



TEEJAY LANKA PLC [TJL.N0000]

MAINTAIN BUY

“WEATHERING THE STORM AWAITING CONSUMER RESURGENCE”

Fair Value: FY24E - LKR 40.0 [+13%]

Total Return with DPS: FY24E - 14% [AER 26%]

FY25E - LKR 50.0 [+41%]

FY25E - 46% [AER 27%]

TJL recorded a net loss of LKR 853.0Mn (-168.4%YoY) in 1QFY24, falling short of expectations amidst a decline in sales volume in key markets due to shifting consumer buying patterns. Accordingly, the top-line exhibited a degrowth of 19.1%QoQ and a 41.3%YoY decline, primarily due to LKR appreciation and a decrease in average selling prices (ASP). However, capacity underutilization persisted across all three of TJL's manufacturing plants, adversely impacting the margins and profitability throughout the quarter. Despite a decline in volume, the synthetic segment recorded a 2.0%YoY growth during the quarter. We anticipate that market softness may persist in the coming quarters, particularly in the US and UK markets, for approximately 9 months. However, gradual improvement is expected in 2HFY24E as brands have cleared out inventory levels and consumer demand may potentially rebound as market conditions improve. TJL also expects its strategic developments to bear fruit within the next 9 months to 1 year. However, considering the current subdued demand due to elevated inflation levels and higher interest rates, we have downgraded the earnings for FY24E to LKR 748.0Mn while earnings for FY25E is estimated at LKR 2.3Bn. Although we adjust our earnings outlook, we are maintaining a FV of LKR 40.0 for FY24E and a FV of LKR 50.0 for FY25E. **MAINTAIN BUY**

| LKR (Mn) | 1QFY23 | 1QFY24 | YoY | FY22 | FY23 | YoY |
|--------------------------------|--------|--------|-------|--------|--------|------|
| Earnings (LKR 'Mn) | | | | | | |
| Revenue | 23,858 | 13,997 | -41% | 49,588 | 84,037 | +69% |
| Gross profit | 2,122 | 283 | -87% | 4,578 | 6,843 | +49% |
| EBIT | 1,115 | -582 | -152% | 2,573 | 3,295 | +28% |
| PBT | 1,506 | -701 | -147% | 2,864 | 3,116 | +9% |
| Net Profit | 1,247 | -853 | -168% | 2,531 | 2,127 | -16% |
| Balance Sheet (LKR 'Mn) | | | | | | |
| Shareholders' Equity | 36,118 | 29,482 | -18% | 28,226 | 32,043 | +14% |
| Borrowings | 13,177 | 10,190 | -23% | 11,495 | 12,582 | +9% |
| NAVPS | 50.4 | 41.1 | | 39.4 | 44.7 | |

QoQ and YoY top-line dips amidst market softening and LKR appreciation

TJL's revenue contracted by 19.1%QoQ to LKR 14.0Bn in 1QFY24, marking the third consecutive quarter of top-line decline. Furthermore, on a YoY basis, the revenue saw a substantial decrease of 41.3% in LKR terms, primarily influenced by a 4.50% LKR appreciation impact. Notably, the USD denominated top-line experienced a steep decline of 36.8%YoY to USD 45.6Mn. Degrowth in topline was driven by fluctuations in raw material prices, decrease in ASPs, dip in sales volume by c.30%YoY exacerbated by high inventory levels held by TJL brands and the softening of orders in international markets, particularly in the US and Europe, which account for c.50.0% and 45.0% of TJL's topline, respectively. In contrast, Asia accounts for the remaining 5.0% of TJL's topline. However, we anticipate that TJL's margins may improve in 2HFY24E, as there still exists some appetite for future consumer expenditure, especially given the pause in US interest rate hikes and a moderation of global inflation levels to 6.8% in 2023E according to the IMF. Accordingly, we have revised our topline forecast for FY24E to LKR 70.2Bn. Furthermore, TJL's plants operated below capacity at 60.0% during 1QFY24 cf. 62.0% capacity in 4QFY23. TJL plans to improve the capacity utilization rate by 10.0%QoQ in 2QFY24E, by capitalizing on its low margin volume brands. TJL also envisions a period of price stability in the cotton market for the next two quarters. Moreover, TJL has acquired new customers and initiated new developments for this expanded clientele, which is expected to yield tangible results by 3QFY24E or early in 4QFY24E.

