KC 1 – KC 4

COMMON PRE- SEEN INFORMATION

Ceramic Industry Overview

Sri Lanka is rich in minerals, such as kaolin, ball clay, feldspar, silica sand, quartz and dolomite. This has encouraged a domestic ceramic industry that manufactures porcelain tableware, porcelain ornamental-ware and glazed wall and floor tiles for local and export markets.

Having developed a stable growth model in recent years, Sri Lanka continued to attract foreign direct investments (FDI) into the country. Predominantly driven by the large scale infrastructure based projects, Sri Lanka's construction industry grew by a healthy 21% during 2014. Although a component of the overall construction sector, the tile industry could not fully realize this success owing to its dependence on the housing construction market, which grew only by 6.5%. The rising interest rates experienced during the year discouraged housing loans, which resulted in lower demand for tiles & bath-ware in the housing sector.

With the housing construction segment demonstrating restrained growth during the year, the continuing influx of cheap imported tiles remained a serious worry for the tile industry. Hence during the year, the government intervened to strengthen the local tile industry with the aim of protecting locally manufactured products. Consequently, the duty protection Cess of 35% was imposed to restrict low cost imports.

The rising energy costs are a major production obstacle as the costs of electricity and fuel are the main production costs. Tile industry consumes large quantities of clay. Although there is abundant supply of high quality ball and china clay in Sri Lanka, mining restrictions prevailing in the country act as a barrier in acquiring required quantities. This excess demand is pushing up the cost of raw materials. The depreciating rupee also contributed towards higher cost of production by increasing the prices of imported raw materials.

Spearheaded by the Sri Lanka Ceramics Council in partnership with the Industrial Technology Institute, a number of initiatives were undertaken to refine and develop certain key areas that were deemed critical for future growth of the industry. Of particular note are the developments in the field of nanotechnology for tiles and self-cleaning technology for tiles. It is believed that these innovations would create the next generation of products on par with international standards.

Migaya Ceramics

Introduction

Migaya Ceramics Lanka PLC (MCLP) is a quoted public company listed on the Colombo Stock Exchange with a market capitalization of over Rs. 3 billion. MCLP was featured in "Asia's 200 Best under a US $ Billion" list issued by a famous rating agency, and received the award for "best return on short-term investment in South Asia" out of more than 10,000 listed companies in the South Asian region. Migaya Ceramics[1] is primarily in the business of manufacturing and selling porcelain and ceramic tiles and sanitaryware under the brand names "Micell" and "Micell Bathware" in both domestic and international markets.

The tile segment is the largest revenue generator for MCLP. The Company is the market leader in the Sri Lankan floor tile industry with a market share of 45 percent (approx.). The Company operates two manufacturing facilities for manufacturing porcelain and ceramic tiles located in Godakawela and Meepe, with a combined capacity of 15,000 sq.m./day. The Godakawela plant which is the oldest plant of the Company manufactures porcelain tiles, operating at a capacity of 5,000 sq.m./day. The Meepe plant which has been established as MCLP's fully owned subsidiary, Migaya Porcelain (Pvt) Limited, manufactures ceramic tiles and operates at a capacity of 10,000 sq.m./day.

The bathware segment of MCLP which started its operations in Avissawella in 2013 is at the take-off stage. The operation has been successful thus far in penetrating the domestic bathware market. Currently, the Company manufactures 200,000 pieces a year, accounting for only 50 percent (approx.) of the current capacity located at Avissawella.

Vision

To continue to be the leader in the surfacing industry locally and to enter and impact the global market.

Mission

To offer state of the art surfacing solutions to both the home and commercial builders with products and services that transcend the highest quality, ensuring customer satisfaction by matching all expectations, growing the market by way of product innovation, thereby enhancing shareholder wealth, developing our human resources to excelling latitudes such that Migaya Ceramic exudes a stance of excellence.

