FC Research

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SRI LANKA

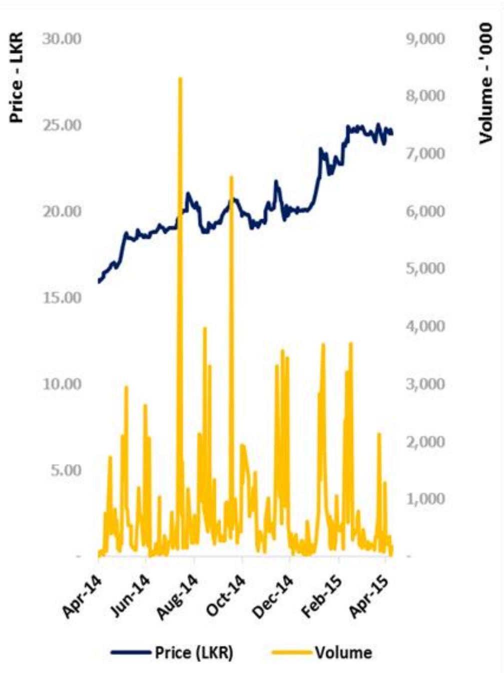
Initiating Coverage

TEXTURED JERSEY LANKA PLC — BUY

TJL.N0000 | **Current Price: LKR 26.9** | **Fair Value: LKR 33.0** | **Apr 2015**

KEY DATA			
Share Price (LKR)			**26.90**
52w High/Low (LKR)			25.60/16.70
Average Daily Volume (Shares)			752,644
Average Daily Turnover (LKR)			15,604,005
Issued Share Capital (Shares mn)			
Market Capitalisation (LKR mn)			16,255
Price Performance (%)	**1mth**	**3mths**	**12mths**
TJL	-3%	14%	51%
ASPI	-6%	-7%	14%
Major Shareholders as at 31st Dec 2014			
Pacific Textured Jersey Holdings Limited			39.65%
Brandix Lanka Ltd-#1 A/c Ltd			29.81%
Mr. Y.S.H.I.Silva			2.88%
Melstacorp Limited			1.91%
Deutsche Bank Ag Singapore-DSS A/C Navis Yield			1.68%
Estimated Free Float			**30.17%**

Figure 1: TJL Price Volume Graph



Source: CSE

Disclaimer on Shareholding:

First Capital Holdings does not hold positions in TJL except for 178,698 shares in First Capital Limited. First Capital has not taken any positions in TJL in the 3 trading days prior this report while it does not envisage taking positions in this share for the succeeding 7 trading days to this report.

"A Fashionable Boom"

P/E 31 March	FY13	FY14	FY15E	FY16E	FY17E
Revenue (LKR Mn)	10,951	12,725	13,507	16,735	20,512
Net Profit (LKR Mn)	**1,016**	**1,153**	**1,255**	**1,667**	**1,870**
EPS (LKR)	1.6	1.8	1.9	2.5	2.9
YoY Growth %	62%	13%	9%	33%	12%
Valuations					
PER	**15.8**	**13.9**	**12.8**	**9.6**	**8.6**
PBV	2.8	2.5	2.3	2.1	1.8
Dividend Yield (%)	4%	4%	4%	6%	7%
NAVPS	8.8	9.7	10.6	11.9	13.3
DPS (LKR)	1.0	1.1	1.1	1.5	1.7
Payout Ratio	66%	61%	55%	61%	60%

