ICRA Lanka reaffirms [SL]BBB+ ratings of E B Creasy & Company PLC; Outlook revised to Negative from Stable

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Instrument*	Current Rated Amount (LKR Mn)	Rating Action
Issuer Rating	N/A	[SL]BBB+ reaffirmed; Outlook revised to Negative from Stable
Proposed Senior Unlisted Unsecured Redeemable Debentures Programme	LKR 700 Mn	[SL]BBB+ reaffirmed; Outlook revised to Negative from Stable

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 S L triple B plus) assigned to E.B. Creasy & Company PLC ("EBCR"/"the Company"). The outlook of the rating has been revised to Negative from Stable. ICRA Lanka has also reaffirmed the Issue Rating of [SL]BBB+(pronounced S L triple B plus) for proposed Senior Rated Unlisted Unsecured Redeemable Debenture programme of the Company, amounting to LKR 700 Mn, while the Outlook has been revised to Negative from Stable.

Rationale

ICRA Lanka has taken a standalone view on EBCR given the low dependence of the Company on its subsidiaries (dividends/advances) and the limited contractual obligations to support group entities which are currently reporting losses/recovering from past financial losses. The Group's strong corporate governance policy to maintain priority of the cash flows required for meeting EBCR's debt obligations and growth needs over that of its subsidiaries and to restrict intercompany borrowings, provides additional comfort. Moreover, ICRA Lanka takes comfort from the Group-shareholding restructuring exercise, which had resulted in a reduced direct investment in Lankem Ceylon PLC (Lankem). Currently, Lankem is being treated as an associate company (as against a subsidiary) and this has further helped E B Creasy Group to limit its obligations for Lankem.

However, the revision of the rating outlook to Negative from Stable, is on account of moderation in the financial profile of EBCR at the standalone level during FY2018 and 9MFY2019. While EBCR's operating margin has remained stable in last few years, the moderation in other incomes and increase in depreciation and interest expenses have adversely impacted net margin. The weakening of performance was on account of weaker macro-economic conditions, forex volatility and high competition in several segments. The impact was however moderated to an extent due to the Company's strong brand name, leading market share in the consumer product segments, and the launch of new product categories. Further, the Company's subsidiaries also witnessed steep moderation in performance. While the direct support from EBCR is not expected due to its corporate governance policy, indirect support in the form of increased credit period to its distribution arm - Darly Butler & Company Ltd, have resulted in increased working capital borrowing at EBCR level, leading to increase in gearing and moderation in coverage indicators (although they remain adequate). ICRA Lanka also takes note of the moderation in market value of investments, which has led to erosion in buffer provided earlier by high market value compared to cost of investments. However, ICRA Lanka draws comfort from the experience of the promoters, the Company's strong track record and reputation in the industry, which have helped the Company to enjoy steady access to funding both from the capital markets as well as financial institutions that have supported its growth over the years. The

Company's professional management team coupled with strong corporate governance structure adds further comfort for the ratings.

These ratings are constrained by high competition prevalent in the consumer product segments from incumbents as well as new entrants, which moderates pricing flexibility and the high dependence on few major brands, which exposes revenues to concentration risks (although, the Company's business risk is diversified through Group subsidiaries to an extent). The Company's revenues and profits are vulnerable to foreign exchange risks (given the large dependence on imports which are not hedged fully) and the regulatory risks such as imposition of new taxes. The Company's investments in Lanka Special Steels Limited, Candy Delights Ltd and Ceyflex Rubber Limited business in recent years would further diversify the business risks although, these operations have sustained some moderation in profitability margins in current fiscal due to weaker macro-economic conditions that prevailed in Sri Lanka during this period. Further, EBCR's dependence on shorter tenor loans also exposes the Company to refinancing risk and shift towards longer duration loans will be positive for the credit profile.

While the Company's financial profile is comfortable, EBCR is presently dependent on short term loans to fund its working capital position, as operating cash accruals have been invested for capital expenditure requirements. The Company intends to utilize the proceeds of the proposed debenture programme to reduce the reliance on short term debt and thereby align cash flows in line with investment (fixed and working capital) requirements. Therefore, ICRA Lanka views this exercise on a positive note.

Key rating drivers

Credit strengths

Experience of the promoters and the strength of the Group: Over the years, EBCR has grown by strategic acquisitions and now constitutes a diversified group with 40 subsidiaries which are into manufacturing of FMCG products, import/export of agricultural inputs/commodities, distribution and freight forwarding, trading of chemicals/auto components and power equipment (solar), managing hotels and plantations. The Colombo Fort Land & Building PLC (CFLB) is the parent company of E B Creasy & Company PLC (holding 52.98% stake), with EBCR accounting for approximately 35% of the consolidated revenue in FYE2018 (LKR 43,293 Mn) and nearly 70% of the net profits of CFLB. Thus, EBCR is strategically important to the Group.

