

# HAYLEYS PLC

A sum-of-the-parts story

## BUY

Bloomberg ticker – HAYL.SL

Capital Goods

Price (LKR) – 359.2

Target Price (LKR) – 464.0

Total Return (%) – 35%

### Share Data

Market Cap (USD mn) 145.5

Market Cap (LKR bn) 26.9

12M H/L (LKR) 439.0/130.0

Free Float (%) 37%

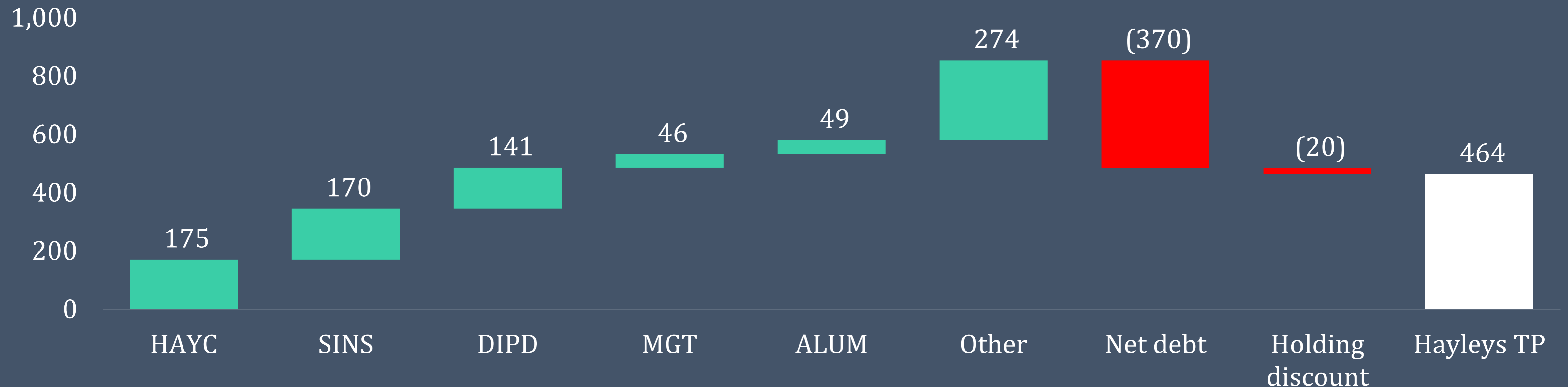


Analyst – Thuvarakan Senthilmani  
23 November 2020

# We expect HAYL to provide a total return of 35% based on our SOTP valuation of LKR 464/share

The SOTP valuation of HAYL is based on our target price for HAYC, DIPD, MGT, and ALUM while taking the carrying value for other investments.

Per share value in LKR



Source: SSB Research

Our buy recommendation for HAYL is based on the strong performance of its subsidiaries during 1HFY21 and positive outcomes from the budget 2021. We believe the company is well-positioned to continue delivering robust performance ahead, reflecting: 1) optimum utilization rate at HAYC, DIPD, MGT, and ALUM; 2) double-digit growth expected from the Agriculture segment due to the government's initiative to boost local harvesting; 3) possibility of HAYL disposing 30% of its Singer ownership, which could reduce its debt by c. LKR 5.6bn (assumed a 30% disposal at LKR 50/share) and lower the finance cost by LKR 560mn (translating into an EPS of LKR 8).

