

Haycarb PLC (HAYC.N)

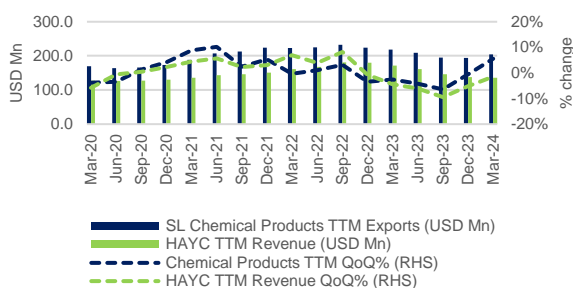
Research Note

June 2024

Negative revenue growth in USD basis bottoming out

Historically, HAYC's revenue in USD terms is highly correlated (correlation coefficient of 0.88) with Sri Lankan exports of chemical products (refer Chart 1a and Annex 1). For the quarter ending March 2024, both HAYC's USD equivalent revenue on a trailing 12M basis and Sri Lankan exports of chemical products showed signs of bottoming out indicating a potential recovery ahead. HAYC's 12M trailing USD equivalent revenue in Q4 FY2023/24 (FY24) came in at c. USD 136 Mn, representing a contraction of -2% sequentially cf. trailing revenues of c. USD 138 Mn in Q3 FY24. However, the sequential quarterly revenue contraction is lower than the -5% decline reported in Q3 FY24, indicating a potential bottoming out in HAYC's revenues in USD basis. HAYC's full year revenue for FY2023/24 was slightly above our last forecast of c. USD 130 Mn for full year FY24E, representing a YoY revenue contraction of -20% in USD terms.

Chart 1a: HAYC TTM \$ Revenue and Chemical Product Exports



LKR currency volatility is a challenge

Despite stabilizing revenues, HAYC faces headwinds in the current year from adverse currency movements as the LKR appreciated c. 9% YoY in FY24 against the USD (HAYC's functional currency) against our expectations of relative stability in the exchange at the time of our last price target in October 2023. We expect the reporting currency to remain stronger against the functional currency in FY25E (avg LKR/USD rate of LKR 310/- for the year) cf. an average LKR/USD rate of LKR 316/- in FY24. The adverse impact on forward earnings from the appreciation of the reporting currency is offset by stronger margins and lower net financial costs enabled by continued strong free cash flow generation.

Table 1a: Quarterly Financial Summary

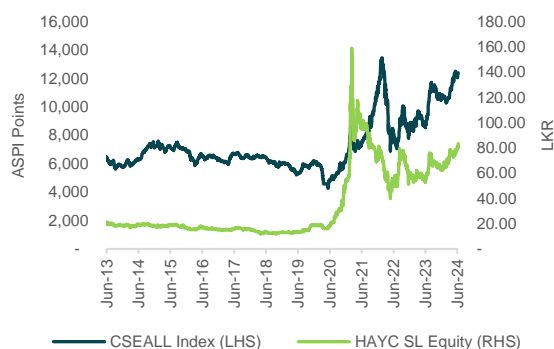
In LKR Mn	4Q 2022/23	1Q 2023/24	2Q 2023/24	3Q 2023/24	4Q 2023/24	QoQ %	YoY %
Revenue	12,850	10,215	11,391	10,701	10,872	1.60%	-15.39%
Gross profit	3,054	2,815	3,168	3,543	3,743	5.65%	22.55%
Gross profit margin (%)	23.77%	27.56%	27.81%	33.11%	34.43%	132 bps	1066 bps
EBIT / Operating profit	1,241	1,288	1,445	1,942	1,847	-4.90%	48.76%
Operating profit margin (%)	9.66%	12.60%	12.68%	18.15%	16.99%	-116 bps	733 bps
Finance cost	688	568	240	395	588	48.73%	-14.50%
Profit attributable to Shareholders	821	631	959	1,280	874	-31.74%	6.43%
Net profit margin (%)	6.39%	6.18%	8.42%	11.96%	8.04%	-393 bps	165 bps
Diluted EPS (LKR)	2.76	2.12	3.23	4.31	2.94	-31.79%	6.52%
TTM EPS (LKR)	19.60	11.99	11.18	12.42	12.60	1.45%	-35.71%
DPS (LKR)	1.00	1.00	2.00	2.00	1.00	-50.00%	0.00%

