



First Capital  
A Janashakthi Group Company



# “TALE OF RESILIENCE”

## Apparel and Textiles sector in Sri Lanka

First Capital Research

Hiruni Perera +94 11 263 9864  
hiruni@firstcapital.lk

EQUITY | SRI LANKA | SECTOR REPORT

JAN 2022



# Contents

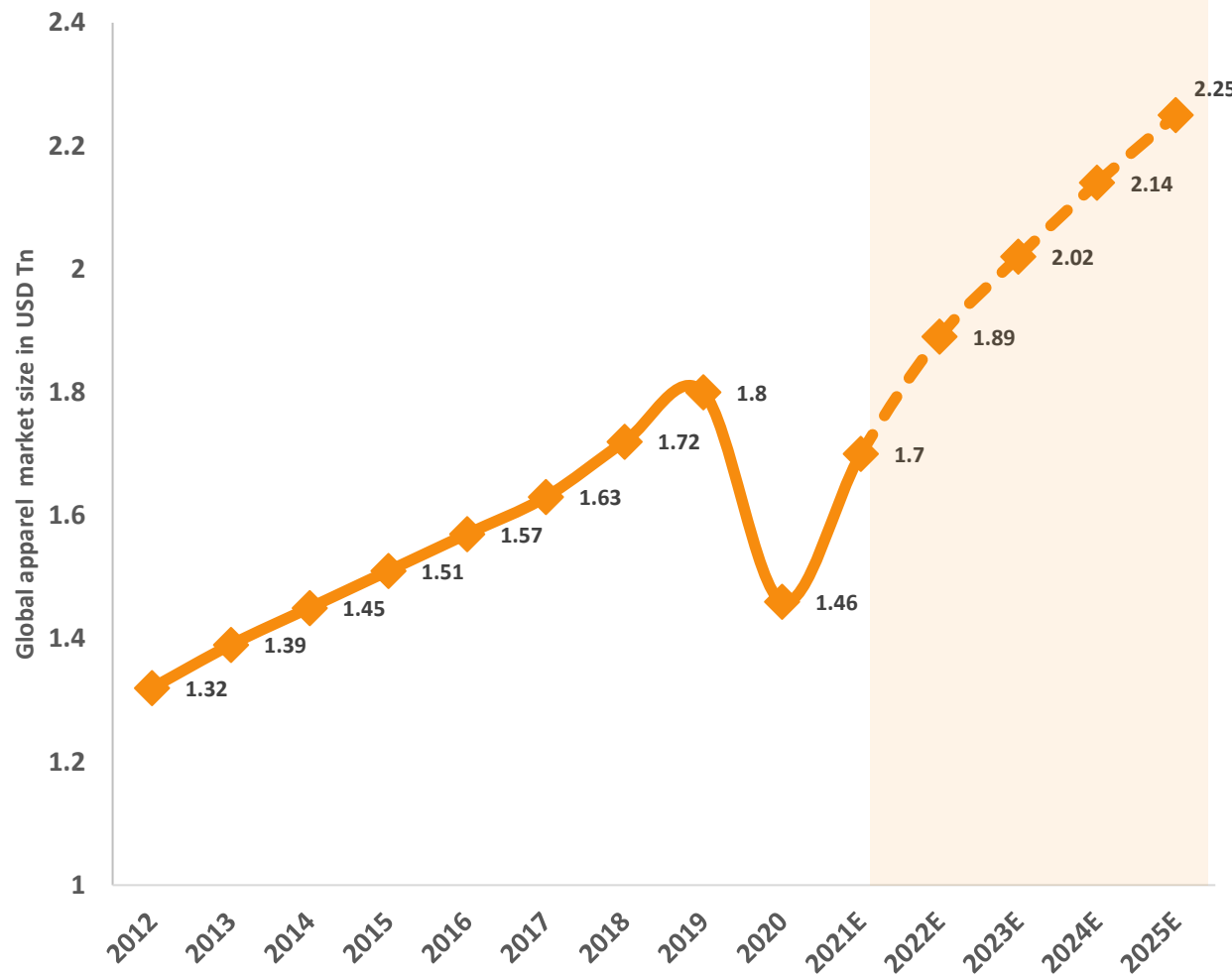
- 01** Rapid Growth in the global apparel demand and currency depreciation to favour apparel and textile industry
- 02** Leveraging on the trade shift
- 03** Sri Lanka's reputation for ethical sourcing to be a key competitive advantage
- 04** Cotton prices are expected to stabilise in upcoming quarters boosting margins of apparel and fabric makers
- 05** Our picks in the sector

1

Rapid Growth in the global apparel demand and currency depreciation to favour apparel and textile industry



# Global apparel market to reach USD 2.2Tn at a CAGR of 9.0% by 2025E

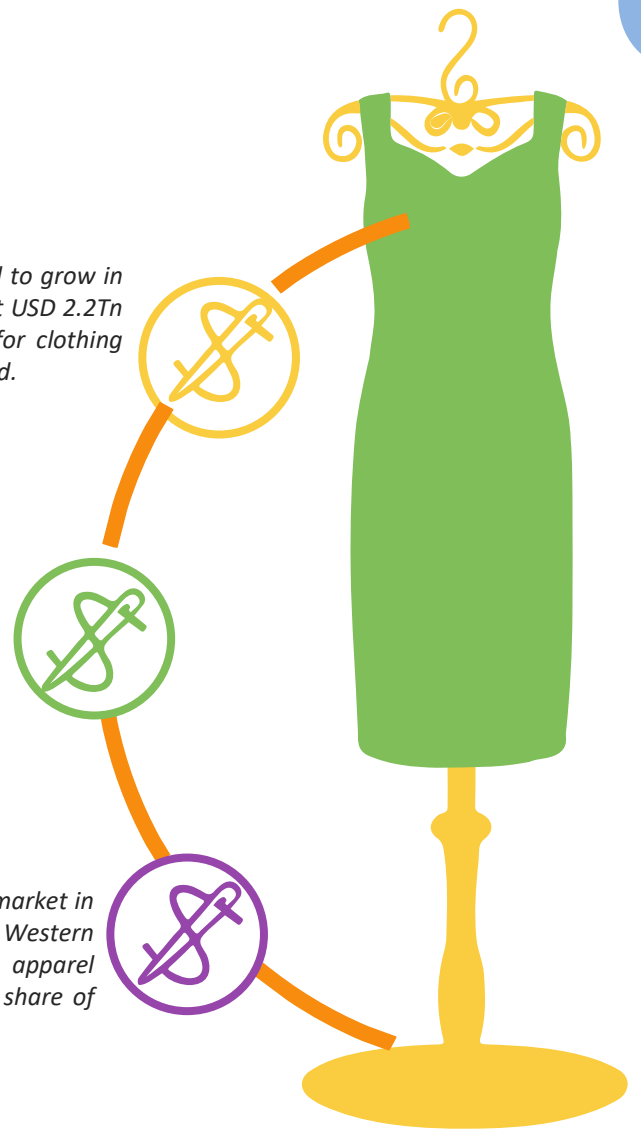


Source: Rush order tees

The global apparel market is projected to grow in value from USD 1.5Tn in 2020 to about USD 2.2Tn by 2025, showing that the demand for clothing and shoes is on the rise across the world.