# The story of **sum-of-the parts**...

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# HAYCARB PLC (HAYC): BUY

## Multiple tailwinds for growth

- **We see two key growth opportunities for HAYC in the capacitors and water purification segments.** HAYC activated carbon is used for electric cars, as it reduces the degradation of battery life. According to IEA, the electric vehicle market is expected to reach 250mn vehicles by 2030 from the present 21mn. Since HAYC is already catering to this market, we expect HAYC's capacity to expand inline with market's growth trajectory.
- **The recent budget proposals to allocate LKR 1tn to expand pipe-borne water projects** might open multiple revenue streams for HAYC, due to its expertise in the water purification field. Further, the company has an LKR 10.3bn water sewerage project in the pipeline from the Maldives. If HAYC is to go ahead with this project we expect earnings to see a boost in FY22E-FY25E.
- **We expect an increase in coconut charcoal prices to slightly taper down margins in the second half but not to the extent of FY19 (19%).** This is mainly due to 1) selling price adjustments made; 2) factories operating at optimum capacity, and 3) improving net debt position. HAYC's gross margin expanded by 10ppt to 32% in 1HFY21. The expansion was largely due to an upward revision of average selling prices and the company's ability to source raw materials at a cheaper rate, due to lack of demand for charcoal during the first half of FY21E.
- **HAYC net debt position improved to LKR 1.6bn in 1HFY21 (cf. LKR 4.6bn in 1HFY20) as the company generated LKR 2.9bn operating cashflows** before working capital changes. We see HAYC as a cash-generating machine and therefore we believe HAYC is well-positioned for capacity expansions to cater to the growing demand. We also note that if investments are made above USD 10mn, HAYC may get concessions for up to 10 years according to the proposed 2021 budget.

CMP LKR 470	+	Gain: 38%	=	TP: LKR 647
		DY: 7%		

### Next twelve-month projection (NTM) based on raw material price increase

LKR mn	10%	15%	20%
Revenue	23,758	23,758	23,758
Gross profit	6,705	6,222	5,739
Opex	(2,851)	(2,851)	(2,851)
Net finance cost	(178)	(178)	(178)
PBT	3,676	3,371	2,888
PAT	3,088	2,832	2,426
EPS	102.9	94.4	80.9
<b>Target price based on 8x PE</b>	<b>823.4</b>	<b>755.1</b>	<b>647.0</b>
<b>Dividend yield</b>	<b>8.8%</b>	<b>8.0%</b>	<b>6.9%</b>

*The above table doesn't factor in capacity expansion and water purification projects.*

*Source: SSB Research*

HAYC is trading at 5.8x PE NTM earnings. We believe a company that has a robust order book and operates in a growth industry should trade at 8x PE implying a target price of LKR 647 (grey sky scenario: factoring 20% increase in raw material price). Total return 45% including a dividend yield of 7%.

