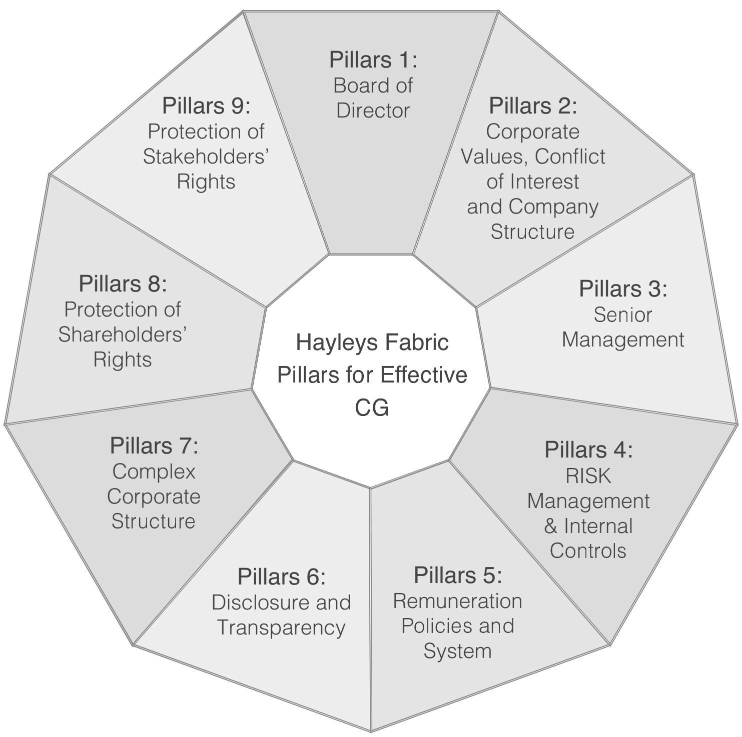
Corporate Governance

Stewardship

Corporate governance and risk management combine to define how we conduct business. Together they form our playbook, articulating our vision, values and philosophy, providing structure for decision making at appropriate levels. Finely balanced to drive efficiency and innovation while providing sufficient safeguards to preserve value, they facilitate careful stewardship of the Company.



Hayleys Fabric PLC's governance structures and frameworks have evolved over time, keeping pace with best practice, regulatory requirements and our own business needs. Strongly supported by the Hayleys Group through the involvement of common directors and within the umbrella of its own group structures, our governance framework has proved to be a solid foundation facilitating oversight and accountability, driving sustainable value creation.

Our Corporate Governance framework is designed to comply fully with the following:

- Companies Act No. 7 of 2007
- Listing rules of the Colombo Stock Exchange (CSE)
- Code of Best Practice on Corporate Governance 2013 issued jointly by the Institute of Chartered Accountants of Sri Lanka and the Securities and Exchange Commission of Sri Lanka (Code)

This report seeks to explain why our Corporate Governance mechanisms are a key strength for the Company, driving our intrinsic value. It is set out in accordance with the Code to ensure that it is comprehensive and in a logical sequence.

SDG Alignment

- Develop effective, accountable and transparent institutions at all levels
- Promote and enforce non-discriminatory laws and policies for sustainable development
- Substantially reduce corruption and bribery in all their forms

The Board

The Board of Directors play a critical role in setting the tone at the top and driving the performance of the Company. Key determinants of an effective board include the composition of the Board, its role and responsibilities and functioning mechanisms.

The Board (11 Principles)

- A1: An effective Board
- A2 & A3: Roles of Chairman & Chief Executive Officer
- A4: Financial Acumen
- A5: Board Balance
- A6: Supply of Information
- A7: Appointments to the Board
- A8: Re-election (A8)
- A9: Appraisal of Board Performance
- A10: Disclosure of Director's Information
- A11: Appraisal of Chief Executive Officer

Composition of the Board

The Board comprises four (4) Independent Non-Executive Directors and two (2) Non-Executive Directors whose profiles are given on pages 26 & 27. The Chairman and two (2) Non-Executive Directors also serve on the Board of the Parent Company Hayleys PLC, creating a vital link with the extensive expertise, networks and tacit knowledge of a highly reputed conglomerate. Their collective skills and experience are summarized below:

Areas of Expertise	No of Directors Deemed to have required expertise	Remarks
Financial acumen, experience in investing and strategy	02	• All directors are experienced directors • 02 directors are members of professional accounting bodies
Experience in manufacturing	03	• These directors have been directly involved in the day to day running of manufacturing operations
Extensive knowledge of the apparel sector	01	• All directors have experience in boards of highly reputed companies
Experience in corporate governance and risk management	07	

As all directors except the Chairman and MD/CEO are Non-Executive of whom 4 are independent, there is a sufficient balance of power, minimising the tendency for one or few members of the Board to dominate the Board processes or decision making. This facilitates the exercise of independent judgement by each individual director, enhancing the quality of decision making and enriching deliberations.

