



TEEJAY LANKA PLC

CSE: TJL.N0000

Bloomberg: TJL SL

Upgrade from HOLD to STRONG BUY

Nov 2017

Current Price – LKR 36.4

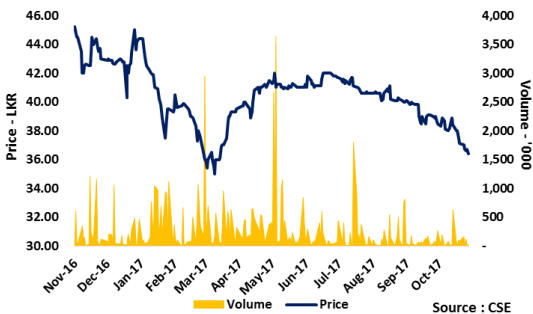
Fair Value – LKR 47.0 [FY19E]

2QFY18 Earnings ↓ 37%YoY

KEY DATA

Share Price (LKR)	36.40
52w High/Low (LKR)	47.5/35
Average Daily Volume (Shares)	265,910
Average Daily Turnover ('000)	10,702
Issued Share Capital (Shares mn)	270.5
Market Capitalisation (LKR mn)	9,848
Price Performance (%)	1 mth 3 mths 12mths
TJL	6.6% 14.8% 24.2%
ASPI	1.1% 3.0% -2.2%
Major Shareholders as at 30th Sep 2017	
Brandix Lanka Ltd-Number 1 Account	33.08%
Pacific Textured Jersey Holdings Limited	27.91%
Bnymansv Re-First State Investments lcv-Stewart Investors	7.24%
Citibank Newyork S/A Norges Bank Account 2	2.97%
HSBC Intl Nom Ltd - BBH - Fidelity Funds	2.73%
Public Holdings	38.54%

Price – Volume Chart



“Continued struggle with margins to end with stabilized cotton yarn prices”

Y/E 31 Dec	FY16	FY17	FY18E	FY19E	FY20E
Revenue (LKR Mn)	17,820	22,138	25,520	30,775	36,233
YoY % Growth	30%	24%	15%	21%	18%
Net Profit (LKR Mn)	2,171	1,959	2,015	2,769	3,366
EPS (LKR Mn)	3.1	2.8	2.9	4.0	4.8
YoY % Growth	63%	-10%	3%	37%	22%
Valuations					
PER (X)	11.7	13.0	12.6	9.2	7.6
PBV (X)	2.5	2.3	2.2	2.0	1.8
Dividend Yield (%)	4.4%	6.2%	6.1%	6.5%	7.9%
NAVPS	14.5	16.0	16.7	18.2	20.2
DPS (LKR)	1.60	2.25	2.24	2.38	2.89
Payout Ratio	51%	80%	78%	60%	60%

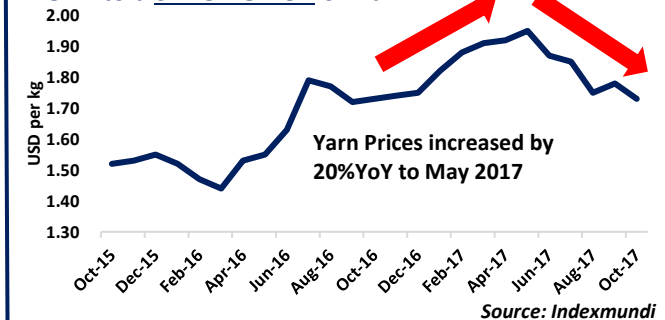
Note: Net profit figures reflect net profit attributable to owners of the parent

LKR (Mn)	2QFY18	2QFY17	YoY	2HFY18	2HFY17	YoY
Revenue	6,094	5,258	↑ 16%	11,502	10,034	↑ 15%
Gross Profit	749	881	↓ -15%	1,353	1,608	↓ -16%
EBIT	442	608	↓ -27%	744	1,042	↓ -29%
Income tax expense	(79)	(27)	↑ 189%	(151)	(72)	↓ 111%
Profit for the year	370	590	↓ -37%	590	989	↓ -40%
3QFY17 4QFY17 1QFY18 2QFY18 QoQ						
Revenue	6,348	5,795	5,408	6,094	↑ 13%	
Gross Profit	832	656	604	749	↑ 24%	
EBIT	557	371	302	442	↑ 46%	
Income tax expense	(79)	98	(72)	(79)	↑ 11%	
Profit for the year	473	494	220	370	↑ 68%	

Disclosure on Shareholding:

First Capital Group and its affiliates does not hold shares of TJL and will not trade in this share for the three trading days following the issue of this document.