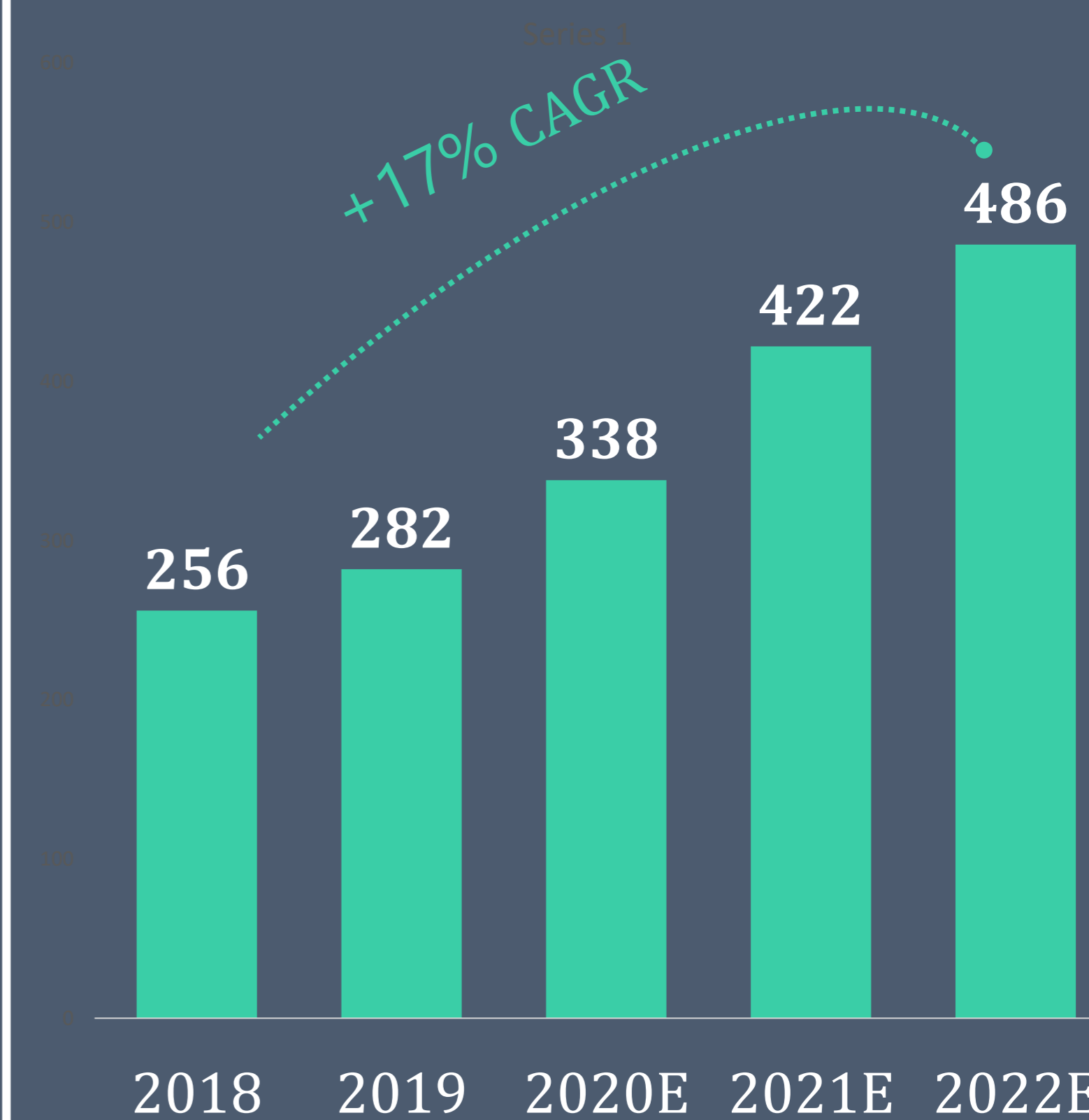
# DIPPED PRODUCTS PLC (DIPD): BUY

## Just the beginning; Miles to go before it normalizes

$$\begin{matrix} \text{CMP} \\ \text{LKR 318} \end{matrix} + \begin{matrix} \text{Gain: 36\%} \\ \text{DY: 6\%} \end{matrix} = \begin{matrix} \text{TP: LKR 420} \end{matrix}$$

- **Despite the possibility that the first vaccine shots may come in Jan 2021, the distribution mechanism makes it practically impossible to vaccinate the entire world population by 2021.** We noticed a crash in share price of DIPD to LKR 310-330 levels down from LKR 400 as news on COVID-19 vaccine trials dented optimism on gloves demand. However, this may be an over-reaction.
- **With daily COVID-19 patients at an all time high of 657k in Nov-20 cf. 72k in Apr-20, We expect the DIPD order book to remain robust until August 2021.**
- **Deployment of the vaccine to 7.5bn population could be a new revenue stream for DIPD, as each contact with a person would require the usage of one pair of disposable gloves.**
- **According to industry sources, the post-pandemic global demand for gloves is expected to grow at 15% annually in 2022E. This remains higher than pre-pandemic projections, given the increased awareness and best practices adopted in medical and non-medical sectors. We expect the DIPD order book to remain robust as global companies will look to maintain a diversified supply chain away from China and Malaysia.**
- **DIPD's diversified gloves portfolio caters to three main segments 1) household, 2) industrials and 3) surgical & examination, could insulate demand variations post 2022 if a successful vaccine contains the virus.** With COVID-19 creating additional demand for examination and surgical gloves, DPL's factories are running at optimum capacity and might expand its capacity in the near future.
- Nevertheless, with the exposure to the plantations sector, we believe DIPD should trade at PE target of 7x cf. a market average of 10x, tagged to NTM EPS of LKR 60. With the share price having declined c.23% since the vaccine news, we think there is a sufficient buffer to warrant our BUY rating.