Underutilized capacity puts a dent in GP and OP Margins

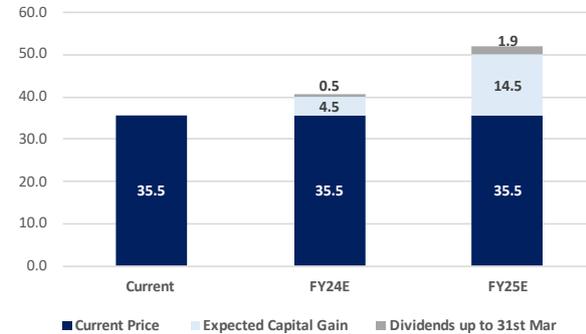
TJL's GP margin deteriorated by 687bps YoY and 483bps QoQ, settling at 2.0% in 1QFY24. This decline was influenced by the capacity underutilization that persisted across all three manufacturing plants owing to market softness, as well as the pressures stemming from the capacity expansion in India and higher fixed costs incurred during the period. Despite the potential recovery in consumer demand in 2HFY24E, which could lead to an expansion in the order book, we expect the GP margin to stabilize at 5.0% in FY24E. Looking ahead to FY25E, we envisage a gradual recovery, with the GP margin forecasted to reach 8.0%. Although we anticipate a slowdown in 1HFY24E due to the negative impact on the order book, TJL has secured multiple bulk orders from top brands to expand its volume businesses, and the company foresees a growth in overall sales volumes during 2QFY24E, with further increases expected in 3QFY24E. In 1QFY24, volume businesses accounted for 30% of TJL's topline.

Expansion into synthetics to increase margins

TJL has plans to convert 30% of its total production capacity to synthetics, marking a significant shift from the current composition of 15% cotton and 20% synthetic, thereby solidifying their foothold in the market. TJL also aims to establish a strong presence in Bangladesh's synthetic business, aiming to generate at least 10% to the top-line in the long run and increase volumes from Bangladesh with shortened lead times with TJL India. TJL experienced a 16.4%YoY increase in distribution costs in 1QFY24 due to its strategic expansion in Bangladesh. Furthermore, TJL is poised for potential revenue growth by expanding its Fleece capacity through outsourcing to China, with hopes of securing a slew of new orders in the immediate future. With existing fleece capabilities in India, the company intends to replicate similar operations in Lanka, leveraging one of their existing outsourcing facilities. These endeavors are expected to enhance TJL's economies of scale, leading to diminished production costs and enhanced margins. TJL has also made strategic investments in the digital brands space, which is expected to yield significant growth and returns in the future.

FV for FY25E maintained at LKR 50.0

In light of the prevailing subdued consumer demand, we have downgraded TJL's earnings forecast for FY24E to LKR 748.0Mn while earnings for FY25E is estimated at LKR 2.3Bn. Hence, on the back of slower than anticipated earnings growth, we are maintaining our FV at LKR 50.0 for FY25E providing an annualized return of 27.0% at the current price level of LKR 35.5. **MAINTAIN BUY**



FIRST CAPITAL RESEARCH

Vinodhini Rajapoopathy +94 11 263 9866

vinodhini@firstcapital.lk

Price Movement of TJL vs ASPI (Indexed and rebased to 100)



Source: CSE

Minimum Return for BUY:

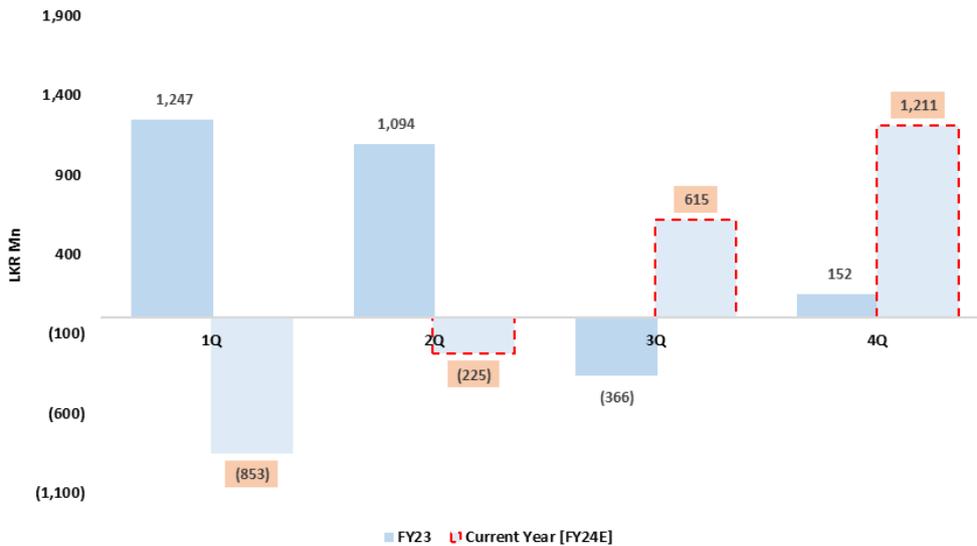
Buy Below for FY25E [AER of 23.0% with DPS]: LKR 36.5
TJL.N categorized as 'Grade B' counter

Disclosure on Shareholding:

First Capital Group or the covering analyst did not hold 1% or more of the total outstanding share capital of TJL during the five trading days prior to the issuance of this document.



Quarterly Earnings



Estimate Revision

| In LKR Mn | FY24E - O | FY24E - R | % Change | FY25E - O | FY25E - R | % Change |
|-------------------------------|-------------|-------------|----------|-------------|-------------|----------|
| Earnings Estimate | | | | | | |
| Revenue | 90,417 | 70,225 | -22% | 93,682 | 76,272 | -19% |
| Gross profit | 6,329 | 3,511 | -45% | 7,026 | 6,102 | -13% |
| EBIT | 3,165 | 808 | -74% | 3,747 | 3,165 | -16% |
| Profit before tax | 3,201 | 1,069 | -67% | 3,743 | 3,323 | -11% |
| Net Profit | 2,188 | 748 | -66% | 2,559 | 2,326 | -9% |
| EPS | 3.1 | 1.0 | | 3.6 | 3.2 | |
| Growth YoY | 6% | -65% | | | | |
| Balance Sheet Estimate | | | | | | |
| Shareholders' Equity | 33,575 | 32,417 | -3% | 35,366 | 33,348 | -6% |
| Borrowings | 13,788 | 13,778 | -0% | 14,962 | 15,094 | +1% |
| NAVPS | 46.8 | 45.2 | | 49.3 | 46.5 | |
| Ratio Estimate | | | | | | |
| ROE (%) | 6.7% | 2.3% | | 7.4% | 7.1% | |
| PER (x) | 11.1 | 34.0 | | 9.5 | 10.9 | |
| PBV (x) | 0.7 | 0.8 | | 0.7 | 0.8 | |