FC Research maintains a **STRONG BUY** Expecting **stabilized cotton prices to favour the margins**: TJL's 2QFY18 earnings continued to get affected by the cotton yarn prices which continued to rise in the Sep quarter as well resulting in the earnings trickling down by 37%YoY to LKR 590Mn, though continuing to be in line with FC Research expectations. However, topline showed sign of encouragement as revenue grew 16%YoY in-line with expectations also support by the improved environment with the regaining of the GSP+. With cotton yarn prices stabilizing we expect GP margins to start improving from 3QFY18 onwards from this quarter's low of 12% to c.16% gradually over the next couple of quarters. We expect top line will continue its current growth trend amidst margin improvement. Thereby, FC Research maintains its current forecast in revenue and earnings for TJL over FY18E-20E. FC Research maintains its fair value for FY19E unchanged at LKR 47.0, while the price depreciation in the last 3 months have improved the overall return including dividends to 39% which allows FC Research to upgrade its recommendation from **HOLD** to a **STRONG BUY** on TJL.



ANALYST CERTIFICATIONS AND REQUIRED DISCLOSURES BEGIN ON PAGE 6



Earnings Performance

Earnings decline by 37%YoY: TJL's earnings for the 2QFY18 saw a dip of 37%YoY to register at LKR 370Mn compared to LKR 590Mn recorded in comparative period in FY17. However, on a QoQ basis earnings registered an impressive 68% growth in comparison to LKR 220Mn recorded in 1QFY18. During the 1HFY18 company's earnings registered a de-growth of 40% to record at LKR 590Mn in comparison to LKR 989Mn recorded in d1HFY17.

Increased volume and depreciating currency led to 16%YoY growth in Revenue: During the period under review TJL generated a revenue of LKR 6.1Bn registering a modest growth of 16%YoY compared to LKR 5.2Bn in 2QFY17. Expansions in India and the prevailing GSP facilities that Sri Lanka is entitled to fueled the volume growth which accounted for c.13% growth while effect of currency depreciation accounted for c.3%. On a QoQ basis topline recorded a moderate 13% improvement. During the 1HFY18 TJL's revenue registered a growth of 15%YoY to record at LKR 11.5Bn compared to LKR 10.0Bn recorded during 1HFY17.

GP margins withers amidst increased CoS: Adverse impact stemmed from raw material price hikes that were first felt in 3QFY17 have largely prevailed during the 2QFY18. During the 9 months period to September 2017 cotton yarn prices saw an increase of 16%YoY hampering the GP margins to 12% in 2QFY18 (17% in 2QFY17). For the 1HFY18, TJL's GP margins shrunk to 12% (16% in 1HFY17). Further, other factors including competitive sales pricing which prevented price hikes and the growth product mix had an adverse impact on the margins.

Investment Case

Turnaround in the consolidated entity and capacity enhancement to increase Revenue: With a total (revenue) annual capacity of USD 210Mn of which USD 110Mn being operational in Sri Lanka while Ocean India (Teejay India) with its doubled capacity (appr. USD 110Mn) is expected to come into operation from December 2017 we expect the topline to record at c.LKR 30.8Bn in FY19E with a CAGR of c.18% over FY17-FY19E.

Stabilized Raw material prices to favour the margins: Cotton prices stabilized towards the 2H2017 and continued into October. With the USA harvest currently ranks as the 5th biggest of all-time while India is projected to collect its second largest harvest on record while other exporting countries are expected to increase their cotton production, the price of cotton yarn is expected to stabilize. (World Bank forecasts cotton yarn prices to reach USD 1.87 per kg in 2018 and USD 1.9/kg in 2019).

Tax expenses to increase: TeeJay Lanka's tax holiday expiring in Sri Lanka coupled with Ocean India's tax losses are being completely utilized is expected to result in an increase in tax expenses to c.LKR 692Mn in FY19E compared to LKR 52Mn in FY17. TeeJay Lanka is subject to a tax rate of 14% at present and is expected to continue at the same rate under the new Inland Revenue Act which will be effected from April 2018.

FY19E Earnings to reach LKR 2.8Bn: Increased volumes and revenue coupled with the improved margins are expected to benefit the earnings to surpass the LKR 2Bn mark by FY18E and to reach c. LKR 2.8Bn by FY19E while NP Margin to stabilize around c.9.0% levels in FY19E.