Lankem Ceylon PLC (LCEY) (including its subsidiaries) was EBCR's largest subsidiary till FY2017. However during Q4FY2018, LCEY has concluded a rights issue and this was largely subscribed by CFLB (including the rights issue entitlements of EBCR). Therefore, post the rights issue, EBCR's direct investment stake in LCEY has declined to 32.4% from 45.5%. This has led the Company to treat LCEY as an associate company rather than a subsidiary.

Strong brand name and dominant market share in relatively stable consumer product segments: The Company is a market leader in several consumer product categories and enjoys comfortable margins from most of the product categories. The BIC brand is a globally renowned brand and given the preference of disposable razors in Sri Lanka, BIC is also a leading product in Sri Lanka. The Company's joss stick products, marketed under the brand name of Amritha, and Denta tooth brush are other key products of the Company. Ninja mosquito coils is another leading product and under the Ninja brand, the Company has a leading market share in the mosquito coil market. The Company intends to further strengthen the growing segments of mosquito repellent products such as mosquito liquid vaporizers, aerosol, and refills product segments, which have a higher demand in the urban areas.

Credit challenges

Moderation in financial profile in recent years marked by profitability decline, increase in gearing and weakening of coverage indicators: The Company had maintained a healthy revenue growth in excess of around 10% or more overall for the period of FY2013 to FY2017. This has been on the back of sustained brand building efforts which have enabled the Company to garner a large share of the product segments it is present in. However, during FY2018, the operating income growth was largely flat at LKR 4,169 Mn (PY LKR 4,153 Mn) and witnessed annualized decline of ~5.6% to LKR 2,951 Mn in 9MFY2019. This is largely attributable to the weaker macro-economic conditions that prevailed in Sri Lanka, the growing competition under key product categories, and the impact from the increased VAT. While, the operating margin remained largely stable, the net margin has moderated from 9.2% in FY2017 to 5.2% and 2.2% in FY2018 and 9M FY2019 respectively, due to impact of lower other incomes and increase in depreciation and interest expenses.

The Company's gearing levels have been at 0.7-1.0x during FY2013 to FY2016, has gradually increased to ~1.1-1.2x during next two years and has further increased to 1.3x as on December 31, 2018 due to increase in working capital debt levels and weaker accretion to reserves. The coverage indicators have also witnessed some moderation with interest coverage and TD/OPBDITA at 1.82(x) and 4.25(x) during 9MFY2019 compared to 1.96(x) & 3.53(x) in FY2018 and 2.71(x) & 3.66(x) in FY2017. Going forward, gradual improvement may be witnessed, as Company has limited capex plans in the medium term. During 9MFY2019, there was some improvement in inventory holding period, although the intercompany trade receivables remained high due to high credit period offered to group entity, Darley Butler & Co Ltd.

High competition from incumbents as well as new entrants, exert some pressure on pricing flexibility: Although, the BIC brand is the market leader in disposable razor market in Sri Lanka, BIC has faced increased competition from Gillette which is the largest disposable razor producer in the world. Similarly, other key products such as Denta, Amritha and Ninja have faced increased competition from the established local/international players in Sri Lanka. Despite the strong market share across product segments, the competitive pressures from incumbents and new entrants exert some pressure on pricing flexibility, although the impact is partly mitigated by lower price ticket size of products and strong brand equity of key products. Nonetheless, going forward, sustained high competition is likely to exert pressure on pricing flexibility and market share of the Company.

High dependence on few major brands (albeit leading brands) exposes revenues to concentration risks: Despite the Company's leading product categories and stable profitability, the Company's revenues are largely concentrated on few major brands/products such as BIC, Ninja, Denta and Amritha with those four products accounting for over 85% of the Company's revenues. In order to mitigate the revenue concentration risk, the Company has started diversifying its product portfolio, and focuses more on indigenous/private label products to diversify its revenue streams. Although, the revenue contribution of these products currently remains low, the Company's ability to promote these products and increase the revenue contribution, notwithstanding the reduction in promotional expenditures given the weaker macro-economic conditions, would be key towards improving the business risk profile over the medium term. The same would also enable the Company to enter into higher margin segments, where competitive pressures would be lesser and hence, mitigate the risk of dependency on few products/brands.