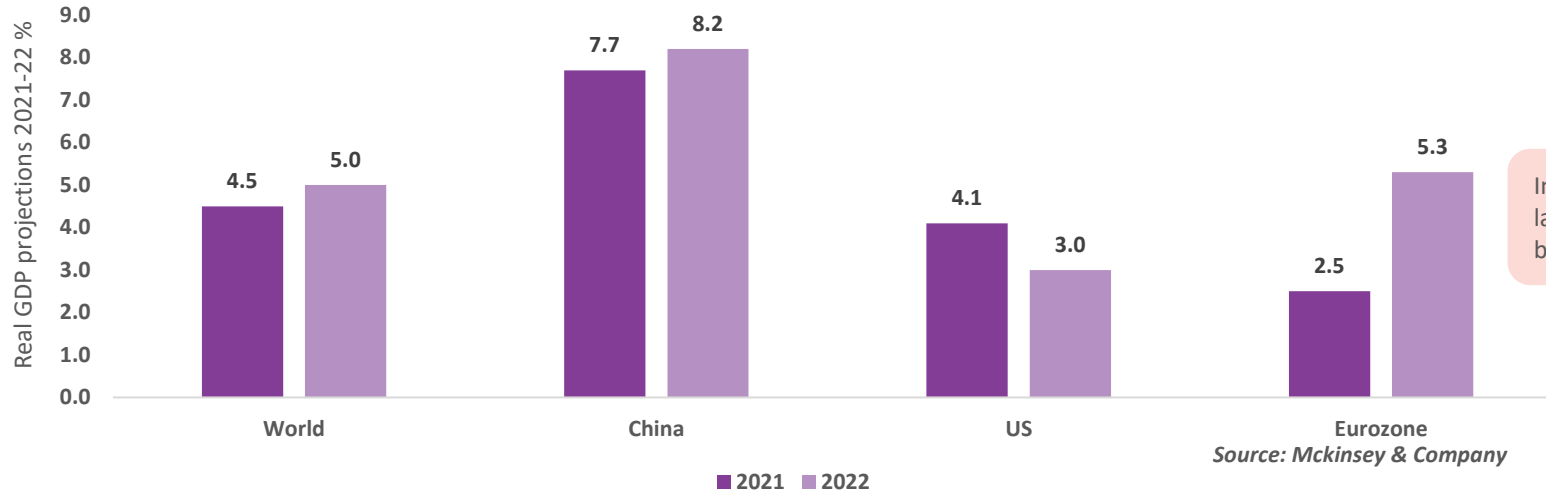
The apparel industry lost an estimated USD 342.0Bn in 2020 revenue compared to 2019 due to the COVID-19.

The Asia Pacific region is the largest apparel market in the world, consuming 33% of global demand. Western Europe is second with 28% of the global apparel market, while Africa represents the smallest share of global demand.



# Recovery in consumer demand post pandemic and...

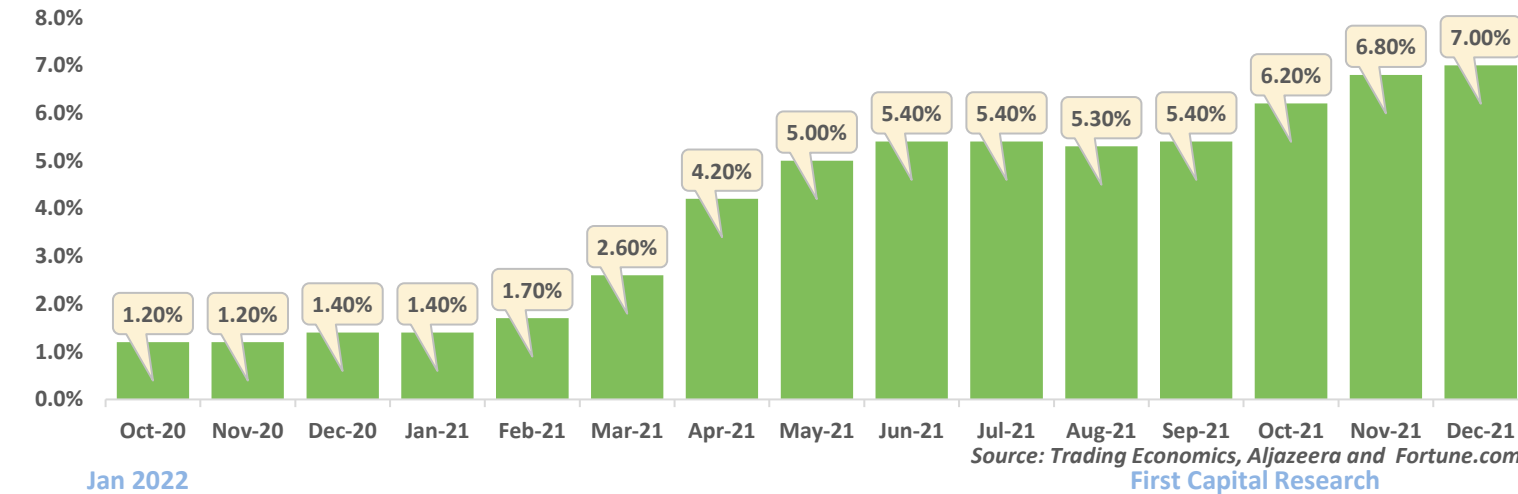
Some of world's largest economies can expect robust recovery in 2022



In the scenarios analyzed across fashion's largest consumer markets, 2022 is broadly expected to be a year of growth.



Annual inflation in US surged to 7.0% in Dec-21 the highest since Nov 1990



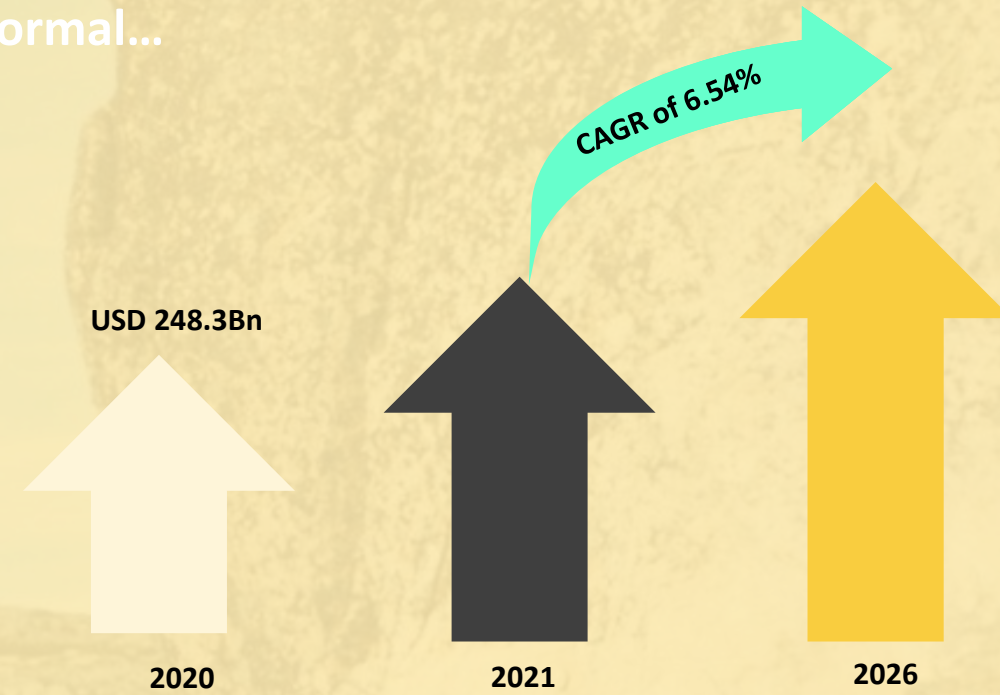
In U.S retail sales grew 16.9% in December 2021 when compared with the same month a year ago while inflation hit 7.00% highest since Nov 1990.

