

# CEO's Review



# CEO's Review

It gives me great satisfaction in presenting to you the performance of your company for the year ended 31st March 2007. The period under review can be summarised as a unique and challenging one for both Sri Lanka and Hemas in many ways.

Posting a GDP growth of 7.4%, the economy grew in 2006 at its fastest rate since 1978. Whilst the services sector made the largest contribution to economic growth last year with a growth of 8.3%, the industry and agriculture sectors too contributed handsomely with growth rates of 7.2% and 4.7% respectively. The year 2006 also posted the lowest ever unemployment rate of 6.5%.

These high growth rates were however accompanied with rising inflation and interest rates, a depreciating currency and a volatile political environment that had a considerable impact on our businesses. After a strong start, consumer markets witnessed a slowdown in demand growth during the second part of the year impacting our Fast Moving Consumer Goods (FMCG) and Healthcare sectors, while dwindling tourist arrivals hampered the growth of the Leisure sector. Despite this the group posted a satisfactory performance achieving record turnover and profits during the year.

## Value Creation - Our Key Strategic Focus

During the period under review your company crossed the billion rupee milestone, with profit attributable to the group closing at Rs 1,006Mn, a growth of 4.9% over last year. Group revenues increased to close the year at Rs 11.8Bn which is a growth of 20.4% over the previous year.

Shareholder value being the key strategic focus at Hemas, we strive to deliver superior returns on equity on a sustainable basis over the long-term.

Shareholder value being the key strategic focus at Hemas, we strive to deliver superior returns on equity on a sustainable basis over the long-term. During 2006/07 your company has posted a Return on Equity (ROE) of 21.1% vis-à-vis a five year average of 25.3%. As the business grows, maintaining ROE's at these high levels is a challenge, but we are confident that the strategic initiatives we have embarked upon will support these levels of return over the long run.

Hemas share price closed on 31st March 2007 at Rs 107.00 and the company paid out a gross dividend of Rs 253Mn to shareholders during the year.

## Business Performance - Mixed Fortunes

Our largest sector, FMCG performed well registering a turnover of Rs 3.8Bn which is a growth of 20.5% over the previous year. Profits declined marginally to Rs 399Mn largely as a result of a change in the sales mix and higher taxation. Our core Personal Care business performed satisfactorily with most of our key brands showing strong growth.

During the year, the sector continued to build on its diversification strategy with the Homecare and Foods division recording an impressive growth off a low base. The sector has identified internationalisation of Personal Care products as an effective way of leveraging our in-depth consumer understanding and brand strengths. In this regard, the sector intensified its focus on entering into regional markets by setting up an international business unit and allocating more resources into this area. Another initiative that commenced during the year was the relocation of our manufacturing facilities to Dankotuwa, in order to benefit from the tax incentives offered under the 'Nipayum Lanka' program. Construction of a new state-of-the-art factory in Dankotuwa has commenced and is expected to be operational during the first quarter of the financial year commencing 1st April 2008.

The Healthcare sector posted a top-line growth of 16.0% and a bottom-line growth of 3.0% for the year under review, closing at a turnover of Rs 2.9Bn and profits of Rs 141Mn. The sector predominantly comprises of Pharmaceuticals distribution, which is the oldest business in our group. Hemas continued to be the market leader in private sector pharmaceutical distribution enjoying a market share of 14.3% in a highly fragmented market. Despite continued value addition to our service delivery, there is

## CEO's Review

constant pressure on margins and the sector has identified diversification into non-prescription medicine area as a key strategy to mitigate this risk. Accordingly, the sector expanded into the fast growing Consumer Health category through the purchase of the 'Paracetol' brand. Paracetol is the number two player in the analgesic market, giving the sector a solid footing from whence it hopes to expand into other segments of the industry. The Hospital solutions and Animal Health segments have also been reorganised to provide more focus for growth. During the year, Hemas progressed closer towards its Healthcare sector Vision of becoming the 'leading provider of Healthcare products and services' by entering the hospital industry. The first hospital of the Hemas group will be located in Wattala, a location that was carefully selected having taken into consideration a number of factors that drive the demand for and supply of healthcare services. As a parallel initiative, a service provider agreement was entered into with a nursing school to provide trained nurses for our hospital.

The Leisure sector experienced a volatile year recording turnover and profits of Rs 864Mn and Rs 43Mn respectively. A significant portion of the profits are on account of negative goodwill arising on conversion of debentures of Serendib Hotels PLC and purchase of shares in Mowbray Hotels Ltd. In fact, the sector showed good performance during the first half of the year, but, unfortunately this was wiped out during the second half on the back of travel advisories and negative international publicity following the escalation of hostilities in the country. Despite this negative backdrop it was heartening to note that Minor International, the largest hotel operator & owner in Thailand, went ahead with its investment in Serendib Hotels PLC, where it has taken a 19.9% stake. The strategic intent of this partnership is to bring 'Anantara', the signature brand of Minor International, to Sri Lanka and to explore possibilities of working together in local and overseas ventures.