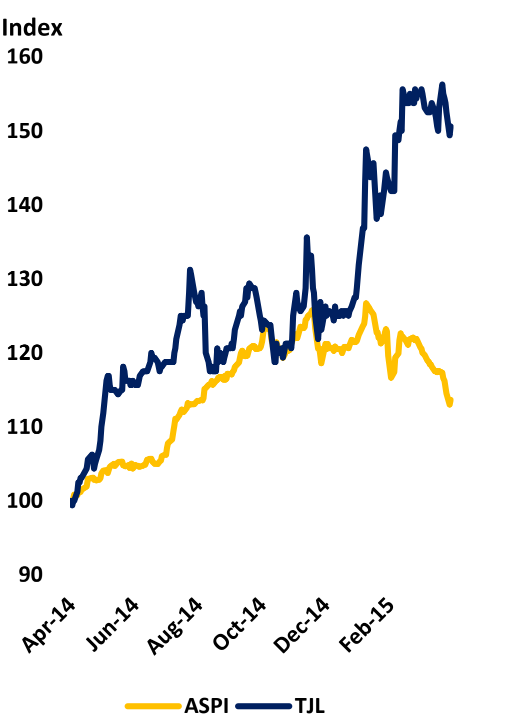
TJL, the market leader in weft knit manufacturing is expected to generate an earnings CAGR of 17% in FY15E-17E despite the expiry of the tax holidays in September 2016. TJL's likely acquisition is expected to boost volumes by 40% by FY17E while its expected cost savings and synergies would enhance gross margins to 14% by FY17E. TJL Fair Value stands at LKR 33.0 on a 1 year period converting to a total return of 28%. BUY

- **Volume Growth of 40% by FY17E:** TJL production volumes are likely to grow at a CAGR of 12% in FY15E-17E. We expect the bulk of the growth to come through the acquisition of Ocean India which is expected to be completed by FY17E thus increasing the production volume of TJL. At present TJL outsources its excess production capacity to Ocean India and Quenby Lanka.

- **Margins to Grow to 14% by FY17E:** TJL's Gross Profit margins are likely to improve to 14% by FY17E from 11.5% in FY14. Company's multi fuel boiler which is yet to operate in its full capacity is expected to reach fully operational level by 1QFY16. TJL would also enjoy enhanced value additions through its investment in Quenby Lanka which contributes through its rotary screen and digital printing facilities. TJL's investments in modernization resulting in cost efficiency coupled with the synergistic effect derived through acquiring Ocean India and Quenby Lanka would have a positive effect on the company's margins.

- **TJL to generate 1 Year Return of 28%:** We believe TJL earnings are likely to grow by 30% in FY16E to LKR 1.6bn. Our fair value for TJL is at LKR 33.0 (average of discounted cash flow based value of LKR 38.0 and PER based price of LKR 27.4) resulting a capital gain of 23% and dividend yield of 5%.

Figure 2: ASPI vs TJL



Source: FC Research

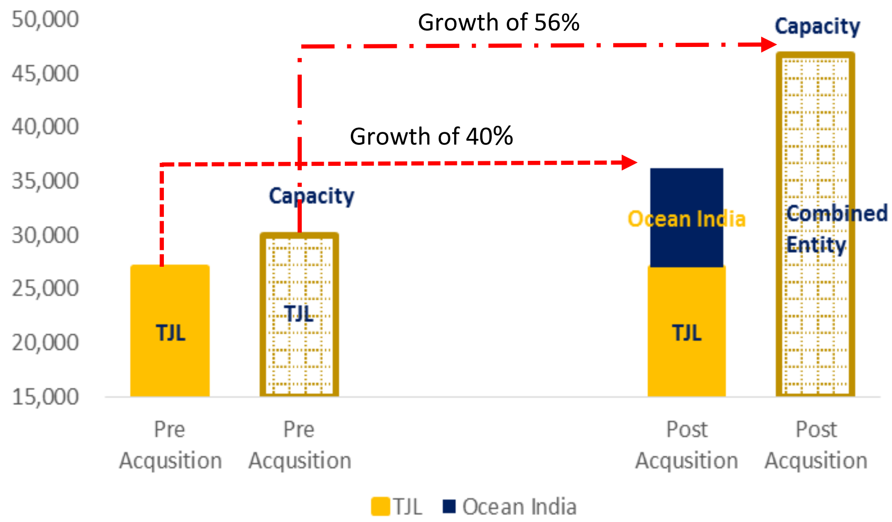
1.0 Introduction

Regaining GSP+: Currently, Sri Lanka being the seventh largest garment exporter, country's Government's continued effort to regain GSP+, granting access to the European Union with lower or no duty which would boost the revenue streams as well as enhancing the bottom line in apparel sector.