Although the fashion industry struggled last year, it seems that activewear and athleisure brands flourished more than ever. With the majority of business meetings taking place in front of a notebook at home, leggings, sweatpants and loungewear have quickly become inherent pieces of our professional wardrobes.



# ATHLEISURE

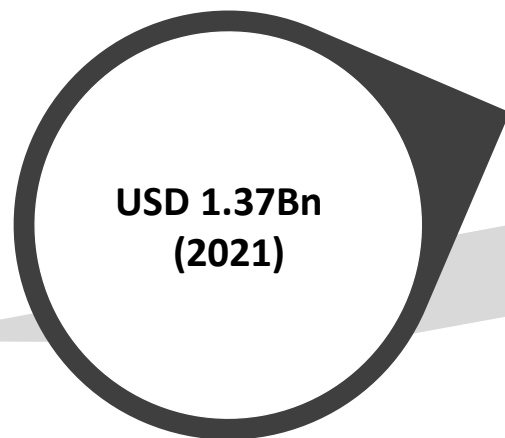
The emerging trend which is becoming the new normal...



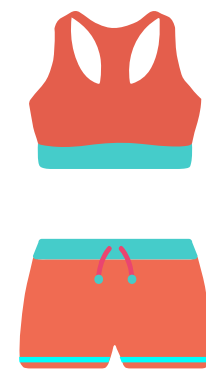
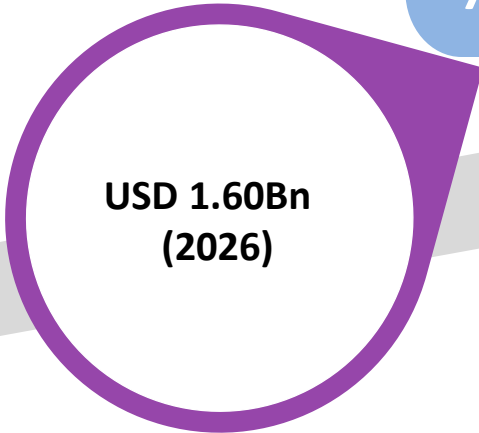
Source: Forbes and reportlinker and mordorintelligence.com

The sportswear industry is clearly a winner in 2021 as consumers continue to spend time at home exercising and seeking comfort in trying times. Global Athleisure Market was valued at USD 248.31Bn in 2020, and it is projected to grow at a CAGR of 6.54% during the forecast period (2021-2026).

...is expected to thrive the global synthetic fabric market...



CAGR of 3.2% in the forecast period of 2021-2026

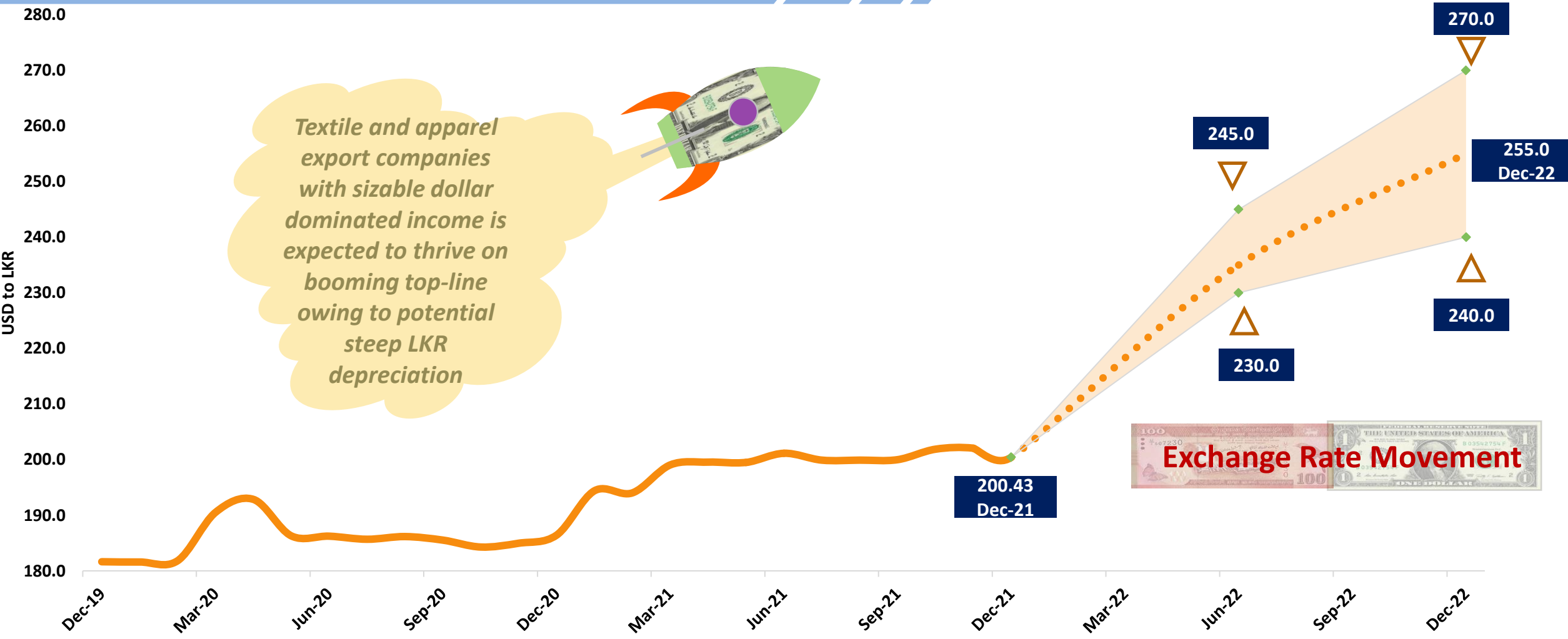


Source: *Indutry arc.com*

Synthetic Fabric market size is forecast to reach USD 1.6Bn by 2026, after growing at a CAGR of 3.2% during 2021-2026. North America accounted for a significant share in the industry in 2020. The demand and production of synthetic fibres in Latin America and Europe are also high. However, the Asia Pacific is expected to create significant opportunities for the market expansion in the forecast period. This can be attributed to the escalating disposable incomes and the presence of a large population in the region. The growing production and consumption of synthetic fibres in China and India are significantly aiding the industry growth. This is further supported by the rapid urbanisation and rising standards of living in these countries.

# ...while potential currency depreciation to favour apparel/Textile manufacturers

*Textile and apparel export companies with sizable dollar dominated income is expected to thrive on booming top-line owing to potential steep LKR depreciation*



