand has steadily developed over the years (see Chart 4.3). Currently over 90% of MGT's revenue is derived through its own branded products. MGT's unique environmental sustainability initiatives are a further differentiator that bolsters Inno's credentials with increasingly environmentally conscious global buyers.

MGT has further differentiated its offering by promoting their self-developed fabrics under the Inno brand to address sustainability, traceability, & recyclability issues and targeted as a potential competitor for globally renowned brands such as Spandex Lycra and Elastane materials with similar specs but with a more environmentally sustainable approach.

MGT's Sustainability Based Differentiators and Offerings

MGT offers self-created natural dyes (i.e.,WARNA using Mahogany and Midnight using charcoal) while substitutes such as Spandex (Lycra/ elastane material) are entirely synthetics based.

MGT uses waste tea from Hayleys Plantations to source natural tea dye and combines it with anti-bacterial materials to process its fabrics. Substitutive materials are generally non-organic and treated with synthetic chemicals.

Capable of using organic inputs to make the end-fabric free of hazardous chemicals. This makes it safer for the wearer, environment, and the manufacturers. A single impact lifestyle assessment revealed a 36% positive environmental impact from this fabric compared to fabrics treated with conventional synthetic chemicals.

Tier-1 Customers of MGT

NIKE, Calvin Klein, PINK, TOMMY HILFIGER, VS, asics, next, DECATHLON, intimissimi, TEZENIS

MGT: Integrated Weft Knit Manufacturing Process Flow

Synthetic & Natural Fibre Knit Fabrics
- Single Jersey
- Interlock
- Pique
- Rib
- Fleece
- Polar Fleece
- Jacquard
- Flat Knits

Knitting → Dyeing → Printing → Brushing → Sueding → Finishing

MGT's Production Facilities

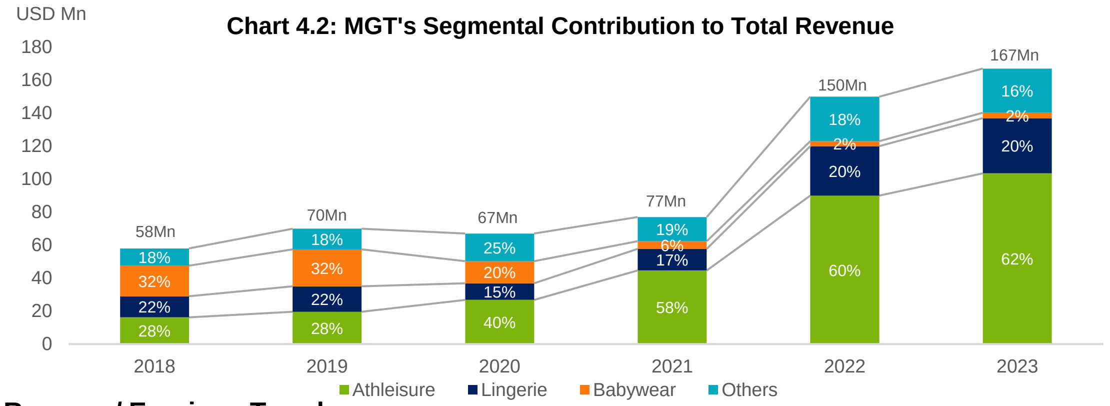
Narthupana Site, Neboda
Current capacity: 950 MT

South Asia Textiles Factory, Pugoda
Current capacity: 860 MT

Wagawatte Knitting Factory
Current capacity: 175 MT

Athleisure and lingerie segments dominate MGT's revenue mix

Chart 4.2: MGT's Segmental Contribution to Total Revenue



Revenue/ Earnings Trends

MGT's revenue can be broadly categorized into four main segments, athleisure, lingerie, babywear and others, with athleisure and lingerie comprising the company's primary focus. MGT has increased its revenue contribution from athleisure and lingerie whilst significantly reducing exposure to the low margin babywear segment over the last few years (see Chart 4.2).

Table 4.1 details the correlation between MGT's revenue/ earnings and selected economic variables, excluding FY2021/22 and FY2022/23 which saw both inorganic growth through the SAT acquisition and high volatility in exchange/ interest rates and taxes resulting in significant non-recuring revenue/ earnings impact. Key variables that have impacted MGT's business performance are identified as the LKR/ USD exchange rate, LKR REER and raw material costs, including cotton and energy prices. MGT's revenue and earnings in LKR terms have shown the strongest positive correlation with the exchange rate with the USD comprising the company's transactional currency.

Table 4.2: MGT Margins/ Cost as a % of USD Revenue

FY ended 31 March	2019	2020	2021	2022	2023
Gross Profit	12%	13%	14%	13%	13%
Operating Profit	4%	4%	6%	6%	7%
Interest Cost	1%	1%	1%	2%	3%
Net Interest Cost	1%	1%	1%	-4%	2%
Tax Expense	1%	1%	-0%	1%	4%
Net Profit	2%	2%	5%	9%	1%

Table 4.1: Correlation of MGT P&L Variables (in USD) & Economic Variables (FY2013/14-21)

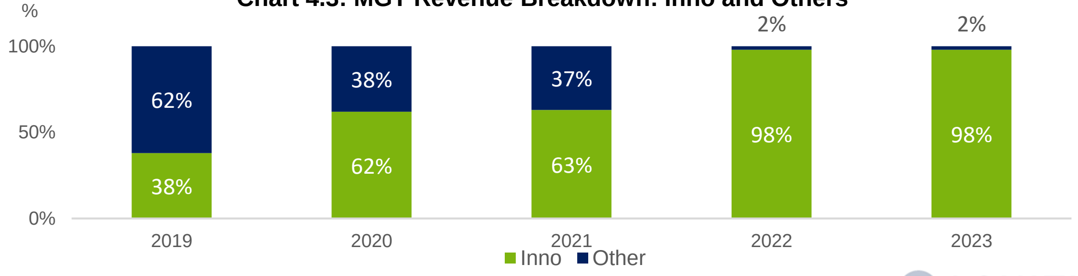
	Revenue	Gross profit	Profit attributable to parents
Exchange Rate (LKR/USD)	0.70	0.84	0.67
LKR REER	-0.78	-0.57	-0.41
Interest rates (%)	-0.42	-0.33	-0.48
Taxes CIT (%)	-0.74	-0.70	-0.73
Lag of US Retail Inventory/Sales (season adj)	0.17	0.59	0.43
OECD Economic Growth	-0.73	-0.65	-0.69
Global Cotton Price	-0.01	-0.52	-0.65
Energy Prices	-0.22	-0.65	-0.69

There was insignificant correlation between the lagging US retail inventory/ sales ratio for clothing & accessories and MGT's revenue, possibly indicating that the company's client mix has more resilience than the overall market. Factors that had significant negative correlation with gross/ net margins of MGT include cotton and energy prices, in addition to higher tax rates.

Growing acceptance of Inno Brand and Changing Consumer Preferences

By FY2021/22 the revenue contribution from "Inno" brand had increased to 98% (cf. 38% in FY2018/19), demonstrating increased acceptance by buyers. Tier-1 customers in recent years have demanded more high-performance fabrics with superior aesthetics and functionality, especially for athleisure and lingerie products as pandemic related "work-from-home" culture induced consumers to seek more comfortable clothing. This in turn boosted demand particularly in the athleisure segment, presenting opportunities for weft knit fabric manufacturers such as MGT. Knit fabrics are inherently more comfortable and stretchy, compared to woven fabrics that are used for more formalwear. It's expected that the shift from formalwear to more casualwear would be a pervasive trend that will continue going forward.

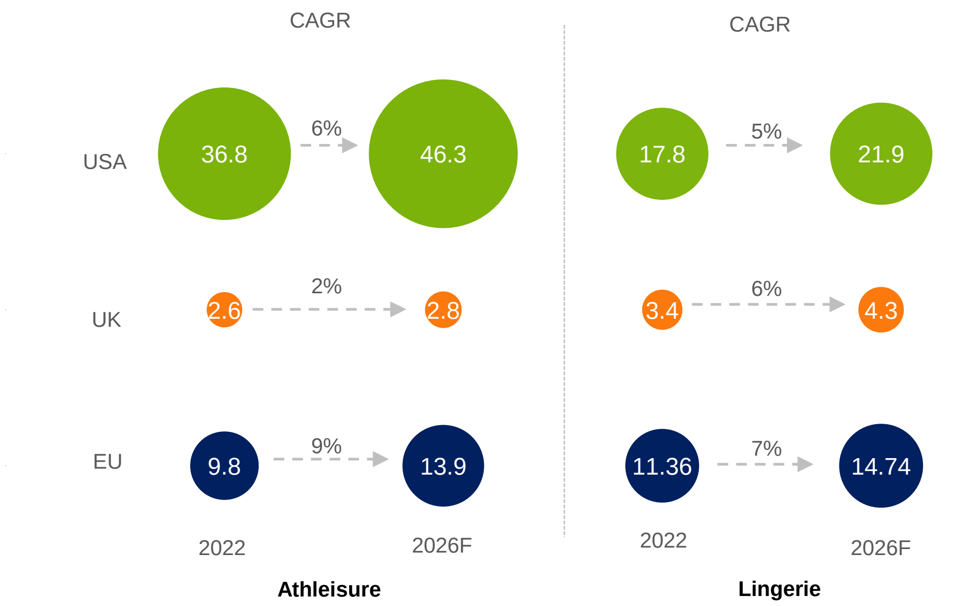
Chart 4.3: MGT Revenue Breakdown: Inno and Others



The athleisure and lingerie markets are expected to grow at a steady pace in the medium term

Athleisure & Lingerie Market Trends

The US is the largest destination market for both the athleisure and lingerie apparel, with the current total addressable markets sized at c. USD 37 Bn and c. USD 18 Bn respectively as of 2022. Market research indicates that athleisure and lingerie markets in the US are expected to grow at CAGRs of c. 6% and c. 5% respectively over 2022-26. Evolving major trends include favorable consumer shifts towards sports & athleticism in the post-pandemic new normal, greater awareness of sustainability, preference for streetwear among younger generations, and increasing informality in the work/ office environment compelling adults to also seek more comfortable and casual clothing options, thus driving the athleisure segment. Experts suggest that these trends which received a boost during the pandemic, will continue in the longer term. McKinsey expects that 2023 will see dampened demand for athleisure apparel owing to global inflationary pressures, with an anticipated recovery in the medium term. The lingerie market, particularly for higher end products, is also expected to see dampened demand in the current year as the stimulus spending during the pandemic is scaled back. However, US consumer spending has remained strong despite recessionary indicators, lending support to expectations that growth will resume in the medium term if the US economy has a soft-landing.



Source: Statista, McKinsey's The State of Fashion 2023

The global knit fabric industry is highly fragmented, which confers high power to buyers. However, industry participants such as MGT seek to differentiate themselves through product innovation, demonstrable track record of reliability and leveraging longstanding relationships which enable deeper integration with the global supply chains of tier-1 customers, thus improving pricing power and increasing switching costs for the buyers. Furthermore, leading market participants such as MGT have developed their ESG credentials as a strategic differentiator to stay ahead of the competition in the backdrop of rising environmental consciousness amongst consumers and brand owners.

Top Regional Competitors

PACIFIC TEXTILES HOLDINGS LIMITED 互太紡織控股有限公司

SHAHI

teejay

SHENZHOU INTERNATIONAL GROUP 申洲國際集團

High competition
Market is fragmented with a large number of smaller players and a few larger players. This suggests intense competition. Industry participants may be willing to rely on price competition for undifferentiated products.

Moderate threat of new entrants
Weft knit technology though not new, requires specialized knowledge, labor skills and machinery. New entrants will require a significant financial outlay to acquire the requisite expertise and buyers.

High power of buyers
Considering that the players in the market tend to cater to large global clothing and accessories manufacturers, the power of buyers is high.

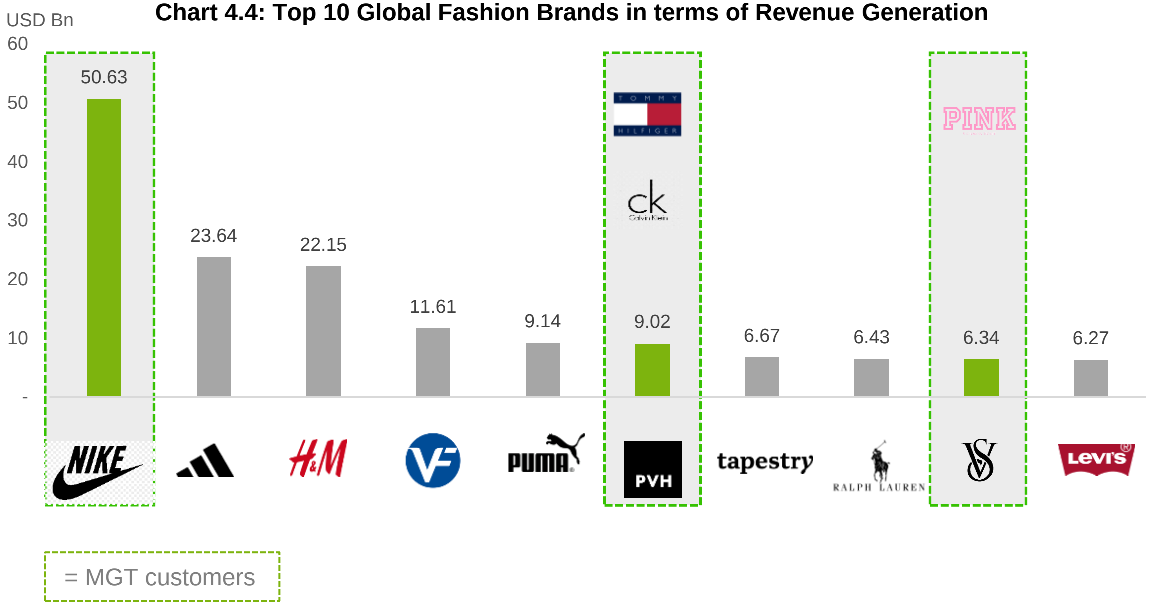
Low threat of substitutes
Although there are no direct substitutes for weft knit fabric, technological developments over time could lead to newer types of fabric or manufacturing processes that have similar or superior attributes.

Low power of suppliers
The main raw materials in knit fabric manufacturing are synthetic and natural yarns and dyes. These inputs are generally commoditized and manufactured by many players globally.

MGT counts some of the top athleisure/ lingerie brands in its portfolio

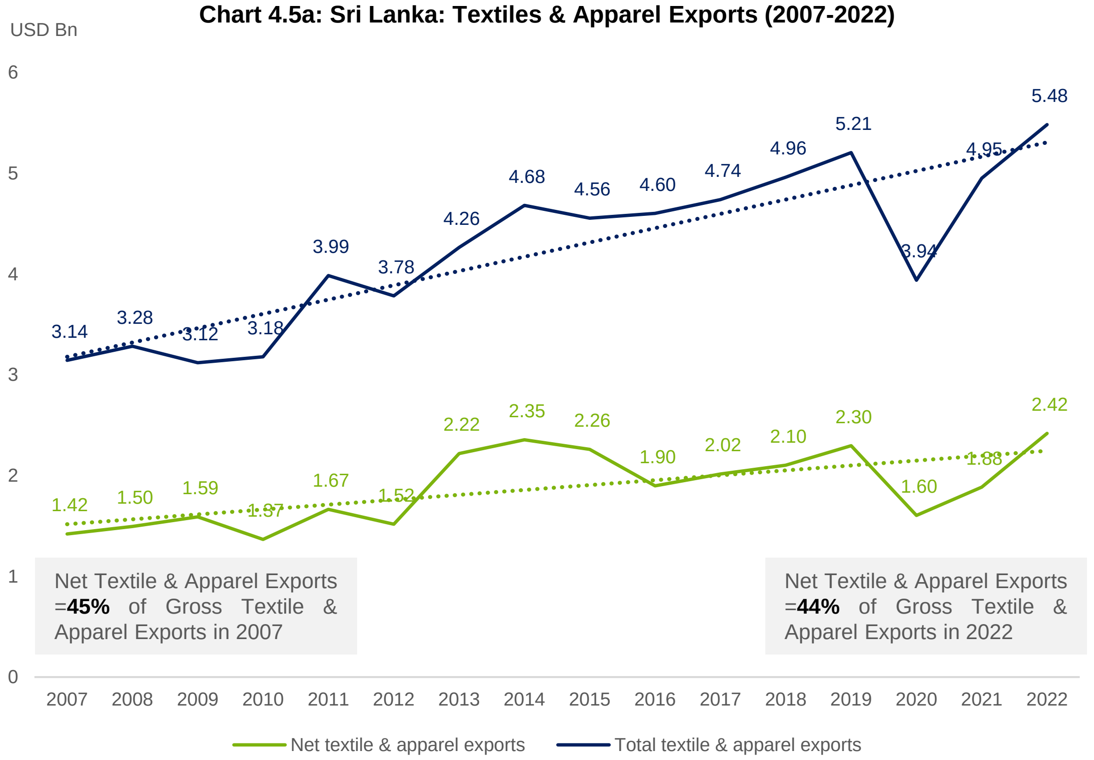
MGT's tier-1 customers include several global fashion brands and brand owners that are among the top 10 largest in the world in terms of global revenue generation. Furthermore, Nike is ranked by McKinsey as the top global fashion brand in terms of "economic profit" generation, which possibly allows the brand to pay its suppliers better prices/ margins compared with less profitable fashion brands and/ or discount brands.

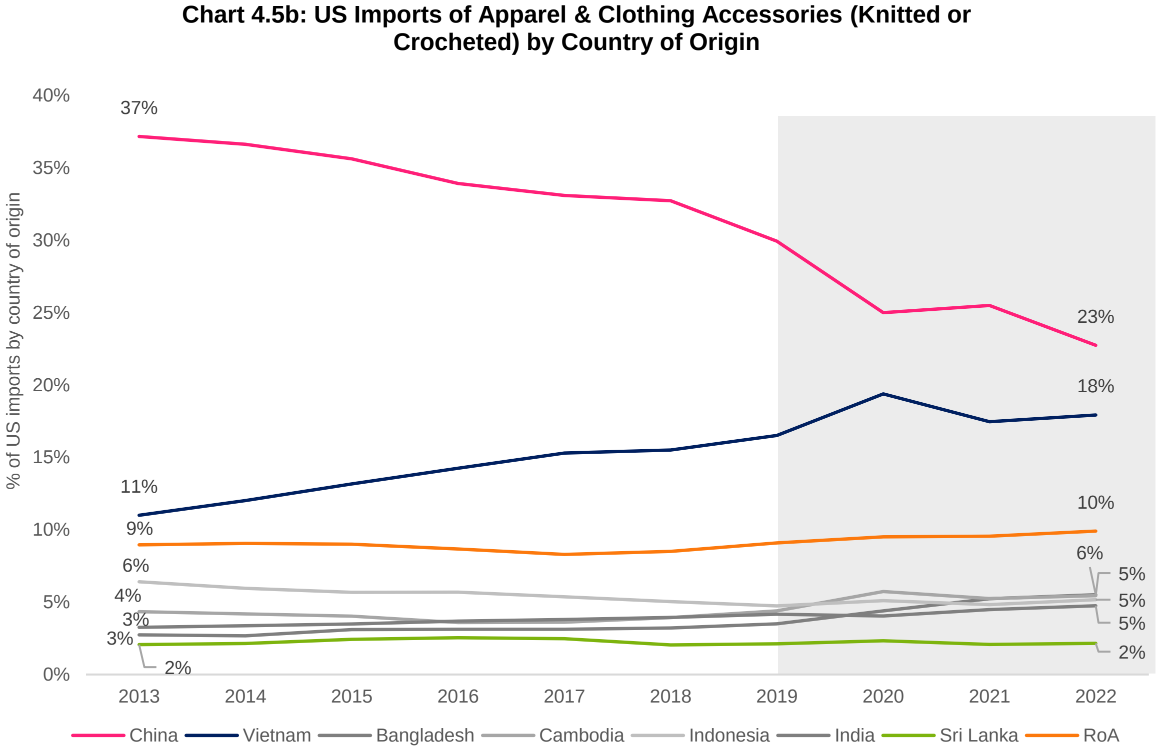
Chart 4.4: Top 10 Global Fashion Brands in terms of Revenue Generation



Source: companiesmarketcap.com, McKinsey's The State of Fashion 2023

Sri Lanka apparel & textile exports and raw material imports





Between 2007 to 2022, Sri Lanka's exports of apparel & textiles has followed an upward trend growing at a CAGR of 3.78%. Apparel & textile exports which peaked at USD 5.5 Bn is 2022 is expected to report a substantially lower value in 2023 based on interim trends as higher inventories and subdued consumer sales in the US and EU negatively impact order flow from buyers. Net apparel & textile exports as a % of total apparel & textile exports has remained flat at c. 45% over the period 2007 to 2022 (see Chart 4.5a). This indicates that the share of domestic value addition has not increased significantly during the period and that the apparel industry still relies on a large proportion of imported inputs including mainly textile fabrics. This presents opportunities for fabric manufacturers such as MGT to expand the scope of their activities and product range to capture greater market share from buyers that source their apparel from Sri Lanka based apparel factories.

