

## ICRA Lanka reaffirms the issuer rating of Ceylon Tea Brokers PLC

March 06, 2019

Instrument*	Current Rated Amount (LKR Mn)	Rating Action
Issuer Rating	N/A	[SL]BBB (Stable) reaffirmed

### Rating action

ICRA Lanka Limited, subsidiary of ICRA Limited, group company of Moody's Investors Service, has reaffirmed the Issuer rating of [SL]BBB (pronounced SL triple B) with stable outlook assigned to Ceylon Tea Brokers PLC ("CTB"/"the Company").

### Rationale

The rating reaffirmation considers the revenue growth and profitability improvements witnessed during FYE2018 and 6MFYE2019, aided by the increase in market share of the Company in the tea broking industry from 11.50% in FYE2018 to 13.5% in 9MFYE2019. ICRA Lanka also takes note of the diversified revenue streams from brokerage, financing and warehousing operations; although they remain susceptible to the cyclicity in the Sri Lankan tea industry. The rating also factors favourably the long standing track record of the Company in the tea broking industry and its strong group support (as CTB is currently held by the ultimate shareholders of the Capital Alliance Group). ICRA Lanka also considers the favorable long term global demand outlook for Sri Lankan tea.

The rating is however constrained by the highly geared capital structure and moderate coverage indicators, which is primarily on account of growing finance operations of the Company. The income from the finance operation accounted for 45% and 52% of total revenue during FYE2018 and 9MFYE2019 respectively. While, the growth in lending portfolio, increases the Company's susceptibility to counterparty risks, the same is mitigated by being part of associations like Colombo Tea Traders and Tea Brokers Associations. Due to exposure to financing operations, the margins also remain susceptible to volatility in interest rates. Any deterioration in credit profile of lending portfolio, leading to increase in bad debt provision/write offs remains a rating sensitivity factor and therefore, ICRA Lanka will continue to monitor the same.

ICRA Lanka also notes the acquisition of Logicare (Pvt) Ltd by the Company during FYE2018. The subsidiary is currently setting up a warehouse facility for which the total capex (including the acquisition cost of Logicare Pvt Ltd) is ~LKR 900 Mn, which will be largely funded by term loan facility of LKR 550 Mn. The project once completed will aid in cost savings and provide further diversification benefits. However the project remains susceptible to execution risks and any shortfall in funding requirements due to cost/time overruns, which might need support from CTB and therefore, remains a sensitivity factor.

### Key rating drivers

#### Credit strengths

**Long standing track record, strong parentage and healthy market share in tea broking industry;** CTB is one of the leading tea brokers in Sri Lanka and is the only standalone tea broker listed on the Colombo Stock Exchange. CTB commenced operations as a partnership in 1963 and was taken over by the Capital Alliance Group (flagship entity - Capital Alliance Limited rated at [SL]A-, with stable outlook) in 2005. During FYE2018, Capital Alliance Group has carried out a restructuring exercise which resulted in CTB

being held directly by the ultimate shareholders of Capital Alliance Group. The Company has healthy market share in the tea broking industry which has grown to 13.5% during 9M FYE2019, compared to 11.50% and 10.85% during FYE2018 and FYE2017 respectively.

**Diversified revenue stream;** The Company has diversified revenue streams comprising of tea brokerage (accounting for about 35-38% of total revenue in the last few years), storage and warehousing (accounting for 10-15% of total revenue), interest income on lending business (~35-45% of total revenue; during 9MFYE2019, the revenue contribution from this segment has increased to 52%) and other activities like providing advisory services etc, which account for the remaining revenue. The Company earns ~1% brokerage income on total value of tea sales, procured from the Colombo tea auction. The brokerage revenue has witnessed ~39% growth in FYE2018. However, during 9MFYE2019, the brokerage revenue has declined by marginal ~4% (annualized) mainly due to moderation of average tea prices during this period. The Company currently charges ~LKR 2.32/kg of tea stocks from sellers for ~40 days and also from buyers if held longer than 40 days. The segment witnessed ~7% YOY and 6% growth (annualized) during FYE2018 and 9MFYE2019 due to increasing market share. The Company also provides short term advances against tea stocks as well as long term loans to tea suppliers as part of financing operations. The interest income from this segment has also witnessed significant growth during FYE2018 (~92%) and 9M FYE2019 (~26%) driven by the increase in loan portfolio largely on the back of increase in tea volumes. However, the performance of the Company remains susceptible to the risks of tea plantation industry in Sri Lanka. The Company had fully acquired a new Company-Logicare (Pvt) Ltd for LKR 233 Mn during FYE2018 and currently the subsidiary is developing a warehousing facility of around 12,000 pallet capacity. While in the first phase, the new facility will cater to the tea brokering industry, subsequently the Company intends to cater to third party logistic companies, which will be done according to regulations under the Ceylon tea board. This is also expected to provide further diversification benefits going forward.