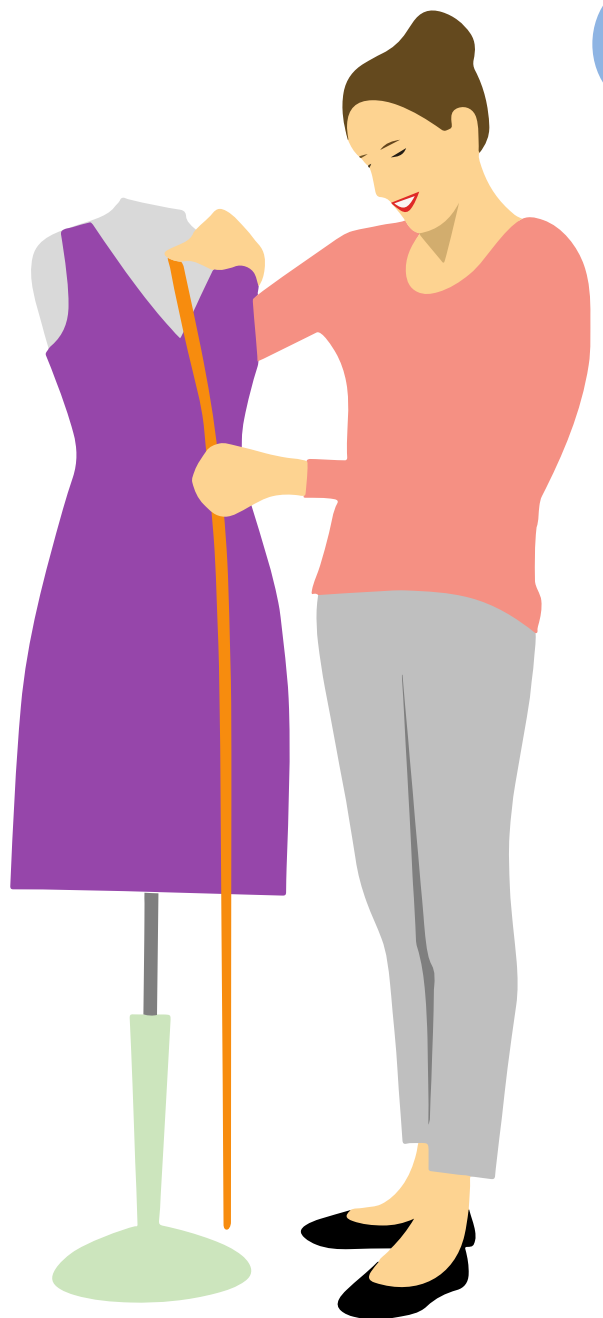
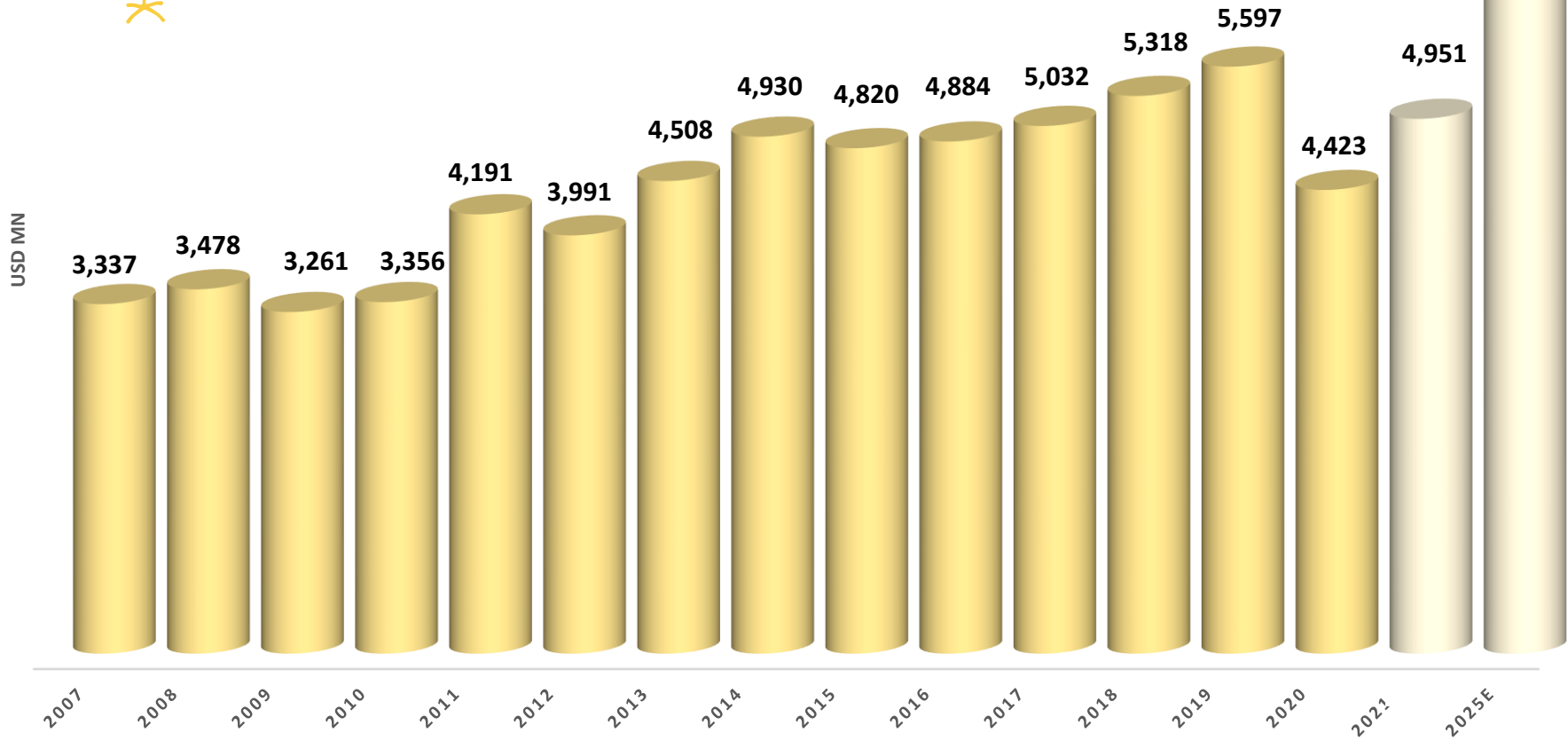
Source: CBSL, First Capital Research



# Sri Lanka's ambitious apparel target of USD 8.0Bn by 2025E for Sri Lanka...



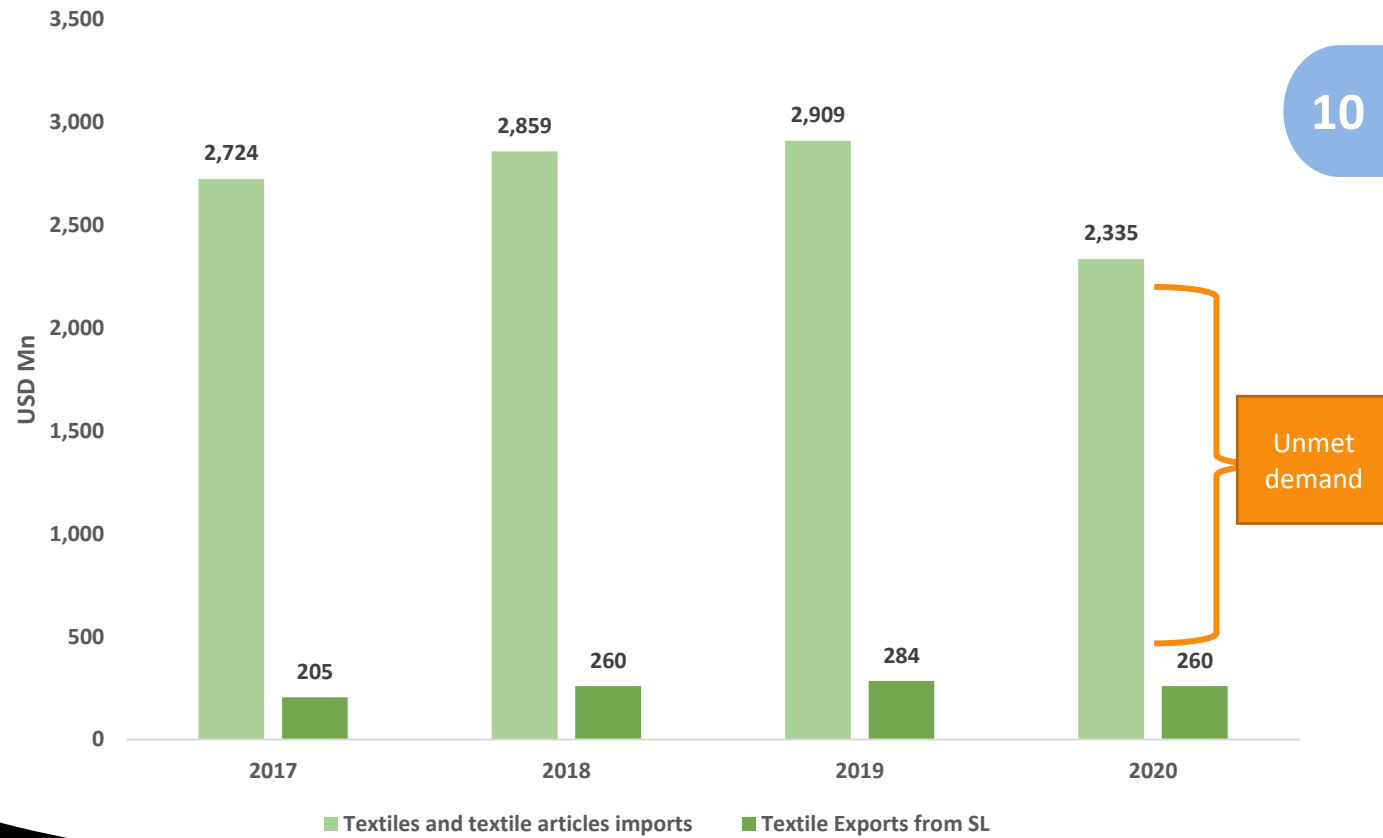
Garment and textile industry has an ambitious target of USD 8.0Bn export target amidst the stronger demand witnessed in 2021. After the dip witnessed in 2020 owing to COVID-19, recovery in the global context is expected to favour apparel and fabric manufactures in Sri Lanka.