Appointment of Directors

Directors are appointed by the shareholders at the Annual General Meeting based on recommendations made by the Board. The Group Nominations Committee makes recommendations to the Board in this regard giving due consideration to the strategic demands facing the Company which are considered and referred to the shareholders at the Annual General Meeting. Retiring directors may be re-elected on a rotational basis excepting the MD/Chief Executive Officer who is appointed by the Board and remains as an Executive Director until expiry/termination of such appointment. Non-Executive Directors are appointed for specific terms subject to re-election and to the provisions in the Companies Act relating to the removal of a Director, and their re-appointment is not automatic. The names of the Directors submitted for election or re-election is accompanied by a resume to enable shareholders to make an informed decision on their election. Casual vacancies are filled by the Board based on the recommendations of the Group Nominations Committee as provided for in the Articles of Association.

A brief resume of each such Director, including the nature of his expertise and the names of companies in which the he holds directorships are provided to the Colombo Stock Exchange (CSE) on appointment of new directors. This information is also updated and disclosed the Annual Report together with their membership of Board Sub-committees. Further, any changes in the details provided by the Directors are disseminated to the CSE without delay.

The Board determines the independence of Directors based on annual declarations submitted by the Non-Executive Directors in line with the Schedule H of the Code. A Director to be deemed ‘independent’, must be independent of management and free of any business or other relationship that could materially interfere with or could reasonably be perceived to materially interfere with the exercise of their unfettered and independent judgment. Accordingly, the following are deemed to be Independent Non-Executive Directors are:

- Mr. H. Somashantha
- Mr. R.N. Somarathne

Corporate Governance

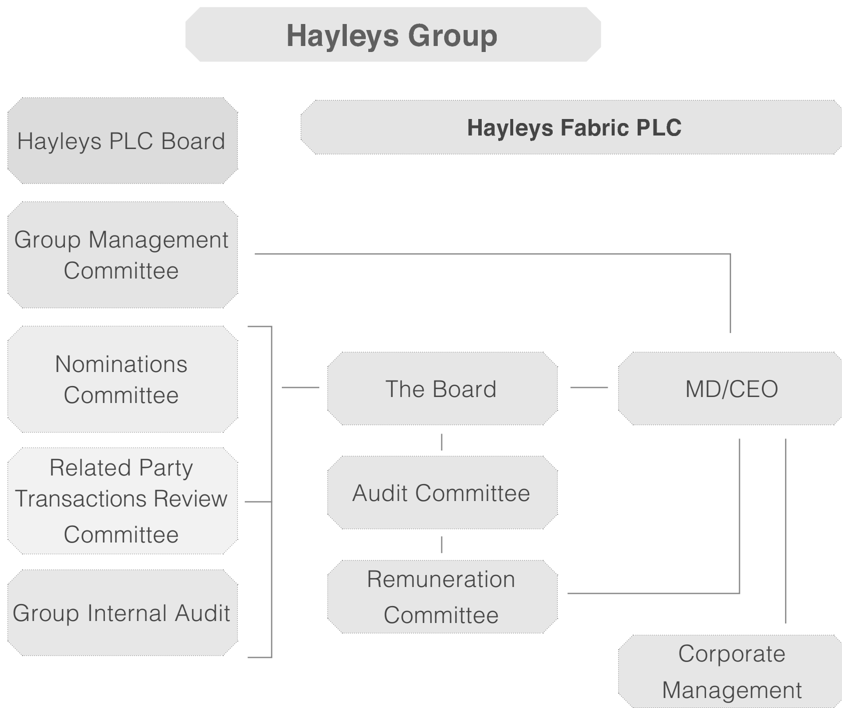
- Dr. N. S. J. Nawaratne
- Mr. A. S. Jayatilleke

Governance Structure

The Board has set in place a sufficiently robust governance structure which ensures compliance with relevant regulatory requirements, maintains an appropriate balance between stakeholder interests and enables efficient functioning of the Company. Key elements of the governance structure are:

- Organisation structure
- Framework of policies
- Systems and processes to monitor progress

As a subsidiary of the Hayleys Group, the Hayleys Fabric PLC's Board is assisted by the Nominations Committee and the Related Party Transactions Review Committee of Hayleys PLC in discharging their responsibilities as outlined in the structure given.