Due to increasing geopolitical tensions, many US and EU buyers have adopted a "China Plus One Strategy" to diversify their supply chains to reduce reliance on China.

Vietnam, Bangladesh and India have emerged as key beneficiaries of "friend-shoring" supply chain strategies by US buyers in the apparel & clothing space (see Chart 4.5b). Whilst Sri Lanka has not been a significant direct beneficiary thus far, ongoing reconfiguration of supply chains moving away from China is expected to benefit Sri Lanka along with other regional peers in the longer term.

Source: CBSL, ITC Trade Map

Chart 4.6a: MGT Production & Revenue

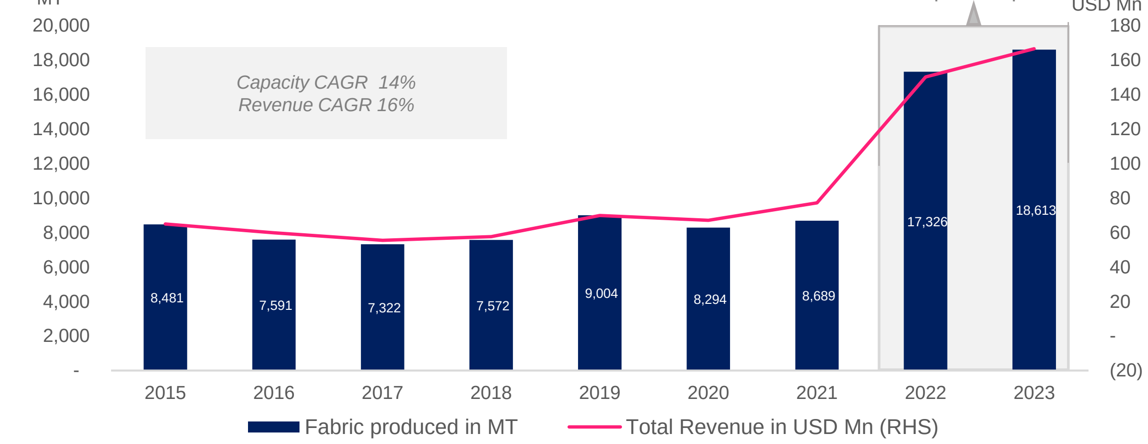
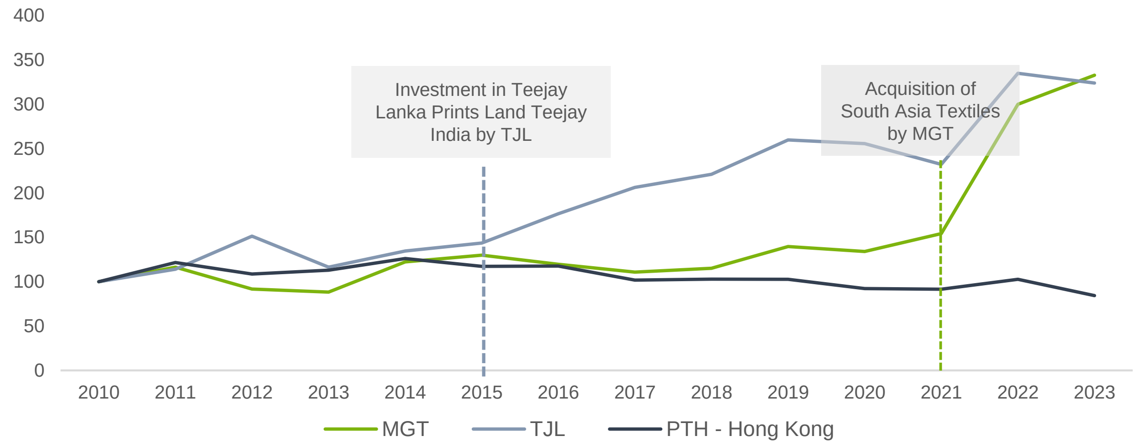


Chart 4.6b: MGT and Peer Revenue Comparison (2010 = 100)

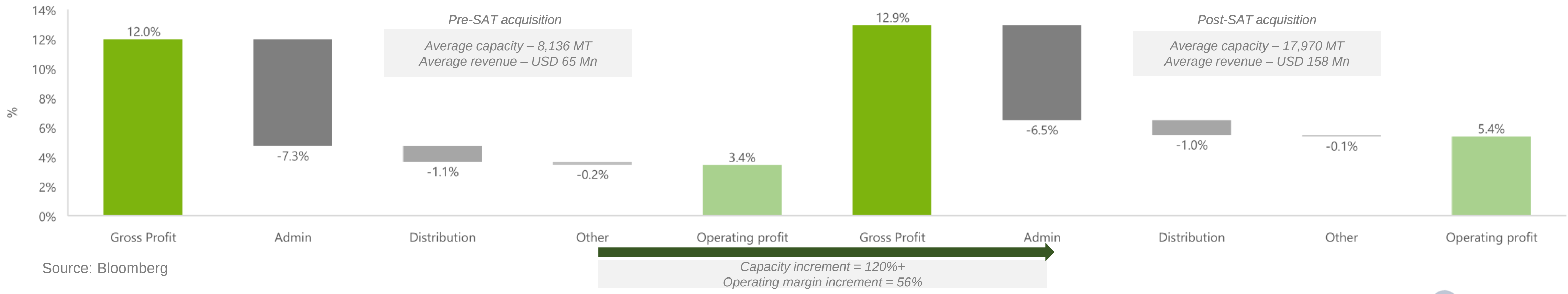


MGT's aggregate production capacity doubled post the SAT acquisition from 800 MT to 1590 MT. Given the capital-intensive nature of the business, MGT's revenue trends reflect its capacity expansion initiatives. MGT has matched in main domestic peer in terms of revenue growth. It's expected that there is further scope for MGT to expand capacity at SAT's existing production sites at in the medium term.

Unit Economics and Margins

MGT's admin costs have generally been higher compared to domestic and global peers. However, post the SAT acquisition which enabled capacity and revenue to increase by c. 120% and c. 140% respectively, MGT has benefitted from greater economies of scale as evidenced by an improvement in admin cost margins of c. 80 bps. Further margin expansion is possible as MGT integrates, scales and fully synergizes its recent acquisitions/ capacity expansions.

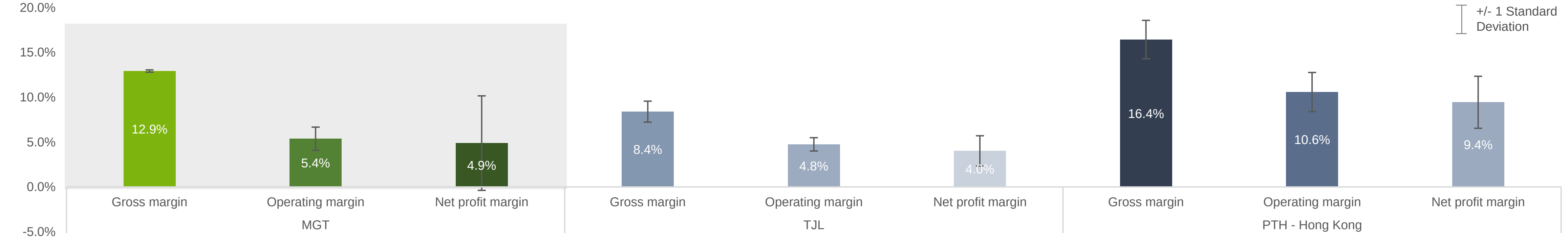
Chart 4.7: Pre-and-post SAT acquisition: MGT's Margin Waterfall



Source: Bloomberg

Unit economics favourable cf. domestic peers, scope for operating leverage and margin expansion

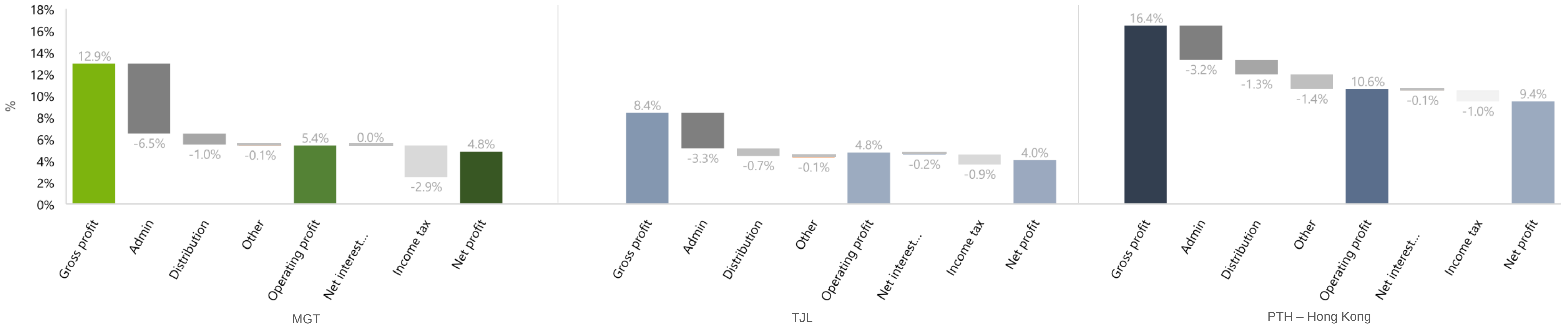
Chart 4.8a: Avg Margins of MGT (post SAT acquisition period) and Peers (FY2021/22 and FY 2022/23)



MGT & TJL suffer from a large share of admin costs eroding operating/ net margins

PTH has a very low portion of admin costs leading to higher sustained net margins

Chart 4.8b: Margin Waterfall of MGT and Peers (FY2021/22 and FY2022/23)



MGT's unit economics are broadly favorable compared to its main domestic peer. However, in comparison with larger global peers, gross margins are lower by c. 300 bps and admin costs are notably higher by c. 320 bps. This suggests that MGT has scope to increase profitability through product innovation, brand recognition and further production efficiencies to enable expansion of gross margin levels which will help improve operating leverage. Greater economies of scale could also expand operating margins by further reducing admin and other overhead costs per unit of production thereby expanding profit margins.

Source: Bloomberg

US retail inventory levels indicates some short-term pain for the textile & apparel sector

US retail inventory/ sales ratio tends to rise above its long-term average during recessionary periods (see highlighted in red in Chart 4.9a), leading buyers in the key US and EU markets to scale back their sourcing. However, these periods are typically followed up by falling retail inventory/ sales as economies rebound. Generally, MGT has enjoyed somewhat higher margins during these expansionary periods. Currently with the prevailing recessionary conditions in the EU and US, the retail inventory/ sales ratio shows signs of rising above its average level which coincides with lower orders/ exports for textiles & apparel experienced during the current year.

With the expectation that several key markets would see further deterioration in economic growth in 2024, we anticipate the overall textile & apparel sector to experience subdued prospects in the short term with a possible pick up towards 2H 2024. Spillover effects from buyers diversifying supply chains away from China to Sri Lanka and other regional markets could possibly mitigate some of the negative impact.

Chart 4.9a: US Retail Inventory/ Sales Ratio of Clothing & Accessories Stores (Seasonally Adjusted)

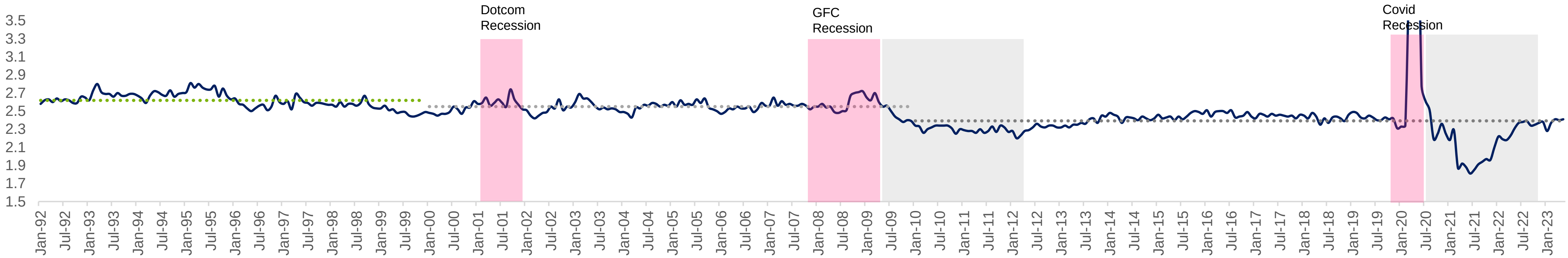
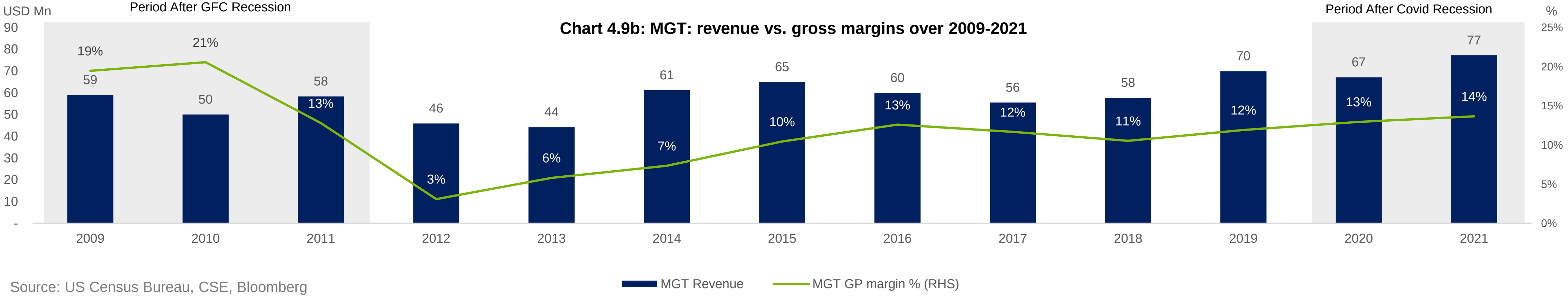


Chart 4.9b: MGT: revenue vs. gross margins over 2009-2021



Source: US Census Bureau, CSE, Bloomberg

Interest cost burden will reduce by c. 35% as interest rates revert to mean…

Chart 4.10a: MGT Revenue Growth Forecast

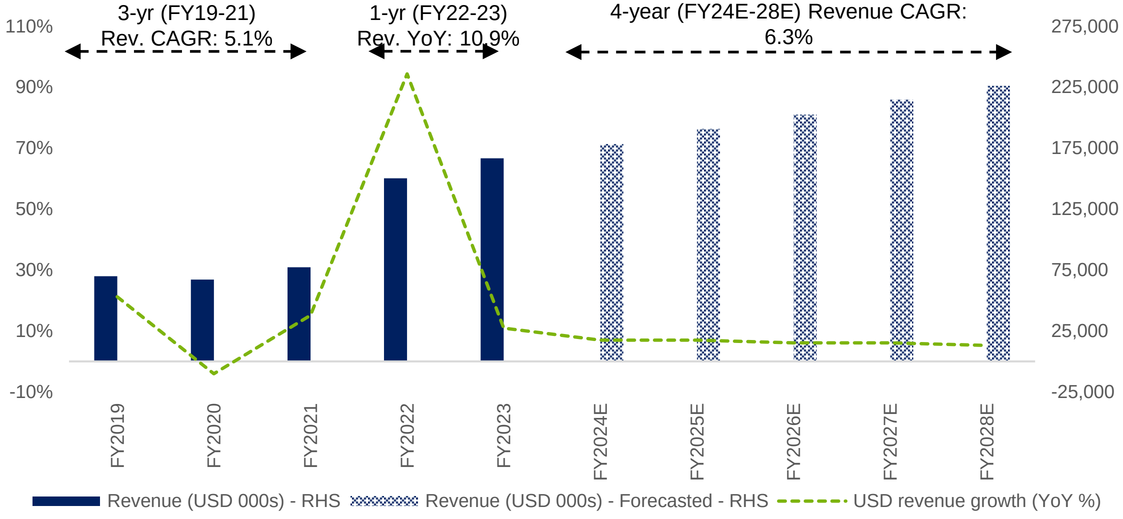
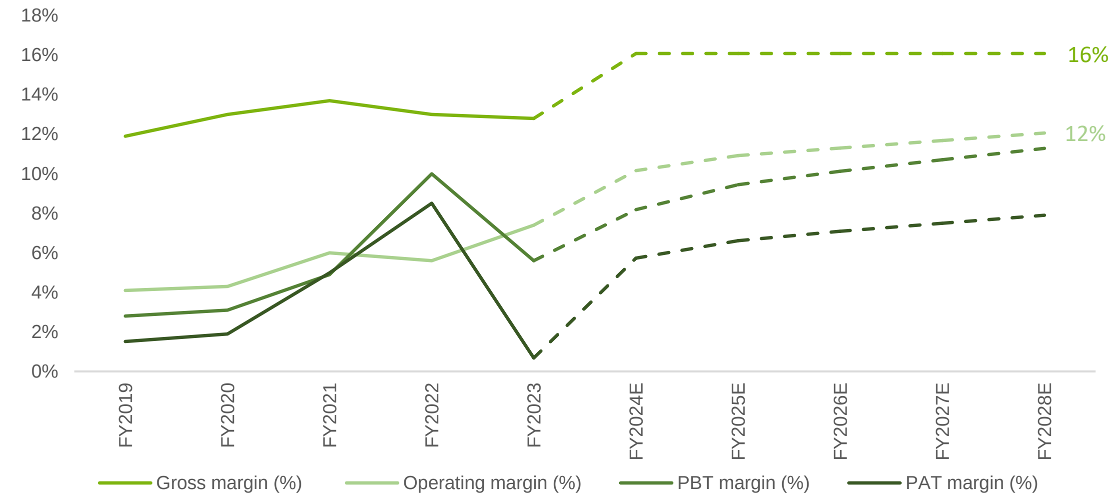


Chart 4.10b: MGT Margin Forecast



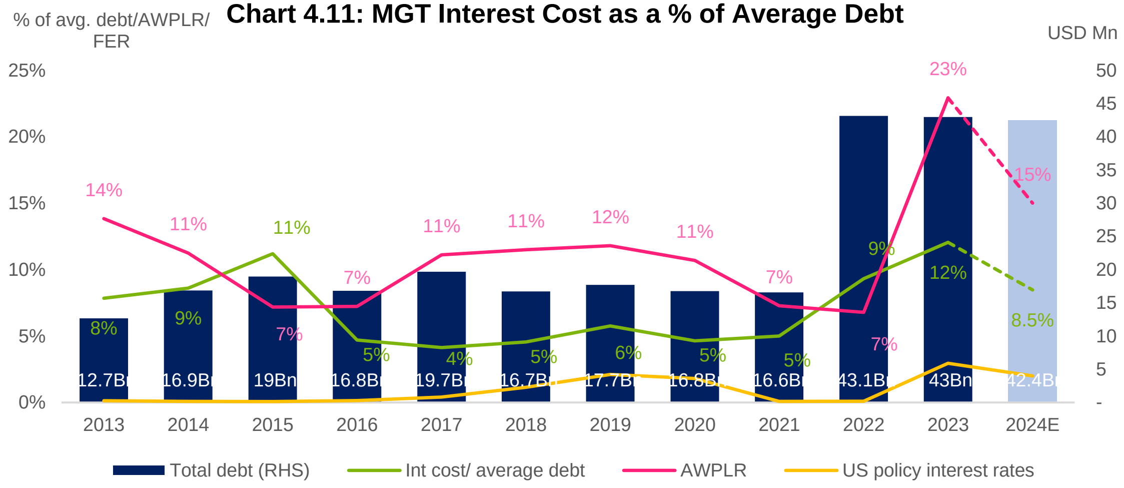
We anticipate MGT's revenues will grow at a CAGR of c. 6% based on expected industry growth rates and in-line with historical norms. Possible multi-year tailwinds which are not specifically factored into our revenue projections include recent developments in the field of diet and blood sugar medication which have shown promising results in the US in reducing obesity rates. Sustained reductions in US obesity rates (currently at around 40% of American adults) could be a catalyst for apparel sales as consumers restock their wardrobes.