Transportation sector turnover grew by 21.4% over the year to close at Rs 507Mn while sector profits declined by 22.3% to Rs 102Mn. A change in the aviation industry business model together with start up costs connected with regional expansion contributed to the drop in sector profitability. On a positive note, two of our new ventures - acquisition of ACX Courier during the latter part of previous financial year and joint venture with Hellmann Worldwide Logistics, have already begun to generate profits. It is worth mentioning that, ACX Courier, which was a loss making business at the time of the takeover, has been turned around within the space of a few months.

The Heladhanavi Power Plant successfully completed two years of commercial operations to-date. For the year under review, Heladhanavi contributed Rs 303Mn to the Hemas bottom-line while generating 664Mn units of electricity to the national grid. We entered the mini-hydro sector during the year by buying out the interests of a developer and embarking on a 2MW project in Giddawa, Kandy. The project is expected to be completed in mid 2008 with an investment of approximately Rs 300Mn.

### Building a Great Team

The talent development initiative that took place a few years back continues to be a high priority item on the Hemas agenda. The focus for last year was to align the competencies of the management with the corporate objectives and strategy of the group. To this end, a leadership competency assessment was carried out amongst the top management with a view to providing focused training and development targeted at each individual.

Whilst our recruitment and career development programs are aimed at attracting and nurturing top quality talent with the potential to become the future leaders of Hemas, our reward systems take into account past performance & future potential, need for retention and conditions in the job market. We endeavor to create more opportunities for young potential leaders by giving them early responsibility in their careers and supporting them to succeed in challenging roles. Creating opportunities across the group and encouraging mobility across sectors is considered an important way by which we enrich the careers of senior professionals.

We also believe that empowering all levels of staff enables us to inspire them to work towards the shared vision of the company. Projects such as 'Tharanaya' where factory staff actively participate in the relocation plans to Dankotuwa and competitions on creating innovative marketing plans in the FMCG sector are examples of such activities. The number of executives who have come up the ranks to senior positions prove the success of such programs.

### Corporate Citizenship

Our group is always mindful of the need to improve the quality of life of the communities we operate in and preserve our environment if we are to sustain the growth of our company and our society.

## CEO's Review

During the year, we continued to focus our energies on the area of Early Childhood Care and Development and we now foster 32 child-friendly 'Piyawara' pre-schools island wide located from Jaffna to Hambantota. A series of programmes were conducted in these pre-schools in partnership with the Ministry of Child Development and Women's Empowerment focusing on education, training, psychosocial development, environment and healthcare. To reach a wider audience 'Piyawara' published a handbook on 'The Child's World' which focuses on the importance of early childhood. This was distributed free of charge island wide. During the year under review, Hemas also partnered with the Sri Lanka Police to create awareness amongst young parents on the 'prevention of child abuse'. We will continue to focus on these projects which we believe is an investment in the future generations of Sri Lanka.

### Focus on the Future

In the past Hemas has enjoyed earnings growth mainly through organic growth, with a few exceptions such as Power and relatively small-scale acquisitions and partnerships. Furthermore, almost all of the past growth has come from business interests in Sri Lanka. Whilst organic growth would remain a key growth mode for the existing businesses, from a group perspective a greater emphasis on inorganic growth and internationalisation would add a new dimension to the Hemas' corporate strategy in the coming years. Inorganic growth in the form of acquisitions, joint-ventures and strategic alliances are likely to feature in most of our business expansions over the medium term.

In this context, our first hospital should be ready for operation in 2008. We believe this will set the foundation from whence we can expand rapidly in the fast growing Healthcare sector. The FMCG sector will continue to look for aggressive ways to grow its Foods & Homecare business, and also to create regional markets, whilst relocating manufacturing operations to the new facility is expected to boost earnings in the financial year commencing April 2008. The Leisure and Transportation sectors have also been tasked with the challenge of restructuring their business models in order to accelerate growth and mitigate country risk.

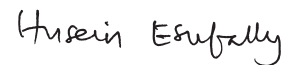
From an internal perspective, Hemas would continue to focus on operational excellence as it has been doing in the past. Special emphasis would be placed on areas such as manpower productivity, central procurement, process enhancement & business reengineering with a view to continuously improving effectiveness and efficiency across the group.

### Conclusion

In conclusion, I wish to thank all our stakeholders, especially our valued customers, for placing their trust and confidence in Hemas over the years and assure them that the organization is committed towards serving their needs better in the years to come.

Let me also thank our Chairman and my fellow Board Members for their support and guidance. Mrs Serena Fonseka, our Group Finance Director for many years retired in February this year. I take this opportunity to convey my sincere gratitude for her tremendous contribution to the group.

Our staff remain the backbone of the company and I thank everyone of them for their unstinted support in taking on new challenges with passion and commitment.



**Husein Esufally**

*Director and Chief Executive Officer*

23rd May, 2007