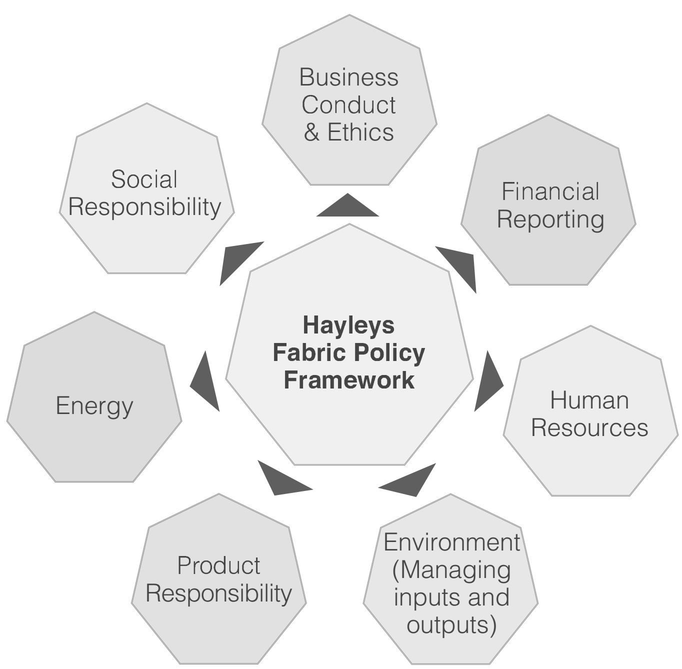


The Board has appointed an Audit Committee and a Remuneration Committee to assist in the discharge of its duties and also has access to the Hayleys Group Nominations Committee and the Related Party Transactions Review Committee. The areas of oversight and the composition of these committees are given below.

Board Committee	Areas of Oversight	Composition	Further Information
Audit Committee	Financial Reporting Internal Controls Internal Audit External Audit	Comprises 3 Independent Non-Executive directors including the Chairman.	Report of the Audit Committee on page 108
Nominations Committee	Appointment of Key Management Personnel Succession Planning Effectiveness of the Board and its Committees	Hayleys PLC Nominations Committee acts as Company's Nomination Committee.	
Remuneration Committee	Remuneration policy for Key Management Personnel Goals and targets for Key Management Personnel Performance evaluation HR Policy Organisation structure	Comprises 2 non-executive directors of whom both are independent directors including the Chairman.	Report of the Remuneration Committee on page 110
Related Party Transactions Review Committee	Review of related party transactions	Hayleys PLC - (Parent Company's) Related Party Transactions Review Committee acts as Company's Committee.	Report of the Committee on page 111

Secretarial services to the Board are provided by Hayleys Group Services (Pvt) Ltd. All Directors have access to the advice and services of this group function as necessary.

A framework of policies and procedures including a risk management framework has been established to ensure compliance with relevant laws and international best practice. The Secretaries and Management keep the Board informed of new laws and revisions, regulations and requirements coming into effect which are relevant to them as individual Directors and collectively to the Board. The policy framework encompass the following:



- Business Conduct & Ethics
- Financial Reporting
- Human Resources
- Environment (Managing inputs and outputs)
- Product Responsibility
- Energy
- Social Responsibility

Regular presentations by the MD/ CEO and Corporate Management on matters including progress in implementation of the strategic goals, financial, social and environmental performance, changes and challenges presented by the operating environment ensure that the Board is apprised of developments impacting the Company.

Powers and Responsibilities of the Board

The Board provides leadership in setting the strategic direction and is responsible for establishing a sound control framework facilitating the smooth functioning of the Company whilst safeguarding interests of key stakeholders as set out in the Board Charter and summarized below.