Company's exposure to foreign currency and other macroeconomic volatilities: The macro economic conditions such as increasing interest rate, depreciation of Sri Lankan rupee and other policy directives of the consumer markets, would likely have an impact on the overall performance of the Company. During 9MFY2019, due to sharp depreciation of SL rupee, the Company's raw material cost has increased noticeably. Although, the Company was able to pass-through the impact to the end customers during this period due to strong brand equity of the key product categories, the Company remains vulnerable to steep volatility in forex rates.

Underperformance of Group companies: During FY2018 and 9MFY2019, the financial performances of several group companies were negatively affected. While during FY2018 several group-companies like Candy Delights Ltd, E B Creasy Logistics and Laxapana Batteries witnessed some moderation in performance due to factors like changes in product strategy being implemented and debt funded capex incurred; there has been some recovery during 9MFY2019. However, performance of Lanka Special Steel Ltd, a fully owned subsidiary of EBCR, which has been performing well over the past two years, due to strong business pipeline, witnessed significant negative impact on profitability during 9MFY2019 due to sharp depreciation of Sri Lankan rupee. Moreover, the Company's recent investment, Ceyflex Rubber Ltd is still reporting operational losses and therefore, until this operation becomes a self-sustaining business, the Company is expected to provide some support. Further, the negative financial performance of Darley Butler has also exerted additional pressure on EBCR to support this operation by way of extended credit payments during 9MFY2019. If, Darly Butler continues to report financial losses, EBCR would also be compelled to support its operation and therefore, this is a key rating sensitivity.

LCEY, currently treated as an associate company of E B Creasy & Co PLC, is engaged in the manufacturing and distribution of Agro Chemicals, Decorative Paints products, Industrial Chemical & Bitumen Products, and FMCG products. During FY2017/18 and 9MFY2019, LCEY, has sustained further losses owing to several reasons including adverse weather conditions and regulatory related issues with the agro chemical segment. While, direct support to subsidiaries and associates from EBCR is not expected according to the Company's corporate governance policy, ICRA Lanka will continue to monitor the financial performance of the group companies and any changes in support policy towards weaker group entities will be key rating 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%20Methology.pdf*

About the Company:

Established in 1878, E B Creasy & Company PLC ("EBCR"/"the Company"), was converted to a limited liability company and listed on the Colombo Stock Exchange in 1968. It is one of the oldest companies in Sri Lanka. The Company is among the pioneers of the Ceylon Chamber of Commerce, having joined it in 1890. Over the years, EBCR has expanded by organic growth as well as by strategic acquisitions and now constitutes a diversified group. The Company on a standalone basis manufactures, markets and distributes a range of homecare, personal care and household products. The range offered includes imported and manufactured disposable razors, toothbrushes, mosquito coils, mosquito liquid vaporizers, coconut shell powder, wood powder and torch/automotive batteries. Besides, own operations, the Company also acts as the key holding company for the Group.

Key standalone financial indicators (audited)

Revenue and profitability indicators-Figs are in LKR Mn	FY14	FY15	FY16	FY17	FY18	9MFY19*
Operating Income	2,642.68	3,208.61	3,646.68	4,146.83	4,161.23	2,951.10
OPBDITA	381.02	436.62	512.96	547.29	571.57	423.43
PAT	224.38	241.06	264.34	383.86	216.49	65.85
ROCE (%)	16.08%	14.36%	15.58%	17.52%	15.20%	10.61%
Total Debt	814.45	1493.89	1518.09	2005.28	2016.84	2,357.82
Networth	1,179.22	1,385.52	1,516.01	1,699.38	1,822.81	1,788.40
Gearing (x)	0.69	1.08	1.00	1.18	1.11	1.31
OPBDITA/Interest & Finance Charges(x)	4.30	6.17	3.82	2.71	1.96	1.82
Total Debt/OPBDITA (x)	2.14	3.42	2.96	3.66	3.53	4.25

Note;- Unaudited Financials*

Rating history for last three years:

Instrument	Amount Rated	Current Rating (FY2019)		Chronology of Rating History for the past 3 years			
		Date & Rating in April 2019	Date & Rating in Sep 2018	Date & Rating in FY 2018 May 2018	Date & Rating in FY 2017 April 2017	Date & Rating in FY 2016 July 2016	Date & Rating in FY 2015
Issuer rating	N/A	[SL]BBB+ (Negative)	[SL]BBB+ (Stable)	[SL]BBB+ (Stable)	[SL]BBB+ (Stable)	[SL]BBB+ (Stable)	**NA**
Proposed Senior Unsecured Unlisted Redeemable Debentures	LKR 700 Mn	[SL]BBB+ (Negative)	[SL]BBB+ (Stable)	NA	NA	NA	**NA**

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