Growth in global demand for rubber gloves (in bn pieces)



Source: Malaysia rubber gloves manufacturer association

# ALUMEX PLC (ALUM): BUY

## Near-term earnings turnaround

- **We expect the aluminum industry to be on a strong growth trajectory, which may allow ALUM to operate above 50% utilization, generating gross margins of 28-30%.** ALUM reported a strong earnings growth of LKR 164mn cf. LKR 41 in 2QFY20. The major reason for the margin expansion was the improvement in the factory utilization rate from 30% to c.50% in 1HFY21.
- **The 2021 budget encouraged the recycling and re-use of material from the construction sector along with a ten-year tax holiday for investments in selected recycling sites.** We expect ALUM to benefit from this outcome, as the company increased the usage of recycled local aluminum billets (which is 10% cheaper than imported aluminum billets). Furthermore, we believe the budget proposal to build 5 “Techno Parks” and expand solar power plants could benefit ALUM (if awarded).
- **The recent cabinet approval to ban the export of scrap aluminum may allow ALUM to source raw materials at a cheaper rate, expanding margins.**
- **The recent circular issued to source material from local manufacturers for government projects may drive overall volumes.**
- **The company has 10 customers onboarded from the USA, UK, and Australia with the first batch of testing orders delivered. Notably 3 customers have written back with full orders.** Going forward management expects export revenue to stand at 10% of the total revenue cf. 1% in FY20.
- **The Target Price of LKR 23 is based on 10x PE NTM earnings, including our base case utilization rate of 55%. With the lower CAPEX in the next 12 months, stabilization of exchange rates, and a dividend yield of 5%, we expect ALUM to provide a total return of 26%.**

$$\begin{array}{|c|} \hline \text{CMP} \\ \hline \text{LKR 19} \\ \hline \end{array} + \begin{array}{|c|} \hline \text{Gain: 21\%} \\ \hline \text{DY: 5\%} \\ \hline \end{array} = \begin{array}{|c|} \hline \text{TP: LKR 23} \\ \hline \end{array}$$

### Next twelve-month projection (NTM) based on utilization rates

LKR mn	55%	60%	65%
Revenue	6,490	7,080	7,670
Gross profit	1,915	2,089	2,301
Opex	(649)	(708)	(767)
Net finance cost	(280)	(280)	(280)
PBT	986	1,381	1,534
PAT	690	966	1,074
EPS	2.3	3.2	3.6
<b>Target price based on 10x PE</b>	<b>23.0</b>	<b>32.2</b>	<b>35.8</b>
<b>Dividend yield</b>	<b>4.8%</b>	<b>6.8%</b>	<b>7.5%</b>

Source: SSB Research

# HAYLEYS FABRIC (MGT): BUY

## Two reasons to like MGT

CMP LKR 24	+	Gain: 17%	=	TP: LKR 28
		DY: 3%		

- **1) With increased focus on tier one customers**, MGT has improved its utilization rate to 100% whilst outsourcing excess capacity to other local firms. The management indicated that with a strong order book stemming from clients like Nike, Intimissimi, and Decathlon the company can reduce its earnings volatility and maintain a steady earnings expansion.
- **The company has plans to expand its knitting line capacity by 18% whilst LKR 185mn is already invested in branded knitting machines.** The management noted that the above capacity expansion will be performed internally by eliminating bottlenecks. We believe that having access to water resources is a key limitation for MGT to expand its capacity. If a fabric zone is established in Batticaloa, we expect MGT to set-up a plant there, given the robust order book from tier-one customers and probable tax holidays on the proposed fabric zone.
- According to Grandview Research, the global athleisure market is expected to grow at a CAGR of 8% to reach USD 517bn by 2025. MGT should be able to capitalize on this development due to its **2) higher focus on synthetics (54% of the total revenue)**. We also note that synthetics are generally a high margin (c.17%) business cf. fabric (c.12%).
- Higher cotton yarn prices (increased by 9% in 3QFY21E vs. 2QFY21) due to increase in demand for India's cotton as US brands banned the usage of China's cotton yarn might exert pressure on MGT's margin in 3QFY21. Nevertheless, with the new cotton crops expected to be released to the market by December-20, we expect cotton prices to stabilize in 4QFY21E.
- MGT is trading at 7x PE NTM earnings. We believe MGT should trade at 8x PE (20% discount to TJL) implying a target price of LKR 28. A total return of 20% including a 3% dividend yield.