Margin improvements seen in the most recent financial quarters are expected to be maintained going forward supported by operating leverage from economies of scale and other initiatives.

MGT's interest cost to average debt reached 12% in 2023 owing to the sharp increase in interest rates locally and globally. As at end FY2022/23, 80% of the MGT's total borrowings are on a floating rate basis (comprising of 51% of total debt in floating rate USD borrowings and 29% of total debt in floating rate LKR borrowings).

USD borrowings costs are a function of both global rates as determined by the US Fed funds rate and local USD liquidity levels in the domestic banking sector. We anticipate that AWPLR will reduce to c.11%-12% p.a. over the next year and for US Fed rate/ LIBOR (current: 3%/ 6%) to taper off at around 2%/ 5% p.a. levels by end 2023 and gradually decline thereafter. MGT's debt levels are expected to remain the same as FY2022/23 levels. We estimate that the interest cost to average debt will decline to c. 8% and the total interest cost burden for FY2023/24 will reduce by c. 35%.

Chart 4.11: MGT Interest Cost as a % of Average Debt



Source: Bloomberg, CBSL, FED

MGT: story behind the numbers

Key performance indicator	Assumption			
	Base year	Years 1 – 5 (FY24 – FY28)	Beyond 5 years	Link to story
Revenue	USD 166.6 Mn (FY23)	6.3% (4yr CAGR)	2.0%	Major markets in the USA and EU expected to grow at a 5-year CAGR of 6% and 9% respectively for athleisure and 5% and 7% respectively for lingerie. MGT is also expected grow its revenue CAGR of 6.3 % over the same period.
Operating margin	7.0% (FY23) & 13.0% (for Q1 FY24)	10.0% - 12.0%	10.0%	Operating margin for Q1 FY24 is improved significantly to 13.0%. Given the competitive market MGT operates in, margin is expected to be converged to historical rates of c. 10% over next five years.
Tax rate	30.0%	30.0%	30.0%	The 30.0% (revised) currently applicable corporate tax rate in Sri Lanka is expected to continue over the forecast period.
Reinvestment (CAPEX as a % of sales)	4.0%	1.0% – 1.3%	1.0%	1.3% of the sales is expected to be incurred as CAPEX, over the next five years, to be facilitate the revenue growth expected over the same period, and 1% during the terminal year and beyond.
Return on capital	8.8%	14.8% - 22.7%	17.0%	This is estimated to range between 15% - 23% over the next five years based on the projected revenue and earnings. In the long term (beyond terminal period), ROC is expected to settle slightly above MGT’s cost of capital at 17.0%.
Cost of capital (WACC)	14.5%	14.5%	14.5%	Assuming the (long term) risk-free rate to settle at around 15.0% and average cost of borrowings to be around 8.2% (with D/E of 70 : 30 and the levered beta of 1.1), WACC assumed to be at 14.5% over the forecast period.
Exchange rate (USD / LKR)	325.00	320.00 – 415.00	420.00	On average, LKR is expected to depreciate c. 5% each year, over the next five years and expected to reach an exchange rate of (USD/LKR) 420.00 on the terminal year.

MGT valuation indicates a upside of >41% based on intrinsic and target prices

For the year ended 31-March	Actual					Forecast				
	FY2019	FY2020	FY2021	FY2022	FY2023	FY2024E	FY2025E	FY2026E	FY2027E	FY2028E
Revenue (USD 000s)	69,941	67,116	77,281	150,219	166,631	178,295	190,776	202,458	214,856	226,133
Recurring Net Profit (USD 000s)	1,058	1,271	3,852	12,778	1,133	10,218	12,615	14,359	16,111	17,865
Earnings per Share (LKR)	0.44	0.56	1.77	6.48	1.00	8.39	10.88	13.00	15.32	17.83
Earnings per Share Growth (%)	89.7%	27.6%	218.1%	265.7%	-84.6%	741.7%	29.6%	19.5%	17.8%	16.4%
Price / Earnings Ratio (X) *	9.74	7.81	7.96	4.55	25.17	5.66	4.37	3.65	3.10	2.66
Gross Dividend per Share (LKR)	-	0.30	0.60	1.20	2.50	1.50	2.00	2.00	2.50	3.00
Gross Dividend Yield (%) *	-	6.9%	-	4.1%	10.0%	3.2%	4.2%	4.2%	5.3%	6.3%
Net Book Value per Share (LKR)	7.90	8.38	9.95	21.92	22.84	29.73	38.61	49.61	62.43	77.27
Price / Book Value (X) *	0.54	0.52	1.42	1.35	1.10	1.60	1.23	0.96	0.76	0.61
Return on Equity (%)	6.1%	7.0%	19.6%	49.7%	3.9%	28.2%	28.2%	26.2%	24.5%	23.1%
Market Price per Share (LKR) *	4.25	4.35	14.10	29.50	25.10	47.50	47.50	47.50	47.50	47.50

* For historical period ratio / price is based on FY end price and forecast period ratio is based on CMP as of 06 Oct 2023.

We have estimated MGT's USD revenues to grow at a 5-year CAGR of 6.2% for athleisure and 6.6% for lingerie segments, to achieve a topline of USD 226.1 Mn by FY28E with the global apparel market predicted to grow at a healthy rate in the coming years (barring any temporary dips from inflation/ recession induced reductions in consumer spending) supported by shorter fashion life cycles, growing popularity of e-ecommerce and potential multi-year tailwinds from recent highly effective diet medications in the US having spillover effects into consumer apparel.

Despite the headwinds in the global apparel industry, MGT reported net attributable profits for Q1 FY24E of USD 2.85 Mn. Furthermore, average dividend payout ratio of 20.0% is assumed over the forecast period and a capex intensity of 1% of sales to provide the necessary capacity to support projected revenue growth. Based on our DCF based valuation using a WACC of 14.5% and a terminal growth rate of 3% and expected market rerating, we assigns a 12M forward price target of LKR 67.00 per share for MGT.

DCF Valuation

LKR Mn	FY2024E	FY2025E	FY2026E	FY2027E	FY2028E
EBIT	6,181	7,466	8,609	9,917	11,317
FCFF	3,531	4,331	5,147	5,962	6,986
Terminal value					59,868
Discounted FCFF (WACC @ 14.5%)	3,299	3,535	3,669	3,711	3,798
Enterprise value					44,632
Net debt					12,879
Equity value					31,754
Equity value (net of NCI)					31,754
# of shares (Mn)					415
DCF based intrinsic value (LKR)					76.43
12M Target Price based on probable (historical / estimated) PER (7.0x) on estimated TTM EPS of LKR 9.6 in Sept 2024					67.00
CMP as of 06 Oct 2023 (LKR)					47.50
Potential Upside / (downside) to 12M Target Price					41%

MGT forecast and WACC sensitivity

Income statement For the year ended 31-March (USD 000s)	Actual		Forecast				
	FY2022	FY2023	FY2024E	FY2025E	FY2026E	FY2027E	FY2028E
Revenue	**150,219**	**166,631**	**178,295**	**190,776**	**202,458**	**214,856**	**226,133**
Revenue YoY Growth	*94.4%*	*10.9%*	*7.0%*	*7.0%*	*6.1%*	*6.1%*	*5.2%*
Results from operating activities / EBIT	**8,333**	**11,479**	**18,112**	**20,835**	**22,883**	**25,104**	**27,284**
EBIT YoY Growth	*79.0%*	*37.8%*	*57.8%*	*15.0%*	*9.8%*	*9.7%*	*8.7%*
EBIT margins	*5.5%*	*6.9%*	*10.2%*	*10.9%*	*11.3%*	*11.7%*	*12.1%*
Net finance cost / (Income)	**(6,643)**	**3,097**	**3,515**	**2,814**	**2,370**	**2,088**	**1,763**
Profit before tax / PBT	**14,977**	**8,382**	**14,597**	**18,021**	**20,513**	**23,016**	**25,521**
PBT margins	*10.0%*	*5.0%*	*8.2%*	*9.4%*	*10.1%*	*10.7%*	*11.3%*
Profit after tax / PAT	**12,778**	**1,133**	**10,218**	**12,615**	**14,359**	**16,111**	**17,865**
PAT YoY Growth	*231.7%*	*-91.1%*	*802.2%*	*23.5%*	*13.8%*	*12.2%*	*10.9%*
PAT margins	*8.5%*	*0.7%*	*5.7%*	*6.6%*	*7.1%*	*7.5%*	*7.9%*
Profit attributable to the SH / Recurrent earnings	**12,778**	**1,133**	**10,218**	**12,615**	**14,359**	**16,111**	**17,865**
Recurrent EPS (USD)	**0.031**	**0.003**	**0.025**	**0.030**	**0.035**	**0.039**	**0.043**
Recurrent EPS (LKR)	**6.48**	**1.00**	**8.39**	**10.88**	**13.00**	**15.32**	**17.83**

Weighted average cost of capital	
Cost of equity (Ke)	
Risk free rate	15.0%
Market risk premium	7.0%
Levered beta	1.27
Cost of equity (Ke)	23.9%
Cost of debt (Kd)	
Average cost of borrowings	11.7%
Tax adjusted Kd	8.2%
Weighted average cost of capital (WACC)	14.5%

		WACC				
		13.5%	14.0%	14.5%	15.0%	15.5%
Terminal growth	1.0%	84.84	80.25	76.00	72.05	68.38
	1.5%	85.31	80.58	76.22	72.18	68.43
	2.0%	85.79	80.91	76.43	72.29	68.45
	2.5%	86.28	81.25	76.63	72.38	68.46
	3.0%	86.79	81.58	76.82	72.45	68.43

Intrinsic value of LKR 76.43 compared against the CMP of LKR 47.50 as of 06 Oct 2023 results in an upside of > 61%.

Table 4.12: Risk Factors that Impact our Rating of MGT

Risk Factors	Likelihood of Risks Negatively Impacting Ratings in Next 1-2 years	Negative Impact on Ratings	Positive Impact on Ratings
Global Economic/ Market Conditions	Moderate	Prolonged deterioration in global economic conditions in key markets and/ or prolonged adverse conditions in the global market for textiles & apparel.	Sustained improvement in global economic conditions in key markets and/ or prolonged favourable conditions in the global market for textiles & apparel.
Market Share	Moderate	Sustained loss of global market share in the medium term.	Sustained gain in global market share in the medium term.
Revenue Growth	Moderate	Sustained decline in USD revenue growth rates below the growth rates assumed in our forecast.	Sustained increase in USD revenue growth rates above the growth rates assumed in our forecast.
Margins	Moderate	Prolonged margin compression from unfavourable economic/ industry conditions or company specific factors.	Sustained margin expansion from favourable economic/ industry conditions or company specific factors.
Capital Expenditure/ ROIC	Moderate	Increase in capital intensity of the business or decline in ROIC from adverse competitive forces or company specific factors.	Decrease in capital intensity of the business or increase in ROIC from favourable competitive forces or company specific factors.
Inflation/ Cost Pressures	Moderate	Increase in localised inflationary pressures or raw material costs which cannot be passed on to end customers.	Decrease in localised inflationary pressures or raw material costs possibly leading to margin expansion.
Devaluation of Reporting Currency	Low	Sustained appreciation of the reporting currency against the functional currency of the export SBU’s can lower reported revenue/ earnings and our valuations/ price targets in LKR.	Devaluation of the reporting currency against the functional currency of the export SBU’s surpassing our forecast assumption of on avg. 5% p.a. can increase reported revenue/ earnings and our valuations/ price targets in LKR.
Changes to WACC	Moderate	Increase in market interest rates/ equity risk premium or beta values and accordingly the cost of capital can negatively impact our valuations and ratings.	Decrease in market interest rates/ equity risk premium or beta values and accordingly the cost of capital or lower market valuation multiples can positively impact our valuations and ratings.
Loss of Human Capital	Low	Sustained loss in talent/ key personnel.	N.A.
Regulatory & Taxation	Low	Adverse regulatory or taxation changes which impact the long-term viability/ competitiveness of the business.	Positive regulatory or taxation changes including in the ease of doing business which favourably impact the long-term viability of the business.

Sri Lanka is a pioneer in ESG initiatives in the textile & apparel space and remains ahead of regional competitors

Environment

- Diversifying energy sources with a heavy focus on renewable energies to reduce reliance on fossil fuel.
- Materials supplier selection bases on customer nominations – different sustainable approaches are used across cotton, polyester, dyes and chemicals.
- The CEO water mandate is a key priority for MGT. Aligning with this, c.10% of water consumption is recycled and re-used. This reduces reliance on ground water. Substantial investments in effluent plants to support goals.
- Attempts are taken to reduce hazardous waste levels while non-hazardous waste is recycled/re-used.
- GHG emission intensity reduced while adopting SBTi (The Science Based Targets Initiative) to which MGT's emission goals were re-aligned. This included efficient energy consumption, higher dependency on renewable and cleaner sources of energy.

Social

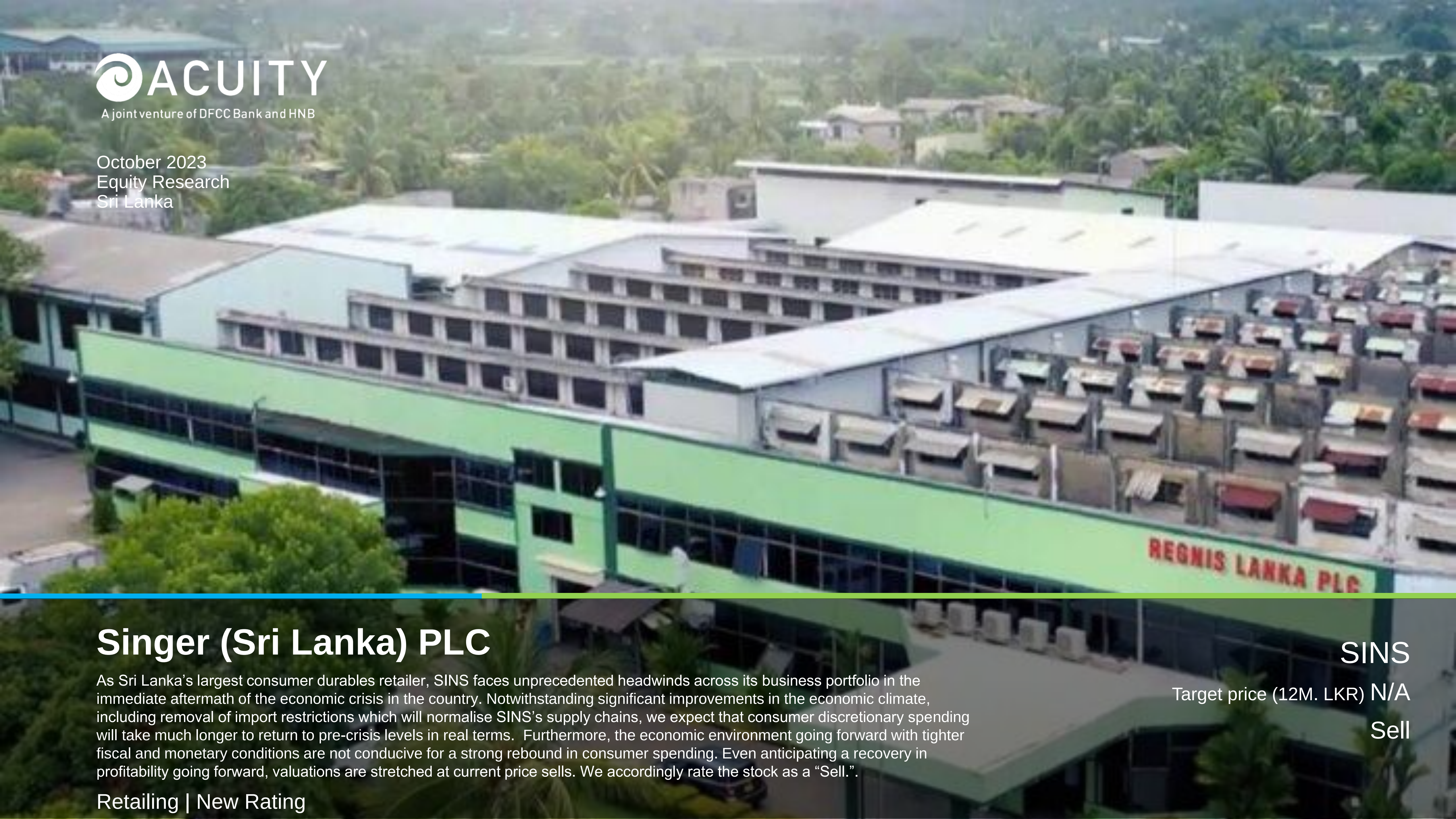
- Customer attraction/ retention is successful as MGT is recognized as an industry innovator by global top tier brands.
- For suppliers, MGT's customer nominated suppliers comprises of 70 key raw material suppliers, 222 SME suppliers, 1,000 other suppliers. Additionally, 2023 saw collaborations with suppliers for over 215 new products ensuring robust supply chain relations.
- Social work is prioritized by MGT as community welfare is ensured through employments, collaborations, and charity events.
- Apart from regular compensation and general wellbeing of employees, a substantial amount of financial capital is invested for employee training

Governance

- MGT adheres to the regulatory and voluntary governance reporting requirements prevailing in Sri Lanka. This adherence implies that aspects such as board of directors, board balance, ratio of independent non-executive directors to executive directors, and other governance measures are in compliance and/ or exceeding required standards.
- MGT's thorough governance reporting suggests that the company upholds its end of non-financial reporting transparency.
- Further, MGT adheres to Hayleys PLC's "The Hayleys Way" , which ensures that the ethical conduct of the company is secured and bounded by common grounds across the Group.

Sri Lankan manufacturers of apparel & textiles were among the pioneers in elevating the ESG standards of the industry, particularly in relation to the environmental impact of the industry. With rising awareness of the carbon, water and other resource intensities of the global fashion industry supply chain, the past and ongoing initiatives in the ESG field by MGT and other local players has allowed Sri Lanka to differentiate itself from its regional competitors as a destination for more ethical sourcing. We expect that MGT and the wider Sri Lankan apparel & textile ecosystem's ongoing focus on ESG initiatives, which remains well ahead of regional competitors, will be a continued source of competitive advantage to the industry going forward. This will continue to endear MGT to more environmentally conscious fashion brands who are typically able to command premium pricing from consumers which in turn translates into better pricing and margins for suppliers.

MGT's ESG initiatives are therefore a strategic differentiator which aligns with its business model and supports our expectations of continued revenue expansion and sustained margin strength in the forecast period.



ACUITY

A joint venture of DFCC Bank and HNB

October 2023
Equity Research
Sri Lanka

Singer (Sri Lanka) PLC

As Sri Lanka's largest consumer durables retailer, SINS faces unprecedented headwinds across its business portfolio in the immediate aftermath of the economic crisis in the country. Notwithstanding significant improvements in the economic climate, including removal of import restrictions which will normalise SINS's supply chains, we expect that consumer discretionary spending will take much longer to return to pre-crisis levels in real terms. Furthermore, the economic environment going forward with tighter fiscal and monetary conditions are not conducive for a strong rebound in consumer spending. Even anticipating a recovery in profitability going forward, valuations are stretched at current price sells. We accordingly rate the stock as a "Sell.".