Key Board Responsibilities	Powers Reserved for the Board
• Setting strategic direction • Financial reporting • Putting in place a competent management team • Establishing an effective system to secure integrity of information, internal controls and risk management • Selection of appropriate accounting policies • Establishing the Company's codes of conduct • Regular review of company's performance against agreed goals and targets • Appropriate delegation of authority	• Approval of strategic plans • Approval of remuneration policies and structures • Approval of capital expenditure • Appointment of the MD/ Chief Executive Officer

The Board may obtain independent professional advice as and when necessary at the Company's expense in accordance with the Board approved policy on independent professional advice and these functions are coordinated through the Company secretary.

Meetings & Minutes

Board meetings are held on a monthly basis with the flexibility to arrange ad-hoc meetings to supplement these when required. Meetings are arranged well in advance with the agenda and

Corporate Governance

information relating to matters set before the Board circulated at least one week in advance facilitating sufficient time for due consideration of the same. There is provision to circulate papers closer to the meeting on an exceptional basis. Additionally, urgent matters may be circulated for which unanimous approval is required as per the Articles of Association.

Roles of Chairman and MD/CEO

Positions of the Chairman and the MD/Chief Executive Officer are segregated in line with best practice to maintain a balance of power and authority. Both the Chairman and the MD/Chief Executive Officer are members of the Board as recommended by the Group Nominations Committee.

Directors	Board Meetings	Audit Committee
Mr. A. M. Pandithage	7/7	
Mr. E. R. P. Goonetilleke	7/7	
Mr. K. D. D. Perera*	3/7	
Mr. S. C. Ganegoda	5/7	
Mr. H. Somashantha	7/7	4/4
Mr. R. N. Somaratne	6/7	
Dr. N. S. J. Nawartne	7/7	4/4
Mr. A. S. Jayatilleka	7/7	4/4
* Ms. Y. Bhaskaran (* Alternate Director to Mr. K. D. D. Perera)	4/7	
Total No. of Meetings	7	4

The Board met seven (7) times during the year as set out below. It is estimated that non-executive directors dedicate not less than 30 hours per annum for the affairs of the Company and those directors who are also on the Audit Committee dedicate a further 12 hours.

Board minutes are prepared providing an accurate record of matters discussed at Board Meetings and Directors may also request recording of any concerns expressed by the Board as a whole or those of individual Directors. Minutes are circulated and formally approved at the subsequent Board meeting, Directors have access to the past Board papers and minutes in case of need via electronic means at all times.

The Chairman provides leadership to the Board, controls and preserves order at Board meeting and provides the Board with strategic direction and guidance in managing the affairs of the Company.

He is also responsible for,

- Ensuring the new Board members are given appropriate induction, covering terms of appointment,
- The effective participation of both Executive and Non-Executive Directors;
- Ensuring that Directors have sufficient information on matters set before the Board
- All Directors are encouraged to make an effective contribution, within their respective capabilities, for the benefit of the Company;

Board Highlights 2016/17

Approval to:

- Purchase brand new Machinery
- Conversion to duel fuel operations with furnace oil and LP Gas.
- Construct new building
- Purchase 20 acres of Land
- Formulate overseas joint ventures.
- Obtain offshore loan to re-structure loan portfolio
- Finalize a collective agreement with trade union for the following year.

- A balance of power between Executive and Non-Executive Directors is maintained;
- The views of Directors on issues under consideration are ascertained
- Bringing director resignations over unresolved issues to the attention of the Board and circulating a written statement provided by the Director to the Board.
- Meeting with the Non-Executive Directors without presence of Executive Directors, annually to evaluate the performance of the Managing Director/CEO and whenever deemed necessary.
- Discussing the annual performance evaluation of the Board and its sub-committees based on self-evaluations submitted by the Directors.

The Board has delegated the responsibility for the day-to-day operations of the Company to the MD/CEO who leads the Corporate

Management team in making and executing operational decisions. The Managing Director is also responsible for recommending strategy to the Board and provides assurance that operations have been conducted in accordance with relevant regulatory requirements.

Training for Directors

The Directors are made aware of the need to keep abreast of current developments affecting the sector both globally and locally with particular reference to regulatory changes and the country's economy. They are members of the Sri Lanka Institute of Directors and attend their sessions from time to time. Management also make presentations to ensure that the Board is aware of key developments affecting the business operations of the Company. Newly appointed directors are provided with an orientation pack with all relevant external and internal regulation documents and a tour of the factory premises. Many of the directors are also members of professional bodies which have Continuing Professional Education requirements for annual renewal of membership.