Valuation Table

| P/E 31 March | FY19 | FY20 | FY21 | FY22 | FY23 | FY24E | FY25E | FY26E |
|----------------------------|--------------|--------------|--------------|--------------|--------------|------------|--------------|--------------|
| Estimates (LKR 'Mn) | | | | | | | | |
| Revenue | 31,747 | 33,277 | 31,780 | 49,588 | 84,037 | 70,225 | 76,272 | 79,011 |
| Gross profit | 3,686 | 4,229 | 3,790 | 4,578 | 6,843 | 3,511 | 6,102 | 6,321 |
| EBIT | 2,345 | 2,728 | 2,441 | 2,573 | 3,295 | 808 | 3,165 | 3,358 |
| Net Profit | 1,859 | 2,384 | 2,140 | 2,531 | 2,127 | 748 | 2,326 | 2,397 |
| Adjusted EPS (LKR) | 2.6 | 3.3 | 3.0 | 3.5 | 3.0 | 1.0 | 3.2 | 3.3 |
| YoY Growth (%) | 16% | 28% | -10% | 18% | -16% | -65% | 211% | 3% |
| Valuations | | | | | | | | |
| PER (x) | 13.7x | 10.7x | 11.9x | 10.1x | 12.0x | 34.0x | 10.9x | 10.6x |
| PBV (x) | 1.8x | 1.6x | 1.4x | 0.9x | 0.8x | 0.8x | 0.8x | 0.7x |
| DY (%) | 4.9% | 6.8% | 4.6% | 5.6% | 4.2% | 1.5% | 5.5% | 5.7% |
| NAVPS | 19.4 | 21.8 | 24.8 | 39.4 | 44.7 | 45.2 | 46.5 | 47.9 |
| DPS (LKR) | 1.8 | 2.4 | 1.7 | 2.0 | 1.5 | 0.5 | 1.9 | 2.0 |
| Dividend Payout | 67% | 72% | 55% | 57% | 51% | 50% | 60% | 60% |



Valuation Summary

| Expected TJL price | FY24E | FY25E |
|--|-------------|-------------|
| EV/EBITDA Valuation based target price | 33.6 | 51.2 |
| DCF Valuation based target price | 39.6 | 46.6 |
| Average Target Price | 36.6 | 48.9 |
| Target Price after Rounding off | 40.0 | 50.0 |

| Return | FY24E | FY25E |
|----------------------------|-------------|-------------|
| Target Price | 40.0 | 50.0 |
| Current Price | 35.5 | 35.5 |
| Capital Gain (LKR) | 4.5 | 14.5 |
| Dividends up to 31st March | 0.5 | 1.9 |
| Capital Gain % | 13% | 41% |
| Dividend Yield % | 1% | 5% |
| Total Return % | 14% | 46% |
| Annualized Return % | 26% | 27% |

Discounted Cash flow Valuation

| DCF based Valuation | FY24E | FY25E |
|------------------------------|---------------|---------------|
| Enterprise Value | 35,430 | 41,580 |
| (-) Debt | (13,778) | (15,094) |
| (+) Cash | 6,727 | 6,912 |
| Total Value of Equity | 28,379 | 33,398 |
| No. of Shares (Mn) | 717 | 717 |
| Target Price | 39.6 | 46.6 |

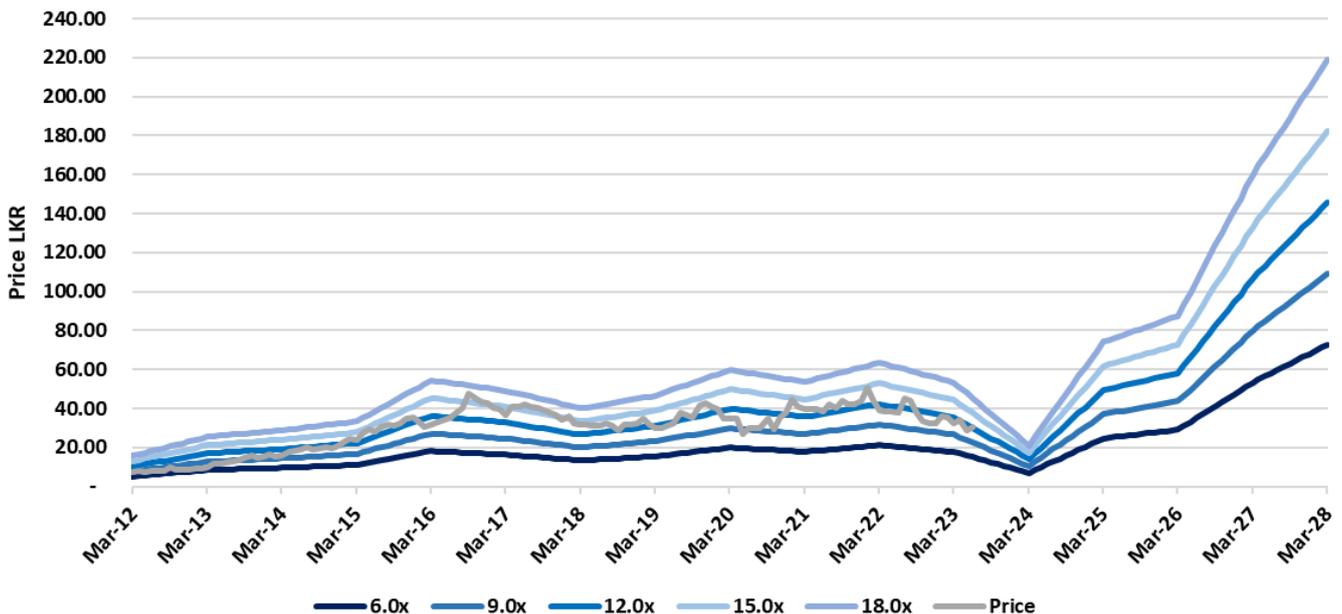
| COE | FY24E | FY25E |
|--|--------------|--------------|
| Rf | 12.0% | 11.0% |
| Rm | 20.0% | 19.0% |
| Growth % | 3.0% | 3.0% |
| β | 0.70 | 0.70 |
| Ke = Rf + β(Rm-Rf) | 17.6% | 16.6% |