Retailing | New Rating

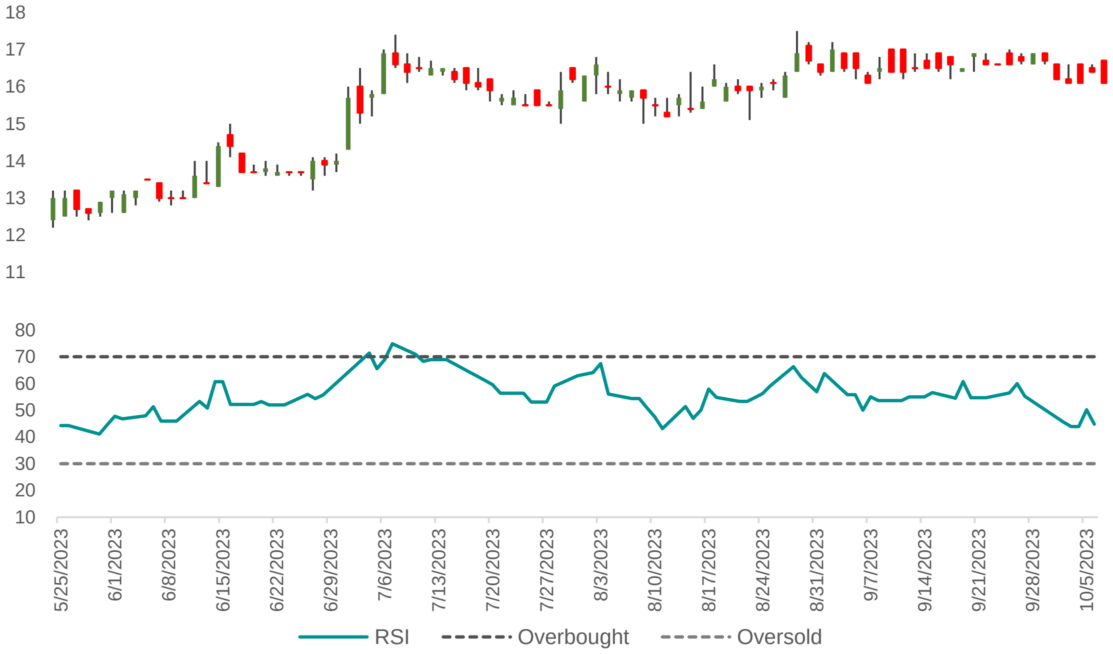
SINS

Target price (12M. LKR) N/A

Sell

CMP as at 06th Oct 2023	LKR 16.10
Bloomberg and CSE Ticker	SINS SL Equity I SINS.N
Market Cap (LKR Bn I USD Mn)	LKR 17.9 Bn I USD 55.4 Mn
Issued Quantity (Shares Mn)	1,126.9
Estimated free float	7.72%
Average daily volume (Last 3M)	129,586
52-week High and Low (LKR)	17.50 I 8.00
Industry & Year end	Retailing I 31st March
Beta and Sharpe ratio	0.97 I 0.21

Chart 5.1: SINS Technical Chart (Trailing 90 days)



Source: Bloomberg

Singer (Sri Lanka) PLC	SINS
Rating	Sell
12M Target Price	N/A
Potential Upside/ (Downside)	N/A
Industry View: Retailing	Cautious

SINS was significantly impacted by the economic crisis in 2022 as inflation, higher taxes and higher interest rates eroded consumer spending, whilst imports of consumer durables were restricted owing to the foreign currency shortage in the country. Economic conditions in the country have significantly normalized in 2023, and we expect there will be a short-term uptick in consumer spending from its trough in the previous year. However, we believe that conditions are not conducive for a sustained boom in consumer spending as economic growth and the increase in discretionary income will be gradual whilst the tight fiscal and monetary policies for the foreseeable future necessitated by the economic crisis will also curtail excessive consumption. Therefore, we envisage that the retailing sector will remain subdued in the medium term. We rate the stock as a “Sell” at the current price levels based on our intrinsic valuations. Upside to our rating would primarily depend on sustained and faster than expected recovery in consumer spending and in SINS operating performance over the next 12-18 month exceeding our projections.

Financial year ended 31 March	FY2021	FY2022	FY2023
Revenue (LKR Mn)	67,412	76,847	54,767
YoY Growth (%)	*23%*	*14%*	*-29%*
Operating profit (LKR Mn)	5,384	8,237	6,688
YoY Growth (%)	*41%*	*53%*	*-19%*
EPS (LKR)	2.18	3.51	0.01
DPS/ Dividend Yield	0/0	0/0	0/0
PER (x)	*7.98*	*3.99*	*0*

SINS at a glance

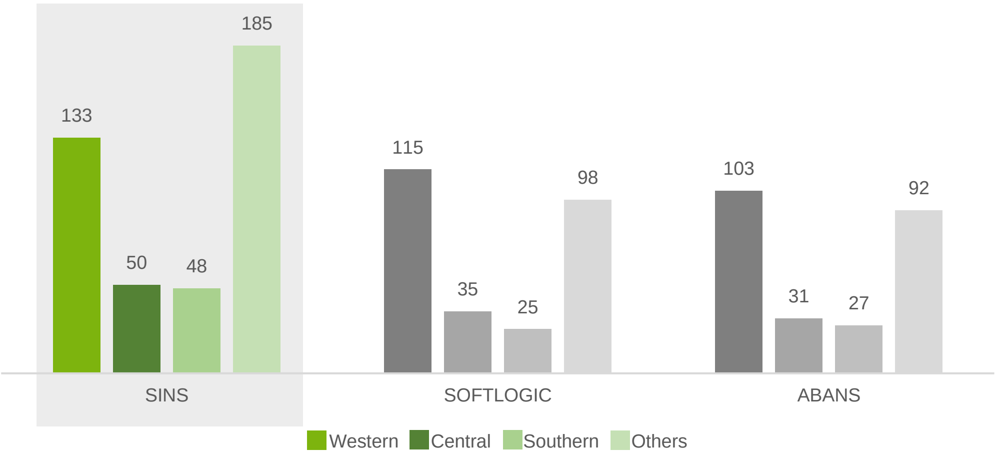
Singer (Sri Lanka) PLC ("SINS") is the market leader in the Sri Lankan consumer durables industry with the largest network of retail outlets. SINS is one of the most recognizable brands in Sri Lanka owing to its longstanding presence in the market and brand reputation built up over 145 years. SINS which started as the Sri Lankan subsidiary of the global consumer durables brand Singer NV and was acquired by HAYL in 2017.

SINS sales are supported by its strong network of principals with over 60 international brands in the company's extensive portfolio of electronic items and home appliances. SINS also differentiates itself from other white goods retailers through locally developed products manufactured in-house through several listed and unlisted subsidiaries; Regnis (Lanka) PLC ("REG"), Regnis Appliances (Private) Limited and Singer Industries (Ceylon) PLC ("SINI"). Products manufactured in-house include refrigerators, washing machines, sewing machines, furniture and related components.

SINS has one of the largest retail networks in the country with 400+ physical outlets, an e-commerce site and possibly the most extensive after-sales service capabilities in Sri Lanka.

SINS also owns majority control in Singer Finance Lanka PLC "SFIN"), a licensed non-bank financial institution ("NBFI") engaged in the business of leasing and hire-purchase financing services.

Chart 5.2: Retail Presence of SINS and Peers



416 outlets in terms of retail presence

c.30% market penetration

4 manufacturing facilities:

SINS home appliances segment is its revenue frontrunner (revenue in FY2022/23)

Home Appliances -33%

Comprises of - Refrigerators, washing machines, kitchen items, etc.

Main drivers – consumer spending on durable household goods, lift of import bans

Digital Products – 23%

Comprises of - Computers, mobile phones, headphones

Main drivers - consumer spending on durable household goods, lift of import bans

Financial Services – 18%

Comprises of - Leasing, hire purchases, loans, provision, etc.

Main drivers – Positive macro economic activities.

Consumer Electronics – 8%

Comprises of - Televisions, DVDs, home theatres, audio solutions

Furniture – 8%

Comprises of - Living room, bedroom and office furniture

Other – 6%

Comprises of - Tractors, Water pumps, agricultural equipment, other personal and household appliances

Sewing Machines – 6%

Domestic and industrial sewing machines

ACUITY

A joint venture of DFCC Bank and HNB

Revenue mix of SINS is dominated by home appliances and digital products

Chart 5.3: SINS Revenue mix based on segments over 2018-2023

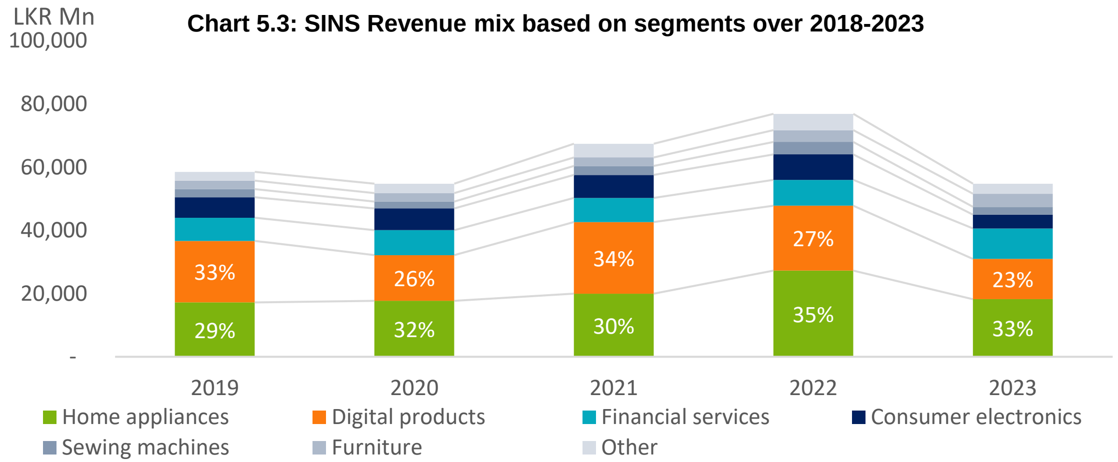


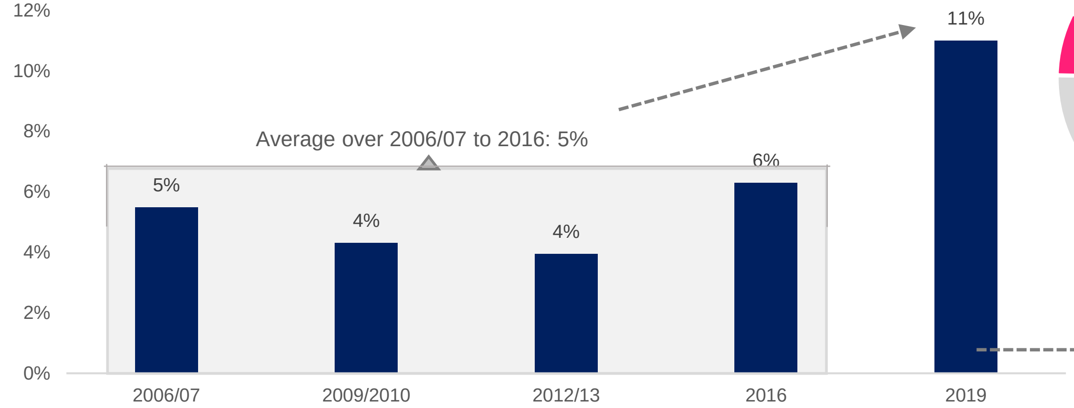
Table 5.1: Correlation of SINS P&L Variables (in USD) & Economic Variables (FYXXXX/XX-21)

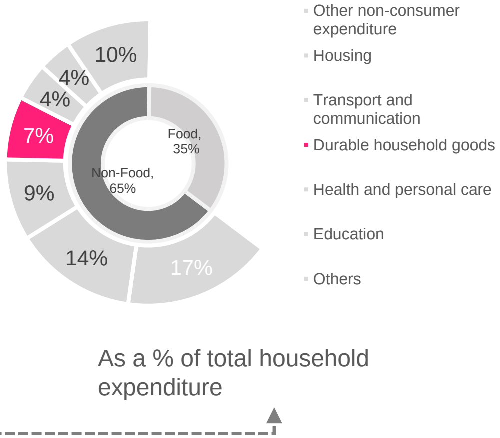
	Revenue	Gross profit	Profit attributable to parents
Exchange Rate (LKR/USD)	0.62	0.90	0.02
Nominal GDP growth (%)	-0.05	0.28	-0.09
Real GDP growth (%)	-0.57	-0.81	0.12
Interest rates (%)	0.12	0.51	-0.27
Taxes CIT (%)	-0.61	-0.26	-0.81

Home appliances and digital products have consistently account for c. 60% of SINS consolidated revenue. However, in FY2022/23 there was a drop in the revenue contribution from both segments due the ban on imports of non-essential goods imposed to during the economic crisis to overcome forex shortages in Sri Lanka. Amidst these challenges coupled with rising inflation, SINS relied on their locally produced refrigerators and washing machines to drive sales. However, with economic conditions stabilizing, sales of imported appliances have resumed.

Rising input materials costs drove SINS to increase the refrigerator and washing machine unit prices by 28% and 37% respectively, which combined with timely marketing strategies helped to stem the revenue contraction.

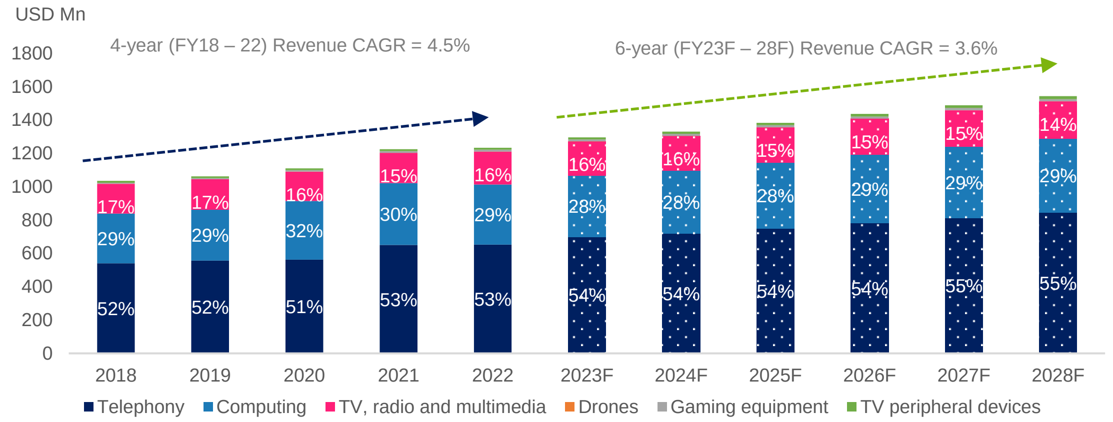
Chart 5.4: Household Expenditure on Durable Household Goods as a % of Total Non-food Expenditure





Source: Department of Census and Statistics

Chart 5.5: Sri Lanka Forecast Consumer Electronics Market Revenue



High competition

Although a few retailers/ brands might command significant market share in certain segments, competition in the consumer appliance retail space is generally high and the market is fragmented. For multi brand retailers, brand owners may not give exclusivity to a single retail chain and/ or have the option of switching between distributors.

Moderate threat of new entrants

Threat of new entrants in the retail space is moderate as new entry level brands, particularly from China, seek out local distributors. The requirement for after-sales servicing facilities/ capabilities provides some entry barriers for new distributors. The in-house brands/ manufacturing segment has higher entry barriers on account of the prerequisite capital and expertise.

Mid to High power of buyers

Buyers have a wide range of options. Buying decisions will be dictated by brand recognition, lifestyle and affordability. In consumer appliances/ furniture, buyers will also seek out the best deal available from multiple retailers.

Low threat of substitutes

Whilst there is low threat of substitutes for retail appliances/ furniture, the competitive nature of the industry necessitates constant innovation by brand owners and investment in retail channels and promotional activities by distributors.

Moderate power of suppliers

Suppliers include local and international supply chain partners, authorized dealers and distributors. Major international brands who provide their products to consumer durables retailers may command high negotiating power.

Over 2018-2022 Sri Lanka's consumer electronics market, which is moderately consolidated amongst a few large modern trade retailers, was driven mainly by the telephony and computing segments, accounting for over 50% and 20% of sales respectively each year. The market growth CAGR over the same period stood at 4.5%. Previous forecasts over 2023-2028 by Statista suggest that this growth trend is expected to continue albeit at a lower pace (see Chart 5.5). Hence, the Sri Lankan consumer electronics market which was expected to grow at a CAGR of 3.6% (in USD basis) may see even lower growth in the aftermath of the economic crisis as disposable incomes have reduced and households will likely extend the replacement cycle of their durables.

SINS together with its peers in the modern trade industry cater to all the major product segments of the consumer durables market. SINS brand portfolio consists of over 50 international brands. Major global brands in SINS portfolio include, Sony, Beko, Huawei, TCL, DELL, HP, Philips, Yamaha and Canon. Furthermore, SINS has consistently added new brands to expand its portfolio to keep up with changing consumer trends and preferences.

Top Local Competitors

Source: Statista

In-House Brands	Exclusive Distributorship	Non-Exclusive Distributorship	New Brands
Manufacture/ White-Label, Marketing, Distribution & Retail	*Marketing, Distribution & Retail*		

Interest cost burden will reduce by c. 40% as interest rates are revising towards single digits…

Chart 5.6a: SINS Avg Margin Analysis (2012-2023)

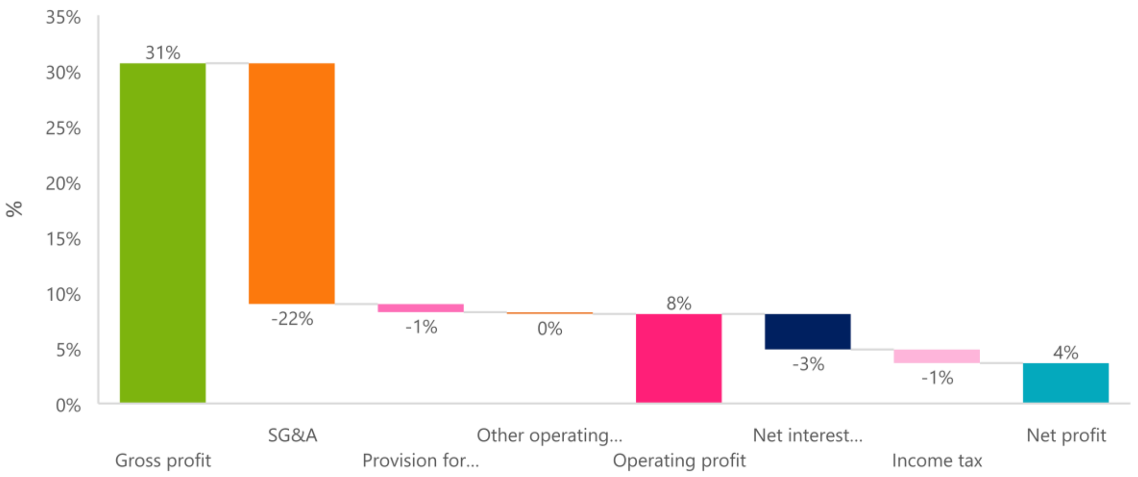
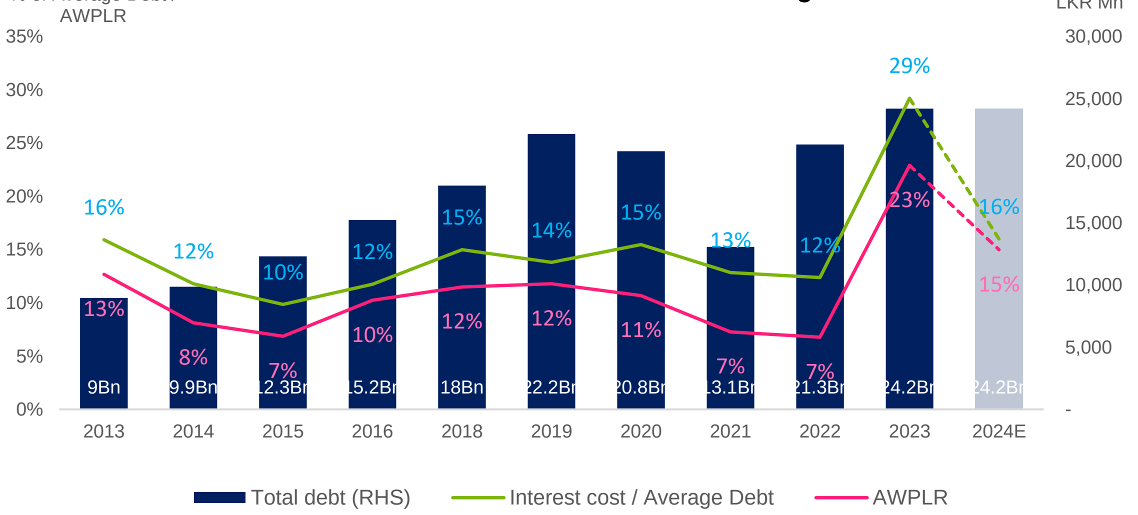


Chart 5.6b: SINS Interest Cost as a % of Avg Debt



SINS high average gross margin of 31% is somewhat misleading and reflects the requirements for extensive marketing activities. Therefore, average operating margins of c. 8% over the last ten years indicates a highly competitive market environment, leaving little buffer to absorb relatively higher interest costs owing to SINS relatively high debt burden.