Recommendation

FC Research estimates TJL's fair value at LKR 47.0 for FY19E (average of DCF based LKR 42.3 and PER based LKR 51.3), providing a total annualized return of 26% in FY19E at current price level of LKR 36.4 over a period of 17 months. **STRONG BUY.**

Investment risks

Escalation in Commodity Prices: The main raw material Cotton; which accounts for over 60% of the Cost of Sales, average price increased c. 16% YTD to September 2017 to reach USD 1.86 per kilogram in comparison to USD 1.6 per kilogram in first nine months in 2016. Rapid escalation in cotton prices in the recent past adversely affected the margins.

Exchange Rate Risk: TJL imports the main raw material cotton primarily from India and East Asia which exposes the company to the exchange risk. Fluctuation in the LKR:USD exchange rate is expected to affect the order values thus impacting the revenue.

Budget Proposal 2018 Impact: In 2018 Budget, the VAT exemption on yarn and fabric was proposed to be removed. However, the impact of the said proposal on TJL is likely to be negligible or nil given the company is registered with the Board of Investment of Sri Lanka and being a net exporter is qualified for tax exemptions.



Valuation Summary

Expected TJL Price	FY19E
DCF Valuations based Price	42.4
PER based Price	51.3
Average Target Price	47.0

Return	FY19E
Target Price	47.0
Current Price	36.4
Capital Gain (LKR)	10.6
Dividend (LKR) -FY18E	2.2
Dividend (LKR) - FY19E *	1.4
Capital Gain %	29%
Dividend Yield %	10%
Total Return %	39%
Annualised Return %	26%

* Included only the dividend up to 31 March 2019.

DCF Based Valuation

Valuations	FY19E
Enterprise Value	29,651
Debt (-)	-448
Cash (+)	577
Total Value of Equity	29,780
No. of Shares	702
Value of Equity per Share	42.4

WACC

K_e	18%
K_d	11%
D/E Assumption	40 / 60
Terminal Growth (%)	3%

WACC	15%
-------------	------------

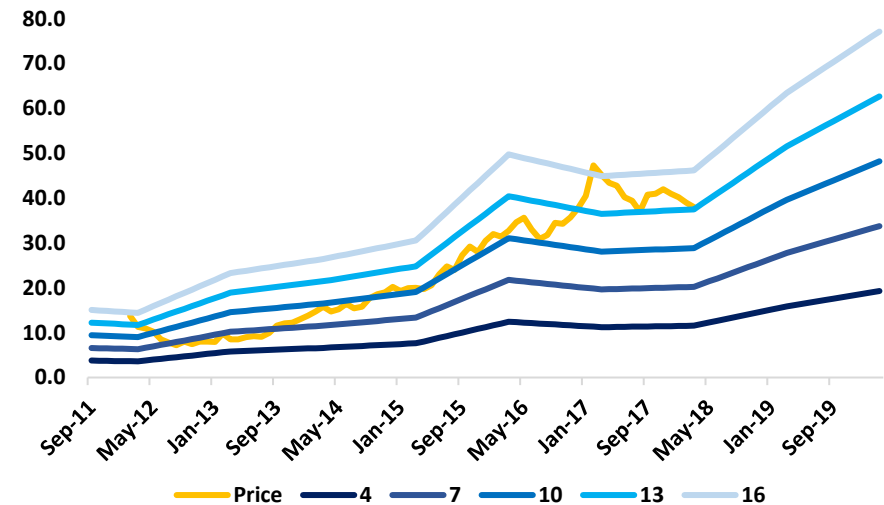
Cost of Equity

R_f	9.4%
R_m	17.4%
β	1.10
$R_m - R_f$	8.0%
$R_f + \beta (R_m - R_f)$	18%

Scenario Analysis

		WACC				
		13%	14%	15%	16%	17%
Terminal Growth (%)	1%	43.9	40.7	37.9	35.6	33.5
	2%	47.0	43.3	40.0	37.4	35.1
	3%	50.6	46.2	42.4	39.5	36.9
	4%	55.1	49.8	45.3	42.0	38.9
	5%	60.6	54.2	48.8	44.8	41.3

PER Valuation



Source: CSE and Research Estimates

PER based Valuation	FY19E
Earnings (LKR 'Mn)	2,768.8
No. of Shares ('Mn)	702.0
EPS	3.9
Expected Average PER	13.0
Price at 13.0x Earnings	51.3

Recommendation criteria

Categorization	Company Category	Strong Buy	Buy	Hold	Sell
Grade A	S&P SL20 Companies	T.Bill + 10% & Above	T.Bill + 5% & Above	T.Bill + 1% & Above	Below T.Bill + 1%
Grade B	Rest of the Companies	T.Bill + 13% & Above	T.Bill + 8% & Above	T.Bill + 3% & Above	Below T.Bill + 3%
Grade C	Companies less than LKR 1Bn Market Cap	T.Bill + 16% & Above	T.Bill + 11% & Above	T.Bill + 6% & Above	Below T.Bill + 6%