The change of strategic orientation

In its initial phase of development until the late 1990s, the Company exported more than 85 percent of its output. However, at the dawn of the new millennium, the Company started to realize that its growth could not rely solely on export markets especially in the context of economic slowdowns in the West where its major markets were located and also due to the fierce competition coming from other tile manufacturing countries, especially China.

In the light of these developments, the Company formulated the following new strategies to maintain the expected growth momentum: These strategies were put in place from the financial year 2009/ 2010.

1. Take necessary actions to continuously tighten quality standards
2. Be innovative in the industry by introducing new and attractive designs
3. Diversify the product portfolio
4. Take necessary measures to strengthen the local market segment.

In order to strengthen the quality standards of the products while lowering the rejection rate, the Company increased the training budget and started several in-house training programmes. Simultaneously, the Company started conducting special seminars and workshops for its employees with the help of the best 'Quality Gurus' in the country at the time. The Company also hired two design specialists.

With the hiring of the new designers, the Company's floor tile range started to expand rapidly. Simultaneously, the management decided to open a few more sales outlets in Colombo, its suburbs and other main cities in order to expand the local market segment.

The decision to introduce the bathware segment was taken with the view of diversifying the product portfolio of the Company. In fact this idea came from one of the new designers hired. According to him, the available designs in the local market did not match the up-market needs and there was a high potential of getting a premium price even in the local market, if the products were better matched to market needs. He further elaborated that giants in the construction industry and some hoteliers who were seeking high quality, stylish bathware products, had to import them from countries such as the US and Italy.

The new strategies helped the Company to keep up its growth momentum. Turnover grew rapidly in both local and foreign segments of the market. The growth was mainly financed through divesting some investments in financial instruments such as government securities and stocks of other companies and through both long-term and short-term borrowings from its network of banks.

Access to capital was not a problem at this stage of development. As a result the Company did not have any cash flow problems despite heavy investments in new plant for the bathware segment and the newly opened sales outlets.

Ambitious plan

The expectations from all corners about the prospects for Sri Lanka's economic recovery from the long and brutal civil war which spanned over 25 years became astonishingly high with the conclusion of the war in early 2011. GDP growth was estimated to be above 8 percent which was expected to be among the most robust in the world. Much of this ambitious growth was expected to come from post-war reconstruction and new investments especially in the tourism and hotel sectors as well as the real estate and property development sectors, despite the global economic slowdown at that time. The acceleration in economic activities led to improvements in overall business confidence in the economy giving rise to a healthy investment climate. Interest rates also showed a sharp drop during the period as a result of the increase in domestic liquidity levels mainly owing to increasing foreign assets created by healthy inflows by way of remittances, investments and long-term borrowings of the country. In this backdrop, the Company felt that increasing borrowings to finance growth would not be a threat. The Company also expected that the demand for construction products in general would increase strongly with the boom taking place, especially in the hotel and property sectors. Further, they anticipated that this growth would be supplemented by increasing investments by individual home-builders driven by the increasing per capita income levels.

In the past, especially prior to the ending of the war, the Sri Lankan tile sector was on a low base with per capita tile consumption at only 0.6 sq.m. in comparison with developed countries in the West that had a per capita tile consumption of 5-6 sq.m.

The management of Migaya Ceramics expected that the economic growth supported by large investments in construction at governmental, business and individual levels would help to rapidly enhance average tile consumption. Further, according to them, the cessation of the civil war was a blessing for the Company which was experiencing continuously declining exports due to the economic crisis in the West and stagnation of the local market due to the civil war. As expected by the management, Company sales started to grow rapidly since 2011, and the tile segment of the Company expanded its operations almost to the fullest capacity. The management was very ambitious and increased the number of sales outlets to 237 by the end of 2012, while adding 4 more warehouses to its network to serve the increasing number of sales outlets. Also, the Company started offering trade credits for construction companies. The duration and the level of credit varied from client to client depending on their balance sheet strength.

Strategic investments & financial reporting and taxation.

