

Chairman's Message



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Q: HOW WOULD YOU DESCRIBE THE GLOBAL BUSINESS AND INDUSTRY ENVIRONMENT DURING THE YEAR?

A : During the year under review, your Company, as well as all fabric manufacturers in Asia, faced a double jeopardy of higher raw material prices on the one hand, and constrained demand growth in key markets on the other hand. A short supply of cotton yarn during the year resulted in a sharp rise in yarn prices, fuelling in turn a sharp rise in costs of production, across markets. At the same time, political changes in the U.S. and slower pace of economic growth in the E.U. during the year, contributed to the lacklustre demand, affording no room for suppliers to transfer a share of the higher costs of production. In Sri Lanka as well, export in Textiles and Apparel remained stagnant for the calendar year 2016 at approximately USD 4.8 Bn due to the global conditions. There was a marginal decline in the US export base compared to a growth in the EU which had an impact on industry as a whole. The loss of GSP+ in 2010 is said to have cost Sri Lanka USD 32 Bn in overall Exports since. Bangladesh enjoys full GSP+ access and has developed an Apparel Industry of over USD 25 Bn per year. Therefore, the recent regaining of the GSP+ through the efforts of many is commendable in the case of Sri Lanka, and the industry can be optimistic about future growth potential.

Q: ...AND TEEJAY'S PERFORMANCE?

A: Teejay's Topline grew the past year by a strong 24%, despite major global uncertainty in most markets. This was driven by a strong Sales engine, and partly due to the timing of our consolidations. Teejay's margins, and that of all other players in the industry, were impacted by these significant challenges during the year. Our profitability, especially our Gross Margins dropped significantly in H2, post the yarn cost hikes, compared with the excellent performance of the previous year. Cotton prices hiked to double digit during H2, and remain at similar levels. But thanks to our previous growth strategies, and cost containment, we remained firmly profitable and reported a Profit after tax of Rs.2 Bn. We also managed to limit the profit slide with full year PAT declining by only 9.7%. I am happy to note that your Company still remained among the top performers in the industry in the region despite these challenges. The strategic initiatives made during the past two years and the Company's well diversified portfolio of key clientele contributed to its resilience amid challenging circumstances.

Half of the Sri Lankan cotton fabric requirement is imported at present. Similarly, almost the entire Synthetic requirement is imported into Sri Lanka. This underlies the portfolio of opportunity that Teejay seeks to tap into, through its local supply chain solution. Your Company took a significant step in launching the manufacture of Synthetic

fabric during the year – a product which offers tremendous potential to capture new markets and higher margins. Synthetics are now being welcomed by the customers as an evolving garment form which contributes to their increasing user friendliness, comfort, performance and even lasts longer. The differences between Cotton and Synthetic fabrics are also reducing considerably.

We also launched a process of expansion of our production capacities in India, and Phase I of it was completed during the latter part of the year, providing us with 9 tons of added capacity as we move into FY18.

With the GSP prospects, all initiatives taken during the year and with the comfort of a strong Balance Sheet, Teejay Group has declared a dividend of LKR 2.25 Rupees for the year compared to LKR 1.60 last year. This demonstrates our firm belief in the team's ability to continually deliver sound margins for the business.

Q: WHAT ARE SOME OF TEEJAY'S STRENGTHS WHICH HELPED IT TO WITHSTAND THE IMPACT OF THESE CHALLENGES IN 2016/17?

A: One is the operational efficiencies and cost reductions which we continue to enhance, and a second is Teejay's market positioning. The Company has focused on enhancing operational efficiency and cost reductions as a key strategic imperative. Moreover, it was also the first full year of operation as a Group, since Teejay's strategic acquisition of Ocean India Private Limited (OCI) and Quenby Lanka Prints (Pvt) Ltd which helped in yielding benefits of economies of scale. Teejay's market positioning in key niche markets and with leading global brands, has been a key success factor in becoming one of Sri Lanka's leading fabric manufacturers. I am pleased to share that your Company integrated and unified the identity of all three entities under the very modern, vibrant and dynamic brand logo and name Teejay. We will leverage this synergy and focus on making it the strongest fabric brand in South Asia. Our emphasis on product quality, and delivery Speed, also helps differentiate our products against these challenges. The company is blessed with strong, competent and skilled talent, and they have been navigating the company very credibly through a rough period.

Q: WHAT DOES SUSTAINABILITY MEAN TO THE COMPANY?

A: Social and Environmental sustainability are integrated into our strategies and business.

Environmental impact is and needs to be, a priority area for any manufacturing industry, and is made that much more important in the textile manufacturing industry. At Teejay minimising our Carbon footprint, and any hazardous waste disposals, are integrated into our business model and manufacturing processes, from stage of design to the disposal of manufacturing waste. Environmental concerns are made more urgent today by threats of climate change which loom large. At the same time, most markets and garment industries which cater to international markets, have evolved rapidly to mandate social and environmental responsibility and compliance among their criteria for sourcing new products and suppliers; thus creating a win-win impact on the industry. Most reputed international buyers who partner us also make physical checks and often unsolicited visits, to assess our commitment and compliance and ensure that we continue to practice what we articulate. Enhancing the environment friendliness of our operations and minimizing our Carbon footprint is a continuous process at Teejay. During the year we installed sophisticated equipment into our State-of-the-art Coal Plant to further reduce emissions, and spent over USD 200,000 during the year to reach even higher standards on all our discharge. Our teams partner closely with the BOI, Environmental Authorities, the Wildlife Society, Academia, and other local parties, to undertake numerous activities aimed at furthering these different aspirations. I am pleased to note the tremendous amount of Community work being undertaken by our teams, to support local Schools, Communities, Religious establishments and the likes. They are clearly the inspiration to the entire Seethawaka zone.