Source: Annual and interim reports, Bloomberg

CMP as of 13 June 2024 (LKR)	82.10
Bloomberg Ticker	HAYC SL Equity
Market Cap (LKR Bn) USD (Mn)	24 80
No. of Shares (Mn)	297.1
Estimated Free Float	31.22%
ADT (LKR Mn USD k) - 3M	8.77 28.87
ADT (volume) - 3M	114,756
52 week High /Low (LKR)	81.5 54.4
Industry and Year End	Materials 31 Mar
Beta and Sharpe Ratio	0.4 -0.02

Rating Summary/ Change		
Rating as of	Revised (14-Jun-24)	Last (12-Oct-23)
Rating	Buy	Buy
12M Target price (LKR)	95.00	81.82
Potential upside (%)	16%	20%
FY25E DPS (LKR)	6.00	2.00
Total return (%)	23%	22%
Industry view: Materials	In-Line	In-Line

Chart 1b: Share Price of HAYC vs ASPI

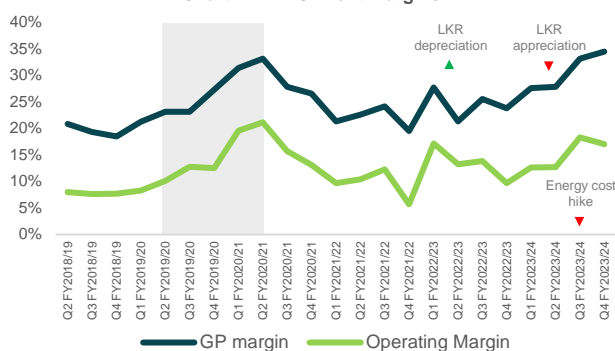


Therefore, we believe that FY25E recurring earnings could come in higher than our earlier expectations, notwithstanding the negative currency impact.

Table 1b: Cumulative YTD Financial Summary

In LKR Mn	FY2022/23	FY2023/24	YoY %
Revenue	60,943	43,179	-29.15%
Gross Profit	14,879	13,269	-10.82%
Gross Profit Margin (%)	24.41%	30.73%	632 bps
EBIT / Operating Profit	8,274	6,521	-21.19%
Operating Profit Margin (%)	13.58%	15.10%	153 bps
Finance cost	3,411	1,792	-47.46%
Net Profit	5,823	3,744	-35.71%
Net Profit Margin (%)	9.56%	8.67%	-88 bps
Diluted EPS (LKR)	19.60	12.60	-35.71%
TTM EPS (LKR)	19.60	12.60	-35.71%
DPS (LKR)	5.65	6.00	6.19%

Chart 2: HAYC Profit Margins



	FY24	10yr Avg	SD	SD of FY24
GP Margin	30.7%	24.3%	3.7%	1.7
EBIT Margin	15.1%	11.2%	3.3%	1.2

Stronger than expected margins expected to revert to mean in the medium term

Notable improvement was observed in gross margins in FY24 (at 30.7%) cf. FY23 (24.4%), despite higher energy and other costs during the period under review. HAYC has historically maintained gross margins at >20% with a lower sensitivity to changes in external variables. We believe that the current margin strength, which is likely driven by both favorable input costs and robust demand from selected customer segments such as gold extraction, could further catalyze higher earnings in FY25E, notwithstanding headwinds such as unfavorable exchange rate movements. It can be observed that historically HAYC's margins have shown higher sensitivity to external demand (i.e during the pandemic boom) and less sensitivity to other exogenous factors such as movements in the reporting currency and higher local energy prices (refer Chart 2). HAYC reported a significant reduction in finance cost (-47% YoY) in the backdrop of reducing market interest rates and strong free cash flow generation resulting in lower financial leverage and cash accumulation.

We expect that gross margin expansion notwithstanding overall softer global demand was enabled by both favorable raw material prices, changing sales mix to higher margin products and pricing power as HAYC builds on the competitive advantages from its track record of innovation, multi-country manufacturing footprint and leveraging ESG as a strategic differentiator. However, we expect that currently elevated gross margins (c. 1.7 standard deviations off the historical mean) maybe transitory and expect some reversion to mean over the next few years. Elevated gross margins coupled with strong cost controls/ favorable impact of appreciation of the reporting currency on USD denominated costs supported EBIT margin expansion of c. 150 bps for FY24 notwithstanding the negative impact of revenue contraction.