During the year under review, all independent directors of the Company attended a two day course on corporate governance conducted by the Sri Lanka Institute of Directors together to ensure that they are updated on best practice in corporate governance.

Directors' Remuneration (3 Principles)
• Remuneration Procedures • The Level & Makeup of Remuneration • Disclosure of Remuneration

Directors' and Executive Remuneration

Remuneration of the Chairman, Managing Director and the Executive Directors are determined by the HR & Remuneration Committee who also set guidelines for the remuneration of the management staff within the Group. The Chairman and Managing Director are not members of this Committee but may be invited to attend meetings. The Remuneration Committee comprises Independent Non-Executive Directors and the Chairman of this Committee is appointed by the Board.

The current composition of the Remuneration Committee is as follows:

- Mr. A.S. Jayatilleka – *Chairman,* Independent Non-Executive Director
- Mr. H. Somashantha - Independent Non-Executive Director

Further information about the activities of this key committee are summarized in the Remuneration Committee Report on page 110.

Remuneration Policy

Remuneration policy is recommended by the Remuneration Committee to the Board for their approval. The Remuneration Committee and the Board seek to ensure that remuneration is in line with market expectations and sufficient to attract, retain and motivate directors, executives and other employees in line with the business requirements of the Company. Surveys are conducted regularly to benchmark remuneration with the market and the Group Companies. The Company seeks to be within the industry band taking in to account the size, expansion plans and current challenges facing the Company and take in to account the provisions set out in Schedule E of the Code as required.

Remuneration of the Non-Executive Directors is determined by the Board as a whole in line with current market conditions. Remuneration paid to directors in total during the reporting period is given on page 149 of the financial statements. Remuneration for Non-Executive Directors reflects the time commitment and responsibilities of their role, taking into consideration market practices. Non-Executive Directors are not included in share options as there is no scheme in existence. No arrangement exists for emoluments in respect of loss of office.

Remuneration for executives including the MD/Chief Executive Officer comprise the following:

Base Pay
• Monthly Salary • Employee Provident Fund Contribution @ 12% • Employee Trust Fund Contribution @ 3% • Gratuity for employees with over 5 years service

Benefits
• Company Vehicle (Corporate Management Only) • Medical Insurance including hospitalisation

Performance-based incentives have been determined for Executive Directors by the Remuneration Committee to ensure that the total earnings of the Executive Directors are aligned with the achievement of objectives and budgets of the Group companies.

Corporate Governance

Relations with Shareholders

The Board is mindful of their accountability to shareholders and the need for transparency at all levels and strives to maintain its value framework in all shareholder dealings and communications. The Annual General Meeting is the main forum for shareholder engagement and their participation is encouraged by the timely circulation of the notice of meeting and the annual report and financial statements. An effective mechanism to count all proxies lodged on each resolution is in place including the balance for and against the resolution after it has been dealt with on a show of hands, except where a poll is called.

Relations With Shareholders (3 Principles)
• Constructive use of AGM and General Meetings • Communication with shareholders • Major and material transactions

Additionally, quarterly financial statements are circulated on the due dates and uploaded on to the investor relations page of the Company's website http://www.hayleysfabric.com/investor-relations/results-and-reporting/interim-reports Every effort is made to provide a balanced review of our performance which is clearly evidenced by our press releases that accompany the release of interim results.

The Chairman of the Company ensures the Chairman of Audit, Remuneration and Nomination Committees are available to answer questions at the AGM if so requested by the Chairman. A copy of the Annual Report including Financial Statements, Notice of the Meeting and the Form of Proxy is sent to shareholders 15 working days prior to the date of the AGM, in order to provide the opportunity to all the shareholders to attend the AGM. A summary of the procedures governing voting at General Meeting is circulated to shareholders with every Notice of the General Meeting.

Please refer pages 42 to 47 on "Our approach to Stakeholder Engagement" in the Sustainability Report for a complete list of the communication channels available at the Company to disseminate timely communication to shareholders.

The Company's future strategies and their potential impact have been disclosed in the following sections of this annual report:

- Chairman's Statement pages 14 to17
- Managing Director's Review page 18 to 23
- A Positive Outlook on pages 94 & 95

Shareholders also have the opportunity to ask questions, make the comments and suggestions to the Board through the Company Secretaries whose contact details are provided on back inner cover of this report and the Investor Relations page of our website. All significant issues and concerns of Shareholders are always referred to the Board of Directors with the views of the Management.