We also believe that Governance is indispensable to creating long term value and sustaining profitability. Teejay's Board sets the tone at the top to ensure good governance by promoting professional standards and Corporate values that cascade down to senior management and other employees of the Company at all levels. Moreover, our Board composition which constitutes two independent members whose contribution reflects true commitment to the role expected of an Independent Director.

Q: WHAT WOULD YOU SAY ARE THE KEY DRIVERS OF GROWTH INTO THE FUTURE, FOR YOUR COMPANY AND THE INDUSTRY?

A: Product innovation will be important and hence R&D will be a key driver of growth for Companies. Textiles is one of the oldest industries in the world, but is currently undergoing rapid transformation. Concurrently, the need for constant and fast paced innovation to sustain a competitive advantage or even merely survive the immediate term is important although somewhat lower than say Information Technology based Industries. Hence, innovation of how we do rather than what we make is a more urgent imperative in the fabric industry, Your Company will continue its journey towards lean manufacturing and focus on the continuous enhancement of the efficacy of its people and processes, whilst also expanding its capacity as well as product and brand portfolio. Our major expansion in India had us investing over USD 15 Mn in our growth aspiration there. We are very well poised as our Indian manufactured fabric will be GSP+ eligible for Sri Lankan Apparel manufacturers. Our topline growth should see healthy impacts in the next two years as a result. We will also see the full impact of our Synthetic manufacture during the near future.

Sri Lanka continues to struggle with good long-term Energy options. While the debates continue, it is expected that Sri Lanka's Coal based Energy consumption will double to over 40% and even exceed that of Hydro within the next two decades. Teejay Lanka has already invested in one of the most advanced Coal powered plants and is well poised to ride that wave.

We are also conscious that some of these trends will be impacted by the strategies and decisions made by the respective apparel manufacturers in Sri Lanka. In addition, steps being taken by the government to pursue more global agreements similar to GSP, or exclusive agreements with specific countries, could help alter and accelerate the growth momentum of the industry. The comments that Sri Lanka would pursue partnerships with ASEAN, specific Asian nations, the ECTA with India, and even potential trade agreements with Japan, will all open up new avenues for the Industry.

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Q: WHAT CHANGES / INITIATIVES OR POLICY MEASURES DO YOU THINK WILL HELP SRI LANKAN INDUSTRIES TO PROGRESS FASTER?

A: Sri Lanka is today one of the most attractive destinations for foreign investment inflows due to many factors. A peaceful political environment and the comparative advantage of its geographic positioning combined with the fact that Sri Lanka is a manufacturer for a large number of the world's leading apparel brands are among the most significant. Sri Lanka thus brims with much potential for new investments for overseas apparel manufacturers. Fiscal reforms, bringing policy clarity and stability and improvements in the ease of doing business, are a few examples of areas which need focus. However, several factors also impede the progress of industries in the country. Sri Lanka's high energy costs for instance, continue to be a challenge which dampens its cost competitiveness for all manufacturing industries. The continued state involvement in many large parts of the economy, with 245 SOE's, may hinder progress towards better liberalisation. Better predictability around tax regimes are essential for investors to be able to focus on the longer term. These issues maybe what is limiting FDI to a mere 1% of GDP. The Sri Lankan road network badly needs an overhaul including the roadways to our factory in Avissawella. Average road speeds are being reduced by one kilometre per hour each year, due to increased traffic congestion. On our part, we remain optimistic about the future prospects of Sri Lanka, and our

investment plans continue seamlessly. Our future aspiration is to build a USD 300 Mn enterprise by 2020, and we remain optimistic about the journey.

Q: HOW DO YOU PERCEIVE THE NEAR TERM AND MEDIUM-TERM OUTLOOK?

A: It is encouraging that cotton prices have now begun to stabilize and seems unlikely to rise further in 2017-18, while demand for garments and hence fabric, has also begun to gather momentum.

However, margins in cotton fabric are also likely to remain tight for several months due to both supply and demand conditions in the future. As mentioned, your Company has identified higher growth potential in the Synthetics market.

When Sri Lanka lost the benefit of concessionary trade terms with the discontinuation of GSP+ in August 2010, there was much concern about the sustainability of many garment and fabric manufacturing businesses in the country. However, the industry was able to weather the storm through market positioning and by enhancing internal efficiencies and cost management while progressing towards leaner manufacturing models. The Sri Lankan fabric manufacturing industry today, has a much stronger set of players. The regain of the GSP+ has bolstered the buoyant outlook we have for the next few years ahead. Companies such as Teejay which have equipped themselves well to thrive in adverse market conditions, through a continuous focus on operational efficiency, are thus well poised to harness the myriad new opportunities that the preferential trade concessions would offer. We are possibly the only company who made major investments in capacity expansion, even during times when profitability was challenged. We thus look ahead with renewed vigour and our medium-term outlook is very positive

We also expect the focus on capacity expansion and becoming a regional player supported by Teejay India, to facilitate economies of scale and a solution to some of the higher costs of labour and energy in Sri Lanka. Our new state of the art digital printer will also open up numerous opportunities for engaging with a broader set of customers and fabric types.

Teejay envisions being the best fabric manufacturer in South Asia, and by looking at where it is today, I can say we are well on our journey. Your Company will continue to learn, evolve and expand to capture markets with the highest quality products .

Also maintaining our dynamic corporate culture, with solid values and a strong team which weathered a very turbulent year, we hope to be outperforming competition in the region and continue our good work into the future. I would like to thank the management team and all our employees, on behalf of the Board, for their sacrifice and commitment throughout the year. They remain the pillars on which our success is built.