EV/EBITDA Valuation

| EV/EBITDA based Valuation | FY24E | FY25E |
|---------------------------|-------------|-------------|
| EBITDA (LKR 'Mn) | 5,353 | 8,157 |
| Avg. EV/EBITDA | 4.5x | 4.5x |
| No. of Shares ('Mn) | 717 | 717 |
| Target Price | 33.6 | 51.2 |

| WACC | FY24E | FY25E |
|---------------------|--------------|--------------|
| Ke | 17.6% | 16.6% |
| Kd | 17.0% | 15.0% |
| D/E Assumption | 40/60 | 40/60 |
| Terminal Growth (%) | 3.0% | 3.0% |
| WACC | 15.3% | 14.1% |

PER Chart





Appendix I: Statement of Income and Expenses

| Statement of Profit or Loss (LKR Mn) | FY19 | FY20 | FY21 | FY22 | FY23 | FY24E | FY25E | FY26E |
|--|--------------|--------------|--------------|--------------|--------------|--------------|--------------|--------------|
| As at 31st March | | | | | | | | |
| Revenue | 31,747 | 33,277 | 31,780 | 49,588 | 84,037 | 70,225 | 76,272 | 79,011 |
| Cost of sales | -28,061 | -29,048 | -27,990 | -45,010 | -77,194 | -66,714 | -70,170 | -72,690 |
| Gross profit | 3,686 | 4,229 | 3,790 | 4,578 | 6,843 | 3,511 | 6,102 | 6,321 |
| Other income | 246 | 173 | 186 | 151 | 532 | 281 | 305 | 395 |
| Selling, Distribution & Admin expenses | -1,587 | -1,673 | -1,534 | -2,156 | -4,079 | -2,985 | -3,242 | -3,358 |
| Operating profit | 2,345 | 2,728 | 2,441 | 2,573 | 3,295 | 808 | 3,165 | 3,358 |
| Finance Income | 102 | 244 | 277 | 440 | 811 | 697 | 619 | 557 |
| Less : Finance Cost | -189 | -160 | -119 | -149 | -990 | -436 | -462 | -491 |
| Net finance income | -88 | 84 | 158 | 291 | -179 | 261 | 157 | 67 |
| Profit before tax | 2,257 | 2,812 | 2,599 | 2,864 | 3,116 | 1,069 | 3,323 | 3,425 |
| Income tax expense | -398 | -428 | -460 | -332 | -990 | -321 | -997 | -1,027 |
| Profit for the Year | 1,859 | 2,384 | 2,140 | 2,531 | 2,127 | 748 | 2,326 | 2,397 |
| EPS | 2.6 | 3.3 | 3.0 | 3.5 | 3.0 | 1.0 | 3.2 | 3.3 |

