

## ICRA Lanka assigns the issuer rating of [SL]BBB+ with Stable outlook to Bogawantalawa Tea Estates PLC

March 19, 2018

Instrument*	Current Rated Amount (LKR Mn)	Rating Action
Issuer Rating	N/A	[SL]BBB+ with stable outlook assigned

### Rating action

ICRA Lanka Limited, Subsidiary of ICRA Limited, group company of Moody's Investors Service, has assigned the Issuer rating of [SL]BBB+ (pronounced SL triple B Plus<sup>1</sup>) with stable outlook to Bogawantalawa Tea Estates PLC ("BTE" / "the company").

### Rationale

ICRA Lanka has taken a consolidated view on Bogawantalawa Tea Estates PLC and its subsidiary- Bogawantalawa Tea Marketing (Pvt) Ltd as a whole, given the significant operational and financial linkages between them.

The assigned rating primarily factors in the Company's strong brand name, which is synonymous with high quality Ceylon Tea, and its leading position in the Sri Lankan tea plantation industry. ICRA Lanka takes into account the experience of the promoters, the company's strong track record and reputation in the industry which have enabled the company to enjoy steady access to funding from financial institutions. Moreover, since Metrocorp group considers its plantation sector as a strategically important sector due to its environmental sustainability and carbon neutrality objectives, the assigned rating factors Metrocorp group's consolidated financial strength and the ability of the group to provide any financial support towards plantation sector.

Bogawantalawa tea estates are located in the Golden Valley located in the central hills of Sri Lanka. This has not only helped the company to produce high quality tea, but also to command premium prices over other tea plantation companies in Sri Lanka. Notwithstanding the reduction of the company's tea production during FY2016/17 due to adverse weather conditions that prevailed during this period, the company's Net Sales Averages (NSAs) have increased substantially by YOY 21% and YOY 11% to LKR 539/Kg and LKR 600/Kg in FY17 and 9MFY18 respectively, resulting in increased profitability during these periods. Moreover, the company's working capital position has remained at a comfortable level due to strong cash flow accruals as well as higher industry regulations. Further, net accruals in the recent past have bolstered the net worth position of the company substantially. As a consequence, the Company's capital structure has remained relatively comfortable with gearing of 0.9x in 9MFY18. The Company's coverage and key debt metrics have also further improved given the relatively lower debt levels on the books as compared to the profits generated.

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<sup>1</sup>For complete rating scale and definitions please refer to ICRA Lanka's Website [www.icralanka.com](http://www.icralanka.com) or other ICRA Rating Publications

Though Sri Lanka's key tea export markets are mainly Middle Eastern and CIS countries, which are dependent on oil income, BTE's key export destinations include Japan, UK, Sweden and Netherlands. This has enabled the company to mitigate the risks of political/economic instabilities that were faced by Sri Lanka's key export destinations to an extent. The Company's operations are exposed to regulatory risks, including changes in interest rates, changes in agricultural practices & policies etc. However, ICRA Lanka notes Sri Lankan tea plantation industry's position as a major foreign exchange earner and employer in the country and therefore, the government's policy towards this industry will tend to be supportive, as in the past. Given the tea plantation industry in Sri Lanka is an export oriented industry, BTE's profits are benefited by the Sri Lankan Rupee depreciation.

Historically, the company's high grown tea segment has accounted for ~95% of the total revenue and therefore, ICRA Lanka takes note of the company's recent/ongoing diversification initiatives into the new segments such as specialty tea varieties, timber plantations, and oil palm cultivation. Specifically, the ongoing diversification into oil palm is expected to require substantial debt funded capex and hence timely maturation and profitable marketing of the output would be critical.

Notwithstanding the company's recent efficiency improvement measures, the risk of margin erosion due to periodical wage hikes is high and is accentuated by BTE's volatile operating profit margins; the estate sector trade unions recent 'go-slow' following the renewal of the collective agreements between the companies and the unions have affected the industry. Therefore, this is a key sensitivity to the assigned rating.

## Key rating drivers

### Credit strengths

**Experience of the promoters and the group support:** The rating considers favorably the experience of the promoters and the management team and BTE's strong operational track record which has enabled the Company to record healthy growth in revenues and profits over the past several years.