Increasing Share Price: Subsequent to the Government's continued effort in regaining GSP+, share price of TJL has been experiencing an upward movement.

2.0 Volume Growth of 40% by FY17E

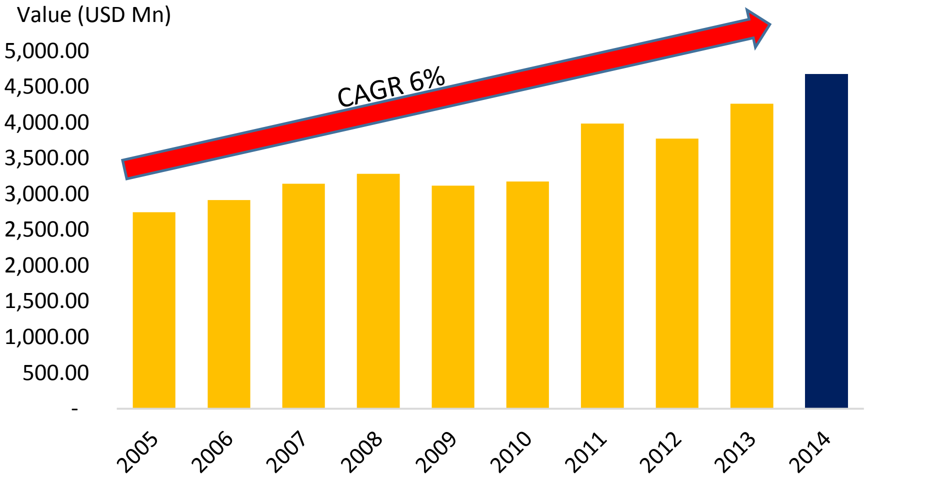
Figure 3: Contribution towards Volume – Pre and Post Acquisition



Sources: FC Research

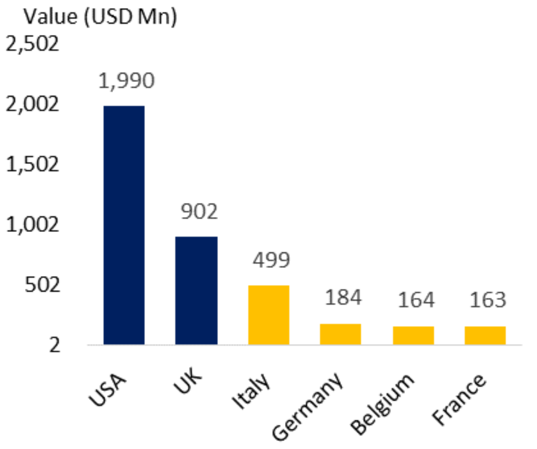
We expect a 40% contribution to the total volumes over a 3 year period leading to a 12% CAGR in FY15E-17E deriving from the likely completion of the acquisition of Ocean India. Further, we are in the view that the acquisition shall be completed in the latter part of the 1HFY16 thus the benefit of the acquisition shall emanate only in the 2HFY16. Being on a conservative note, we expect the volume contribution in the FY16E to be 20% of the total volume while a 40% growth is expected in FY17E.

Figure 4: Export Performance – Apparel Sector



Sources: Sri Lanka Export Development Board

Figure 5: Major Markets – Apparel Sector - 2014



Sources: Sri Lanka Export Development Board

2.1 Invest in Modernization of Existing Machinery: Company invested in modernization of TJL plant enabling a capacity increase of 10-12% allowing for volume growth in FY15E and FY16E. Increased orders have resulted in capacity utlilisation being maintained at 90% supporting the volume growth at present.

2.2 Demand Back on Track: With the demand from the USA back on the track and demand from Europe slowly but steadily picking up, TJL is well poised to achieve a 24% YoY growth in revenue, generating LKR 1.6bn in its top line in FY16E. We believe that the growth momentum would be further improved by the increased demand derived from the likely development of new brands of the existing clientele which would be met by the two new additions to the TJL umbrella.

