

ICRA Lanka revises the issuer rating of Ceylon Tea Brokers PLC to [SL]BBB(Stable)

April 23, 2018

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

Rating action

ICRA Lanka Limited, Subsidiary of ICRA Limited, group company of Moody's Investors Service, has revised the Issuer rating assigned to Ceylon Tea Brokers PLC ("CTB"/"the company") to [SL]BBB (pronounced SL triple B¹) with stable outlook from [SL]BBB- (pronounced S L Triple B minus) with stable outlook.

Rationale

The rating revision considers the revenue growth and profitability improvements witnessed during FYE2017 and 9MFYE2018 aided by the increase in market share of the company in the tea broking industry from 10.85% in FYE2017 to 11.63% in 9MFYE2018 and YOY 53% increase in the loan portfolio during this period, leading to increased income. The rating also factors favourably the long standing track record of the company in the tea broking industry and its strong parentage, being part of the Capital Alliance Group, which is primarily engaged in financial services business. 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 driven by factors like agro climatic risks, demand volatility and labour issues. ICRA Lanka also considers the healthy demand for Sri Lankan tea from Middle Eastern and CIS countries, as witnessed in the last two years when the prices of Sri Lankan tea witnessed significant growth amidst decline in tea production due to adverse weather conditions and restrictions in usage of certain weedicides and the demand outlook remains favourable.

The rating is however constrained by the highly geared capital structure and moderate coverage indicators, which is primarily on account of financing operations of the company, the income from which accounted for 37% and 44.8% of total revenue during FYE2017 and 9MFYE2018 respectively. ICRA Lanka also notes that industry associations like Colombo Tea Traders and Tea Brokers Associations, ensure that buyers generally maintain a good credit history, which mitigates credit risk for brokers like CTB. Due to exposure to financing operations, the margins also remain susceptible to volatility in interest rates. ICRA Lanka also notes the acquisition of Logicare (Pvt) Ltd by the company during 9M FYE2018, funded by a short term loan from the group, which was later settled largely by the proceeds of the rights issue of LKR 205 Mn during Q4FYE2018. The subsidiary will be setting up warehouses and the total capex estimated to be about LKR 600 Mn, which will be partly funded by debt. 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 might need support from CTB and therefore, remains a sensitivity factor.

¹For complete rating scale and definitions please refer to ICRA Lanka's Website www.icralanka.com or other ICRA Rating Publications

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 listed tea broker 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. The company has healthy market share in the tea broking industry which has grown to 11.64% during 9M FYE2018 compared to 10.85% and 9.90% during FYE2017 and FYE2016 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) and other activities like providing advisory services etc accounting 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 ~29% growth in FYE2017 and ~38% growth (annualized) during 9MFYE2018 mainly on the back of healthy increase in tea prices, even though the tea volumes witnessed some moderation during FYE2017. The company charges ~Rs. 2.21/kg of tea stocks from sellers for ~40 days and also from buyers if held longer than 40 days. The segment witnessed ~13% decline during FYE2017 due to fall in tea volumes but witnessed an improvement in current fiscal. 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 growth during FYE2017 (~52%) and 9M FYE2018 (~80%) driven by the increase in loan portfolio largely on the back of increase in tea prices. However, the performance of the company remains susceptible to the risks of tea plantation industry in Sri Lanka. The company has acquired a new company-Logicare (Pvt) Ltd for LKR 233 Mn during 9MFYE2018 and plans to set up a warehousing facility of around 60,000 sqr ft under the subsidiary of Logicare (Pvt)Ltd. While in the first phase, the new facility will cater to the tea brokering industry, the company intends to cater to other industries also subsequently, which will provide further diversification benefits.

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 FYE2017 and 9MFYE2018 aided by growth in topline of 25% and 48%(annualized) during this period, due to increase in tea prices (along with increasing tea volumes) and benefit of other cost control measures adopted by the Company.

Favourable demand outlook - The demand outlook for Sri Lankan tea remains favourable and mainly driven by Middle East and CIS countries. The tea production in Sri Lanka had witnessed a decline during CY2016/17 largely due to adverse weather conditions that prevailed during this period, but average prices witnessed healthy growth during FYE2017 from LKR 400/Kg in preceding fiscal to LKR 539/Kg and further increased to LKR 641/Kg during 9MFYE2018, driven by strong demand from these regions. The demand outlook remains favourable from these regions, further supported by improvement in oil prices, global supply shortages and depreciation in Sri Lankan rupee and the same is expected to benefit CTB.

Credit challenges

Performance is susceptible to demand cyclicity, forex fluctuations, regulations and adverse weather conditions: CTB's performance is linked to demand cyclicity in tea industry, volatility in forex rates and impact of any adverse weather conditions. During CY2016/17, Sri Lanka's tea production has declined by ~10-13% due to adverse weather conditions that prevailed during this period. Further, any moderation in

demand from Middle Eastern and CIS countries due to economic cycles or other exogenous factors (like war /unrest) 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 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 2.3(x) to 3.8(x) in last few years. The gearing increased from 2.4(x) as on March 31, 2016 to 3.7(x) as on March 31, 2017, mainly due to increase in the lending portfolio. The high gearing is on account of lending operations of the company. The coverage indicators have also remained moderate but have witnessed improvements during FYE2017 and 9MFYE2018 due to improvements in profitability with interest coverage of 1.6 and 1.8 times (compared to 1.7 during FY2016), TD/OPBDITA of 5.1 and 5.2 (4.8 during FYE2016) and NCA/Debt of 4.2% and 6.9%(1.2% during FYE2016). While the company's debt mainly comprises of short term loans, during the current fiscal the company had also availed short term loans (including LKR 332 Mn loan from the group) to acquire Logicare (Pvt) Ltd and plans to incur a total capex of LKR 600 Mn at the subsidiary level during FYE2019 to set up new automated warehouses facility, which will be partly funded by debt. However, the company had also raised LKR 205 Mn during Q4 FYE2018 through a rights issue and the proceeds of the same were fully utilized for the repayment of the group debt. Therefore, ICRA Lanka expects gradual improvement in the capital structure in the medium term.

Project execution risks related to warehousing project: The company will be setting up warehouses under the subsidiary -Logicare (Pvt) Ltd during FYE2019, for which it will incur total capex of 600 Mn, of which LKR 233 Mn will be funded by its equity contribution and ~LKR 370 Mn will be through the debt availed at subsidiary level. While the project is expected to provide saving of rental cost 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.

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

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 listed standalone tea brokering company. The company provides wide range of services such as tea brokerage, warehousing and financing. During 9MFYE2018, the company has fully acquired Logicare (Pvt) Ltd, which holds the lease hold rights for a land in Muthurajawela Zone for 38 years.

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