*...provides tremendous opportunity to cater to uncatered local demand*



*With imported raw materials amounting to USD 2.0-3.0Bn, the local textile manufactures can significantly enhance its contribution. An opportunity exists for fabric manufactures (TJL, MGT and HELA) to capture the market share by enhancing its capacity.*



Source: CBSL

2

Leveraging on the trade shift



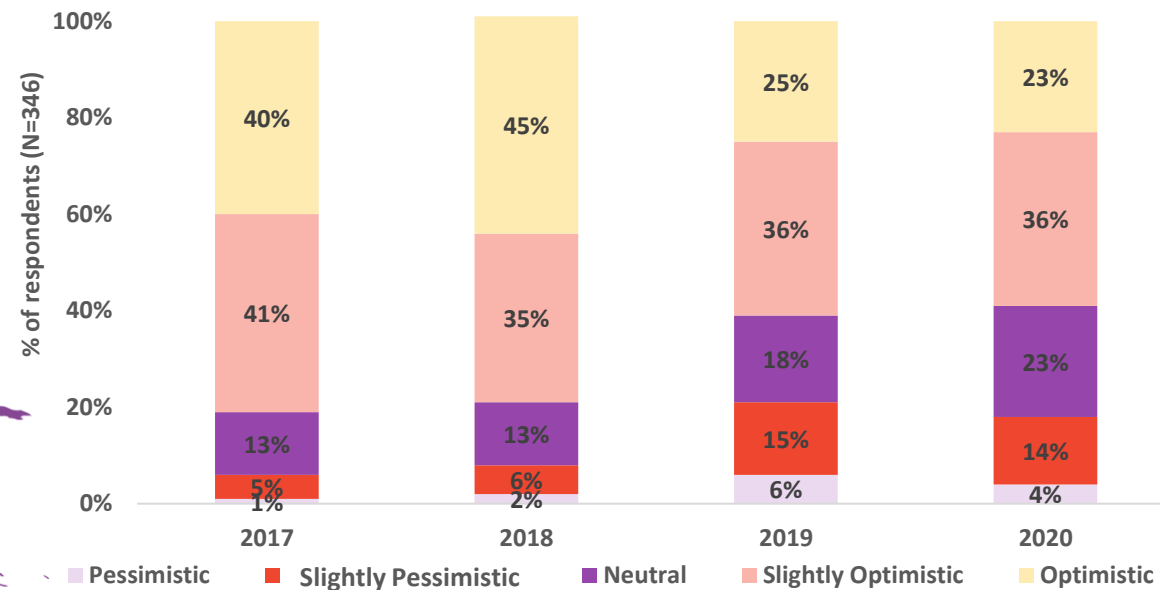
# changes in global landscape with “China Plus One Strategy” ...

*Major fabric and apparel manufactures are expected to benefit from the relocation strategy by brands out of China to South Asia.*



*The disruption wrought by the COVID-19 pandemic has been profound on the world's factory floors, possibly accelerating the adoption of a “China-Plus-One” strategy by manufacturers wishing to diversify their sources of production away from the world's second largest economy, which is currently locked in a trade dispute with the United States. As businesses seek to wean their dependence on China, moves towards diversification seem probable.*

120% 4-year business outlook-China (optimism in the Chinese economy has fallen from 81% to 59% in 4 years)

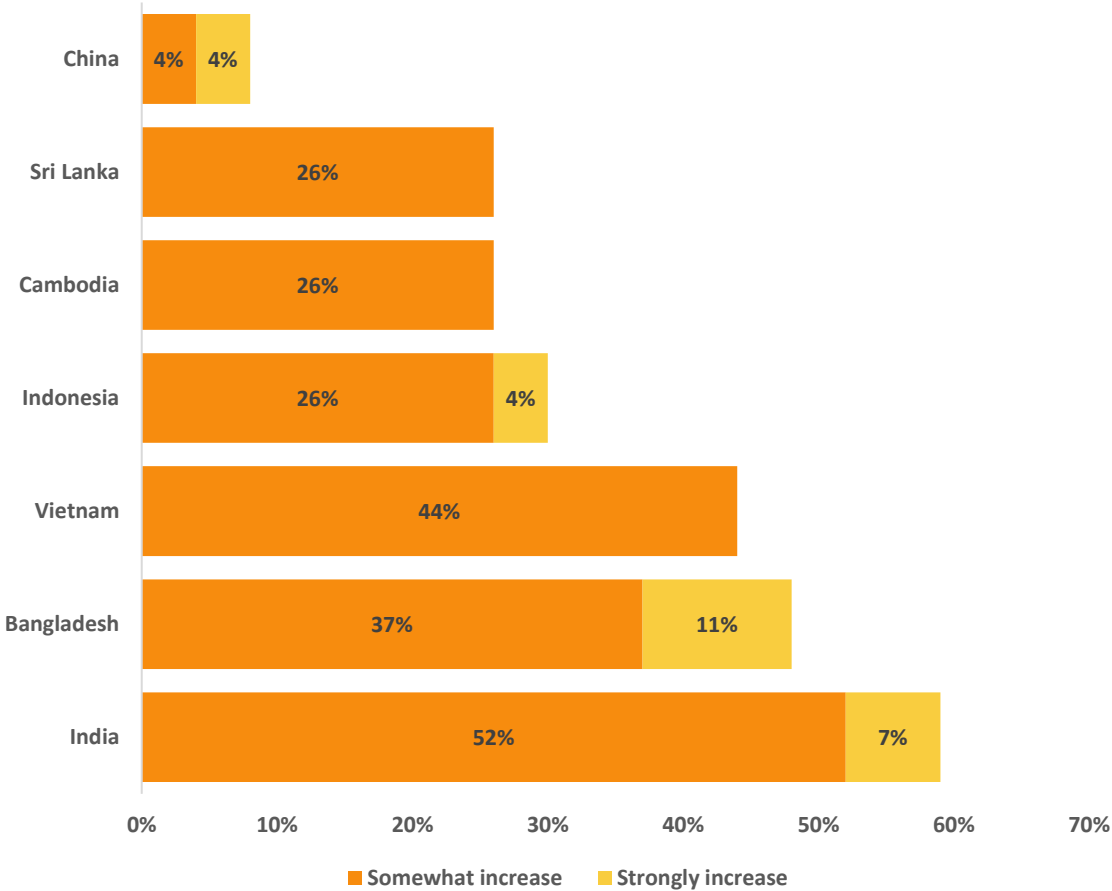


Source: cme group.com

*American business sentiment is indicative of the shifting sands: as China looks to tap into its growing middle class to boost domestic demand for a variety of consumer goods as a way to reduce its reliance on exports, American manufacturers are increasingly looking outward. Calvin Klein, Tommy Hilfiger, Levi's, Crocs and Uniqlo have already moved their production out of China as costs rise and nation moves up value chain.*