Out of SINS's total long-term loans, less than 20% of the loans are subject to fixed interest rates (as of 31st March 2023). The spike in interest cost to average debt in FY2022/23 is due to the sharp increase in market interest rates during the year.

Anticipating AWPLR to come down to c.15% and debt level to remain the same at FY2022/23 levels, it is estimated that the interest cost to average debt will decline to c. 16% and the total interest cost burden for FY2023/24 will reduce by >50%.

SINS: story behind the numbers

Key performance indicator	Assumption			
	Base year	Years 1 – 5 (FY24 – FY28)	Beyond 5 years	Link to story
Revenue	LKR 44,126 Mn (FY20)	7.4% (4yr CAGR)	5.0%	SINS retail segment is expected grow its revenue at a CAGR of 7.4% in LKR over the next four years (FY24 – FY28), primarily driven by digital products SBU. Also, for the base year normalized earnings, pre-COVID and pre-economic crisis year, FY2019/20 is considered.
Operating margin	6.9% / 1.6% (FY20 / Q1 FY24)	1.9% - 7.4%	7.4%	SIN's latest two quarters, Q4 FY23 and Q1 FY24 reported a substantially lower operating margin of 2.5% and 1.6% respectively. SIN's ongoing marketing initiatives is expected to result in long-term stabilized operating margins of c. 7.4%.
Tax rate	30.0%	30.0 %	30.0 %	Currently applicable 30.0% (revised) corporate tax rate is expected to continue over the forecast period.
Reinvestment (CAPEX as a % of sales)	2.0%	1.4% - 1.5%	1.2%	1.4% – 1.5% of the sales is expected to be incurred as CAPEX, over the period of next five years, to be in line with the revenue growth expected over the same period. Also, additional CAPEX of 1.2% (of sales) is predicted for the terminal year and beyond given the potential maintenance and expansions.
Return on capital	6.7%	0 – 3%	4.5% - 5%	This is to range between 0% - 3.0% over the next five years. And in long run (beyond terminal period), ROC is expected to settle around 4.5 - 5.0%.
Cost of capital (WACC)	14.5%	14.5%	14.5%	Assuming the (long term) risk-free rate to settle at around 15.0 % and average cost of borrowings to be around 17.5% (with D/E of 70:30 and the levered beta of 0.97), WACC assumed to be at 14.5% over the forecast period.
Exchange rate (USD / LKR)	325.00	320.00 – 415.00	420.00	On average, LKR is expected to depreciate c. 5% each year, over the next five years and expected to reach an exchange rate of (USD/LKR) 420.00 on the terminal year.

SINS current market valuation indicates a significant premium to intrinsic value

For the year ended 31-March	Actual					Forecast				
	FY2019	FY2020	FY2021	FY2022	FY2023	FY2024E	FY2025E	FY2026E	FY2027E	FY2028E
Revenue (LKR Mn)	43,618	44,126	54,864	68,652	47,950	47,855	51,012	54,431	58,282	62,488
Recurring Net Profit (LKR Mn)	141	13	1,749	3,909	221	(1,819)	289	765	1,137	968
Earnings per Share (LKR)	0.12	0.01	1.55	3.47	0.20	(1.61)	0.26	0.68	1.01	0.86
Earnings per Share Growth (%)		-91%	13629%	123%	-94%	-925%	116%	165%	49%	-15%

* For historical period ratio / price is based on FY end price and forecast period ratio is based on CMP as of 06 Oct 2023.

DCF Valuation (Singer Company)					
LKR Mn	FY2024E	FY2025E	FY2026E	FY2027E	FY2028E
EBIT	891	3,104	3,685	4,322	4,614
FCFF	-76	1,508	1,858	2,210	2,338
Terminal value					27,304
Discounted FCFF (WACC @ 14.5%)	(71)	1,231	1,325	1,377	1,273
Enterprise value					19,995
Net debt					(18,654)
Equity value					1,341

SOTP valuation			
Company	Valuation Method	% held	Equity Value (LKR Mn)
Singer Sri Lanka PLC	DCF		1,341
Singer Finance (Lanka) PLC	Average of NAV & Market Cap	79.9%	3,074
Singer Industries (Ceylon) PLC	Net Asset value (NAV)	87.7%	1,286
Regnis (Lanka) PLC	Net Asset value (NAV)	58.3%	992
SINS Group equity value			6,692
SINS no of shares (Mn)			1,127
Equity value per share (LKR)			5.94
CMP as of 06th Oct 2023 (LKR)			16.10
Potential Upside / (downside) to Equity value			- 63%

SINS current market valuation indicates a significant premium to intrinsic value

Subsidiaries	Book Value (LKR Mn)	Equity valuation basis	Equity Valuation (LKR Mn)	Market Values (LKR Mn)	Average Equity Values (LKR Mn)
Singer Finance (Lanka) PLC	5,067	20% discount on Historical SFIN's PBV of 0.7(x)	5,067	2,627	3,847
Singer Industries (Ceylon) PLC	1,466	NAV basis	1,466	-	-
Regnis (Lanka) PLC	1,701	NAV basis	1,701	-	-

Income statement For the year ended 31-March (LKR Mn)	Actual		Forecast				
	FY2022	FY2023	FY2024E	FY2025E	FY2026E	FY2027E	FY2028E
Revenue	**68,652**	**47,950**	**47,855**	**51,012**	**54,431**	**58,282**	**62,488**
Revenue YoY Growth	*25.1%*	*-30.2%*	*-0.2%*	*6.6%*	*6.7%*	*7.1%*	*7.2%*
Results from operating activities / EBIT	**7,132**	**6,273**	**891**	**3,104**	**3,685**	**4,322**	**4,614**
EBIT YoY Growth	*68.0%*	*-12.0%*	*-85.8%*	*248.2%*	*18.7%*	*17.3%*	*6.8%*
EBIT margins	*10.4%*	*13.1%*	*1.9%*	*6.1%*	*6.8%*	*7.4%*	*7.4%*
Net finance cost	**1,994**	**6,263**	**2,610**	**2,710**	**2,810**	**2,910**	**3,110**
Profit before tax / PBT	**5,044**	**(68)**	**(1,819)**	**289**	**765**	**1,296**	**1,383**
PBT margins	*7.3%*	*-0.1%*	*-3.8%*	*0.6%*	*1.4%*	*2.2%*	*2.2%*
Profit after tax / PAT	**3,909**	**221**	**(1,819)**	**289**	**765**	**1,137**	**968**
PAT YoY Growth	*123.5%*	*-94.4%*	*-924.8%*	*-115.9%*	*165.0%*	*48.7%*	*-14.9%*
PAT margins	*5.7%*	*0.5%*	*-3.8%*	*0.6%*	*1.4%*	*2.0%*	*1.5%*
Recurrent EPS (LKR)	**3.47**	**0.20**	**(1.61)**	**0.26**	**0.68**	**1.01**	**0.86**

Weighted average cost of capital	
Levered beta	0.97
Cost of equity (Ke)	21.8%
Average cost of borrowings	17.5%
Tax adjusted Kd	12.3%
Weighted average cost of capital (WACC)	14.5%

Risk factors impacting our rating for SINS

Table 5.2: Risk Factors that Impact our Rating of SINS

Risk Factors	Likelihood of Risks Negatively Impacting Ratings in Next 1-2 years	Negative Impact on Ratings	Positive Impact on Ratings
Local Economic/ Market Conditions	Moderate	Prolonged deterioration in domestic economic conditions and reduction in purchasing/ debt servicing power of consumers.	Sustained improvement in domestic economic conditions and increase in purchasing/ debt servicing power of consumers.
Market Share of SINS	Moderate	Sustained loss of local market share in the retail space the medium term.	Sustained gain in local market share in the retail space in the medium term.
Revenue Growth	Moderate	Sustained decline in revenue growth rates below the growth rates assumed in our forecast.	Sustained increase in revenue growth rates above the growth rates assumed in our forecast.
Margins	Moderate	Prolonged margin compression from unfavourable economic/ industry conditions or company specific factors.	Sustained margin expansion from favourable economic/ industry conditions or company specific factors.
Capital Expenditure/ ROIC	Moderate	Increase in capital intensity of the business or decline in ROIC from adverse competitive forces or company specific factors.	Decrease in capital intensity of the business or increase in ROIC from favourable competitive forces or company specific factors.
Loss of Principals or Significant Customers	Low	Loss or key agencies, principals or customers which have a material impact on revenue/ earnings.	N.A.
Devaluation of Reporting Currency	Moderate	Sustained depreciation of the local currency impacting the availability/ affordability of retail items.	Sustained appreciation/ stabilisation of the local currency impacting the availability/ affordability of retail items.
Changes to WACC	Moderate	Increase in market interest rates/ equity risk premium or beta values and accordingly the cost of capital can negatively impact our valuations and ratings.	Decrease in market interest rates/ equity risk premium or beta values and accordingly the cost of capital can negatively impact our valuations and ratings.
Loss of Human Capital	Low	Sustained loss in talent/ key personnel.	N.A.
Regulatory	Low	Adverse regulatory changes which impact the long-term viability/ competitiveness of the business.	Positive regulatory changes which impact the long-term viability/ competitiveness of the business.

Environment

- An intensified focus on energy reduction is embedded into product offerings of SINS (i.e., refrigerators, washing machines manufacturing involving environmentally conscious approaches expanding to their packaging).
- Collaborating with the "Sri Lanka Solar Energy Authority" SINS committed to renewable energy sources.
- "Repair and re-use" concept is promoted through SINS' actions such as offering extended product life cycles, and extended warranty facilities (i.e., "Senasuma" program) promoting less e-waste buildup.
- SINS' environmental initiatives spread to more areas such as materials, GHG emissions which SINS is attempting to reduce overall.

Social

- SINS maintains key HR policies such as health & safety, whistle blower policy, recruitment & selection policy, remuneration, & sexual harassment policy. SINS invested LKR 21 Mn in FY2022/23 for employee training indicating their commitment towards employee development.
- Overall customer satisfaction is high proving success on SINS approaches such as revamping customer loyalty systems, improvised services for customer value addition.
- SINS maintains solid relationships with suppliers while, prioritizing community servicing as part of building up their social capital.

Governance

- SINS' board of directors comprises of a total 9 members, out of which a majority are independent non-executive directors. Thus, the board is balanced, while CEO-chairman role duality is ensured.
- Compliance with codes (i.e., Companies Act no. 07 of 2007, CSE Listing rules, etc.) ensures SINS' governance structure is sound..

ACUITY
A joint venture of DFCC Bank and HNB

October 2023
Equity Research
Sri Lanka

HAYL Transportation & Logistics Sector

The transport & logistics business vertical of HAYL accounts for a significant part of the Group's overall valuation. The sector benefitted from significant tailwinds in the last two financial years; the pandemic induced skyrocketing of freight costs was a bonanza for freight-forwarders/ shippers while the fuel shortages in Sri Lanka during the economic crisis provided a further fillip for HAYL's bunkering fuel business. Base-effect of these non-recurring items will negatively impact the sector in the current year. However, the medium-term prospects for the sector are highly favourable on the back of multiple growth drivers.

Transportation | N/A

HAYL is the most diversified transport & logistics player in Sri Lanka

HAYL's transport & logistics cluster mostly operates under the "Advantis" brand, and dates back to 1959 when it emerged as the shipping division of the Group. At present, transport & logistics is the largest revenue contributor to the Group (28% in FY 2022/23) and the highest contributor to group profits with a share of 30% of profit before tax.

HAYL is a major player in the container handling at the Port of Colombo through its shipping agencies, accounting for around 14% of the throughput. HAYL is among the biggest agency houses in Sri Lanka, representing some of the world's leading shipping lines and freight forwarders. They dominates 3PL services and operate modern multi-user warehousing and distribution facilities in Sri Lanka.

Table 6.1: HAYL & Listed Peer Transport & Logistics Business Verticals

Services	Description of Services	HAYL	JKH	SPEN
Airline services	GSA, cargo/ freight services	x	x	x
Integrated Logistics	3PL services, warehousing & warehouse management	x	x	x
Shipping Agency	Agency services for international shipping lines	x	x	x
Port & Marine Service	Port operations, servicing of vessels and misc. marine services	x	x	x
Courier	Express courier services, island-wide transportation, and logistic services	x	x	x
International Freight Forwarding	International freight management, project cargo management	x	x	x
Bunkering	Bunkering of fuel and gasoline	x	x	
Maritime Education	Maritime education and training			x
Port & Container Terminals	Ownership/ operation of container terminals		x	
Ship Owning & Ship Chartering	Ownership/ operation of ships & related services	x		

The Advantis Logistics City ("ALC") in Ekala, Ja-Ela, is the largest warehouse in Sri Lanka, with Advantis controlling over 3.5 million square feet of total warehousing space locally and regionally, surpassing its local peers by a wide margin. HAYL also has the country's largest fleet of floating assets, with c. 21 vessels in its possession. For nearly two decades, Advantis 3PL Plus has been a 3PL leader in Sri Lanka, in addition to providing clients in South and Southeast Asia with a full range of 3PL services. Taking advantage of the strategic location and enabling legislation in the country, Advantis has established an international logistic hub to provide freeport services to its clients.

HAYL's transport & logistics business is presently involved in operating distribution centres in India, Indonesia, Myanmar, Thailand, and Bangladesh, in addition to Sri Lanka. HAYL represents FedEx in Sri Lanka, the world's largest air express transportation company, and is also one of the biggest car carrier handling agents in Sri Lanka. Advantis acquired Sri Lanka Shipping Company Ltd in 2017, expanding its offering as a ship owning/ operator and major player in maritime operations in Sri Lanka.

Table 6.2: Correlation of HAYL Transport & Logistics P&L Variables (in USD) & Economic Variables (2011-22)

	Revenue	PBT
Exchange Rate (LKR/USD)	0.98	0.92
Freight rates - Sea	0.75	0.91
Freight rates - Air	0.65	0.81
OECD economic growth	0.24	0.38
Container Handling (TEU)	0.69	0.58
Nominal GDP growth (%)	0.60	0.61

Agent for two main global shipping lines

Agent for a main express fright service providers

Fully acquired a market-leading shipping and marine services company in 2017

Owns the largest warehouse facility on the island, Advantis Logistics City (ALC)

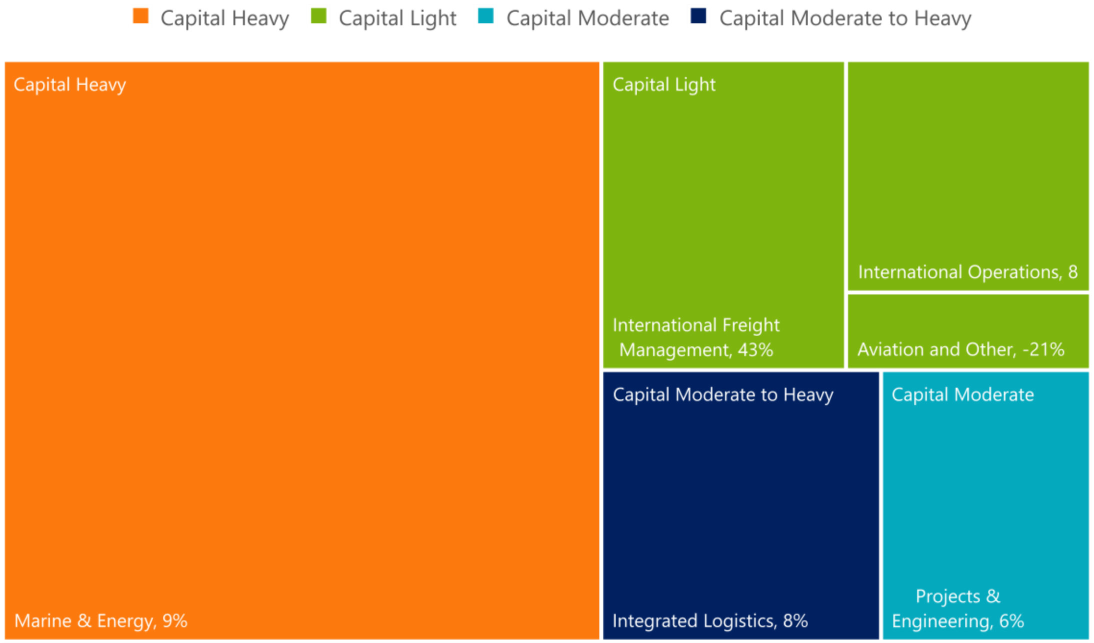
Advantis Free Zone is a Freeport facility owned by Advantis

Transport & logistics has a larger exposure to capital light businesses reflected in higher contribution margins

Unit Economics & Margins

The unit economics of HAYL's transport & logistics business is highly favourable. Historically a larger proportion of the profitability of the business vertical has accrued from high margin and capital light businesses. The international freight segment, a capital light business, reaped a significant windfall during the pandemic economy with the rapid escalation in sea and air freight rates in FY2021/22 (see Chart 6.2a and b). The normalisation of freight rates throughout FY2022/23 was offset by the favourable exchange rate movements with the LKR devaluation contributing to sustained high profitability in the international freight segment in FY2022/23. Furthermore, in FY2022/23 the marine & energy segment witnessed significantly higher sales and profitability as the fuel shortages during the economic crisis opened avenues for bunker fuel suppliers to supply fuel to domestic industries.

Chart 6.1: Capital Intensity and Avg PBT Margin % (FY2021/22 and FY2022/23)



Note: size of the box in the tree map Chart 6.1 indicates the revenue contribution within the cluster.

