

JAT Holdings Limited: Initial Public Offering

JAT Holdings Limited (JAT) incorporated in 1993, is one of the pioneers in wood-based coating in Sri Lanka and Bangladesh. Sayerlack- the flagship brand distributed by JAT, represents Sherwin- Williams- the largest producer of paints, varnishes, and specialty coatings in the United States. JAT's trusted relationship with Sherwin Willian has enabled JAT to emerge as the undisputed market leader in the water-based and PU wood coating segment with a c. 55% market share in Sri Lanka and c. 28% market share in Bangladesh. This uninterrupted relationship has also allowed JAT to secure the exclusive distribution rights for Sayerlack products in South Asia and certain regions in East Africa.

JAT also has its footprints in decorative painting and interior living space market segments in Sri Lanka. JAT represents global brands like Harris brushes, Herman Miller ergonomic office furniture, Knauf ceiling solutions, SEA Bauformat for bespoke kitchens and homegrown brands such as J Chem solvent based paints, WHITE by JAT brilliant white paint, Brush Master brushes for wood coatings, Euro Metallic metal ceilings cushioning bottom line.

JAT marked its first LKR 1Bn in FY 2011 after entering the Bangladesh market in 2001 and subsequently entering the Maldives market. JAT has thereafter been able to touch a topline of over LKR 6Bn after having access to the Indian market and partnering with many global leaders.

JAT after these key milestones is now planning to raise LKR2.2Bn via an initial public offering (IPO) for a 16.24% stake. The funds are expected to be utilized to construct a manufacturing plant in Bangladesh (cost of LKR 515Mn) and in Africa (cost of LKR 302Mn) by FY23. The company also expects to expand "WHITE by JAT" paint range by incurring a cost of LKR 257Mn and enhance its R&D facility to a fully-fledged state of the art facility at a cost of LKR 433Mn while remaining LKR 731Mn is reserved to provide an exit option for an existing investor- Emerald Sri Lanka Fund Limited.

Pick-up in economic activities and low interest rates to drive demand in FY22: We expect the bottom line of JAT in FY22 to return to normalcy after seen a profit dip of 15% in FY21 which was hit by strict lockdown measures that hindered activities in both Sri Lanka and Bangladesh. Our expectation is based on less stringent travel restrictions and opening of economy with Sri Lanka targeting to vaccinate minimum of 70% of the population. All time low interest rates on mortgaged backed loans (~7%) should fuel the demand for home builders' market which should eventually push the demand for wood coatings (JAT's biggest contributor to revenue), paints and brushes segments. Low interest regime should also help push the demand for condominium properties too, as the spike should continue through residential and investments that will assist in gaining market share through JAT's furnishing and finishing projects.

JAT's newest- 'WHITE by JAT' – emulation paint- which was launched in December 2020 is also expected gather momentum through its innovative direct-to-consumer e-commerce strategy. The pent-up demand together with substantial savings to end consumer in the absence of dealer commissions should further help JAT's paint segment on top of the main business.

Export revenue to be fueled by Bangladesh and African Ventures. Margins to strengthen further: The new wood coating manufacturing plant that is expected to commence operations in Bangladesh is estimated to be 55,000 sq.ft. in size, which is almost the size of the three manufacturing plants in Sri Lanka put together. JAT plans to construct the plant by 2Q'FY22 and complete it by 4Q'FY22 after using part of the IPO proceeds (LKR 515Mn). According to our calculations, the additional contribution to the topline from this venture could even exceed LKR 1Bn, where part of it could get reflected from FY23E onwards. This could be possible on the back of positive dynamics in Bangladesh economy like higher economic growth rates, pick up in construction sector and JATS already established presence in Bangladesh (Bangladesh contributed to 26% of JAT's revenue in FY 20).

Issue Highlights

Industry	Materials
Total issue of shares	82,904,846
Issue per share	27.00
Market cap. (LKR Bn)	13.8
% of holding to the public	16.24%
Opening of the subscription list	20th July 2021
Closure of the subscription list	10th August 2021

Shareholding Pattern

	Pre IPO
Mr. Aelian Gunawardene & family	80.60%
Dr. Sivakumar Selliah & family	5.13%
Akbar Brothers Group	5.96%
Emerald Sri Lanka Fund I Limited	5.96%
Others	2.35%
IPO Shareholders	0.00%

	Post IPO
Mr. Aelian Gunawardene & family	71.80%
Dr. Sivakumar Selliah & family	4.58%
Akbar Brothers Group	5.31%
Emerald Sri Lanka Fund I Limited	0.00%
Others	2.08%
IPO Shareholders	16.24%

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In the next line of investment, JAT also expects to commence a wood coating manufacturing facility in South Africa, with an investment of LKR 301Mn. The plant is expected to be 25,500 sq.ft in size and will commence construction in 2Q'FY23 and complete by 4Q'FY23. JAT has already entered the African market in FY20 holding exclusive rights to market Sayerlack products, thus capitalizing market share would be a fairly easy after the commencement of the plant in our view.