Strategic Investment & financing

The management of the company decided to invest Rs. 900 million in a new plant for the bath-ware segment in 2015. The construction will take place on a 30 acre land in Mathugama area and the commercial operation is expected to commence in early 2017. The plant will expand the current capacity of the bath-ware segment by 40%. The management expects to recoup the investment in four years. Further capacity expansion was anticipated through an acquisition or a joint venture. This may enable company to meet the increased demand in the short run.

A decision was taken to issue Rs. 100 unsecured 5 year convertible debentures with a fixed interest rate of 15% p.a. to finance 50% of the initial investment in the project. The debenture issue was opened on 15th December 2014 and fully subscribed and closed on 6th January 2015 as planned.

Financial Reporting.

Migaya Ceramics adopted full SLFRS effective from 1st April 2012. On adoption of SLFRS, the trading investment portfolio was classified as Fair Value through Profit or Loss and measured at fair value. Investment in non-quoted and non-trading shares were classified as Available-for-Sale financial assets and measured at fair value.

Fair value of quoted investments was based on price quotations at the reporting date. The fair value of unquoted instruments was estimated by discounting future cash flows using rates currently available for debt on similar terms, credit risk and remaining maturities and hence approximates its fair value. The group used the following hierarchy for determining and disclosing the fair value of financial instruments by valuation techniques:

Level 1- Quoted prices in active markets for identical assets/liabilities.

Level 2- Other techniques for which all inputs which have a significant effect on the recorded fair value are observable, either directly or indirectly.

Level 3- Techniques which use inputs that have a significant effect on the recorded fair value that are not based on observable market data.

During the financial year 2014/2015 the company had discussions with the NEXT leasing company to get into a sale and leased back arrangement for one of the existing plants of the company.

The Board of Directors of Migaya Ceramics PLC have decided to follow" Integrated Reporting" in compiling its 2014/2015 annual report.

<u>Taxation</u>

The company enjoyed a 10 year tax holiday under BOI law which expired in 2014. The company will be liable to income tax from 2015.

The Company has received a notice of intimation for the year of assessment (2013/14) from the assessor of the Department of Inland Revenue handling the income tax file of the Company.

Extract of the intimation letter

<u>Income tax for Y/A 2013/14</u>

This refers to the return of income tax filed for the above year of assessment and interviews had with your authorized representative.

I would like to inform you that the return of income tax submitted for the above year of assessment has been rejected due to the following reasons and assessment will be issued in due course.

> *"Stock losses amounting to Rs. 3.4 Million are not an expense incurred in the production of income and therefore this amount has been disallowed."*

Please treat this as intimation under Section 163(3) of the Inland Revenue Act.