The promoters of the Metrocorp group are actively engaged in the strategic decisions of Bogawantalawa Tea Estates PLC and have centralized the finance and treasury functions. This has also helped the company to perform well compared with other Regional Plantation Companies (RPCs) in Sri Lanka. Moreover, BTE has a home-developed ERP system, which has helped the company to efficiently operate in different business stages upto the tea auction levels.

**Attractive NSA levels;** The overall increase in the Sri Lankan tea prices during FY16/17 were attributable to increasing demand (from the CIS & Middle Eastern tea market, which accounts for ~ 70% of total Sri Lankan tea exports, amidst the sustaining oil prices), the global supply shortages (due to the effects from global climate changes) and the depreciation of the Sri Lankan Rupee. The company's NSAs are among the top three plantations companies in Sri Lanka and further, the company's estate level NSAs are well diversified. The alleged reported cases of labour conditions in other black tea export nations, have also helped to increase the demand for the Sri Lankan tea (particularly, for Bogawantalawa tea) in the European market.

**Strong revenue visibility amidst the diversification Strategy:** the company intends to further develop highly demanded specialty tea varieties (such as oolong and organic tea varieties) going forward although this market segment is still at initial stages. The company's biological assets (timber) are valued on annual basis and the fair value of these trees was valued at LKR.741 Mn as at 31st March, 2017. Going forward this

segment will be a major income generator of the company as certain regulations preventing the harvesting of timber trees have now been resolved by the company.

**Comfortable Financial Profile:** BTE's revenues have increased at a compounded annual growth of 1.2% over the last five years (FY12-FY17) driven by the sharp increase (9.3% annual growth) in average NSAs. The company has recorded a PAT of LKR 94 and LKR 339 Mn in FY17 and 9MFY18 respectively from LKR 3.3 Mn in FY16. The company's capital structure is comfortable on account of increasing profitability margins and relatively low debt levels: The debt profile of the Company is largely skewed towards long term loans, with the same contributing to over 70% of the debt outstanding in 9MFY18. BTE's cash flows and coverage metrics have improved in the last few years stemming from increased profitability, and consequently, the moderation in debt levels. Going forward too, the capital structure is likely to remain comfortable given the expected increase in profitability levels. However, the company is likely to further increase its capital expenditure plan on replantation and revenue diversifications projects. This would exert some pressure on the debt coverage metrics to an extent.

### Credit challenges

**Cyclical nature of the plantation industry, leading to risk of volatile cash flows:** Plantation industry is cyclical in nature and the exposure to adverse weather conditions, impacts the net realizations (due to quality variations) as well as tea production. During past two years, Sri Lanka's tea production has declined by 10-13% due to adverse weather conditions that prevailed during this period. Generally, the company's yield levels are relatively higher than the national average owing to increased capital expenditures on the company's replantation exercise. Given, the company's tea plant-age profile, which represents relatively older tea plants in the tea plantation estates, ICRA Lanka envisages that the company's ongoing replantation/infilling exercises ought to continue going forward, besides the company's increased capital commitments towards the new oil palm project.

**New Investments in Oil palm Project:** The rating also factors in BTE's new investments in the oil palm cultivation project, at a cost of over LKR 1.0 billion over the next five years (on a phased out basis), requiring significant debt funding (~ 60% of the cost). The total land extent of this project is about 800 Ha and this project is currently being implemented in Sabaragamuwa region of the island. The Company has already invested in excess of LKR 250 Mn (for the immature plantations of 200 Ha) in YTD and these immature plantations are expected to reach maturity in FY2019. ICRA Lanka views positively the viability of the oil palm investments in Sri Lanka, given the attractive investment returns and relatively lower labour intensity of this industry. However, the timely completion of the project and successful management of agricultural risks will be critical and we will continue to monitor the same.

**Increased cost of Production due to periodic wage hikes:** the increased labour costs and lower productivity levels have negatively affected the performance of the tea plantation industry over the past several years. The labour cost represents around 60-70% of the company's production cost. Moreover, labourers in this industry are highly unionized and periodic wage hikes (every two years) have inflated the current wage levels. However, during the last wage hike, which took place in Oct 2016, the plantation companies had negotiated a wage system based on a productivity linked model, which is a positive development.