Appendix II: Statement of Financial Position

| Statement of Financial Position (LKR Mn) | FY19 | FY20 | FY21 | FY22 | FY23 | FY24E | FY25E | FY26E |
|--|---------------|---------------|---------------|---------------|---------------|---------------|---------------|---------------|
| As at 31st March | | | | | | | | |
| ASSETS | | | | | | | | |
| Non-Current Assets | | | | | | | | |
| Property, plant and equipment | 8,408 | 8,777 | 8,711 | 14,715 | 20,259 | 22,302 | 23,895 | 25,138 |
| Capital work-in-progress | 119 | 590 | 425 | 5,269 | 1,836 | 1,756 | 1,676 | 1,596 |
| Intangible Assets | 94 | 78 | 125 | 143 | 161 | 143 | 125 | 109 |
| Deferred tax assets | 111 | 256 | 273 | 432 | 1,856 | 1,856 | 1,856 | 1,856 |
| Goodwill | 58 | 62 | 66 | 96 | 106 | 116 | 128 | 141 |
| Right-of-use assets | 236 | 910 | 899 | 1,341 | 1,740 | 1,740 | 1,740 | 1,740 |
| Total Non-Current Assets | 9,026 | 10,673 | 10,500 | 21,996 | 25,958 | 27,913 | 29,421 | 30,580 |
| Current Assets | | | | | | | | |
| Inventories | 4,494 | 5,904 | 7,281 | 16,356 | 13,383 | 11,544 | 12,538 | 14,071 |
| Trade and other receivables | 4,013 | 4,137 | 7,181 | 12,859 | 9,026 | 10,582 | 12,538 | 15,153 |
| Current Tax Receivable | 9 | 18 | 6 | 477 | 497 | 0 | 0 | 0 |
| Cash and cash equivalents | 4,290 | 5,263 | 4,452 | 6,383 | 7,914 | 6,727 | 6,912 | 4,426 |
| Other Financial Assets | 553 | 967 | 1,680 | 1,822 | 3,281 | 3,445 | 3,445 | 3,445 |
| Total Current Assets | 13,359 | 16,289 | 20,600 | 37,897 | 34,100 | 32,299 | 35,433 | 37,095 |
| Total Assets | 22,386 | 26,962 | 31,099 | 59,894 | 60,058 | 60,211 | 64,854 | 67,675 |
| EQUITY AND LIABILITIES | | | | | | | | |
| Capital and Reserves | | | | | | | | |
| Stated capital | 4,057 | 4,057 | 4,249 | 4,442 | 4,442 | 4,442 | 4,442 | 4,442 |
| Exchange equalisation reserve | 4,172 | 5,263 | 6,225 | 15,220 | 18,048 | 18,048 | 18,048 | 18,048 |
| Retained earnings | 5,600 | 6,232 | 7,137 | 8,410 | 9,400 | 9,774 | 10,704 | 11,663 |
| Share option scheme | 97 | 97 | 153 | 153 | 153 | 153 | 153 | 153 |
| Total Equity | 13,925 | 15,649 | 17,764 | 28,226 | 32,043 | 32,417 | 33,348 | 34,307 |
| Non-Current Liabilities | | | | | | | | |
| Borrowings | 801 | 412 | 198 | 5,581 | 6,239 | 6,974 | 7,795 | 8,714 |
| Lease Liability | 0 | 628 | 655 | 930 | 1,341 | 1,341 | 1,341 | 1,341 |
| Deferred tax liabilities | 538 | 648 | 627 | 919 | 2,364 | 2,364 | 2,364 | 2,364 |
| Retirement benefit obligations | 252 | 378 | 520 | 425 | 569 | 569 | 569 | 569 |
| Total Non-Current Liabilities | 1,591 | 2,065 | 2,000 | 7,855 | 10,512 | 11,247 | 12,068 | 12,987 |
| Current Liabilities | | | | | | | | |
| Trade and other payables | 4,703 | 5,643 | 8,087 | 17,623 | 10,556 | 9,139 | 11,535 | 11,949 |
| Borrowings | 2,167 | 3,502 | 3,108 | 5,914 | 6,343 | 6,804 | 7,299 | 7,829 |
| Current tax liability | 0 | 92 | 126 | 233 | 490 | 490 | 490 | 490 |
| Lease Liability | 0 | 12 | 14 | 43 | 114 | 114 | 114 | 114 |
| Total Current Liabilities | 6,869 | 9,248 | 11,335 | 23,813 | 17,503 | 16,547 | 19,437 | 20,382 |
| Total Equity & Liabilities | 22,386 | 26,962 | 31,099 | 59,894 | 60,058 | 60,211 | 64,854 | 67,675 |
| Adjusted NAVPS | 19.4 | 21.8 | 24.8 | 39.4 | 44.7 | 45.2 | 46.5 | 47.9 |