Chart 6.2a: Revenue by Segment

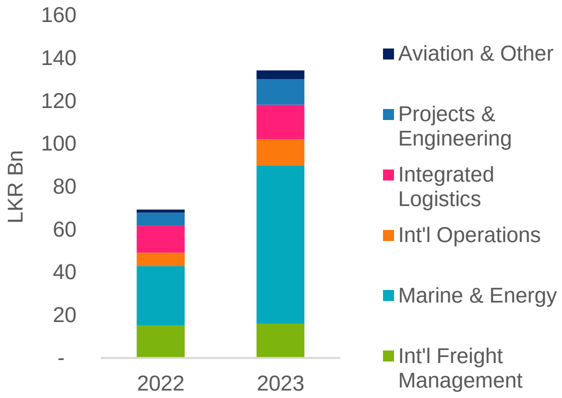
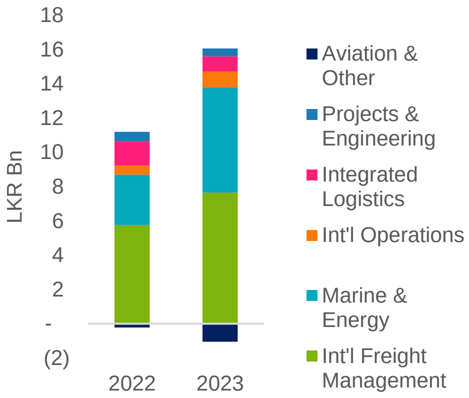


Chart 6.2b: PBT by Segment

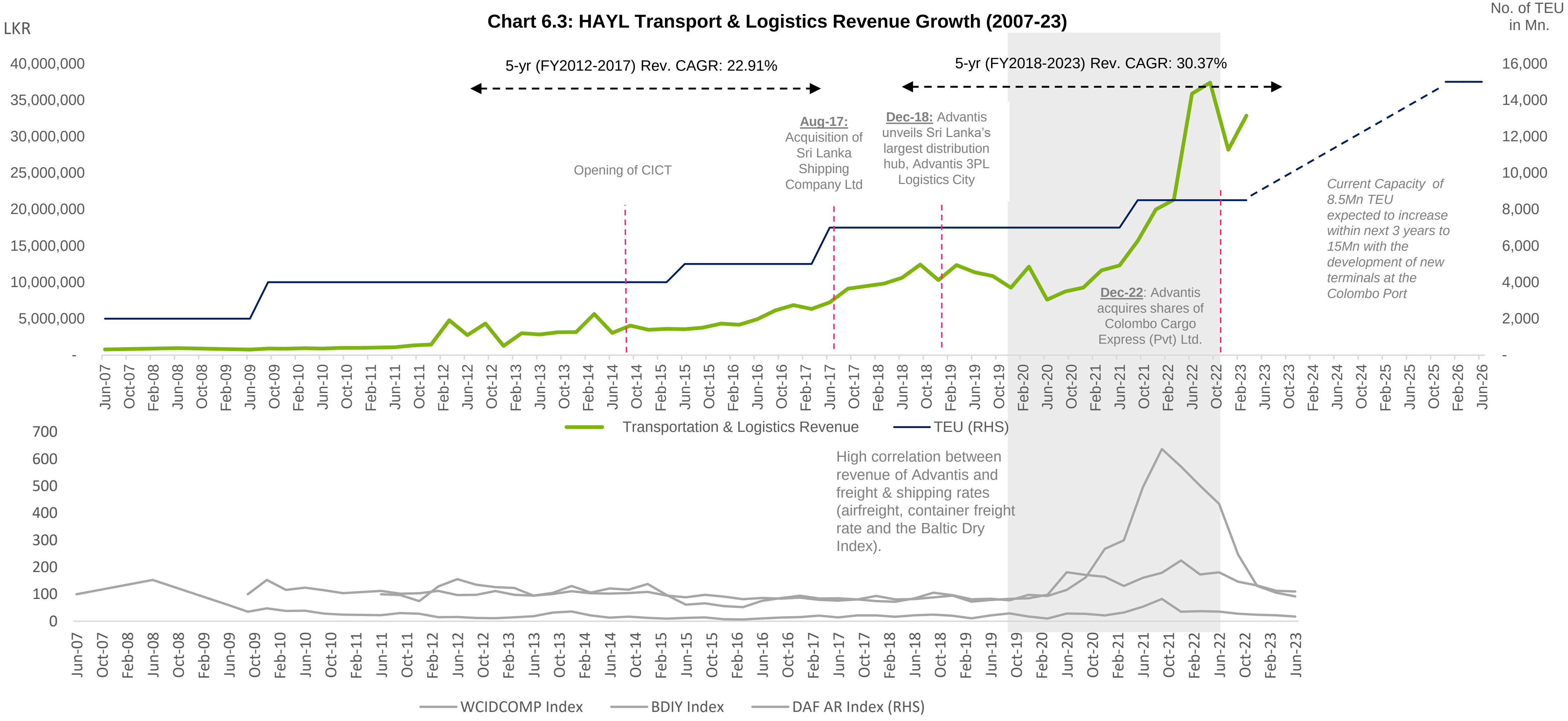


These non-recurring events temporarily skewed the revenue and profit contribution mix in the transport & logistics business vertical towards the more capital-intensive marine & energy segment. However, with normalised earnings from FY2023/24 going forward, we would expect the sectoral revenue and earnings contributions to be more evenly distributed amongst the constituent product segments.

Capacity expansion at Colombo Port will catalyse revenue growth going forward

Historically, the revenue of HAYL's transport & logistics cluster was driven by both organic and acquisition led growth. Even in the absence of further inorganic growth, revenues will be supported by spillover effects from the significant capacity expansion at the Colombo Port which will spur the transshipment/ shipping agency business. Recovery in the domestic economy and evolution of Sri Lanka as a regional freight & logistics hub will further catalyze topline growth. HAYL's transport & logistics revenue and PBT has a positive correlation with both sea and air freight rates, container handling of Colombo Port and the overall the local economy (i.e nominal GDP). As majority of the revenue is in dollar terms, exchange rate fluctuations also notably influence the earnings of the cluster (see Table 6.2 and Chart 6.3).

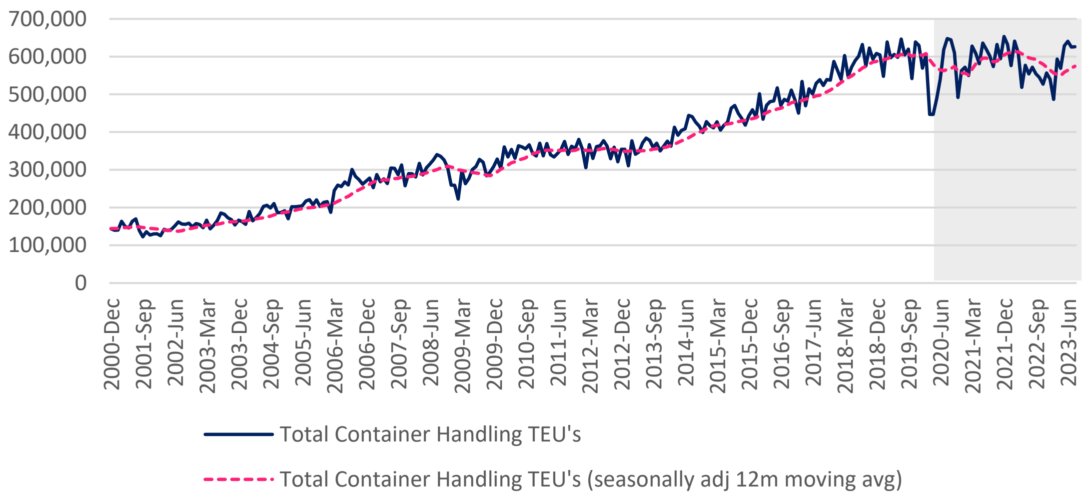
Chart 6.3: HAYL Transport & Logistics Revenue Growth (2007-23)



Source: Bloomberg

Transhipment volumes are recovering after a slump during the pandemic and the economic crisis

Chart 6.4: Colombo Port Container Handling



Container Handling Volumes

Container throughput at the Colombo Port experienced a slump in 2022 with the onset of the economic crisis as shippers diverted transshipment cargo to alternate ports to avoid potential disruptions in Colombo. However, container volumes since mid 2023 are showing a recovering trend.

We expect that HAYL's transport & logistics cluster will see revenues returning to a growth trajectory as economic conditions stabilize in Sri Lanka enabling domestic and transshipment volumes to recover.

Colombo is a Regional Transshipment Hub

Colombo Port is the busiest port in the Indian Subcontinent, ranking as the 26th largest port in the world based on container handling volumes and having an annual capacity of c. 7.5 Mn to 8.5 Mn TEUs.

Colombo is the primary transshipment port in South Asia, with 85% of container throughput comprising transshipment volumes, primarily to/ from India and Bangladesh. It's estimated that c. 60% - 70% of the transshipment volumes are from the Indian market. Transshipment volumes through Colombo have shown growth at a historical CAGR of >9% over the past 15 years and is expected to accelerate in the coming years with the ongoing development of the West Container Terminal ("WCT") by Adani Ports led Consortium and the East Container Terminal ("ECT") by the SLPA.

India's Growth will Generate Sufficient Container Traffic

The main driver of transshipment traffic is the significant economic growth trajectories in South Asian economies led by India. Although Colombo Port will face competition from other hub ports in the Middle East and South-East Asia, as well as new ports in India, its expected that volumes will exceed the available and currently planned capacity. In 2021, Colombo Port handled its all-time highest volume of 7.25 million TEUs in the calendar year, a YoY growth of almost 6% over 2020.

Colombo Port Consolidating its Lead over South Asian Ports

Compared to other countries in the region, the Port of Colombo in Sri Lanka has the highest share (26%) of South Asia's total capacity expansion from 2021 to 2026. The greenfield projects at Chittagong, with a share of 16%, are expected to add 1.8 Mn TEU by 2026, followed by Jawaharlal Nehru Port Trust with a share of 13%.

Table 6.3: Port-wise Share of South Asia Port Capacity Expansion

Port	Container Throughput (TEU Mn)	Global Rank	Share of Planned Capacity Expansion in South Asia
Colombo	6.9	25	26%
Chittagong	3.2	-	16%
Mumbai / JNPT	5.9	27	13%
Visakhapatnam	-	-.	7%
Vizhinjam	-	-	7%
Mundra	6.5	26	n.a.

Source: SLPA

Short-Term to Long-Term Growth Plans

With infrastructure upgrade plans in place, Colombo Port plans to increase its container handling capacity to 15 Mn TEUs by 2025/26. The existing capacity at Colombo Port of c. 8.5 Mn TEU will be augment by an additional 6 million TEUs through the WCT and ECT terminals which are under construction. The new terminals will have a depth of 20 meters, and quay cranes of 26 boxes across reach. A further 10 Mn TEUs will be added in the North Port project which will bring the total capacity of the Colombo Port to 24 Mn TEUs by 2040.

Evolving Beyond a Transshipment Hub

Sri Lanka intends to leverage its strategic location to evolve into a fully fledged logistics hub, moving beyond container transshipment by facilitating a plethora of related businesses, especially freeport and multi country consolidation ("MCC") activities. The country also has the potential as a ship repair and maintenance hub providing both dry dock and afloat ship repair services. Maritime arbitration and bunkering are other potential verticals. All these factors indicate that transport & logistics will remain as a cornerstone of the Sri Lankan economy going forward.

Source: SLPA

Current & Planned Capacity

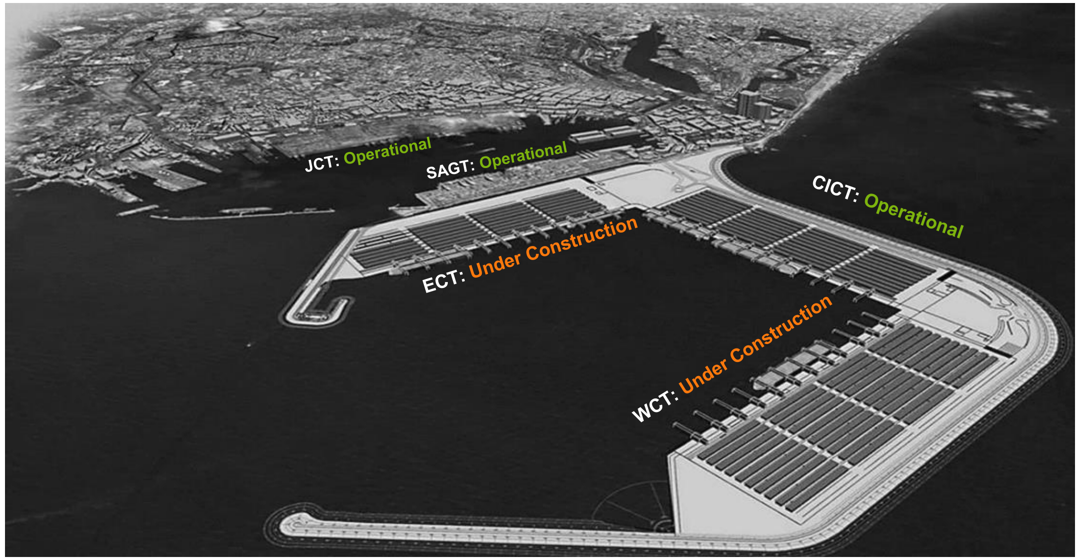


Table 6.4: Colombo Port Container Terminals

	Colombo International Container Terminal ("CICT")	South Asia Gateway Terminal ("SAGT")	Jaya Container Terminal/Unity Terminal	Under Construction	
				East Container Terminal	West Container Terminal
Capacity TEUs	***2.4 Mn***	***2.0 Mn***	***4.0 Mn***	***3.0 Mn***	**3.2 Mn**
No. of container berths	*4*	*3*	*6*	*4*	**4**
Berth Depth	*18 m*	*15m*	*15m*	*20m*	*20m*
Quay Length	*1,200m*	*940m*	*1,300m*	*1,320m*	*1,400m*

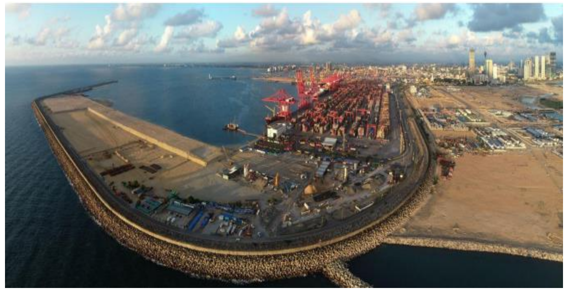
**ECT - Second phase expected completion in 2024*
**WCT - Completion in 2025/26*

Capacity Expansion in Progress

WCT : Status as of Nov. 2022

WCT : Status as of May 2023

WTC : Status as of June 2023



Bunkering windfall transient; however, HAYL commands significant market share in shipping agency business

Table 6.5: HAYL & Listed Peer Shipping Agency Principals

	Advantis		JKH	Aitken Spence	Hemas Holdings
Global Shipping Line Affiliations	COSCO SHIPPING	CMA CGM	MAERSK	Hapag-Lloyd	EVERGREEN
Global Ranking	4	3	2	5	6
Global volumes *(container carrying capacity, TEUs)*	2.8 million	3.4 million	4.1 million	1.7 million	1.6 million
Global Market Share	10.70%	12.80%	15.20%	6.90%	6.10%

Hayleys Advantis has a strong foothold in the domestic shipping agency business through its main principals, COSCO Shipping and CMA CGM who have a combined market share of c. 24% of the global container trade. CMA CGM and COSCO are ranked as third and fourth largest shipping lines in the world respectively. The global market share of the shipping lines represented by Advantis surpass that of HAYL's listed peers on the CSE who also have an exposure to the transport & logistics sector. This positions Advantis to capture a greater share of the shipping agency related business from the growing container handling throughput at the Colombo Port.

Bunkering Services

Sri Lanka's bunkering industry is consolidated with the presence of several large players. Significant players in the market include Lanka Marine Services (part of JKH), Lanka IOC PLC (LIOC), Sinopec, Interocean Energy (McLarens Group) and Hayleys Advantis.

The industry confers a significant advantage to large vertically integrated oil companies/ refiners who can procure bunker fuel either at more competitive prices or leveraging their global purchasing power/ market share to procure supplies on longer term contracts. Reported figures for 2022 suggests that bunkering oil capacity in Sri Lanka was around c.37,000 MT pm. Recent reports suggest that with more activity by Sinopec leveraging its tank farm at the Hambantota Port to grow the wholesale and retail bunkering business, the monthly volumes may have increased to c. 62,500 MT. Whilst the availability of bunker fuel at competitive prices with the entry of oil majors such as Sinopec will help to grow the overall market as more vessels call at Sri Lankan ports for their bunker requirements, the business affords little opportunity for product differentiation or lasting competitive advantages for retailers.

In the longer term, the bunkering market is expected to continue to grow spurred by higher ship arrivals to Sri Lankan ports as well as the efforts of wholesale and retail bunkering suppliers to grow the market. In this regard, the entry of more oil retailers to the Sri Lankan market as part of the overall liberalization of the petroleum sector bodes well for the overall industry to position Sri Lanka as a competitive location for bunkering supplies.

Sri Lanka Shipping Company

Sri Lanka Shipping Company

HAYL acquired Sri Lanka Shipping Company Ltd ("SSC") in August 2017 for a consideration of LKR 4.9 Bn. SSC is a company with a track record of over six decades and having expertise in ship-owning and maritime operations and services. The acquisition of SSC enabled HAYL to emerge as the largest fleet owner/ operator in Sri Lanka offering the broadest range of maritime operations & logistics services, which sets HAYL apart from its listed peers that have an exposure to the transport & logistics space. HAYL/ SSC currently operates a fleet of c. 21 sea-going vessels.

The following services are provided by HAYL/ SSC with many of the service offerings in maritime operations vertical being unique differentiators between HAYL and its domestic peers in the listed space. The broad range of services provided by HAYL/ SSC places the group in the most competitive position to capitalize on growth in Sri Lanka's ports, maritime operations and logistics sectors.

Freight & Logistics	Maritime Operations	Maritime Services
Customs House Agents	Salvage & Towage	Shipping Agency Services
Bonded & Entrepot Trade	Port Operations	Ship Husbandry Services
Inland Transportation	SPMB Operations	Maritime Security Services
Sea/ Air Freight	Offshore Transfers	Launch Services
Project/ Bulk Cargo Logistics	Vessel Chartering	Bulk Cargo Bagging
Warehousing/ 3PL	Technical Management	
	Crew Placement	

Revenue Drivers in Freight & Logistics	Revenue Drivers in Maritime Operation	Revenue Drivers in Maritime Services
Domestic Economic Growth	Ship Arrivals & Port Activity in Sri Lanka/ Region	Transhipment & Domestic Container Volume Growth
MCC/ Regional Hub Operations in Sri Lanka		Ship Arrivals & Port Activity in Sri Lanka/ Region

= services provided solely or primarily by HAYL amongst listed peers

ACUITY

A joint venture of DFCC Bank and HNB

Largest fleet owner/ operator in Sri Lanka and a leading contender in maritime operations

Tugboats & Offshore service vessels

Offshore Support Vessels ("OSV") are specially designed vessels for multiple logistical purposes offshore. They can support platform, anchor handling, construction, and maintenance. OSV's transport supplies, materials, and people from land to offshore rigs and ships.

Tugboats are specifically designed to assist other vessels into and out of ports. Their primary purpose is to help move larger ships by towing, pushing, and guiding vessels toward the port. Tugs also act as salvage boats when required.

SSC is equipped with a fleet of offshore service vessels and tugboats to fulfill all their clients' requirements for marine operations. Three of the vessels are Anchor Handling Tugs ("AHT").

Vigo

Maha Wawe

Hercules

Aries

Off Port Limit Vessels

Off Port Limit ("OPL") vessels are specifically made to offer a dependable and secure support system for marine vessels within their anchorage area or close to shore. Their primary purpose is to deliver essential supplies, and spare parts, and facilitate crew changes. SSC is the owner of two OPL vessels, which include utility boats and motor launch boats, that are utilized to provide offshore services to anchored vessels.

Dora Express

Galle Express

Shanya II

Ships

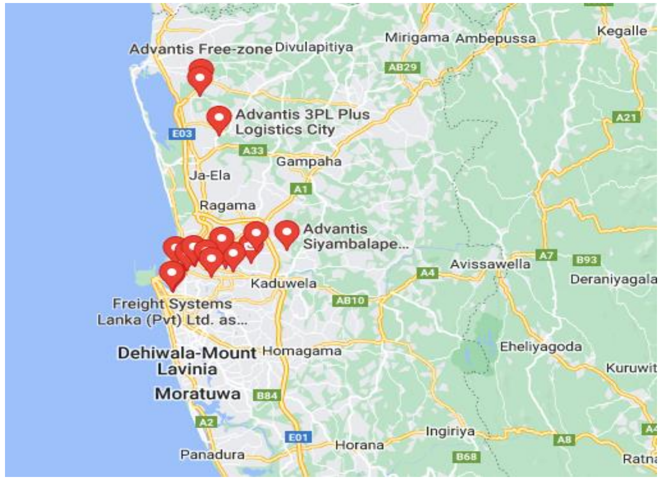
SSC owns two cargo ships, which are available on charter to clients. SSC's fleet consists of two such vessels: a self-loading Cement Carrier and an Oil Tanker.

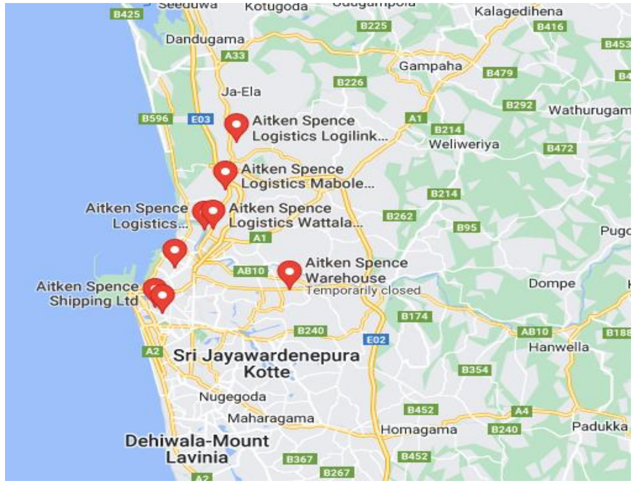
Mahanuwara

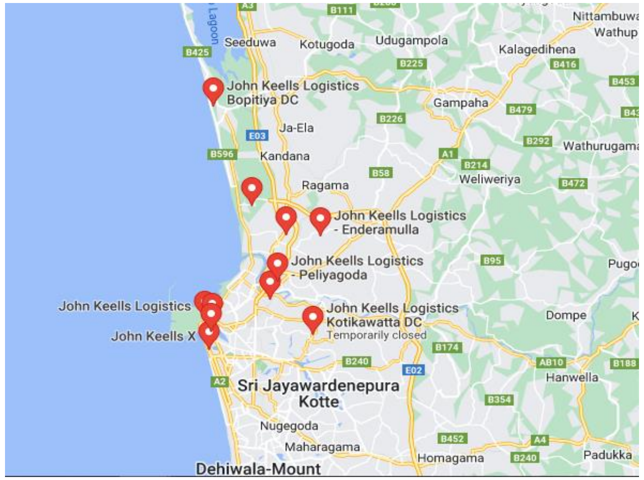
Taurus

Largest footprint to support 3PL, integrated logistics and MCC activities

	Advantis	SPEN	JKH







Advantis Logistics City (ALC) is housed in Ekala, the largest Warehouse complex in the country.