**Healthy profit margins;** The Company's financial profile is characterized by healthy profit margins with OPM in the range of 30-55% in the last five years and NPM in the range of 7 -15% during the same period. The margins have witnessed improvement during FYE2018 and 6MFYE2019 aided by growth in topline of 56% and 10% (annualized) during these periods, due to increase in tea volumes (along with higher average tea prices), growth in interest income and benefit of other cost control measures adopted by the Company.

**Favourable long term demand outlook;** The long term demand outlook for Sri Lankan tea is favourable, although the production and demand remains susceptible to agro climatic risks, labour issues, government regulations in Sri Lanka and economic and political issues at key tea importing nations. The tea production in Sri Lanka had witnessed a decline during CY2016/17 and CY2018, but the average tea prices witnessed healthy growth during FYE2017 from LKR 400/Kg in preceding fiscal to LKR 539/Kg and further increased to ~ LKR 640/Kg during FYE2018 (although, average tea prices have currently moderated to LKR 600/Kg), driven by strong demand from importing countries.

## Credit challenges

**Performance is susceptible to demand cyclicality, forex fluctuations, regulations and adverse weather conditions:** CTB's performance is susceptible to demand cyclicality in tea industry, volatility in forex rates and impact of any adverse weather conditions. During CY2016/17 and CY2018, Sri Lanka's tea production was lower by ~10-13 %, compared to the average production levels during CY2010-CY2016, impacted by adverse weather conditions, labour issues and changes in government policies. Further, any moderation in demand from Middle Eastern and CIS countries due to economic cycles or other exogenous factors (like war/economic sanctions) would also have adverse impact on CTB's performance. Moreover, any

regulatory changes with regards to labour cost, usage of fertilizers/weedicides etc. could also have an adverse impact on the performance of the tea industry.

**Highly geared capital structure;** The Company's capital structure remains highly geared with gearing in the range of 3.8(x) to 3.3(x) during FYE2018 to FYE2019. Increased gearing levels were mainly driven by growth in lending portfolio. However, the gearing moderated from 3.8(x) as on March 31, 2017 to 2.8(x) as on Sep 30, 2018, mainly due to healthy accretion to reserves and new capital infusion, which took place during FYE2018, notwithstanding the increase in the lending portfolio. The capital infusion of LKR 210 Mn was carried out by the Company during FYE2018 for the acquisition of Logicare Pvt Ltd. Post completion of acquisition, the consolidated entity had gearing of 3.3(x) as on March 31, 2018 and interest coverage and TD/OPBDITA was 1.8(x) and 3.8(x) during FYE 2018. The coverage indicators have also remained moderate during 6MFYE2019, with interest coverage of 1.8 times and TD/OPBDITA of 7.30%. While the Company's debt has mainly comprised of short term facilities, during the current fiscal, the Company had also availed short term loans (including LKR 400 Mn loan from the CAL group) for working capital requirements. The Company plans to incur a total capex of LKR 600-700 Mn at the subsidiary level (Logicare Pvt Ltd) during FYE2019/20 to set up new warehouses facility, which will be largely funded by debt. Therefore, ICRA Lanka expects some moderation in the capital structure and coverage indicators for the consolidated entity in the near to medium term.

**Project execution risks related to warehousing project:** The Company will be setting up a warehouse facility under the subsidiary -Logicare (Pvt) Ltd during FYE2019/20, for which it will incur additional capex of LKR 650 Mn. While the project is expected to provide savings of rental costs and additional diversification benefits once completed, in the interim, it remains susceptible to project execution risks and any shortfall in funding requirements due to cost/time overruns, which might need support from CTB. The timely execution of the project without major cost overruns remains a sensitivity factor.

**Analytical approach:** For arriving at the ratings, ICRA has applied its rating methodologies as indicated below. **Links to applicable criteria:** [www.icralanka.com/images/pdf/Corporate%20Rating%20Methodology.pdf](http://www.icralanka.com/images/pdf/Corporate%20Rating%20Methodology.pdf)

## About the Company:

Ceylon Tea Brokers was founded in 1963 as a partnership firm, which was converted into a private limited Company in June 1999 and was taken over by the Capital Alliance Group in February 2005 and renamed as Ceylon Tea Brokers Ltd. It was subsequently listed on the Colombo Stock Exchange in Feb 2010 and is the first standalone listed tea brokering company. The Company provides wide range of services such as tea brokerage, warehousing and financing. During FYE2018, the Company has fully acquired Logicare (Pvt) Ltd, which holds the lease hold rights for a land in Muthurajawela Zone for 38 years.

## ANALYST CONTACTS

**Mr. Sai Krishna,**  
+91-4445964304  
[sai.krishna@icraindia.com](mailto:sai.krishna@icraindia.com)

**Mr. Danushka Perera,**  
+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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