First Capital

First Capital Holdings PLC

No.2, Deal Place,
Colombo 3

Tel: +94 11 2145 000
Fax: +94 11 2145 050

RESEARCH

| | | | |
|------------------------|-----------------|-------------------|-----------------|
| Dimantha Mathew | +94 11 2639 853 | Tharusha Ashokgar | +94 11 2639 866 |
| Ranjan Ranatunga | +94 11 2639 863 | Zaeema Jihan | +94 11 2639 863 |
| Vinodhini Rajapoopathy | +94 11 2639 866 | Nethmi Fernando | +94 11 2639 863 |

GOVERNMENT SECURITIES SALES

| | | | |
|---------------------|-----------------|---------------------|-----------------|
| Anjelo Simmons | +94 77 3031 636 | Neminda Jayawardena | +94 76 6644 080 |
| Anushka Dissanayake | +94 77 2220 021 | Arun Kandasamy | +94 75 4861 506 |
| Anushi Ranawaka | +94 77 3876 819 | | |

CORPORATE DEBT SALES

| | |
|--------------------|-------------------|
| Tharusha Ekanayake | + 94 77 7 809 154 |
|--------------------|-------------------|

EQUITY SALES

| | | |
|-----|------------------|-----------------|
| CEO | Jaliya Wijeratne | +94 70 2910 042 |
|-----|------------------|-----------------|

Colombo

| | | | |
|---------------------|-----------------|----------------------|-----------------|
| Rasika Indra Kumara | +94 77 7072 698 | Anjelo LaBrooy | +94 77 7546 645 |
| Isuru Jayawardena | +94 76 7084 953 | Dillon Lowe | +94 76 616 0647 |
| Nishantha Mudalige | +94 70 2910 041 | Evelyn John | +94 77 779 2452 |
| Anushka Buddhika | +94 71 4310 600 | Yudheshan Kannadasan | +94 77 415 5809 |
| Thushara Pathiraja | +94 70 2910 037 | | |

Negombo

| | | | |
|--------------------|-----------------|--------------------|-----------------|
| Priyanka Anuruddha | +94 70 2910 035 | Priyantha Wijesiri | +94 70 2910 036 |
|--------------------|-----------------|--------------------|-----------------|

UNIT TRUST SALES

| | | | |
|---------------------|-----------------|-----------------------|-----------------|
| Kavin Karunamoorthy | +94 77 0328 060 | Imali Abeygunawardena | +94 77 1764 799 |
|---------------------|-----------------|-----------------------|-----------------|

BRANCHES

| Kandy | Kurunegala | Matara | Negombo |
|--|---|---|---|
| CSE Branch Office, No. 88, Dalada Veediya, Kandy 20000. | No.174/B2, Negombo Road, Kurunegala. Kurunegala 60000. | CSE Branch Office, 1st Floor, E.H.Cooray Tower, No.24, Anagarika Dharmapala Mawatha, Matara 81000. | Colombo Stock Exchange Negombo Branch Office, No. 72 A, 2/1, Old Chilaw Road, Negombo 11500. |
| Manager: Salinda Samarakoon | Manager: | Manager: Rohana Jayakody | Manager: |
| Tel: +94 81 2236 010 | Tel: +94 37 2222 930 | Tel: +94 41 2222 988 | Tel: +94 31 4937 072 |

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