Main logistics complex in Mabole, Wattala. 100,000 Sq ft Container Freight Station for expansion of export consolidation & 3PL service offering.

260,000 square feet facility, the island's 3rd largest warehouse located at an industrial zone in Kerawalapitiya.

	Advantis	SPEN	JKH
Warehouse Locations	• **450,000Sq.Ft. at 3PL+ Advantis Logistic City. Ekala.** • **900,000 Sq.Ft. of storage space in multiple locations in Sri Lanka (including space in Katunayake FTZ).**	**Warehousing complexes in Wattala, Mabole, Welisara, Colombo and Katunayake.**	**Seeduwa, Peliyagoda, Enderamulla, Seedawatta, Awissawella, Wattala, Mabola, Kerawal Pitiya, Bopitiya, Thudella, Ekala, Kotikawatta, Rajagiriya**
Total Warehousing Space	**3,500,000 Sq.Ft.**	**500,000 Sq.Ft**	**520,000 Sq.Ft.**

MCC activities a future growth lever that could piggyback India's rise to propel Sri Lanka as a logistics hub

REUTERS

Sri Lanka starts building $700 Mn port project funded by India's Adani

COLOMBO, Nov 9 (Reuters) - Sri Lanka's largest port began on Wednesday construction of a $700 million terminal project, partly funded by India's Adani Group, an official said, marking the first foray by an Indian company into the sector.

economynext

China Merchants, Sri Lanka's Access to build US$392mn logistics hub

ECONOMYNEXT – China Merchants Port Holdings said it is teaming up with Sri Lanka's Access Engineering and Colombo Port to set up a 392-million-dollar logistics center as a build-operate-transfer project.

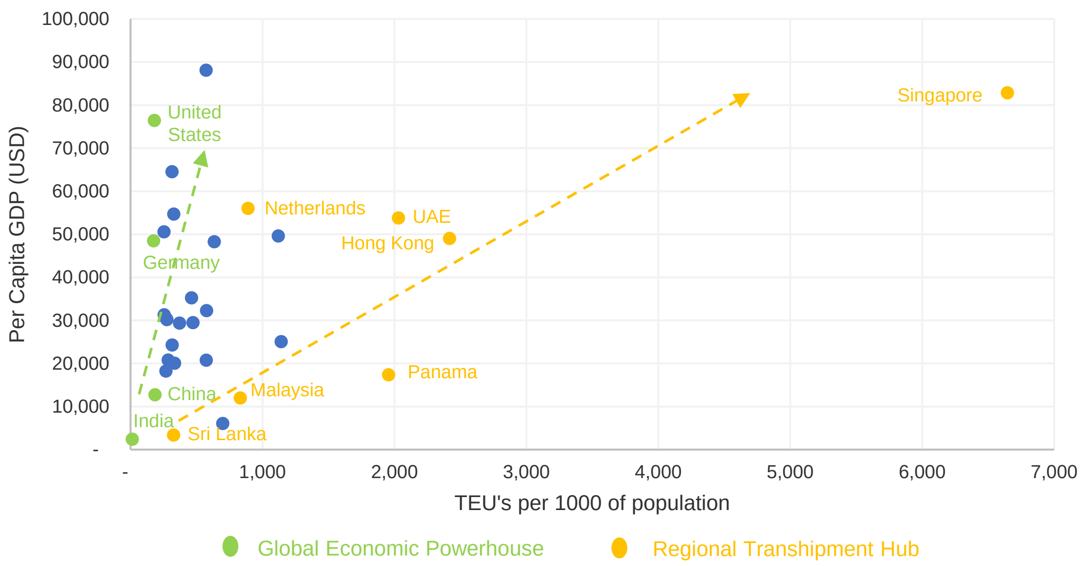
Daily FT Be Empowered

KERRY LOGISTICS

Asia's logistics leader Kerry expanding operations in SL

"Sri Lanka is a very good hub for logistics, and we see great potential for expansion. At present, we are looking for land to build a 100,000-plus square feet warehouse to cater to the growing demand. The new facility will complement part of our existing warehousing business," Yip told the Daily FT in an interview.

Chart 6.5: Shipping Hubs, Port Volumes and Per Capita GDP



In the longer term, India's rise as a global manufacturing hub and economic powerhouse will allow Sri Lanka to consolidate and grow its status as a regional shipping & logistics hub serving the Indian subcontinent. Historically, the emergence of global economic powerhouses in other parts of the world led to outsized growth in their respective regional transhipment hubs (i.e. Netherlands in relation to the EU, Singapore, Hong Kong & Malysia serving China/ SE Asian and the UAE for the ME Asian region). Although the high-income levels of such transhipment hubs are not solely related to shipping related activities, the ports & logistics sectors are nevertheless critically important for the economies of those countries. How well Sri Lanka capitalises on its strategic location will depend on how effectively the country integrates with India and global supply chains to leverage the country's core competency as a regional hub to diversify into other value-added manufacturing and services activities.

Whilst we've had FDI into Sri Lanka's port terminals in the past, in the last year we've seen significant proposed FDI into the multi country consolidation ("MCC") and export-oriented logistics sectors which could act as a catalyst to accelerate the growth of the country as a regional shipping & logistics hub.

HAYL transport & logistics sector: story behind the numbers

Key performance indicator	Assumption			
	Base year	Years 1 – 5 (FY24 – FY28)	Beyond 5 years	Link to story
Revenue	USD 134.3 Mn (FY23)	8.8% (4yr CAGR)	4.0%	Segment is expected to grow at a CAGR of 8.8% over the next four years (FY24 – FY28), primarily driven by growth anticipated in integrated logistics and freight SBUs.
Operating margin	11.9% / 8.3% (FY23 / Q1 FY24)	8.3% - 9.3%	9.4%	Segment reported a substantially higher operating margin of 11.9% in FY23 attributable to one-off income earned from marine and freight SBUs. However, the margin is expected to revert to pre-COVID level (8% - 9%) during the forecast years.
Tax rate	30.0%	30.0 %	30.0 %	Currently applicable 30.0% (revised) corporate tax rate is expected to continue over the forecast period.
Reinvestment (CAPEX as a % of sales)	2.5%	1.3% - 1.7%	1.7%	1.3% – 1.7% of the sales is expected to be incurred as CAPEX, over the period of next five years, to be in line with the revenue growth expected over the same period. Also, additional CAPEX of 1.7% (of sales) is predicted for the terminal year and beyond.
Cost of capital (WACC)	17.2%	17.2%	17.2%	Assuming the (long term) risk-free rate to settle at around 15.0 % and average cost of borrowings to be around 11.2% (with D/E of 60:40 and the levered beta of 1.50), WACC assumed to be at 17.2% over the forecast period.
Exchange rate (USD / LKR)	325.00	320.00 – 415.00	420.00	On average, LKR is expected to depreciate c. 5% each year, over the next five years and expected to reach an exchange rate of (USD/LKR) 420.00 on the terminal year.

HAYL transport & logistics sector EV amounts to c. LKR 42.4 Bn

For the year ended 31-March	Actual					Forecast				
	FY2019	FY2020	FY2021	FY2022	FY2023	FY2024E	FY2025E	FY2026E	FY2027E	FY2028E
Revenue (LKR Mn)	45,345	44,344	37,692	69,273	134,295	88,396	96,820	105,388	113,940	123,767
Profit Before tax (LKR Mn)	2,408	2,456	3,218	10,873	15,008	6,576	7,228	8,494	9,329	10,781

We have estimated Hayleys Advantis's revenue to grow at a 4-year CAGR of 8.8% to achieve a topline of LKR 123.8 Bn by FY2027/28E based on the growth potential of the overall transport & logistics sector. Despite the challenges anticipated in the year ahead from global macro-economic risks and lagged effect of the economic crisis in Sri Lanka, a gradual recovery is expected over the forecast period with long-term growth rates in-line with historical norms.

FY2023/24E total revenue forecast is at LKR 88.4 Bn (-34% YoY) due to the base-effect on revenue/ earnings after significant one-off income generated in the last two years by the marine and freight segments which are normalized in the forecast period,

- Marine segment's one-off income derived from supply of fuel to domestic industries in 2023 during the height of the economic crisis and accompanying fuel shortages.
- Freight segment experienced mean reversion in freight rates (from peak rates which prevailed during the pandemic period).

Our DCF based valuation using a WACC of 17.5% and a terminal growth rate of 4% assigns an enterprise value of LKR 42.43 Bn for HAYL's transport & logistics segment.

DCF Valuation					
LKR Mn	FY2024E	FY2025E	FY2026E	FY2027E	FY2028E
EBIT	7,349	8,001	9,268	10,103	11,555
FCFF	3,671	4,197	5,060	5,646	6,451
Terminal value					52,906
Discounted FCFF (WACC @ 17.2%)	3,391	3,309	3,404	3,242	3,161
Enterprise value					42,431

HAYL transport & logistics sector forecast and WACC sensitivity

Income statement For the year ended 31-March (LKR Mn)	Actual		Forecast				
	FY2022	FY2023	FY2024E	FY2025E	FY2026E	FY2027E	FY2028E
Revenue	69,273	134,295	88,396	96,820	105,388	113,940	123,767
Revenue YoY Growth	*83.8%*	*93.9%*	*-34.2%*	*9.5%*	*8.8%*	*8.1%*	*8.6%*
Profit before tax	10,873	15,008	6,576	7,228	8,494	9,329	10,781
PBT YoY Growth	*237.9%*	*38.0%*	*-56.2%*	*9.9%*	*17.5%*	*9.8%*	*15.6%*
PBT margins	*15.7%*	*11.2%*	*7.4%*	*7.5%*	*8.1%*	*8.2%*	*8.7%*

Weighted average cost of capital	
Cost of equity (Ke)	
Risk free rate	15.0%
Market risk premium	7.0%
Levered beta	1.50
Cost of equity (Ke)	25.5%
Cost of debt (Kd)	
Average cost of borrowings	16.0%
Tax adjusted Kd	11.2%
Weighted average cost of capital (WACC)	17.2%

	WACC					
		16.2%	16.7%	17.2%	17.7%	18.2%
Terminal growth	3.0%	45,180	43,444	41,833	40,334	38,935
	3.5%	45,586	43,789	42,125	40,580	39,142
	4.0%	46,018	44,153	42,431	40,837	39,357
	4.5%	46,478	44,539	42,755	41,108	39,582
	5.0%	46,970	44,951	43,098	41,392	39,816

Table 6.6: Risk Factors that Impact our outlook on HAYL Transportation Sector

Risk Factors	Likelihood of Risks Negatively Impacting Ratings in Next 1-2 years	Negative Impact on Ratings	Positive Impact on Ratings
Global Economic/ Market Conditions	Moderate	Prolonged deterioration in global economic conditions in key markets and/ or prolonged adverse conditions impacting global freight volumes.	Sustained improvement in global economic conditions in key markets and/ or prolonged favourable conditions impacting global freight volumes.
Market Share of HAYL/ Advantis	Moderate	Sustained loss of local market share in the medium term.	Sustained gain in local market share in the medium term.
Market Share of Sri Lanka Hub Ports	Moderate	Sustained loss of market share by the Port of Colombo/ Sri Lanka as a regional shipping and logistics hub.	Sustained gain in market share by the Port of Colombo/ Sri Lanka as a regional shipping hub and logistics hub.
Revenue Growth	Moderate	Sustained decline in USD/ LKR revenue growth rates below the growth rates assumed in our forecast.	Sustained increase in USD/ LKR revenue growth rates above the growth rates assumed in our forecast.
Margins	Moderate	Prolonged margin compression from unfavourable economic/ industry conditions or company specific factors.	Sustained margin expansion from favourable economic/ industry conditions or company specific factors.
Capital Expenditure/ ROIC	Moderate	Increase in capital intensity of the business or decline in ROIC from adverse competitive forces or company specific factors.	Decrease in capital intensity of the business or increase in ROIC from favourable competitive forces or company specific factors.
Loss of Principals or Significant Customers	Low	Loss or key agencies, principals or customers which have a material impact on revenue/ earnings.	N.A.
Devaluation of Reporting Currency	Low	Sustained appreciation of the reporting currency against the functional currency of the export SBU's can lower reported revenue/ earnings and our valuations/ price targets in LKR.	Devaluation of the reporting currency against the functional currency of the export SBU's surpassing our forecast assumption of on avg. 5% p.a. can increase reported revenue/ earnings and our valuations/ price targets in LKR.
Changes to WACC	Moderate	Increase in market interest rates/ equity risk premium or beta values and accordingly the cost of capital or lower market valuation multiples can negatively impact our valuations and ratings.	Decrease in market interest rates/ equity risk premium or beta values and accordingly the cost of capital or higher market valuation multiples can positively impact our valuations and ratings.
Loss of Human Capital	Low	Sustained loss in talent/ key personnel.	N.A.
Regulatory & Taxation	Low	Adverse regulatory or taxation changes which impact the long-term viability/ competitiveness of the business.	Positive regulatory or taxation changes including further liberalisation of ports/ airports and transport related services and general improvements in the ease of doing business which favourably impact the long-term viability of the business.

ACUITY

A joint venture of DFCC Bank and HNB

October 2023
Equity Research
Sri Lanka

Other Group sectors

HAYL’s smaller business verticals contribute c. 18.2% and 24.5% to Group revenue and PBT respectively. The agriculture and eco-solutions segments are largest contributors within HAYL’s portfolio of smaller SBU’s and collective account for c. 10% of Group revenue. The outlook HAYL’s other miscellaneous sectors are mostly favourable going forward.

Miscellaneous | N/A

Agriculture and eco solutions both have a favourable industry outlook

Agriculture

Hayleys Agriculture is a leading player in the Sri Lankan agriculture industry offering a full array of agriculture-related products and services to the local and export markets.

Revenue 22/23	PBT 22/23
LKR 33.00Bn (+37%)	LKR 5.01Bn (+118%)
7% Revenue Contribution to the group	12% PBT Contribution to the group

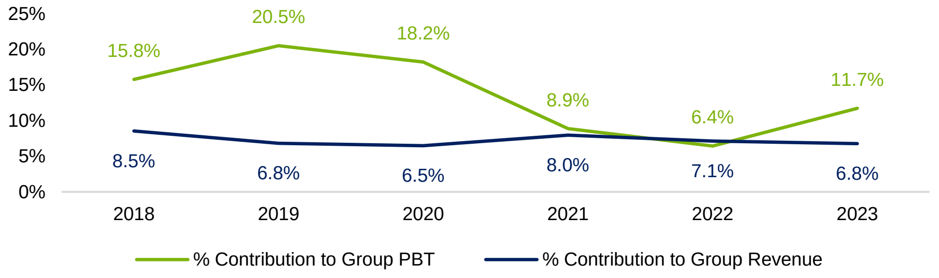
Agro Fertilizer
Contributions to sector
Revenue **29%**
PBT **43%**

Haychem (Bangladesh) Ltd
Contributions to sector
Revenue **20%**
PBT **14%**

Agro Exports
Contributions to sector
Revenue **16%**
PBT **13%**

The sectors growth prospects are boosted by increasing need for sustainable agriculture, higher food production and rapid mechanization of agriculture. The sector Is exposed to some climate/ weather related cyclicality.

Agriculture Revenue and PBT contribution to the Group



Industry Outlook: Attractive

Eco Solutions

HAYL Fibre is Sri Lanka's pioneering manufacturer of value-added coconut fibre products, sold in over 80 countries around the world with over 1,000 product varieties.

Revenue 22/23	PBT 22/23
LKR 15.22Bn (+37%)	LKR 2.66Bn (+50%)
3% Revenue Contribution to the group	6% PBT Contribution to the group

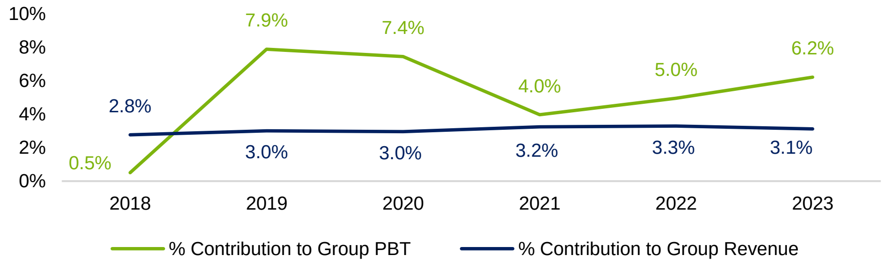
Eco Fibre
Contributions to sector
Revenue **55%**
PBT **94%**

Brush ware
Contributions to sector
Revenue **22%**
PBT **4%**

Floor Covering
Contributions to sector
Revenue **23%**
PBT **2%**

The sector is anticipated to grow on the back of increasing demand for growing media and further environmental regulations. Climate/ weather changes expected could impact negatively on the sourcing/ pricing of raw materials.

Eco Solution Revenue and PBT contribution to the Group



Industry Outlook: In-line

Hospitality segment expected to turnaround with the rapid recovery in tourism back to pre-pandemic trendline

Leisure

HAYL is a smaller player in the hospitality and wellness industry and owns/ operates resorts, wellness retreats and a collection of boutique properties in Sri Lanka and Maldives.

Revenue 22/23
LKR 6.69Bn (+96%)

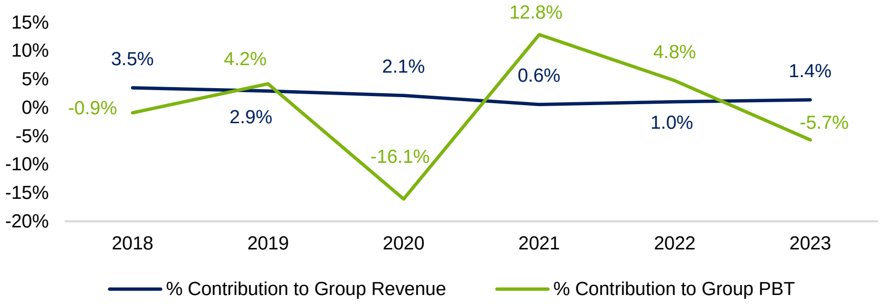
1% Revenue
Contribution to the group

PBT 22/23
LKR -2.43 Bn (-43%)

-6% PBT
Contribution to the group

The sector's property portfolio comprises of 5-owned and operated properties including a five-star city hotel in Colombo, the Kingsbury, and 5 managed properties in Sri Lanka through the Amaya Resorts chain. The segment is expected to witness a strong recovery with the growing number of tourist arrivals to the country.

Leisure Revenue and PBT contribution to the Group



Industry Outlook: Attractive

Industry Inputs

Hayleys Aventura is among Sri Lanka's leading suppliers of industrial raw materials, medical and analytical equipment and engineering solutions.

Revenue 22/23
LKR 7.39Bn (+29%)

2% Revenue
Contribution to the group

PBT 22/23
LKR 0.94Bn (+132%)

2% PBT
Contribution to the group

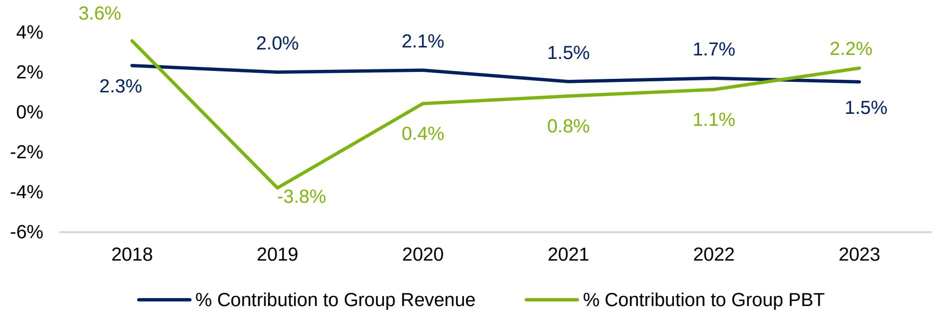
Industrial raw materials
Contributions to sector
Revenue **46%**
PBT **71%**

Lifesciences
Contributions to sector
Revenue **28%**
PBT **19%**

Engineering
Contributions to sector
Revenue **25%**
PBT **10%**

The sector is anticipated to grow on the back of a general recovery in industrial activity within the country.