Note: 1 year T-bill rate as of 08 Nov 2017: 9.44%



Annex I – Income Statement

Income Statement (LKR 'Mn)	FY16	FY17	FY18E	FY19E	FY20E
Y/E 31st March					
Revenue	17,820	22,138	25,520	30,775	36,233
Cost of sales	(14,825)	(19,062)	(21,820)	(25,851)	(30,435)
Gross Profit	2,995	3,076	3,700	4,924	5,797
Other income	110	195	166	271	326
Selling, Distribution & Admin expenses	(937)	(1,278)	(1,480)	(1,785)	(1,957)
Operating Profit	2,168	1,992	2,386	3,410	4,167
Non operating income	18	-	-	-	-
EBIT	2,185	1,992	2,386	3,410	4,167
Net finance income	43	19	41	51	40
Profit before tax	2,229	2,011	2,427	3,461	4,207
Income tax expense	(58)	(52)	(413)	(692)	(841)
Profit for the year	2,171	1,959	2,015	2,769	3,366
EPS	3.11	2.81	2.89	3.97	4.82

Source: Company Annual Reports and FC Research Estimates

Annex II – Balance Sheet

Balance Sheet (LKR 'Mn)	FY16	FY17	FY18E	FY19E	FY20E
As at 31st March					
ASSETS					
Non-current assets					
Property, plant and equipment	5,954	6,961	6,501	6,059	5,679
Intangible assets & Goodwill	84	66	36	20	11
Other Assets	580	629	629	629	629
	6,619	7,655	7,166	6,708	6,319
Current assets					
Inventories	2,641	2,878	3,467	4,108	5,003
Trade and other receivables	2,703	3,370	3,985	4,637	5,758
Cash and cash equivalents	967	1,494	281	577	778
	6,311	7,742	7,734	9,322	11,539
Total assets	12,929	15,397	14,900	16,030	17,858
Equity and liabilities					
Capital and reserves					
Stated capital	3,853	3,943	3,943	3,943	3,943
Retained earnings	4,151	4,725	5,178	6,286	7,632
Other	2,132	2,510	2,510	2,510	2,510
	10,136	11,177	11,631	12,738	14,084
Non-current liabilities					
Borrowings	142	567	520	364	341
Deferred tax liabilities	240	357	357	357	357
Retirement benefit obligations	191	208	208	208	208
	573	1,133	1,086	929	906
Current liabilities					
Trade and other payables	3,513	3,050	2,996	3,760	4,176
Borrowings	803	1,519	670	84	173
	4,316	4,569	3,666	3,845	4,349
Total liabilities	4,889	5,702	4,752	4,774	5,255
Total equity and liabilities	15,025	16,879	16,382	17,512	19,339
NAVPS	14.52	16.01	16.66	18.25	20.17

Source: Company Annual Reports and FC Research Estimates



Annex III - Cash flow Statement

Cash Flow Statement (LKR 'Mn)	FY16	FY17	FY18E	FY19E	FY20E
As at 31st March					
Cash generated from operations					
Profit before tax	2,229	2,011	2,427	3,461	4,207
Adjustments for:					
Depreciation and Amortisation	750	963	1,039	958	889
Interest income	(63)	(87)	(61)	(57)	(52)
Interest expenses	34	70	20	6	11
Changes in working capital:					
Inventories	446	(173)	(590)	(641)	(895)
Trade and other receivables	(174)	(672)	(615)	(652)	(1,120)
Trade and other payables	400	(424)	-54.71	764.70	415.53
Cash generated from operations	3,744	1,780	2,166	3,840	3,456
Interest income received	63	87	61	57	52
Interest expenses incurred	(34)	(70)	(20)	(6)	(11)
Income Tax paid	0	(129)	(413)	(692)	(841)
Retirement benefit obligations paid	(5)	31	-	-	-
Net cash generated from operating activities	3,768	1,698	1,794	3,199	2,655
Cash flows from investing activities					
Purchase of property, plant and equipment	(1,282)	0	(550)	(500)	(500)
Net cash used in investing activities	(1,754)	(1,774)	(550)	(500)	(500)
Cash flows from financing activities					
Dividend paid	(946)	(1,397)	(1,561)	(1,661)	(2,019)
Repayments of borrowings	-265	1,233	(891)	(743)	66
Net cash used in financing activities	(1,212)	(75)	(2,453)	(2,404)	(1,954)
Net increase in cash and cash equivalents	769	571	(1,208)	295	202
Cash and cash equivalents at beginning of year	150	919	1,490	281	577
Cash and cash equivalents at end of year	919	1,490	281	577	778