3.0 Margins to Grow to 14% by FY17E

TJL's continued focus on cost efficiency and higher volume addition is likely to grow GP margins to 14% by FY17E. The multi fuel boiler and modernization of machinery reduces cost contribution while the two new acquisitions may bring economies of scale and increased value additions.

Figure 6: GP Margin

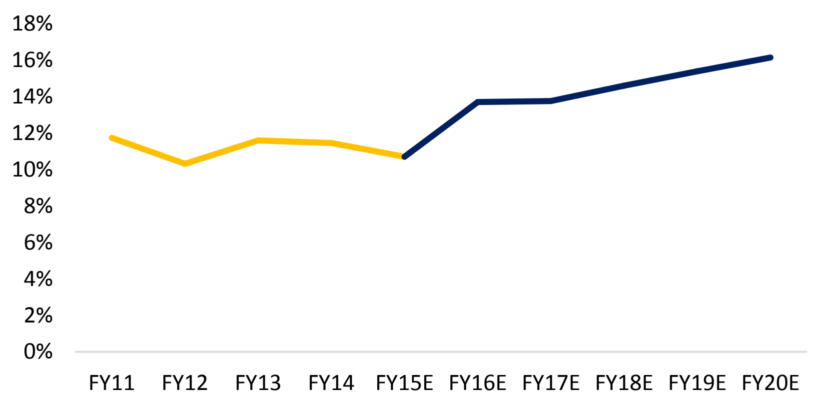
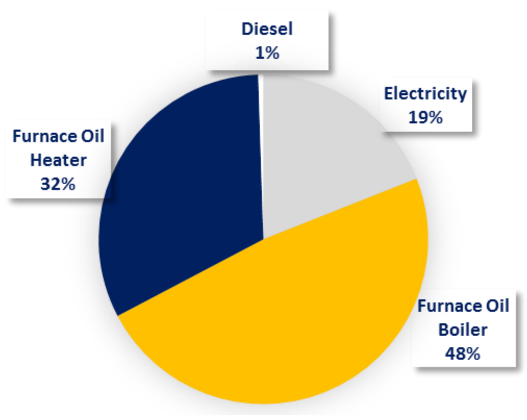


Figure 7: Energy Sources

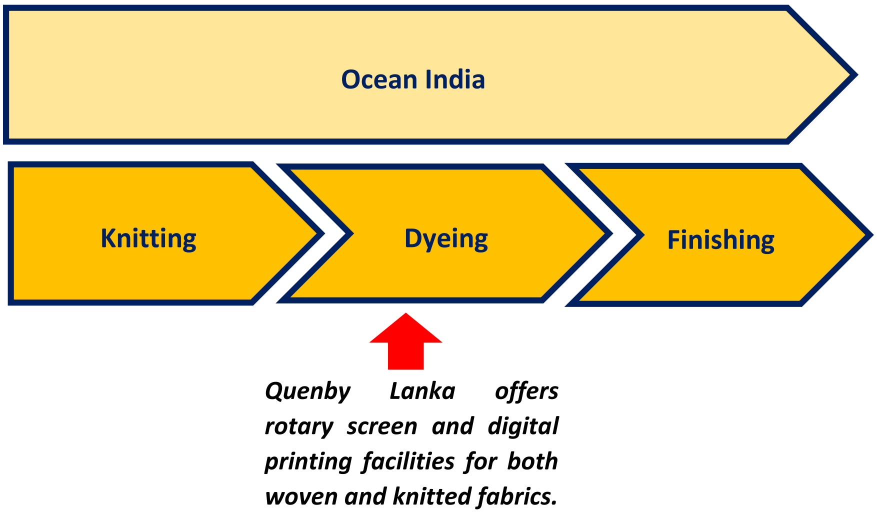


3.1 Multi Fuel Boiler reaching envisaged efficiency levels: We expect the energy cost of the company which accounts for 10% of the total revenue and 11% of the cost of sales to reduce to 9% of the cost of sales by FY16E. Multi fuel boiler and power plant which successfully completed the testing process during the FY15 is expected to reach the optimal levels in the near future which would enable the company to reduce the dependency on the national power grid and furnace oil by generating the total steam requirement, generation of 1MW of electricity power and reduce the energy required for air conditioning through heat absorption technology.