End of extract

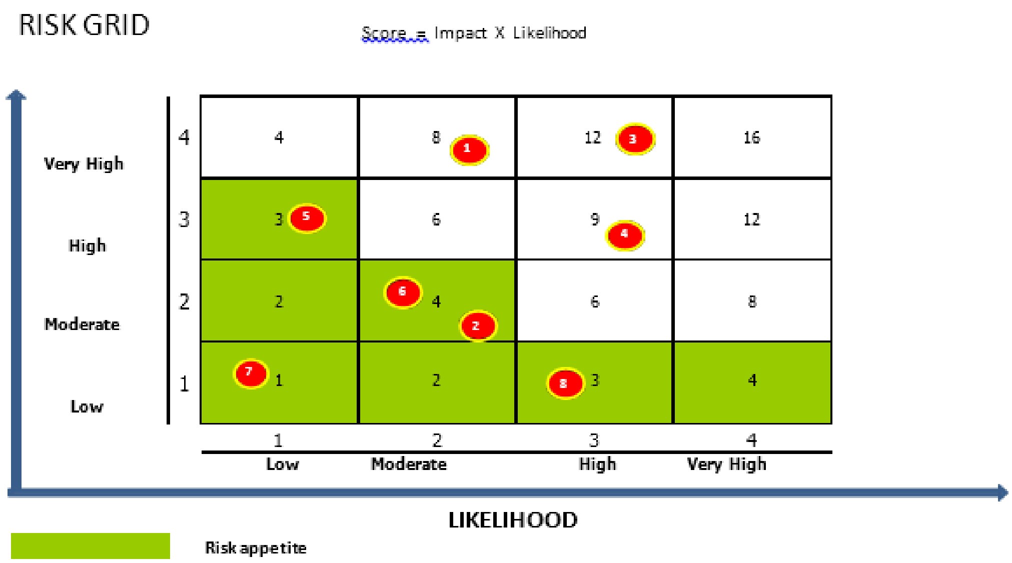
Audit committee & risk management

Enterprise-wide risk management is carried out by a committee representing heads of business units. The committee is responsible for compiling a risk register for each business segment. ***Refer Annexure 1 for extract of Company's risk grid.*** MCLP has an internal audit division established with the main objective of strengthening the internal control system of the group.

Decline in profitability & challenges ahead in financial year 2014/15.

At the board meetings held in January 2015, two non-executive directors raised concerns over the declining profitability and the current risk profile of the Company resulting from strategies put in place in 2011/2012. The chairman explained that expected revenue targets for 2013/2014and 2014/2015 were not achieved due to actions of several competitors through their innovative tile and bathware products. Further, several orders from construction companies received during the peak seasons were not accepted as all plants were running at their fullest capacity. The operations director emphasized the need to invest in R&D due to the rising cost of production, especially the cost increase in electricity and fuel. He further stressed that there had been bottlenecks in the supply chain of raw materials which resulted in the loss of a few construction customers. At this meeting, the finance director explained the need to proactively manage interest rate risk and exposure to foreign currency.

Annexure 1- Risk grid of Migaya Ceramics Lanka PLC



Circles represent positioning of the risk based on the risk score given in the table below.

Risk Event	#	Impact (a)	Likelihood (b)	Risk Score c= (a*b)
Competitor activity - imitation	1	4	2	**8**
Deterioration in product quality standards	2	4	1	**4**
Increasing prices of electricity and fuel	3	3	4	**12**
Loss of talent	4	3	3	**9**
New outlets not achieving expected profitability	5	3	1	**3**
Exchange rate fluctuation	6	2	2	**4**
Supply chain issues	7	1	1	**1**
Non-compliance with regulatory requirements	8	3	1	**3**

Migaya Group of Companies

Consolidated Summary Financial Statements (2011 - 2015)

Consolidated Income Statement (5 year summary 2011 - 2015)

For the year ended					
31st March	***2015(Drafted)***	***2014***	***2013***	***2012***	***2011***
	Rs.'000	***Rs.'000***	***Rs.'000***	***Rs.'000***	***Rs.'000***
Turnover	4,106,015	3,641,563	3,750,385	3,012,237	2,426,454
Cost of Sales	(3,026,511)	(2,512,679)	(2,625,270)	(2,123,627)	(1,698,518)
Gross Profit	***1,079,504***	***1,128,884***	***1,125,115***	***888,610***	***727,936***
Other Income Gains	3,782	4,232	2,242	4,454	1,235
Investment Income	14,422	111,849	208,557	128,988	57,001
Distribution Expenses	(462,450)	(297,914)	(129,603)	(59,591)	(44,207)
Administrative					
Expenses	(252,207)	(158,757)	(82,403)	(57,588)	(55,598)
Finance Cost	(252,894)	(165,562)	(105,271)	(79,300)	(12,434)
Profit Before Tax	130,157	622,732	1,018,637	825,573	673,933
Income Tax Expenses	(39,047)	(186,820)	(305,591)	(247,672)	(202,180)
Net Profit for the Year	***91,110***	***435,912***	***713,046***	***577,901***	***471,753***