Table 2: Estimate Revisions

In LKR Mn	FY23 – A	FY24 – A	% Δ	FY24E – O	FY24 – A	% Δ2	FY25E – O	FY25E – R	% Δ3
Revenue	60,943	43,179	-29.15%	44,462	43,179	-2.89%	51,260	43,344	-15.44%
EBIT	8,274	6,521	-21.19%	5,202	6,521	25.36%	6,228	6,285	0.91%
EBIT margin (%)	13.60%	15.10%	150 bps	11.70%	15.10%	340 bps	12.20%	14.50%	230 bps
PAT	6,505	4,306	-33.81%	2,921	4,306	47.40%	3,869	4,555	17.74%
PAT margin (%)	10.70%	9.97%	(-73 bps)	6.60%	9.97%	337 bps	7.50%	10.51%	301 bps
Recurring Net Profit	5,823	3,744	-35.70%	2,615	3,744	43.17%	3,463	3,961	14.38%
Recurring EPS (LKR)	19.60	12.60	-35.71%	8.80	12.60	43.18%	11.66	13.33	14.33%
DPS (LKR)	5.65	6.00	6.19%	2.00	6.00	200.00%	3.00	6.00	100.00%

O – Original estimate, R – Revised estimate, A – Actual

Source: Annual and interim reports, Bloomberg

Chart 3a: TTM Revenue

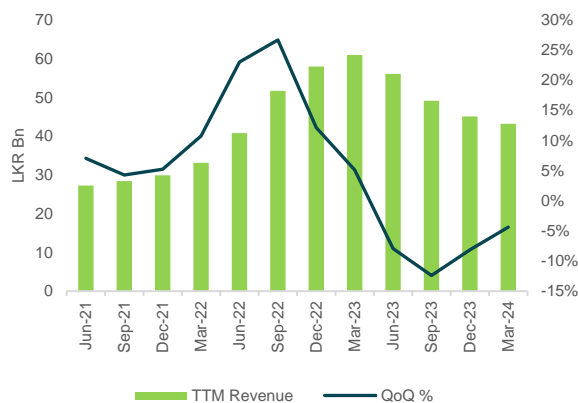


Chart 3b: TTM EBIT

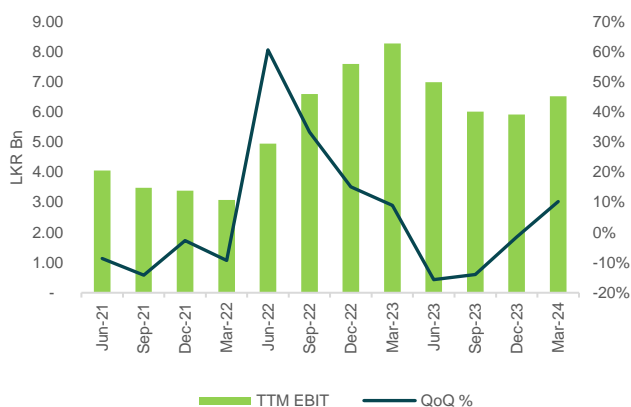


Chart 3c: Quarterly EPS

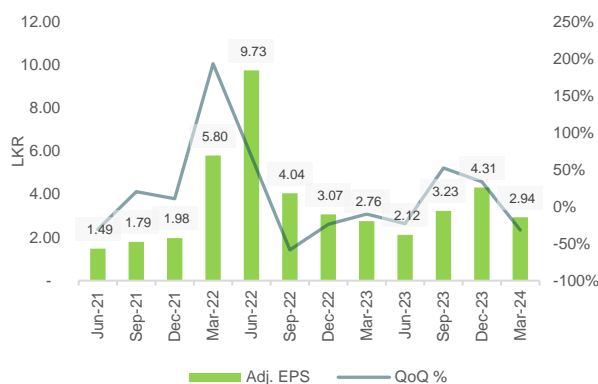


Chart 3d: TTM DPS



Our primary valuation assumptions include USD revenue growth reverting to a CAGR of c. 6% in FY2026E through FY2030E and depreciation of the reporting currency to avg 5% p.a. over the same period. We expect GP and EBIT margins to revert to slightly above historical mean over the next 3 years. We expect capex to average a little over LKR 2 Bn per annum

over the next five years and increase to over LKR 6 Bn per annum in the five years thereafter as the current expansion projects scale up to capacity. We assume the effective tax rate to be below marginal tax rate on account of capital allowances and lower tax rates applicable on HAYC's foreign operations.