### Cotton yarn prices increased by 9% QoQ in 3QFY21E



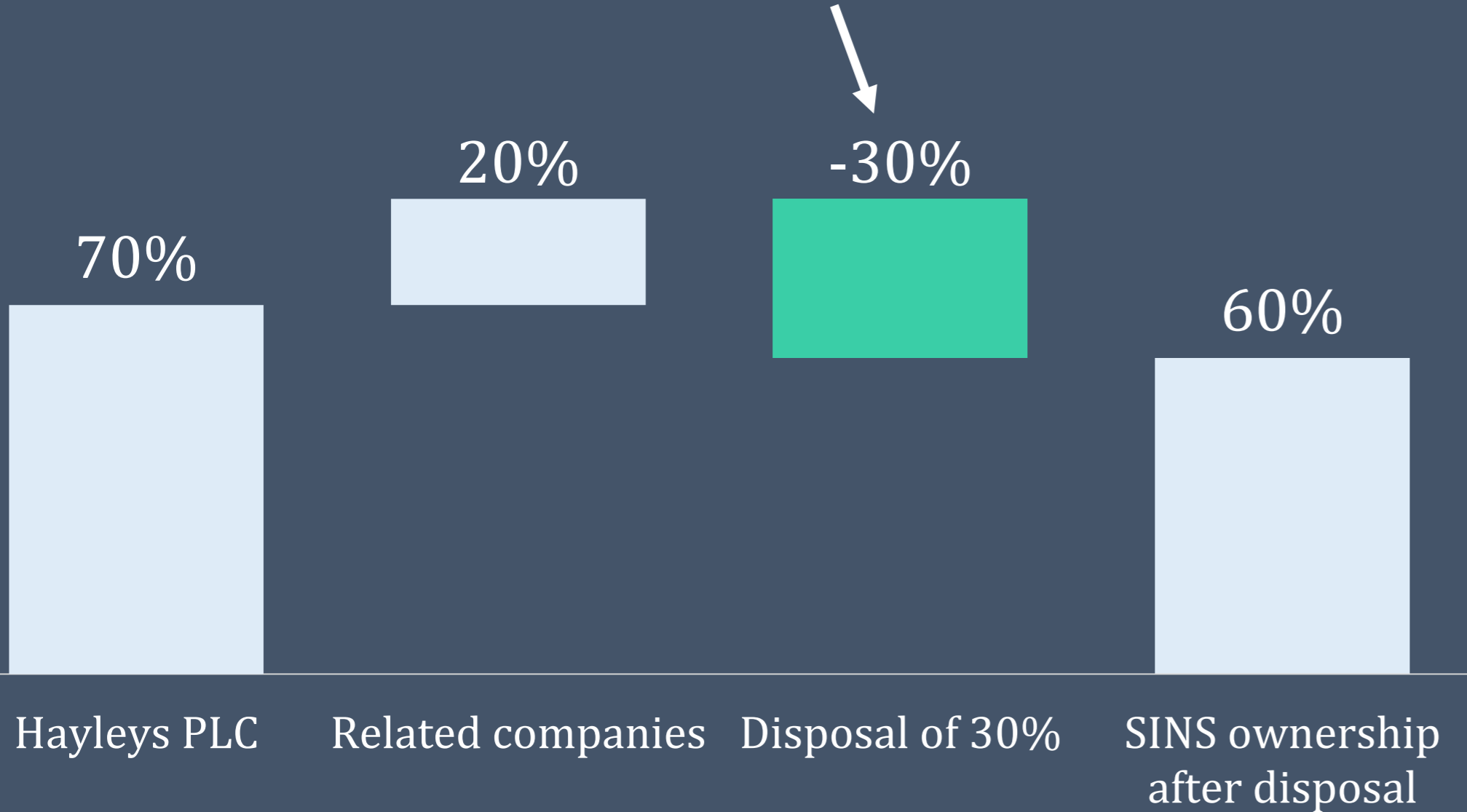
Source: Bloomberg

# Probable disposal of a stake in SINS to boost earnings, while improving balance sheet quality

**Scenario: If HAYL disposes