3.2 More Focused Cost Management: With the modernization of the existing TJL plant, efficiency of its machinery is expected to increase while reducing costs via lower consumption of dye, chemical and water, as well as process time. We expect a gross margin of 14% in FY17E which would further improve to 16% in FY20E compared to 11% in the FY14 while EBIT margin is expected to be 14% in FY17E from 11% in FY14.

3.3 Greater Presence in the Value Chain: With the horizontal integration of the acquisition of Ocean India and vertical integration with the acquisition of Quenby Lanka would enable a greater presence in the value chain for TJL. Thus TJL would be in a better position to benefit from the economies of scale deriving from the horizontal integration and to manage costs efficiently. These cost efficacies in the value chain would further enhance the cost savings leading to the thinning of the cost of sales to 86% and 84% in FY17E in FY20E from 89% in FY14. With the value additions derived from Quenby Lanka we believe that TJL would improve the product quality at a comparatively lower cost.

Figure 8: Value Chain of TJL



3.4 Quenby Lanka: Quenby is a key member of the textile manufacturing chain, linking the fabric mill and the garment manufacturer, which provides rotary screen and digital printing facilities for both woven and knitted fabrics. With a production capacity of 500,000 meters a month along with the innovativeness, speed and flexibility Quenby successfully passes on the cost advantages and quality to its customers. On a conservative note, we expect capacity utilization of Ocean India to reach 58% level in FY17E, a 3% growth from the previous year and to gradually improve the capacity utilization to reach 67% in FY20E.

4.0 TJL to Generate 1 Year Total Return of 28%

P/E 31 March	FY13	FY14	FY15E	FY16E	FY17E
Revenue (LKR Mn)	10,951	12,725	13,507	15,588	20,512
Net Profit (LKR Mn)	**1,016**	**1,153**	**1,255**	**1,631**	**1,846**
EPS (LKR)	1.6	1.8	1.9	2.5	2.8
YoY Growth %	62%	13%	9%	30%	13%
Valuations					
PER	**15.8**	**13.9**	**12.8**	**9.8**	**8.7**
PBV	2.8	2.5	2.3	2.1	1.9
Dividend Yield (%)	4%	4%	4%	6%	7%
NAVPS	8.8	9.7	10.6	11.8	13.2
DPS (LKR)	1.0	1.1	1.1	1.4	1.7
Payout Ratio	66%	61%	55%	58%	61%

TJL Value at LKR 33.0: We believe TJL earnings to grow to LKR 1.6bn registering a growth of 30% in FY16E backed by the improved volumes and synergistic effects derived from the acquisition of Ocean India and Quenby Lanka.

4.1 Discounted Cash flow Valuation

COE (K_e)	
R_f	8%
R_m	14%
β	1.40
$K_e=R_f+\beta(R_m-R_f)$	**16%**

Valuations	*FY16E*
Enterprise Value	23,605
Debt (-)	-
Cash (+)	1,243
Total Value of Equity	24,848
No. of Shares	655
Value of Equty per Share	**37.94**