JAT also believes that having a production footprint overseas to help strengthen its competitive edge via improvement in gross margins stemming from backward vertical integration and associated cost reductions. Hence, we have estimated an overall GP margin improvement of 400bps kicking in from FY23.

Timeline of IPO fund utilization

Investment	Fund utilization (LKR Mn)	Expected utilization timeline
Enhancing the existing R&D facility to a fully-fledged state-of-the-art facility for all coatings	433	2Q'FY22 - 4Q'FY22
Setting up manufacturing plant in Bangladesh	515	2Q'FY22 - 4Q'FY22
Expanding the "WHITE by JAT" marketing and development initiatives	257	2Q'FY22 - 4Q'FY23
Setting up a manufacturing facility in East Africa	302	2Q'23FY - 4Q'FY23

R&D facility to improve GP margins further: JAT also expects to invest LKR 433Mn to enhance the existing R&D facility to a fully-fledged state-of-the-art facility for all coatings. This would enable JAT to improve collaboration with suppliers' and improve JAT's wood coating product range as well as enhance quality and offer tailor made product solutions to new market segments. This will help JAT improve revenue with the inclusion of innovative products while also helping to improve GP margins. According to the management an overall 2% margin improvement can be expected once R&D is fully operational, however on a conservative note we have assumed a margin improvement of 0.5%-1% giving some levy for LKR depreciation that may result in increase of raw material prices.

Investors to reap benefits from the secondary market transactions: Although we are bullish on JAT's earnings potential, the valuations of JAT do not seem to warrant the current market conditions. For instance, with on offer price of LKR 27/- per share, JAT's current PE stands at 22.9 (on post IPO shares) on a ROE of 11.6%. However, peers like RCL, TKYO, TILE, LWL, ALUM, PARQ who are also directly linked to construction sector, currently trades in a PE range of 5x-11x, which is much lower than JAT, despite generating a ROE of north of 20%. On a forward PE too JAT is expected to trade at 14.7 on FY 22E earnings and 9.2 PE on FY 23E earnings. Thus, purely given the current market conditions we believe that investors could benefit more in the secondary market transactions of JAT.

Peer Comparison

Listed Peers	Market Cap.		TTM PAT to SH		PBV	PER	ROE
	(LKR Mn)	No. Shares (Mn)	(LKR Mn)				
JAT Holdings*	13,781	510	599		2.6	22.9	11.6%
Royal Ceramics Lanka PLC	39,663	1,108	6,134		1.3	6.5	20.2%
Lanka Tiles PLC	13,873	265	2,475		1.4	5.6	24.9%
Lanka Walltiles PLC	17,008	273	2,879		1.2	5.9	19.8%
Access Engineering PLC	23,000	1,000	2,170		1.0	10.6	9.2%
Lanka Aluminium Industries PLC	1,692	69	260		0.9	6.5	14.4%
Swisstek (Ceylon) PLC	4,174	137	597		1.5	7.0	22.1%
Alumex PLC	7,782	599	841		2.6	9.3	28.3%
Tokyo Cement Company (Lanka) PLC	17,802	267	5,440		1.2	4.9	24.7%

*PE PBV & market cap calculated at issue price of LKR 27.00. For other counters prices as at 08.07.21

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Earnings Forecast

YE Mar	2019	2020	2021	2022E	2023E
<u>Income Statement (LKR Mns)</u>					
Revenue	6547	6295	5359	7391	9897
Gross Profit	1932	1739	1644	2143	3266
Selling & Distribution Expenses	-592	-667	-711	-850	-1168
Admin Expenses	-306	-311	-301	-370	-594
PBT	941	751	645	1045	1668
PAT	881	707	601	941	1502
Profit attributable to shareholders (LKR Mn)	884	712	599	938	1497
<u>Balance Sheet (LKR Mn)</u>					
Property Plant & Equipment	1487	1435	1531	2331	2621
Total Assets	6993	7156	7057	9527	10810
Total Equity	4568	4962	5341	7342	8245
Total Liabilities	2425	2195	1717	2185	2565
<u>Ratios & Other</u>					
GP Margin	30%	28%	31%	29%	33%
EBIT Margin	16%	13%	13%	14%	16%
NP Margin	13%	11%	11%	13%	15%
EPS pre IPO	1.93	1.56	1.31	2.05	3.27
EPS post IPO	1.73	1.39	1.18	1.84	2.93
NAVPS pre IPO	9.99	10.86	11.69	16.07	18.04
NAVPS post IPO	8.95	9.73	10.47	14.39	16.16
PE (x)	15.63	19.49	22.93	14.69	9.20
PBV (x)	3.02	2.77	2.58	1.88	1.67
Dividend payout	37%	28%	32%	40%	40%
Dividend yield	2.6%	1.6%	1.5%	2.7%	4.3%
ROE	21%	15%	12%	15%	19%

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