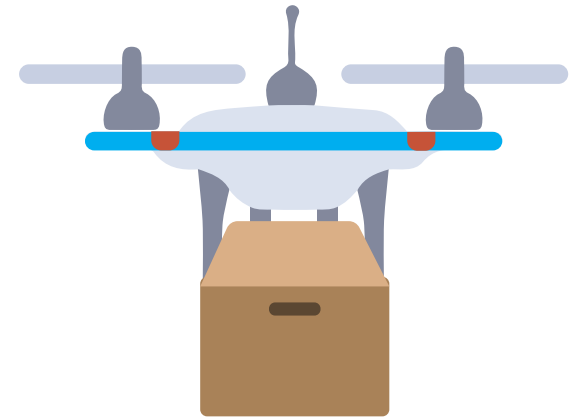
# ...to favors Asian countries including Sri Lanka

Your company's sourcing value (or volume) from the following countries or regions will increase in the next two years?



Source: 2021 Fashion industry Benchmarking study

With an improved industry look and the continued interest in reducing "China exposure," U.S. fashion companies actively explore new sourcing opportunities. More than 85% percent of respondents plan to increase sourcing from a few Asian countries over the next two years, including India, Bangladesh, Indonesia, Philippines, Vietnam, Cambodia and Sri Lanka.



A close-up photograph of a person's hands operating a white sewing machine. The person is wearing a blue plaid shirt. They are sewing a piece of light-colored, intricate lace fabric. The machine's needle and foot are visible, stitching the fabric. The background is a soft-focus blue plaid pattern.

3

**Sri Lanka's reputation for ethical sourcing to be a key competitive advantage**

# SL has a reputation as a trusted partner indicated by its partnerships with reputed Brands

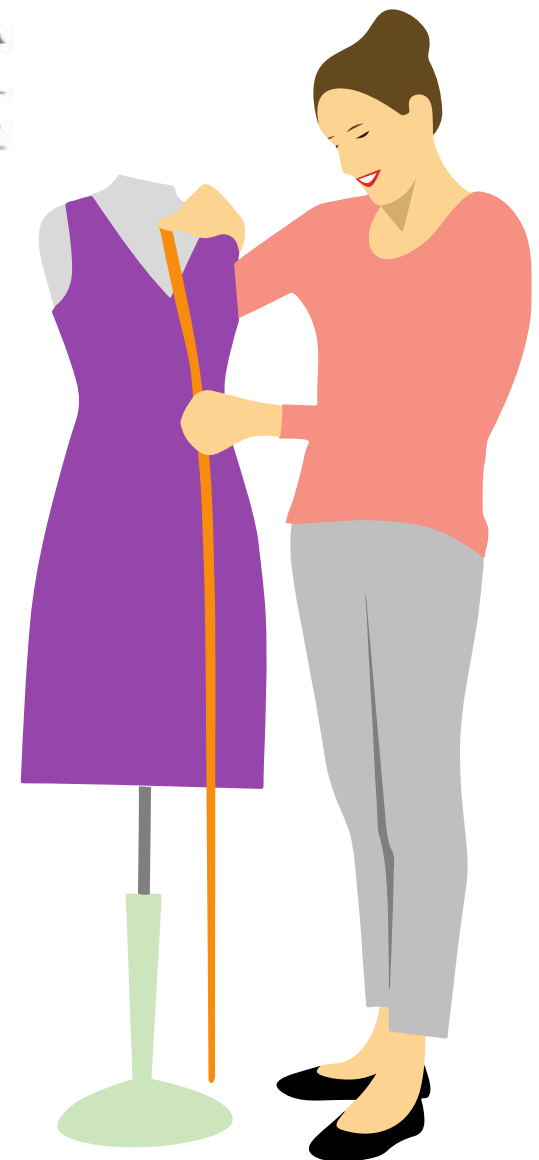


Throughout the years Sri Lankan apparel manufacturers & suppliers have gained a strong reputation worldwide for ethical manufacturing of high-quality apparels trusted by the iconic global fashion brands.

Sri Lankan apparel manufacturers initiated the cause of ethical labour practices and use of people and environment friendly factories in garment sector. A campaign under the slogan of 'garment without guilt' promoted the need for positive and ethical work conditions among the garment factory workers in the world.

- The country's ethical environment and labour practice has also led to some leaders in fashion world including Victoria's Secret, Gap, Nike, Tommy Hilfiger, Intimissimi and Next partnering with local garment manufacturers to improve customer confidence.

First Capital Research



# This provides a significant competitive advantage to SL over the other countries



Amid a shift in the global textile and apparel sector, Sri Lanka has managed to provide quality assurance along with improved working conditions for labourers. The country is also known for its triple bottom-line approach: People-Planet-Profit. This has won accolades all over the world.

Showcases the best of technology including the world's first eco-friendly "Green Garment Factory" that cut energy in half and water consumption by 70%.

Several leading Lankan textile and apparel plants have managed to get Leadership in Energy and Environmental Design (Platinum) certification by the United States Green Building Council.

Continuous investments in sustainable and renewable energy sources such as Solar, wind and hydro power.