Source: Company Annual Reports and FC Research Estimates

Annex IV – Key Ratios

		FY16	FY17E	FY18E	FY19E	FY20E
Growth	Revenue	30%	24%	15%	21%	18%
	Cost of Sales	23%	29%	14%	18%	18%
	Gross Profit	85%	3%	20%	33%	18%
	EBIT	68%	-9%	20%	43%	22%
	Net Profit	63%	-10%	3%	37%	22%
Margins	GP Margin	17%	14%	15%	16%	16%
	EBIT Margin	12%	9%	9%	11%	12%
	NP Margin	12%	9%	8%	9%	9%
Gearing	Debt/Equity	9%	19%	10%	4%	4%
	Debt/Debt+Equity	9%	16%	9%	3%	4%
	Debt/Total assets	6%	12%	7%	3%	3%

Source: Annual Reports and FC Research Estimates



Research Disclosure

NOTICE TO US INVESTORS

This report was prepared, approved, published and distributed by First Capital Equities (Pvt) Ltd, company located outside of the United States (a “non-US Group Company”). This report is distributed in the U.S. by LXM LLP USA, a U.S. registered broker dealer, on behalf of First Capital Equities (Pvt) Ltd only to major U.S. institutional investors (as defined in Rule 15a-6 under the U.S. Securities Exchange Act of 1934 (the “Exchange Act”)) pursuant to the exemption in Rule 15a-6 and any transaction effected by a U.S. customer in the securities described in this report must be effected through LXM LLP USA.

Neither the report nor any analyst who prepared or approved the report is subject to U.S. legal requirements or the Financial Industry Regulatory Authority, Inc. (“FINRA”) or other regulatory requirements pertaining to research reports or research analysts. No non-US Group Company is registered as a broker-dealer under the Exchange Act or is a member of the Financial Industry Regulatory Authority, Inc. or any other U.S. self-regulatory organization.

Analyst Certification. Each of the analysts identified in this report certifies, with respect to the companies or securities that the individual analyses, that (1) the views expressed in this report reflect his or her personal views about all of the subject companies and securities and (2) no part of his or her compensation was, is or will be directly or indirectly dependent on the specific recommendations or views expressed in this report. Please bear in mind that (i) First Capital Equities (Pvt) Ltd is the employer of the research analyst(s) responsible for the content of this report and (ii) research analysts preparing this report are resident outside the United States and are not associated persons of any US regulated broker-dealer and that therefore the analyst(s) is/are not subject to supervision by a US broker-dealer, and are not required to satisfy the regulatory licensing requirements of FINRA or required to otherwise comply with US rules or regulations regarding, among other things, communications with a subject company, public appearances and trading securities held by a research analyst account.

Important US Regulatory Disclosures on Subject Companies. This material was produced by Analysis First Capital Equities (Pvt) Ltd solely for information purposes and for the use of the recipient. It is not to be reproduced under any circumstances and is not to be copied or made available to any person other than the recipient. It is distributed in the United States of America by LXM LLP USA and elsewhere in the world by First Capital Equities (Pvt) Ltd or an authorized affiliate of First Capital Equities (Pvt) Ltd. This document does not constitute an offer of, or an invitation by or on behalf of First Capital Equities (Pvt) Ltd or its affiliates or any other company to any person, to buy or sell any security. The information contained herein has been obtained from published information and other sources, which First Capital Equities (Pvt) Ltd or its Affiliates consider to be reliable. None of First Capital Equities (Pvt) Ltd accepts any liability or responsibility whatsoever for the accuracy or completeness of any such information. All estimates, expressions of opinion and other subjective judgments contained herein are made as of the date of this document. Emerging securities markets may be subject to risks significantly higher than more established markets. In particular, the political and economic environment, company practices and market prices and volumes may be subject to significant variations. The ability to assess such risks may also be limited due to significantly lower information quantity and quality. By accepting this document, you agree to be bound by all the foregoing provisions.

LXM LLP USA assumes responsibility for the research reports content in regards to research distributed in the U.S. LXM LLP USA or its affiliates has not managed or co-managed a public offering of securities for the subject company in the past 12 months, has not received compensation for investment banking services from the subject company in the past 12 months, does not expect to receive and does not intend to seek compensation for investment banking services from the subject company in the next 3 months. LXM LLP USA has never owned any class of equity securities of the subject company. There are not any other actual, material conflicts of interest of LXM LLP USA at the time of the publication of this research report. As of the publication of this report LXM LLP USA, does not make a market in the subject securities.