Disclosure of Major Transactions including Related Party Transactions

During the year, there were no major transactions as defined by Section 185 of the Companies Act No. 07 of 2007 which materially affect the net asset base of Company. Related party transactions are given in Note 25 to the Financial Statements of the Annual Report on pages 151 & 152 and Report on Related Party Transaction Review Committee is given on page 111.

Accountability & Audit (5 Principles)
• D1: Financial Reporting • D2: Internal Control • D3: Audit Committee • D4: Code of Conduct & Ethics • D5: Corporate Governance Disclosures

Accountability & Audit

Every effort has been made to present a balanced and understandable assessment of the Company's financial position, performance and prospects in compliance with the various legal enactments applicable, the Sri Lanka Financial Reporting Standards, the G4 standard on Sustainability Reporting published by the Global Reporting Initiative and the Integrated Reporting Framework published by the International Integrated Reporting Council. The Company's position and prospects have been discussed in detail in the following sections of this Annual Report.

- Chairman's Statement pages 14 to17
- Managing Director's Review pages 18 to 23
- The Capitals Report on page 54 to 93
- A Positive Outlook on page 94 & 95
- Managing Risk on page 96 to 100

The Company has also complied with the requirements of the Colombo Stock Exchange and published Interim Reports on the Company website within15 days of first three quarters and within 2 months of the last quarter. Price sensitive information, which may have an impact on the shares of the Company, has been disclosed in a comprehensive but concise manner to the Colombo Stock Exchange on a timely basis. Reports required by regulators including the Department of

Inland Revenue, Sri Lanka Accounting & Auditing Standards Monitory Board, and the Colombo Stock Exchange have been filed in a timely manner in compliance with specified requirements. The following reports set out further information required by the Code:

- The Directors' Report on pages 113 to 118 (including the declaration that the Company is a going concern)
- The Statement of Directors' Responsibility on page 121
- Report of the Auditors on page 125
- The Management Discussion & Analysis on pages 48 to 95
- Audit Committee on pages 108 & 109
- Board of Directors' Statement on Internal control on pages 119 & 120
- Related Party Transactions Review Committee Report on page 111

The Board is responsible for formulating and implementing appropriate and adequate internal control systems to safeguard the assets of the Company and has appointed an Audit Committee to assist in discharge of this duty. The principal responsibility of the Audit Committee is oversight over financial reporting, internal controls, internal audit and monitoring auditor independence. Its duties include gaining assurance on the control over financial processes and the integrity of the Company's financial reports, monitoring the performance, objectivity and independence of the external auditor and reviewing work of the internal auditor. The Terms of Reference for the Audit Committee complies with the Code of Best Practice on Corporate Governance issued by the SEC and CASL and the Code of Best Practice on Audit Committees issued by CASL and is available with the Company Secretaries. The Audit Committee Report is given on pages 108 & 109 of the Annual Report and provides information on the composition of the Board, key responsibilities and activities during the year.

Code of Business Conduct & Ethics and Corporate Governance Report

The Company has developed Code of Conduct for its employees including the Corporate and Senior Management. This Codes addresses conflict of interest, bribery and corruption, entertainment and gifts, accurate accounting and record keeping, corporate opportunities, confidentiality of information, fair dealing, protecting and proper use of the Company's assets, compliance with laws and regulations and encouraging the reporting of any illegal or unethical behaviour, Conduct of business in an ethical manner at all times by keeping with acceptable business practices.

Shareholders (2 principles)
• E1: Institutional Shareholders • Shareholder voting • Evaluation of Governance Disclosures • E2: Other investors • Investing Divesting Decision • Shareholder voting

Shareholders

The Board conducts the Annual General Meetings in a manner that encourages relevant discussion amongst shareholders and active participation in voting on matters reserved for shareholders. Voting of the shareholders is crucial in carrying a resolution at the AGM. The Chairman, who plays the role of the agent, communicates the views and queries of the shareholders to the Board and the senior management, in order to ensure that the views are properly communicated to the Company. Institutional Investors are encouraged to give due weight to all relevant matters relating to the Board structure and composition.

Individual investors are encouraged to carry out adequate analysis or seek independent advice in investing or divesting decisions. The Company's website provides a wide range of information on the Company, the Group and its activities and the CSE is also informed about price sensitive information on a timely basis to facilitate dissemination to the investing public in a timely manner. Individual shareholders are encouraged to participate in General Meetings of the Company and exercise their voting rights.