**Negative financial performance of the Subsidiary:** Financial performance of Bogawantalawa Tea Marketing (Pvt) Ltd (BTM) has been negative over the past several years largely due to operational losses in the local division, which is approximately 25-30% of the company's revenue. The losses in the local operation is attributable to the increased competitive landscape in Sri Lankan market. Moreover, BTM has been strategically investing in the distribution system during the past two years. Over the past few years,

BTE has not provided any direct capital support for Tea Marketing (Pvt) Ltd and going forward, BTE's capital outlay towards the marketing operation, entails limited financial support, as Metrocorp group considers the plantation sector (including the marketing arm) as a strategically important sector of the group. However, the ability of the company to successfully manage and turnaround the marketing operation in the medium term remains to be reviewed.

**Analytical approach:** For arriving at the rating, ICRA Lanka has applied its rating methodologies as indicated below.

**Links to applicable criteria:** [www.icralanka.com/images/pdf/Corporate%20Rating%20Methology.pdf](http://www.icralanka.com/images/pdf/Corporate%20Rating%20Methology.pdf)

### **About the company:**

Bogawantalawa Tea Estates has been producing predominantly high grown tea since 1869 from the Golden Valley located in the central hills of Sri Lanka and manages over 6,000 hectares of land (with 11 estates). After the privatization of the plantation estates in 1992 by the Sri Lankan Government, Metrocorp group, through Metropolitan Resource Holdings Plc (MRH) acquired the Bogawantalawa tea estates (along with some rubber estates). However, during 2002/03, the management decided to fully focus on the tea plantation business and therefore, 17 rubber estates were subleased to Lalan Rubber (Pvt) Ltd. Therefore, currently, the company's operation is largely limited to the production of high grown tea (the company has only one low grown tea estate, and the low grown tea production of this estates is about 5-7% of the total tea production). The company was incorporated in 1992, and is today a public quoted company listed on the Colombo Stock Exchange. Metropolitan Resource Holdings PLC (MHR) is the plantation agent of Bogawantalawa Tea Estates PLC and currently MHR owns a 79% stake in Bogawantalawa Tea Estates PLC.

Bogawantalawa Tea Marketing Pvt Ltd (BTM) is the marketing arm and a fully owned subsidiary of Bogawantalawa Tea Estates PLC. BTM markets a wide range of black and green tea in packets and tea bags. The company's product range includes flavoured, herbal and bulk forms. BTM is one of the largest and preferred suppliers of tea and herbs from Sri Lanka to many prestigious global supermarket chains and large scale food & beverage distributors.

### **About the Group:**

Metrocorp (Pvt) Ltd, formerly known as Metropolitan Investment (Pvt.) Ltd, was established in 1994 and has diversified interests in Agro Industries, Plantations, Hydro power, Water and Environment, Office Automation and Leisure Sectors. The mini-hydropower segment (through Eco Power (Pvt) Ltd), is the largest revenue contributor of Metrocorp Group. Eco Power (Pvt) Ltd is now expanding rapidly in the overseas market, particularly in the African and East Asian regions. Eco Power has a total installed capacity of 75MW of which 37 MW installed capacity (12% of Sri Lanka's installed mini hydro power capacity) is based in Sri Lanka while the balance is in overseas projects. Currently, under the leisure sector, Metrocorp group manages 40 tourism related bungalows based in the tea estates. The group has continuously expanded its businesses through organic as well as inorganic growth. Metrocorp Group along with BTE currently has an asset base of US\$ 175 Mn and consolidated revenues of US\$ 75 Mn.

## ANALYST CONTACTS

**Mr. Raghunath T,**  
Tel. No. +91-4445964440  
[Raghunath.t@icraindia.com](mailto:Raghunath.t@icraindia.com)

**Mr. Danushka Perera,**  
Tel. No. +94-77-4781591  
[danushka@icralanka.com](mailto:danushka@icralanka.com)

## RELATIONSHIP CONTACT

**Mr. W. Don Barnabas**  
+94 11 4339907  
[wdbarnabas@icralanka.com](mailto:wdbarnabas@icralanka.com)



*Subsidiary of*

**ICRA Limited**

*A Group Company of Moody's Investors Service*

### CORPORATE OFFICE

Level 10, East Tower, World Trade Center, Colombo 01, Sri Lanka

Tel: +94 11 4339907; Fax: +94 11 2333307

Email: [info@icralanka.com](mailto:info@icralanka.com); Website: [www.icralanka.com](http://www.icralanka.com)

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