a 30% stake at LKR 50 per share, the Group finance cost may reduce by LKR 560mn, translating into an EPS of LKR 8/share**

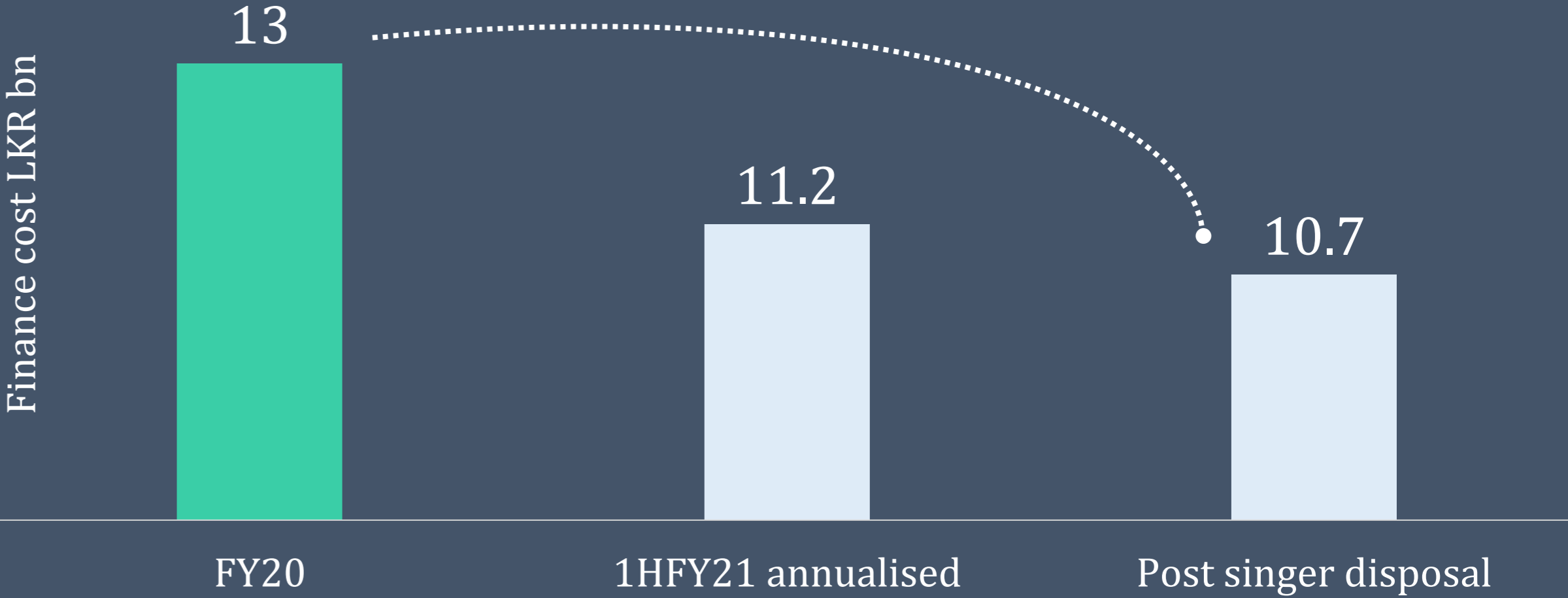
Hayleys owns 90% of SINS both directly and through its related companies