Source: Sri Lanka apparel.com



4

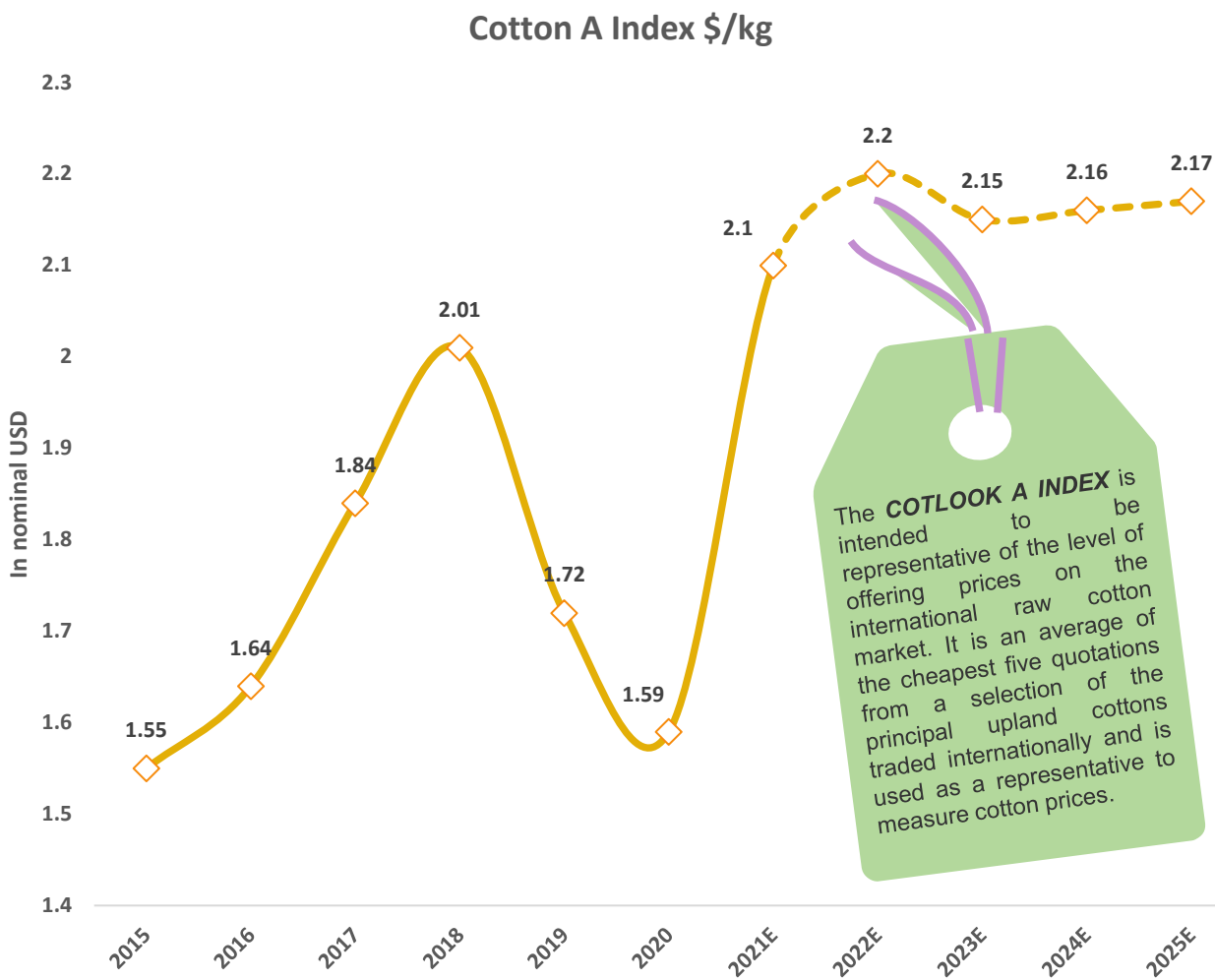
**Cotton prices are expected to stabilise in upcoming quarters boosting margins of apparel and fabric makers**



# Cotton have witnessed an escalation in prices in 2021 amidst more than expected demand...



...however, prices are expected to stabilize gradually with the increase in supply



The **COTLOOK A INDEX** is intended to be representative of the level of offering prices on the international raw cotton market. It is an average of the cheapest five quotations from a selection of the principal upland cottons traded internationally and is used as a representative to measure cotton prices.

Source: World bank, Time of India

First Capital Research

Cotton prices may continue to rally in the coming quarters and are likely to cool-off in the second half of 2022. With the sort of economic recovery seeing and the post-Covid demand with online business picking up for garments, there is a tremendous scope for prices to rise.

As per the commodity outlook report by World Bank, cotton prices are expected to peak in 2022 and stabilize thereafter. The outlook for consumption is a marked improvement over the previous season's pandemic-related contraction of nearly 13.0%. On the supply side, global production is projected to increase 6.4%, led by the world's largest exporters—Brazil (16.0%) and the U.S. (27.0%). Cotton prices are expected to gain 5.0% in 2022, following a projected increase of 32.0% in 2021.

However, the chances of re-emergence of the Covid through the Omicron variant is said to be having a global impact. In India, the industry is fearing adverse impacts due to the spread of the new variant.

5

Our “HOT PICKS” in the sector



**TJL.N0000**

**Current Price: LKR 54.1**

**Fair Value: LKR 75.0 (FY23E)**

***TJL's revenue to grow at a three-year CAGR of 34% to LKR 76Bn by FY24E***

TJL's capacity expansion in its existing Indian plant and the exploration of new market segments such as Bangladesh and Africa, along with projected currency depreciation in the LKR are anticipated to fuel TJL's topline growth. Further, the global apparel market is poised to expand at a steady CAGR of 9.0% by 2025E, following the post pandemic recovery in consumer demand and, changes in global landscape with "China Plus One strategy" favoring Asian countries, thereby providing tremendous opportunities for TJL. With multiple catalysts, TJL's revenue is expected to reach LKR 76.0Bn by FY24E with a 3-year CAGR of 34%.

***Manufacturing operations to normalize post pandemic***

Uncertainty caused by the inevitable COVID-19 outbreak, led TJL outsource sections of its topline, resulting in subdued margins, which was exacerbated by an increase in cotton prices, thereby further aggravating the situation. However, stabilization of cotton prices in upcoming quarters and reduction in outsourced orders amid improved efficacies in manufacturing are expected to enhance margins in the near term.

***Focus on value added products to further escalate margins in the medium to long term***

Athleisure is becoming a fast-growing trend, due to the increasing fashion trends, coupled with the evolving retail landscape across brands, and have been the key factor for the booming global synthetic fabric market. TJL is poised to benefit from this emerging trend and is geared to reap benefit through more sophisticated fabric and process innovations. Further, expansion into synthetic from cotton is expected to enhance TJL's NP margins at 5.5% for FY22E and at 6.6% for FY23E.

***FY23E fair value is upgraded to LKR 75.0-MAINTAIN BUY***

In FY22E, we expect TJL to record a profit of LKR 2.8Bn (31%YoY) while FY23E net profit is expected to record at LKR 4.2Bn (51%YoY). We have arrived at a TP LKR 75.0 for FY23E which indicate an upside of 39% on the current Price. **MAINTAIN BUY**

P/E 31 March	FY18	FY19	FY20	FY21	FY22E	FY23E	FY24E
<b>Estimates (LKR 'Mn)</b>							
Revenue	24,647	31,747	33,277	31,853	51,312	63,803	76,317
Gross profit	2,911	3,686	4,229	3,766	5,388	7,656	9,730
EBIT	1,811	2,345	2,728	2,487	3,320	5,085	6,655
<b>Net Profit</b>	<b>1,596</b>	<b>1,859</b>	<b>2,384</b>	<b>2,139</b>	<b>2,807</b>	<b>4,228</b>	<b>5,517</b>
Adjusted EPS (LKR)	2.2	2.6	3.3	3.0	3.9	5.9	7.7
YoY Growth (%)	-19%	16%	28%	-10%	31%	51%	30%
<b>Valuations</b>							
PER (x)	24.3x	20.9x	16.3x	18.1x	13.8x	9.2x	7.0x
PBV (x)	3.3x	2.8x	2.5x	2.2x	2.1x	1.9x	1.7x
DY (%)	3.0%	3.6%	2.4%	5.2%	4.8%	7.1%	9.1%
NAVPS	16.3	19.4	21.8	24.8	26.1	28.2	31.0
DPS (LKR)	1.6	2.0	1.3	2.8	2.6	3.8	4.9
Dividend Payout	72%	75%	39%	94%	66%	65%	64%

**MGT.N0000**

**Current Price: LKR 43.7**

**Fair Value: LKR 60.0 (FY23E)**

***MGT's revenue to grow at a three-year CAGR of 41% to LKR 42Bn by FY24E***

MGT's expanded capacity through the acquisition of South Asian and along with projected currency depreciation in the LKR are anticipated to fuel MGT's topline growth. Further, the global apparel market is poised to expand at a steady CAGR of 9.0% by 2025E, following the post pandemic recovery in consumer demand and, changes in global landscape with "China plus strategy" favoring Asian countries, thereby providing tremendous opportunities for MGT. With multiple catalysts, MGT's revenue is expected to reach LKR 42.0Bn by FY24E with a 3-year CAGR of 41%.