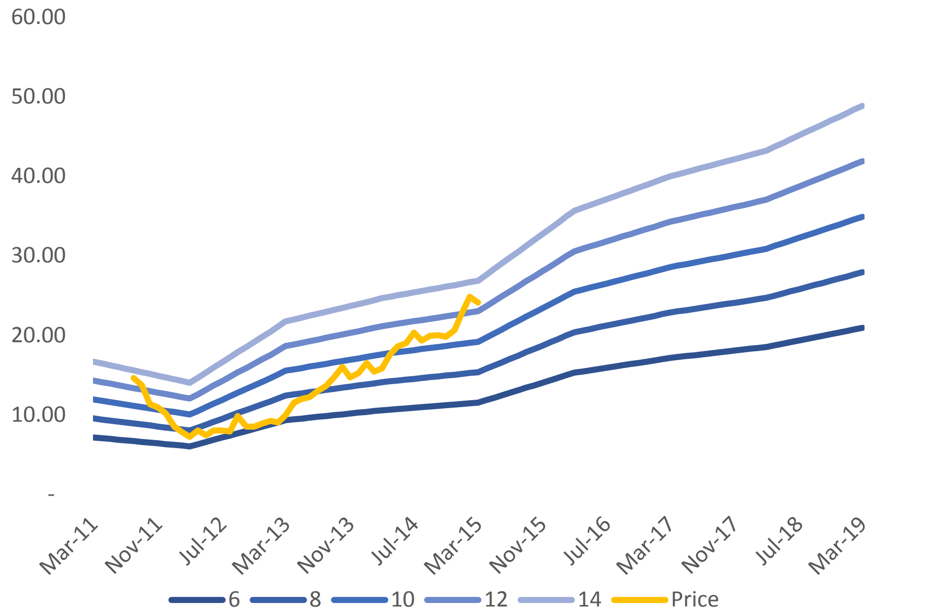
WACC	
K_e	16%
K_d	8%
D/E Assumption	40 / 60
Terminal Growth (%)	3%
WACC	**13%**

		WACC					
		11%	**12%**	**13%**	**14%**	**15%**	**16%**
Terminal Growth (%)	**1%**	40	36	33	31	28	27
	2%	43	39	35	32	30	28
	3%	47	42	38	35	32	29
	4%	53	46	41	37	34	31
	5%	60	52	45	40	36	33

4.2 Average PER of 11.0 times

PER based Valuation	
FY16E Earnings (LKR 'Mn)	1,631
No. of Shares ('Mn)	655
FY16E EPS	2.49
Expected Average PER	11.00
Price at 11.0x FY16E Earn	27.39

Figure 9: PE Band Graph



Source: FC Research

Considering the higher PE at which the TJL has been traded in the past on average we expect TJL to trade at a PER of 11.0x on FY16E earnings, above the average PE of the manufacturing sector.

4.3 Fair Value of LKR 33.0 and total return of 28%

Expeceted TJL Price for FY16E	
DCF Valuations based Target Price	37.94
PER based Target Price	27.39
Average Target Price	32.66

Return	
Target Price	33.00
Current Price	26.9
Capital Gain (LKR)	6.10
Dividend FY16E (LKR)	1.45
Capital Gain %	23%
Dividend Yield %	5%
Total Return %	28%

Appendix 1 – Income Statement

Income Statement (LKR 'Mn) Y/E 31st March	FY13	FY14	FY15E	FY16E	FY17E
Revenue	10,951	12,725	13,507	16,735	20,512
Cost of sales	(9,682)	(11,268)	(12,062)	(14,441)	(17,690)
Gross Profit	1,270	1,456	1,445	2,293	2,822
Other income	29	16	20	-	-
Selling, Distribution & Admin expenses	(344)	(419)	(405)	(502)	(615)
Operating Profit	955	1,054	1,060	1,791	2,206
Non operating income (Consultancy Income)	-	49	103	53	-
EBIT	955	1,103	1,163	1,844	2,206
Net finance income	59	90	100	3	2
PBT	1,014	1,193	1,263	1,847	2,208
Income tax expense	2	(40)	(8)	(10)	(155)
Profit for the year	1,016	1,153	1,255	1,837	2,053
Minority Interest	-	-	-	170	183
Profit attributable to Equity Holders of the Company	1,016	1,153	1,255	1,667	1,870
EPS	1.55	1.76	1.92	2.55	2.85