Industry Inputs Revenue and PBT contribution to the Group



Industry Outlook: In-line

Construction materials sector may see subpar growth with the slow recovery in domestic construction activity

Power & Energy

Hayleys Power & Energy is a producer of renewable energy with a cumulative installed capacity of 50 MW in mini hydro, wind and solar power plants.

Revenue 22/23
LKR 1.33Bn (+3%)

0.3% Revenue
Contribution to the group

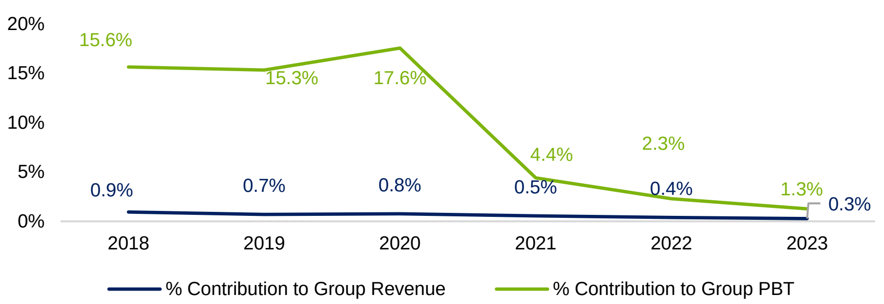
PBT 22/23
LKR 0.54Bn (-34%)

1.3% PBT
Contribution to the group

The cluster operates 6 mini hydro plants, 3 wind power plants and is one of Sri Lanka's largest embedded solar power generating plants which collectively amounts for 3% of installed capacity in the renewable sector of Sri Lanka.

Growing importance and reliance on renewable energy is expected to facilitate the continued growth of the sector. Growth opportunities are expected in coming years with the government aspirations of reaching 70% renewable energy generation by 2030.

Leisure Revenue and PBT contribution to the Group



Industry Outlook: In-line

Construction Materials

Alumex is Sri Lanka's leading manufacturer of aluminium extrusions, holding a market share of over 50%.

Revenue 22/23
LKR 10.12Bn (+6%)

2% Revenue
Contribution to the group

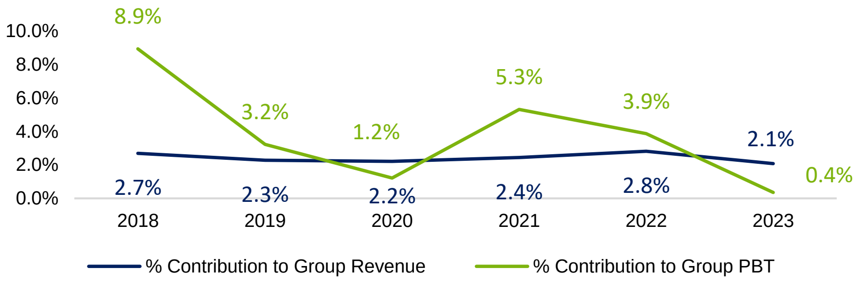
PBT 22/23
LKR 0.15Bn (-89%)

0% PBT
Contribution to the group

Operations extend across the domestic residential and industrial construction sectors and with some exports to a range of countries.

The sector is anticipated to recover following ton from government efforts to revive the construction sector, coupled with consumer demand for sustainably manufactured building products. Reduced disposable income and higher taxes since the domestic economic crisis will be an obstacle to recovery.

Construction Materials Revenue and PBT contribution to the Group



Industry Outlook: Cautious

Eco Solutions sector: story behind the numbers

Key performance indicator	Assumption			
	Base year	Years 1 – 3 (FY24 – FY26)	Beyond 3 years	Link to story
Revenue	USD 42.6 Mn (FY23)	5% (3yr CAGR)	2.0%	Segment is expected grow at a CAGR of 5.0% over the next four years (FY24 – FY26), primarily driven by growth anticipated in growing media and erosion control products.
Operating margin	16.0% / 8.2% (FY23 / Q1 FY24)	7.3% - 8.0%	9.4%	Segment reported a substantially higher operating margin of 16.0% in FY23 attributable to one-off income earned. However, the margin is expected to revert to pre-COVID level (8% - 9%) during the forecast years.
Tax rate	30.0%	30.0 %	30.0 %	Currently applicable 30.0% (revised) corporate tax rate is expected to continue over the forecast period.
Reinvestment (CAPEX as a % of sales)	3% - 4%	2.4%	2.0%	2.4% of the sales is expected to be incurred as CAPEX, over the period of next three years, to be in line with the revenue growth expected over the same period. Also, additional CAPEX of 2.0% (of sales) is predicted for the terminal year and beyond.
Cost of capital (WACC)	17.2%	17.2%	17.2%	Assuming the (long term) risk-free rate to settle at around 15.0 % and average cost of borrowings to be around 11.2% (with D/E of 60:40 and the levered beta of 1.50), WACC assumed to be at 17.2% over the forecast period.
Exchange rate (USD / LKR)	325.00	320.00 – 415.00	420.00	On average, LKR is expected to depreciate c. 5% each year, over the next five years and expected to reach an exchange rate of (USD/LKR) 420.00 on the terminal year.

Hayleys' Eco Solution segment's EV amounts to c. LKR 3.7 Bn

Income statement For the year ended 31-March	Actual			Forecast		
	FY2021	FY2022	FY2023	FY2024E	FY2025E	FY2026E
Revenue (USD Mn)	**41.6**	**54.6**	**42.6**	**44.7**	**47.0**	**49.3**
Revenue YoY Growth	*19.8%*	*31.4%*	*-22.0%*	*5.0%*	*5.0%*	*5.0%*
Revenue (LKR Mn)	**7,820**	**11,130**	**15,220**	**15,269**	**16,834**	**18,560**
Revenue YoY Growth	*26.1%*	*42.3%*	*36.7%*	*0.3%*	*10.3%*	*10.3%*
Results from operating activities / EBIT (LKR Mn)	**657**	**718**	**2,430**	**1,222**	**1,291**	**1,361**
EBIT YoY Growth	*51.0%*	*9.3%*	*238.4%*	*-49.7%*	*5.7%*	*5.5%*
EBIT margins	*8.4%*	*6.5%*	*16.0%*	*8.0%*	*7.7%*	*7.3%*

Segment reported higher revenue growth in FY2020/21 and FY2021/22 attributable to customer overstocking incurred during COVID pandemic. Performance in FY2022/23 is lower on the back of normalization of inventory levels. We have estimated the eco solution segment to gradually recover and USD revenue to grow at a 3-year CAGR (FY24 to FY26) of 5.0% to achieve a topline of USD 49.3 Mn by FY2025/26E on account of high potential for growing media and stronger external demand for erosion control products due to rising stringent environmental regulations. Our DCF based valuation using a WACC of 17.2% and a terminal growth rate of 2% assigns an enterprise value of LKR 3.7 Bn for HAYL's eco solutions segment.

DCF Valuation			
LKR Mn	**FY2024E**	**FY2025E**	**FY2026E**
EBIT	1,222	1,291	1,361
FCFF	492	503	511
Terminal value			3,704
Discounted FCFF (WACC @ 17.2%)	454	396	344
Enterprise value			3,686

Weighted average cost of capital	
Risk free rate & Market risk premium	15.0% & 7.0%
Levered beta	1.50
Cost of equity (Ke)	25.5%
Average cost of borrowings	16.0%
Tax adjusted Kd	11.2%
Weighted average cost of capital (WACC)	17.2%

		WACC				
		16.2%	16.7%	17.2%	17.7%	18.2%
Terminal growth	1.0%	4,484	4,379	4,281	4,188	4,101
	1.5%	4,186	4,087	3,995	3,908	3,827
	2.0%	3,862	3,771	3,686	3,607	3,532
	2.5%	3,510	3,428	3,352	3,281	3,214
	3.0%	3,126	3,056	2,990	2,929	2,872

Agriculture sector: story behind the numbers

Key performance indicator	Assumption			
	Base year	Years 1 – 3 (FY24 – FY26)	Beyond 3 years	Link to story
Revenue	LKR 32,988 Mn (FY23)	10.5% (3yr CAGR)	2.0%	Segment is expected grow at a CAGR of 10.5% over the next four years (FY24 – FY26), primarily driven by growth anticipated in crop protection, fertilizer and exports segment.
Operating margin	22.4% / 10.8% (FY23 / Q1 FY24)	10.0% - 10.67%	11.0%	Segment reported a substantially higher operating margin of 22.4% in FY23 attributable to one-off income earned. However, the margin is expected to revert to pre-COVID level (10.0% - 11.0%) during the forecast years.
Tax rate	30.0%	30.0 %	30.0 %	Currently applicable 30.0% (revised) corporate tax rate is expected to continue over the forecast period.
Reinvestment (CAPEX as a % of sales)	3% - 4%	0.8% - 1.0%	0.9%	0.8% - 1.0% of the sales is expected to be incurred as CAPEX, over the period of next three years, to be in line with the revenue growth expected over the same period. Also, additional CAPEX of 0.9% (of sales) is predicted for the terminal year and beyond.
Cost of capital (WACC)	17.2%	17.2%	17.2%	Assuming the (long term) risk-free rate to settle at around 15.0 % and average cost of borrowings to be around 11.2% (with D/E of 60:40 and the levered beta of 1.50), WACC assumed to be at 17.2% over the forecast period.
Exchange rate (USD / LKR)	325.00	320.00 – 415.00	420.00	On average, LKR is expected to depreciate c. 5% each year, over the next five years and expected to reach an exchange rate of (USD/LKR) 420.00 on the terminal year.

HAYL agriculture segment EV amounts to c. LKR 19.8 Bn

Income statement For the year ended 31-March	Actual			Forecast		
	FY2021	FY2022	FY2023	FY2024E	FY2025E	FY2026E
Revenue (LKR Mn)	**19,230**	**24,090**	**32,998**	**36,298**	**40,109**	**44,521**
Revenue YoY Growth	*41.4%*	*25.3%*	*37.0%*	*10.0%*	*10.5%*	*11.0%*
Results from operating activities / EBIT (LKR Mn)	**1,981**	**3,011**	**7,379**	**3,630**	**4,145**	**4,749**
EBIT YoY Growth	*28.1%*	*52.0%*	*145.1%*	*-50.8%*	*14.2%*	*14.6%*
EBIT margins	*10.3%*	*12.5%*	*22.4%*	*10.0%*	*10.3%*	*10.7%*

The diversified nature of the business coupled with a resumption in fertilizer imports in 2022 allowed HAYL's agriculture segment managed to remain resilient and report consistently LKR revenue growth over the last three years (FY2020/21 - FY2022/23), despite a multitude of challenges impacting Sri Lanka's agriculture sector, including inconsistent government policies, economic crisis and restrictions on material import bans leading to higher production costs.

We have estimated the agriculture segment's revenue to grow at a 3-year CAGR (FY24 to FY26) of 10.5% to achieve a topline of LKR 44.5 Bn by FY2025/26E on account of rising food production needs, adoption of more sustainable forms of agriculture and growing demand for agricultural machinery and equipment. Our DCF based valuation using a WACC of 17.2% and a terminal growth rate of 2% assigns an enterprise value of LKR 19.75 Bn for HAYL's agriculture segment.

DCF Valuation			
LKR Mn	FY2024E	FY2025E	FY2026E
EBIT	3,630	4,145	4,749
FCFF	2,241	2,555	2,923
Terminal value			20,356
Discounted FCFF (WACC @ 17.2%)	2,070	2,014	1,967
Enterprise value			19,747

Weighted average cost of capital	
Risk free rate & Market risk premium	15.0% & 7.0%
Levered beta	1.50
Cost of equity (Ke)	25.5%
Average cost of borrowings	16.0%
Tax adjusted Kd	11.2%
Weighted average cost of capital (WACC)	17.2%

		WACC				
		16.2%	16.7%	17.2%	17.7%	18.2%
Terminal growth	1.0%	21,679	21,147	20,649	20,184	19,747
	1.5%	21,196	20,680	20,198	19,747	19,324
	2.0%	20,713	20,214	19,747	19,310	18,900
	2.5%	20,230	19,747	19,296	18,873	18,477
	3.0%	19,747	19,280	18,845	18,437	18,054

Glossary of terms

ALC	Advantis Logistics City
AHT	Anchor Handling Tugs
Avg.	Average
AWPLR	Average Weighted Prime Lending Rate
BDIY	Baltic Exchange Dry Index
BPS/bps	Basis Points
Bn	Billion
BOD	Board of Directors
CAPEX	Capital Expenditure
CIL	Carbon-In-Leach
CIP	Carbon-In-Pulp
CBSL	Central Bank of Sri Lanka
CEO	Chief Executive Officer
c.	approximately
CCPI	Colombo Consumer Price Index
CICT	Colombo International Container Terminal
CSE	Colombo Stock Exchange
CRB	Commodity Research Bureau
CAGR	Compound Annual Growth Rate
Cf.	Compare with
CIT	Corporate Income Tax
COGS	Cost of Goods Sold
CMP	Current Market Price
D/E	Debt-to-equity
DCF	Discounted Cash Flow
DPS	Dividend Per Share
DAF AR Index	Drewry Air Freight Index
EBIT	Earnings Before Interest and Taxes
EBITDA	Earnings Before Interest, Taxes, Depreciation and Amortization
EPS	Earnings Per Share
ECT	East Container Terminal
EV	Enterprise Value
Env.	Environment
ESG	Environment, Social, Governance
EU	European Union
FY	Financial Year
FDI	Foreign Direct Investment
FCF	Free Cash Flow
FCFF	Free Cash Flow to Firm
FTZ	Free Trade Zone
GSA	General Sales Agent
GFC	Global Financial Crisis
GHG	Greenhouse Gas
GDP	Gross Domestic Product
GP	Gross Profit
GP Margin	Gross Profit Margin
HP	Hand Protection
HR	Human Resources
IMF	International Monetary Fund
JNPT	Jawaharlal Nehru Port Trust
JCT	Jaya Container Terminal
LHS	Left Hand Side
Market Cap	Market Capitalization
MT	Metric Ton
Mn	Million
MCC	Multi Country Consolidation
NP	Net Profit
NCI	Non-controlling Interest
OPL	Off Port Limit
OSV	Offshore Support Vessels
OP	Operating Profit
OECD	Organization for Economic Co-operation and Development
p.a.	Per Annum
PER	Price-to-earnings ratio
PAT	Profit after Tax
P&L	Profit and Loss Statement
PBT	Profit before Tax
QoQ	Quarter on Quarter
REER	Real Effective Exchange Rate
RSI	Relative Strength Index
ROA	Return on Assets
ROE	Return on Equity
ROIC	Return on Invested Capital
RHS	Right Hand Side
SH	Shareholders
SME	Small and Medium Enterprises
SAGT	South Asia Gateway Terminal
Sq. Ft	Square Feet
SL	Sri Lanka
SLPA	Sri Lanka Ports Authority
SSC	Sri Lanka Shipping Company LTD
LKR	Sri Lankan Rupee
SD	Standard Deviation
SLF	Standing Lending Rate
SBU	Strategic Business Unit/s
SOTP	Sum of the Parts Valuation
FED	The Federal Reserve System of the United States
3PL	Third-Party Logistics
TTM	Trailing Twelve Months
TEU	Twenty-Foot Equivalent Unit
UAE	United Arab Emirates
UK	United Kingdom
US	United States
USD	United States Dollar
WACC	Weighted Average Cost of Capital
WCT	West Container Terminal
WCIDCOMP Index	World Container Index
YoY	Year on Year
YTD	Year to Date

ACUITY
A joint venture of DFCC Bank and HNB

ACUITY Stockbrokers (Pvt) Ltd., (Company Reg: No-P.V.3310)
'ACUITY House', No. 53, Dharmapala Mw,
Colombo 03, Sri Lanka.
TEL: (+94) 112 206 206 I FAX: (+94) 112 206 298

Research Team

Shehan Cooray
(+94) 112 206 256
shehan@acuitystockbrokers.com

Arun Sarweswaran
(+94) 112 206 251
arun@acuitystockbrokers.com

Isuri Thakshala
(+94) 112 206 254
isuri@acuitystockbrokers.com

Dhanuka Gunarathna
(+94) 112 206 253
dhanuka@acuitystockbrokers.com

Poorni Abeykoon
(+94) 112 206 253
poorni@acuitystockbrokers.com

Sales Team

Prashan Fernando
(+94) 112 206 222
prashan@acuitystockbrokers.com
(+94) 77 225 0609

Kapila Pathirage
(+94) 112 206 227/228
kapila.p@acuitystockbrokers.com
(+94) 77 766 0131

Naren Godamunne
(+94) 112 206 225
naren@acuitystockbrokers.com
(+94) 77 225 0603

Dhammika Wanniarachchi
(+94) 112 206 229
dhammika.w@acuitystockbrokers.com
(+94) 77 106 3754

Mohandas Thangarajah
(+94) 112 206 207
mohandas@acuitystockbrokers.com
(+94) 77 257 6430

Kumar Dias Desinghe
(+94) 814 474 443
kumar@acuitystockbrokers.com
(+94) 77 780 1713

Susil Fernando
(+94) 112 206 234
susil@acuitystockbrokers.com
(+94) 77 243 2110

Auburn Senn
(+94) 112 206 239
auburn@acuitystockbrokers.com
(+94) 71 494 3304

S. Vasanthakumar
(+94) 112 206 250/251
vasantha.k@acuitystockbrokers.com
(+94) 77 361 3285

Prasanna Semasinghe
(+94) 814 474 443
prasanna@acuitystockbrokers.com
(+94) 77 361 3284

Warana Sumanasena
(+94) 112 206 231
warana@acuitystockbrokers.com
(+94) 71 955 3617

Dinuk Subasinghe
(+94) 112 206 237
dinuk@acuitystockbrokers.com
(+94) 77 587 7878

Danuksha Koralage
(+94) 112 206 233
danuksha@acuitystockbrokers.com
(+94) 77 728 1221

Buddhenia Narangoda
(+94) 112 206 248
buddhenia@acuitystockbrokers.com
(+94) 77 745 3640

Thushintha Hettige
(+94) 112 206 232
thushintha@acuitystockbrokers.com
(+94) 78 102 5871

Dushan Senanayaka
(+94) 112 206 236
dushan@acuitystockbrokers.com
(+94) 76 551 1456

Rusdi Abdeen
(+94) 112 206 230
rusdi@acuitystockbrokers.com
(+94) 77 744 1672

ACUITY Stockbrokers (Pvt) Ltd., (Company Reg: No-P.V.3310)
'ACUITY House', No. 53, Dharmapala Mw,
Colombo 03, Sri Lanka.
TEL: (+94) 112 206 206 I FAX: (+94) 112 206 298

Disclaimer:

"Distributed in Sri Lanka and abroad by Acuity Stockbrokers (Private) Limited (ASB) and its authorized representatives. ASB is fully owned by Acuity Partners (Pvt) Ltd (APL) and APL is a joint venture of DFCC Bank and Hatton National Bank PLC. The Information contained herein has been compiled from sources that ASB ("The Research Institution") believes to be reliable but None of the Research Institution holds itself responsible for its completeness or accuracy. It is not an offer to sell or a solicitation of an offer to buy any securities. The Research Institution and its affiliates and its officers and employees may or may not have a position in or with respect to the securities mentioned herein.

The Research Institution and its affiliates may from time to time have consulting relationship with any company, which is being reported upon. This may involve the Research Institution providing significant corporate finance services or acting as the company's official or sponsoring broker.

All opinions and estimates included in this report constitute judgment as of this date of the Research Institution and are subject to change or amendment without notice. The Research Institution has the copyright for this report and the views herein cannot be reproduced and/or distributed in any form without the explicit (written or otherwise) permission from Research Institution.