***Focus on Synthetic products and enhanced volumes to escalate margins in the medium to long term***

Athleisure is becoming a fast-growing trend, due to the increasing fashion trends, coupled with the evolving retail landscape across brands, and have been the key factor for the booming global synthetic fabric market. MGT is poised to benefit from this emerging trend and is geared to reap benefit through more sophisticated fabric and process innovations. Currently, MGT is the largest synthetic fabric manufacturer in Sri Lanka, having gained the confidence of selected Tier-1 brand owners and securing the required business volumes. We believe that MGT has a significant potential to leverage its 'Inno' brand and R&D capabilities to create innovative fabrics that attract premium prices thus enhancing its margins.

***FY23E fair value is upgraded to LKR 60.0-UPGRADE TO BUY***

In FY22E, we expect MGT to record a profit of LKR 1.3Bn (72%YoY) while FY23E net profit is expected to record at LKR 1.7n (32%YoY). We have arrived at a TP LKR 60.0 for FY23E which indicate a capital gain of 37% on the current price. **UPGRADE TO BUY**

P/E 31 March	FY18	FY19	FY20	FY21	FY22E	FY23E	FY24E
<b>Estimates (LKR 'Mn)</b>							
Revenue	8,965	11,983	12,225	14,769	27,666	34,583	41,499
Gross Profit	944	1,429	1,585	2,019	3,984	5,360	6,432
EBIT	144	470	450	890	1,868	2,540	3,044
<b>Net Profit</b>	<b>-106</b>	<b>181</b>	<b>231</b>	<b>736</b>	<b>1,269</b>	<b>1,670</b>	<b>1,934</b>
Adjusted EPS (LKR)	-0.3	0.4	0.6	1.8	3.1	4.0	4.7
YoY Growth (%)	-244%	272%	28%	218%	72%	32%	16%
<b>Valuations</b>							
PER (x)	N/A	100.1x	78.4x	24.7x	14.3x	10.9x	9.4x
PBV (x)	6.8x	5.7x	5.1x	4.3x	3.6x	2.9x	2.4x
DY (%)	-	-	0.7%	1.4%	2.4%	3.1%	3.6%
NAVPS	6.5	7.7	8.5	10.2	12.2	14.8	17.9
DPS	0.0	0.0	0.3	0.6	1.0	1.4	1.6
Dividend Payout	0%	0%	54%	34%	34%	34%	34%

**Current Price: LKR 15.0**

**Fair Value: LKR 19.2 (FY23E)**

***Strategically located in Africa with first mover advantage***

Having identified Africa as the final frontier for apparel manufacturing, HELA's first mover advantage has secured it as the pioneer of the industry's rehabilitation in East Africa and one of the region's largest apparel exporters. This position has allowed HELA to attract a substantial portion of business from major global brands that are migrating to the region since Africa offers indefinite duty-free access to the US and Europe. HELA represents 20% each of Kenyan and Ethiopian apparel exports and aims to be the largest intimates exporter of Egypt by 2024. With the global spending on apparel is expected to grow at a CAGR of 6.1% from 2021 to 2025, HELA obtains greater potential to improve its revenue in future.

***Product innovations gained huge market credibility and higher margins***

HELA's forte is into intimates and is gradually moving towards the high margin Active wear and added Medical Wear as an additional product category in FY22 via the establishment of Safeguard Work wear EPZ Limited (SGW) in Kenya. By offering an attractive multicounty manufacturing offering, continuously testing new supply chain models to reduce delivery times, and fostering innovative collaborations, HELA is dedicated to ensuring the customer gets the best solutions that exceed their requirements. HELA's holistic market approach enables it to achieve a level of flexibility which is unique in the apparel sourcing sector. Improving profitability during COVID-19 is a testament to this strategy as e-commerce and supermarket channels remained active during the pandemic.

***Future expansion plans via IPO proceeds***

With the IPO proceeds, HELA intends to invest LKR 1Bn to start a fabric mill in Sri Lanka which is expected to be completed in 2Q23. The investment will ensure a reliable and consistent supply of fabrics for the Sri Lankan operations, and aid product innovation and higher blended margins.

***Fair Value is estimated at LKR 19.2 for FY23E***

We have valued the share at LKR 19.2 for FY23E and at the current IPO price level of LKR 15.0 share is implying an upside of 28%.

P/E 31 March	FY19	FY20	FY21	FY22E	FY23E
	(5 Months)				
<b>Earnings (LKR 'Mn)</b>					
Revenue	16,155	32,874	32,155	46,625	60,612
Gross Profit	2,654	6,996	6,065	8,159	11,213
EBIT	467	1,988	1,960	2,232	2,928
<b>Net Profit</b>	<b>-192</b>	<b>805</b>	<b>767</b>	<b>1,259</b>	<b>1,923</b>
Adjusted EPS (LKR)	-0.19	0.78	0.74	0.97	1.48
YoY % Growth		-519%	-5%	31%	53%
<b>Valuations</b>					
PER (x)	N/A	19.3x	20.3x	15.5x	10.2x
PBV (x)	18.3x	6.2x	4.3x	2.6x	2.6x
DY (%)	0%	0%	0%	0%	0%
NAVPS	0.8	2.4	3.5	5.9	5.9
DPS (LKR)	0	0	0	0	0
Dividend Payout	0%	0%	0%	0%	0%



## Disclaimer

This Review is prepared and issued by First Capital Holdings PLC based on information in the public domain, internally developed and other sources, believed to be correct. Although all reasonable care has been taken to ensure the contents of the Review are accurate, First Capital Holdings PLC and/or its Directors, employees, are not responsible for the accuracy, usefulness, reliability of same. First Capital Holdings PLC may act as a Broker in the investments which are the subject of this document or related investments and may have acted on or used the information contained in this document, or the research or analysis on which it is based, before its publication. First Capital Holdings PLC and/or a connected person or associated person may also have a position or be otherwise interested in the investments referred to in this document. This is not an offer to sell or buy the investments referred to in this document. This Review may contain data which are inaccurate and unreliable. You hereby waive irrevocably any rights or remedies in law or equity you have or may have against First Capital Holdings PLC with respect to the Review and agree to indemnify and hold First Capital Holdings PLC and/or its principal, their respective directors and employees harmless to the fullest extent allowed by law regarding all matters related to your use of this Review. No part of this document may be reproduced, distributed or published in whole or in part by any means to any other person for any purpose without prior permission.



# THANK YOU

“Successful Investment Is About Managing Risk...”

## CONTACT US

### **First Capital Holdings PLC**

No: 02, Deal Place, Colombo 00300, Sri Lanka.

E: [research@firstcapital.lk](mailto:research@firstcapital.lk)

#### **Dimantha Mathew**

Head of Research

T: +94 11 2639 853

E: [dimantha@firstcapital.lk](mailto:dimantha@firstcapital.lk)

#### **Hiruni Perera**

Assistant Manager- Research

T: +94 11 2639 864

E: [hiruni@firstcapital.lk](mailto:hiruni@firstcapital.lk)

#### **Vidushika Perera**

Assistant Manager- Research

T: +94 11 2639 864

E: [vidushika@firstcapital.lk](mailto:vidushika@firstcapital.lk)

#### **Tharusha Ashokgar**

Junior Analyst-Research

T +94 11 2639 864

[tharushaash@firstcapital.lk](mailto:tharushaash@firstcapital.lk)



**First Capital**