We expect HAYL to retain a controlling ownership of SINS, while disposing the remaining stake to a strategic investor at c. LKR 50 per share cf. acquired price of LKR 47 per share. Given the improved earnings of SINS to LKR 855mn in 1HFY21 cf. loss of LKR 25mn in 1HFY20, along with the improved investors' sentiment should facilitate this disposal.



Disposal of a 30% stake may reduce HAYL's finance cost by LKR 560mn

The group debt currently stands at LKR 112bn, translating into an EV/EBITDA of 6x. The management indicates that they prefer to maintain the EV/EBITDA multiple at 4x. As a result, we expect the disposal from the proceedings to settle the debt. It should also be noted that the prevailing lower interest will aid HAYL to save LKR 1.7bn in finance cost.



Source: Company data, SSB Research



# Agriculture and Power segments to benefit from proposed budget 2021; HAYL to see robust earnings growth ahead

## Agriculture

- **With the government's initiative to boost local agricultural output and reduce the reliance on agricultural imports, we believe that the Hayleys Agri segment could see double-digit earnings growth going forward.** The company has exposure to seeds, fertilizer, equipment supplies, feed and landscaping. The agriculture segment's EBIT margin expanded 136bps YoY to 9.3% in 1HFY21 to LKR 672mn. The margin expansion was driven by increased agricultural output during 1HFY21.
- **Further, the management also indicated that they see a lucrative opportunity in the field of landscaping for port city development.**

## Power & Energy

- **The Renewable Energy space is assured to have lucrative growth prospects in the coming years,** in line with the efforts of the GoSL to expand the sector by over 1,000 MW by 2023 along with the proposed 7-year tax holiday. Therefore, the Non-conventional Renewable Energy market which had already been growing at a 5-Year CAGR of 17%, could see exponential growth going forward.
- **Whilst the details are yet to be clarified as to whether the tax holiday impacts current projects or only investments in the future, the entire supply chain stands to gain via capacity expansions, with the main beneficiaries being EPC's (for installation) and importers (for panels/inverters).** Being a market leader in solar installation may aid HAYL to capitalize on such growth opportunities. Notably, the company supplies 50MW renewable energy to the national grid. During 1HFY21 Power & Energy sector contributed LKR 476mn EBIT to the group.
- However, the true benefit to power producers for new projects may be negligible as tender systems attract bidding wars which may bring down tariff rates, resulting in the stabilization of margins and ROE's at pre-budget levels. However, new projects in the pipeline that have already finalized PPA's prior to the proposed tax holiday would see a direct benefit in profitability and ROE, owing to the pre-agreed tariff rates.

# A tie-up with COVID-19 vaccine company to distribute vaccine may boost the transportation segment's earnings in FY22E

## Vaccine Distribution

- According to a study published by DHL about COVID-19 vaccine delivery, close to 200,000 pallet shipments, 15mn deliveries (in cooling boxes) and 15,000 flights will be required across the various supply chain set-ups. The management noted that they are exploring opportunities to tie up with a vaccine producer to distribute the COVID-19 vaccine. If the company is to establish a partnership to distribute vaccine, we expect transportation segment earnings to see double digit-growth in FY22E.
- We are ambitious on the government's initiative to promote Colombo and Hambanthota ports as commodity trading hubs with tax concessions for warehouse related investments, which can be the catalyst for growth in the transportation sector.
- The transportation sector EBIT declined by LKR 523mn to LKR 871mn in 1HFY21. The decline was mainly due to weaker trade volumes as a result of the COVID-19 lockdown in 1QFY21. However, on a QoQ basis, EBIT grew 8x in 2QFY21 to LKR 762mn.

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