Consolidated Statement of Financial Position (5 year Summary 2009 - 2013)					
As at 31 March	***2015(Drafted)***	***2014***	***2013***	***2012***	***2011***
	Rs.'000	***Rs.'000***	***Rs.'000***	***Rs.'000***	***Rs.'000***
Non-current Assets					
Property, Plant and Equipment	2,971,624	2,654,682	2,177,784	1,193,319	1,065,080
Available for sale investments	142,995	194,742	259,891	502,725	300,700

Total Non-current Assets	***3,114,619***	***2,849,424***	***2,437,675***	***1,696,044***	***1,365,780***
Current Assets					
Inventories	1,919,980	1,565,072	1,091,122	785,104	687,489
Trade and Other Receivables	978,845	591,773	461,646	395,162	245,266
Other Financial Assets	318,859	450,027	504,339	468,621	174,311
Cash and Cash Equivalents	35,272	47,462	54,940	50,156	52,757
Total Current Assets	***3,252,956***	***2,654,334***	***2,112,047***	***1,699,043***	***1,159,823***
Total Assets	**6,367,575**	**5,503,758**	**4,549,722**	**3,395,087**	**2,525,603**
Equity and Liabilities					
Stated Capital and Reserve					
Stated Capital	2,289,750	2,096,250	2,096,250	1,075,000	1,075,000
Reserves	77,850	77,850	77,850	615,350	815,350
Retained Earnings	588,469	690,859	641,947	509,401	254,000
Total Equity	***2,956,069***	***2,864,959***	***2,816,047***	***2,199,751***	***2,144,350***
Non-current Liabilities					
Interest Bearing Loans	806,388	684,499	507,578	458,400	18,720
Deferred Tax Liabilities	40,023	101,636	169,349	123,689	95,493
Retirement Benefit					
Liabilities	104,276	98,017	54,307	46,482	22,509
Total Non-Current Liabilities	***950,687***	***884,152***	***731,234***	***628,571***	***136,722***
Current Liabilities					
Bank overdraft	490,086	339,239	76,114	22,454	87
Trade and Other Payables	1,134,848	514,967	225,534	146,377	47,503
Dividend Payable		193,500	240,250	111,250	107,500
Income Tax Liabilities	45,828	62,046	115,884	120,426	2,578

Interest Bearing Loans	790,057	644,895	344,659	166,258	86,863
Total Current Liabilities	***2,460,819***	***1,754,647***	***1,002,441***	***566,765***	***244,531***
Total Equity and Liabilities	**6,367,575**	**5,503,758**	**4,549,722**	**3,395,087**	**2,525,603**

Other available information

1. The Migaya Group consists of three companies: Migaya Ceramics Lanka PLC. (MCLP), Migaya Porcelain (Pvt.) Limited and Migaya Bathware (Pvt.) Limited. Both Migaya Porcelain (Pvt.) Limited and Migaya Bathware (Pvt.) Limited are fully owned subsidiaries of MCLP which is a company listed on the Colombo Stock Exchange.

2. Both the Income Statement and the Statement of Financial Position show the consolidated position of all three companies of the Migaya Group.

3. The investment income of the Company consists of dividends received from investment in equities, interest received on debt securities and bank deposits, and capital gain or loss from selling equity or debt securities.

4. MCLP's stated capital is as follows:

	2015	***2014***	***2013***	***2012***	***2011***
Stated capital (Rs'000)	2,289,750	2,096,250	2,096,250	1,075,000	1,075,000
Number of ordinary shares ('000)	212,850	193,500	193,500	107,500	107,500

In January 2013, the company made the first bonus issue at the rate of eight (08) bonus shares for ten (10) existing shares. Again in March 2015, the company made a right issue of one (01) share for ten (10) existing shares for Rs. 10 per share.

5. MCLP's EPS, DPS and the end of the year share price information for the last five years is given below.

	2015(Draft)	***2014***	***2013***	***2012***	***2011***
EPS	0.43	2.25	3.68	5.38	4.39
DPS	-	2.00	3.00	3.00	2.00
Share Price	14.60	18.40	25.80	16.40	15.20