Table 3: Financial Summary and Key Forecast Assumptions

For the year ended 31-March	Actual					Forecast	
	FY2020	FY2021	FY2022	FY2023	FY2024	FY2025E	FY2026E
Revenue (USD Mn)	127.32	135.18	157.3	169.21	136.4	139.8	148.2
USD Revenue Growth (%)	3.00%	6.17%	16.36%	7.57%	-19.39%	2.50%	6.00%
EBIT (LKR Mn)	2,502	4,436	3,079	8,274	6,521	6,285	6,191
EBIT Margin (%)	10.96%	17.41%	9.29%	13.58%	15.10%	14.50%	12.83%
Effective Tax Rate	18.83%	20.57%	20.08%	21.22%	29.57%	26.70%	26.70%
Capital Expenditure (LKR Mn)	692	1,052	1,678	1,907	2,205	1,645	1,719
Sales to Capital (X)	0.81	1.41	2.78	2.25	-4.71	2.85	2.85
Exchange Rate (LKR/ USD)	179.2	186.5	199.3	325.7	316.5	310.0	325.5
Investor Ratios							
Earnings per Share (LKR)	5.25	10.25	11.06	19.60	12.60	13.33	13.24
Earnings per Share Growth (%)	63.27%	95.24%	7.90%	77.22%	-35.71%	5.80%	-0.72%
Gross Dividend per Share (LKR)	1.50	3.70	2.80	5.65	6.00	6.00	6.00
Net Book Value per Share (LKR)	31.40	45.10	60.80	74.52	77.09	84.42	91.66
Market Price per Share (LKR) *	16.00	93.00	50.20	56.30	68.10	82.10	82.10

Source: Annual and interim reports, Bloomberg

Table 4: Valuation Summary

DCF Valuation						Original estimate (12-Oct-23)
LKR Mn	FY2025E	FY2026E	FY2027E	FY2028E	FY2029E	
EBIT	6,285	6,191	6,443	7,171	7,982	
FCFF	2,962	2,819	2,810	3,128	3,481	
PV of Terminal Value					23,387	21,784
Discounted FCFF (WACC @ 11.4%)	2,658	2,270	2,030	2,028	2,025	
Enterprise Value/ Sum of PV					34,398	36,133
Net Debt					-1,844	1,082
Equity Value					36,242	35,051
Equity Value (net of NCI)					33,449	31,980
# of shares (Mn)					297	297
DCF based Intrinsic Value (LKR)					112.58	107.63
12M Target Price based on probable (historical / estimated) PER (7.0x) on estimated TTM EPS of LKR 13.33 in Mar 2025					95.00	81.82
CMP as of 13 June 2024 (LKR)					82.10	69.00
Potential Upside / (downside) to 12M Target Price					16%	20%

HAYC share price has adjusted upwards to our last price target set in October 2023.

Fundamentally sound business with solid medium term growth prospects from HAYC's dominant position within a global addressable market growing at c. 4-8% p.a. in USD terms coupled with our quantitative valuations underpins our price target change. Management confidence in HAYC as evidenced by substantial insider buying and growing dividend are sources of additional confidence. See Table 6: Risk Factors for

potential risks that might negatively impact our ratings and/ or price targets for HAYC in short to medium term.

In the longer term HAYC's valuations will be primarily driven by its revenue growth potential, sustainability of its margins, ability to innovate and commercialize new activated carbon applications and capital efficiency of the business as the Company deploys additional funds for capacity expansion to support volume growth and R&D to innovate new products.