Sustainability Reporting

Sustainable reporting is part of the established annual reporting process of the Company and Hayleys Fabric PLC has presented the relevant information within this report as follows:

- Economic sustainability - pages 48 to 53
- The Environment - Natural Capital on pages 83 to 91
- Labour Practice - Human Capital on page 70
- Society - Social & Network Capital on pages 65 & 66
- Product Responsibility - Social & Network Capital on pages 61 to 64
- Shareholder identification, engagement and effective communication - Investor Relations on page 44

Corporate Governance

Colombo Stock Exchange Listing Rules Section 7.10

Statement of Compliance

This section covers Hayleys Fabric PLC's compliance with the requirements of the Continuing Listing Requirements Section 7.10 on Corporate Governance Rules for Listed Companies issued by the Colombo Stock Exchange.

This reflects the Company level of conformity to CSE's Listing Rules which comprise of the following fundamental principles:

- Non- Executive Directors (NEDs)
- Independent Directors
- Disclosures relating to Directors
- Remuneration Committee
- Audit Committee
- Related Party Transactions Review Committee

Rule No.	Subject	Applicable requirement	Compliance Status	Applicable Section in the Annual Report
7.10.1(a)	Non-Executive Directors (NED)	As at the conclusion of the immediately preceding AGM six (6) out of eight (8) Directors were Non-Executive Directors.	Yes	Corporate Governance
7.10.2(a)	Independent Directors	Four (4) out of six (6) Non-Executive Directors were independent as at 31st March, 2017.	Yes	Corporate Governance
7.10.2(b)	Independent Directors	All Non-Executive Directors have submitted their confirmations on independence as per the criteria set by the Company, which is in line with the regulatory requirements.	Yes	Corporate Governance
7.10.3(a)	Disclosure relating to Directors	The Board assessed the independence declared by the Directors and determined the Directors who are independent and disclosed same on pages 26 & 27 which contains their profiles.	Yes	Corporate Governance
7.10.3(b)	Disclosure relating to Directors	The Board has determined that four (4) Non-Executive Directors satisfy the criteria for "independence" set in the Listing Rules.	Yes	Corporate Governance
7.10.3(c)	Disclosure relating to Directors	A brief resume of each Director should be included in the Annual Report including the Director's areas of expertise.	Yes	Board of Directors (profile) section in the Annual Report

Rule No.	Subject	Applicable requirement	Compliance Status	Applicable Section in the Annual Report
7.10.3(d)	Disclosure relating to Directors	Disclosed the appointments of new Directors to the Colombo Stock Exchange when it is disclosed to the public, brief resumes of the Directors appointed during the year have been provided to the Colombo Stock Exchange.	Yes	Corporate Governance and Board of Directors (profile) section in the Annual Report
7.10.5(a)	Composition of Remuneration Committee	The Remuneration Committee comprises two (2) Independent Non-Executive Directors as disclosed in the Remuneration Committee Report on page 110.	Yes	Corporate Governance
7.10.5(b)	Functions of Remuneration Committee	The Remuneration Committee shall recommend the remuneration of the Managing Director	Yes	Corporate Governance
7.10.5(c)	Disclosure in the Annual Report relating to Remuneration	Names of Remuneration Committee members are given in item 30 of the CASL code table on page 37 the disclosure of the Remuneration Committee is given on Committee page 110 and the Remuneration paid to Directors is given in the Note 22 to the Financial Statement on page 149.	Yes	Corporate Governance and the Board Committee Reports
7.10.6(a)	Composition of Audit Committee	Comprises NEDs, all of whom are independent.	Yes	Corporate Governance
7.10.6(b)	Audit Committee Functions	Refer Audit Committee Report on pages 108 &109	Yes	Corporate Governance
7.10.6(c)	Disclosure in the Annual Report relating to Audit Committee	The names of the Audit Committee members given on page 108. The basis of determination of the independence of the Auditor is also given in the Audit Committee Report.	Yes	Corporate Governance Committee Report
9.3.2	Related Party Transactions Review Committee	This is mandatory If the Parent Company and the Subsidiary Company both are listed entities, the Related Party Transactions Review Committee of the Parent Company may be permitted to function as such Committee of the subsidiary. Committee Report is given on page 111.	Yes	The Committee of the Parent Company which functions as the Committee of the Company.