Sources: Company Reports and FC Research Estimates

Appendix 2 – Balance Sheet

Balance Sheet (LKR 'Mn) As at 31st March	FY13	FY14	FY15E	FY16E	FY17E
ASSETS					
Non-current assets					
Property, plant and equipment	2,289	2,179	1,985	3,830	3,703
Capital work-in-progress	68	780	780	780	780
Intangible assets	41	57	51	463	416
Lease rentals paid in advance	93	92	92	92	92
	2,491	3,108	2,908	5,165	4,992
Current assets					
Inventories	1,795	1,925	1,983	2,334	2,860
Trade and other receivables	1,383	1,281	1,360	1,651	1,967
Cash and cash equivalents	2,197	2,122	2,828	1,213	2,010
	5,375	5,327	6,171	5,198	6,836
Total assets	**7,866**	**8,435**	**9,079**	**10,362**	**11,828**
Equity and liabilities					
Capital and reserves					
Stated capital	2,797	2,797	2,797	2,797	2,797
Exchange equalisation reserve	909	1,092	1,092	1,092	1,092
Retained earnings	2,044	2,462	3,027	3,854	4,778
Share option scheme	-	19	19	19	19
	5,750	6,371	6,936	7,762	8,687
Non-current liabilities					
Borrowings	-	-	-	-	-
Deferred tax liabilities	68	96	96	96	96
Retirement benefit obligations	55	98	98	98	98
	123	194	194	194	194
Current liabilities					
Trade and other payables	1,633	1,818	1,946	2,330	2,854
Borrowings	-	-	-	-	-
Bank overdrafts	360	52	3	76	93
	1,993	1,870	1,949	2,406	2,947
Total liabilities	2,115	2,064	2,143	2,600	3,141
Total equity and liabilities	**7,866**	**8,435**	**9,079**	**10,362**	**11,828**

Sources: Company Reports and FC Research Estimates

Appendix 3 – Cash Flow Statement

Cash Flow Statement (LKR 'Mn) As at 31st March	FY13	FY14	FY15E	FY16E	FY17E
Cash generated from operations					
Profit before tax	1,014	1,193	1,263	1,847	2,208
Adjustments for:					
Depreciation	321	316	208	239	377
Amortisation of intangible assets	31	24	6	5	46
Amortisation of leasehold lands	4	4	-	-	-
(Reversal of provision) / provision for	37	(52)	-	-	-
Reversal of provision for bad and	(19)	-	-	-	-
Reversal of previously written off ESC	(3)	(10)	-	-	-
Interest income	(79)	(87)	(101)	(10)	(10)
Interest expenses	5	-	-	7	8
Profit on disposal of property, plant	-	14	-	-	-
Share based payment	-	19	-	-	-
Exchange translation loss	-	-	-	-	-
Changes in working capital:	-	-	-	-	-
Inventories	224	(75)	(58)	(352)	(525)
Trade and other receivables	85	102	(79)	(291)	(316)
Trade and other payables	353	185	128	384	524
Provision for defined benefit obligations	16	16	-	-	-
Effect of movement in foreign exchange	(37)	107	-	-	-
Cash generated from operations	1,952	1,755	1,368	1,829	2,312
	-	-	-	-	-
Interest income received	79	87	101	10	10
Interest expenses incurred	(5)	(0)	(0)	(7)	(8)
Income Tax paid	0	0	(8)	(10)	(155)
Retirement benefit obligations paid	(14)	(4)	-	-	-
Net cash generated from operating	2,012	1,838	1,460	1,822	2,159
Cash flows from investing activities	-	-	-	-	-
Additions or expenses incurred on	(122)	(897)	-	-	-
Purchase of property, plant and	-	-	(14)	(2,083)	(250)
Purchase of intangible assets	-	-	-	(417)	-
Proceeds from sale of property, plant	-	-	-	-	-
Net cash used in investing activities	(122)	(897)	(14)	(2,500)	(250)
Cash flows from financing activities	-	-	-	-	-
Proceeds from issue of shares	-	-	-	-	-
Share issue expenses	-	-	-	-	-
Dividend paid	(668)	(707)	(690)	(1,010)	(1,129)
Repayments of borrowings	(601)	-	-	-	-
Net cash used in financing activities	(1,269)	(707)	(690)	(1,010)	(1,129)
	-	-	-	-	-
Net increase in cash and cash	621	233	755	(1,688)	780
Cash and cash equivalents at	1,216	1,837	2,070	2,825	1,137
Cash and cash equivalents at end of	1,837	2,070	2,825	1,137	1,917

Sources: Company Reports and FC Research Estimates.

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