Chart 4: HAYC Share Price & 12M Target Price



Chart 5: HAYC Net Insider Buying

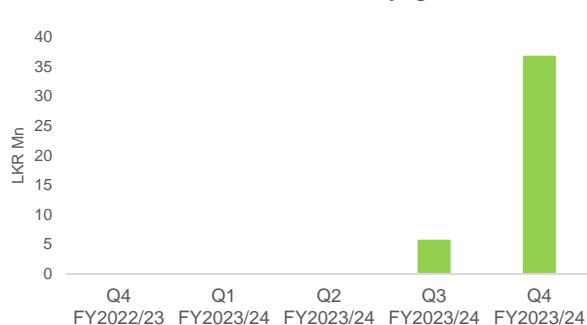


Table 5: Summarized P&L Forecast

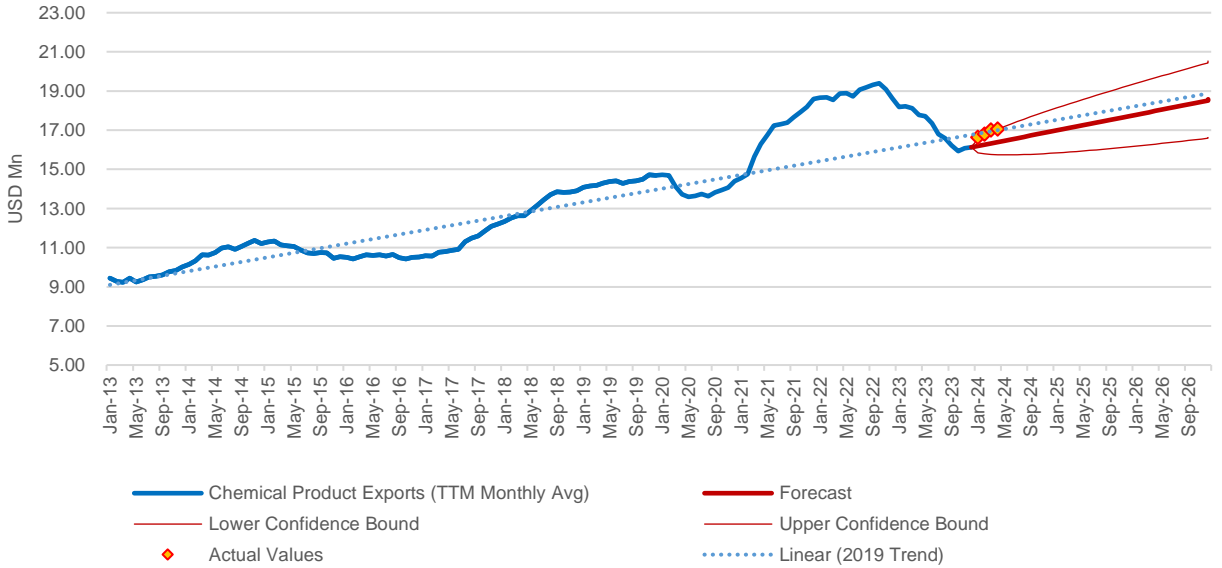
For the year ended 31-March in LKR Mn	Actual					Forecast	
	FY2020	FY2021	FY2022	FY2023	FY2024	FY2025E	FY2026E
Revenue	22,823	25,485	33,160	60,943	43,179	43,344	48,242
COGS	(17,433)	(17,948)	(25,943)	(46,064)	(29,910)	(29,908)	(34,734)
Gross Profit	5,390	7,537	7,218	14,879	13,269	13,437	13,508
EBIT	2,502	4,436	3,079	8,274	6,521	6,285	6,191
Net Interest Cost	(323)	49	1,598	(19)	(399)	(-73)	(-23)
PBT	1,853	4,539	6,254	8,239	5,714	6,215	6,170
Tax	(410)	(924)	(935)	(1,753)	(1,808)	(1,659)	(1,647)
Recurring Net Profit	1,559	3,047	3,288	5,823	3,744	3,961	3,933
Earnings per share (LKR)	5.25	10.25	11.06	19.60	12.60	13.33	13.24
Dividends per share (LKR)	1.50	3.70	2.80	5.65	6.00	6.00	6.00
Dividend Yield (%)	9.38%	3.98%	5.58%	10.04%	8.81%	7.31%	7.31%
Price / Earnings Ratio (X) *	3.05	9.07	4.54	2.87	5.40	6.16	6.20
Price / Book Value (X) *	0.51	2.06	0.83	0.76	0.88	0.97	0.90
Return on Equity (%)	16.72%	22.73%	17.90%	25.80%	16.35%	15.79%	14.44%

* For historical period ratio / price is based on FY end price and forecast period ratio is based on CMP as of 13th June 2024.

Table 6: Risk Factors

Risk Factors	Likelihood of Negative Impact on 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 can lower reported revenue/ earnings and our valuations/ price targets in LKR.	Devaluation of the reporting currency against the functional currency 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.

Annex 1: Sri Lanka Chemical Products Exports & Forecast Fan Chart



Source: CBSL, Acuity Research

Sri Lanka exports of chemical products (which includes the HS codes for activated carbons) show a pickup in exports values. YTD export values are at the higher end of the confidence band based on our fan chart of chemical products exports generated as at end 2023. Historically, chemical products export values have closely followed the long-term trendline excluding the temporary surge in exports associated with the covid pandemic and excess stocking by foreign buyers.

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