

ICRA Lanka assigns issue rating of [SL]AA- (Negative) for the proposed Debenture Programme of Hayleys PLC

May 09, 2018

Instrument*	Current Rated Amount (LKR Mn)	Rating Action
Proposed Senior Unsecured Redeemable Debenture Programme	4,000	Issue Rating of [SL]AA- with Negative outlook assigned;
Issuer Rating	N/A	Issuer rating of [SL]AA- with Negative outlook reaffirmed;
Senior Unsecured Listed Redeemable Debenture (issued on May 31st, 2016)	2,000	Issue rating of [SL]AA- with Negative outlook reaffirmed;
Senior Unsecured Listed Redeemable Debenture (issued on March 6, 2015)	2,000	Issue rating of [SL]AA- with Negative outlook reaffirmed;

Rating action

ICRA Lanka Limited, Subsidiary of ICRA Limited, group company of Moody's Investors Service, has assigned the issue rating of [SL]AA- (pronounced SL double A minus¹) with Negative outlook for the proposed Senior Unsecured Redeemable debenture programme of Hayleys PLC ("Hayleys"/ "the Company") amounting to LKR 4,000 Mn to be listed on the Colombo Stock Exchange. ICRA Lanka has also reaffirmed the Issuer rating of [SL]AA- (pronounced SL double A minus¹) with Negative outlook assigned to the Company. ICRA Lanka has also reaffirmed the issue ratings of [SL]AA- (pronounced SL double A minus¹) with Negative outlook for the Company's two Senior Unsecured Listed Redeemable debenture programmes amounting to LKR 2,000 Mn each.

Rationale

The assigning and reaffirmation of the Negative outlook for the ratings is on account of the impact on capital structure and projected coverage indicators of the company on account of increased debt levels in the aftermath of the Singer acquisition; the gearing of Hayleys PLC has increased from 0.7(x) as on FYE March 2017 to ~1.8 as on 9M ending FYE March 2018. Nevertheless, the company has plans to monetize some of its physical/financial assets in the near term to reduce the debt levels and ICRA Lanka will continuously monitor the same.

In September 2017, the Hayleys group acquired a 61.73% stake in Singer (Sri Lanka) PLC (Singer) for a total consideration of LKR 10.9 Bn. Hayleys PLC on its own has acquired a majority stake of 56.06%, while the balance was acquired by the group's two subsidiaries - Volanka (Pvt) Ltd and Carbotels (Pvt) Ltd. The acquisition also triggered a Mandatory Offer under the Company Takeovers & Mergers Code of 1995 (as amended) and therefore, the Group along with its subsidiary companies purchased additional shares from the other minority shareholders and currently, Hayleys group holds ~82.81% of Singer (Sri Lanka) PLC. Post the acquisition, Singer has become the largest subsidiary of the Hayleys Group (based on revenue contribution). Hayleys PLC has funded this acquisition through term debts from local lenders; the company intends to raise additional LKR 5-6 Bn through realignment and divestiture of some identified assets in the short to medium term and settle portion of the debts taken up for the acquisition.

The assigned and reaffirmed ratings take into account Hayleys position as the holding company of one of Sri Lanka's largest manufacturing conglomerates which is into diverse sectors such as purification

products, hand protection, plantations, transportation and logistics, leisure, agriculture, industrial inputs, power, construction materials, textiles, fiber and consumer products. The ratings draw comfort from the fact that several of the Hayleys group entities hold leading market shares in Sri Lanka as well as in the global markets. Over the years, the group has also diversified its revenue streams with none of its 12 sectors contributing to more than 15% of revenues (except the fast expanding logistics division). Unlike regional peers, the Group is also not entirely dependent on Sri Lanka, with over 55% of revenues being derived from exports to more than 70 countries (including deemed exports). ICRA Lanka also considers Hayleys experienced management team, the Company's strong professional setup and its sound corporate governance practices as key positives, which have complemented its business strengths. Cumulatively these factors have enabled the Group to record healthy growth rates in the past largely through prudent organic growth.

The assigned and reaffirmed ratings also take into account the substantial market buffer over the book value of Hayleys investments in publicly listed subsidiaries, Hayleys strong relationship with financial institutions, easy access to capital markets, besides the Company's access to undrawn sanctioned lines which provide comfort on the overall liquidity position. The strategic importance of the group to the promoters and their past track record of divesting/diluting stake in group entities provide incremental comfort on the group's ability to raise capital for meeting growth and repayment needs.

With no independent operations, Hayleys PLC is almost exclusively dependent on dividend income from the group entities/subsidiaries to generate cash flows for meeting administrative expenses as well as debt repayment obligations. In the post Singer acquisition, the Company further intends to upstream high dividend from the group's key subsidiaries (including Singer which has been maintaining a high dividend payout of ~60%) to support the servicing of the increased debt levels.

The Hayleys Group has restrictions on inter-company lending with each division being solely responsible for meeting its capex needs and debt obligations; however, Hayleys PLC has extended/is likely to extend financial support to a few entities. One of the Group's recently setup businesses (Global Beverages) also has sizeable debt repayment obligations which may require financing support from Hayleys for a limited period although, the plantation sector (Global beverage is a JV between Hayleys PLC and Kelani Valley Plantations PLC) has recovered significantly during 9MFY18 amidst the increased tea prices and the recovering tea volumes. Singer, being a leading retailer in the consumer durable market with a moderately strong financial profile, would be able to largely fund the operational and capex requirements, therefore, limited financial support is expected from Hayleys PLC post the acquisition.

ICRA Lanka takes note of the under-performance of the group's agriculture, hand protection, purification, leisure and textile sectors during 9MFY18 which have partially negated the positive growth in other business segments (including plantations, transport & logistics and power sectors during this period). This has impacted the overall profitability of the Group during 9MFY18.

Key rating drivers

Credit strengths

Holding company is one of the largest conglomerates in Sri Lanka with significant diversifications across several sectors of the economy; Hayleys is one of the most diversified groups in Sri Lanka with a presence spanning across 12 diverse sectors. The Group is also the largest listed manufacturing conglomerate in Sri Lanka. Starting initially with trading and Logistic & shipping operations, over the years the Group has expanded its operations to sectors such as plantations, agriculture and industrial inputs,

textiles, activated carbon, latex products, FMCG, construction materials and power. In line with the group's policy no division (barring Transport & Logistics and consumer sectors, after the Singer acquisition) contributes in excess of 15% of group turnover. This lends significant diversity to revenue streams and insulates the revenues from risk of concentration / high dependence on any one sector.

Leading market positions of several of the group companies in both local and global markets (including the recently acquired-Singer Sri Lanka PLC); the Group's revenues are also well spread across several geographies, lending a considerable measure of diversity to the revenue streams. Moreover, the Group has market leadership (both global and local) in several sectors. For instance, Haycarb is a global leader in charcoal based activated carbon, DPL is among the top players in the rubber gloves industry, Hayleys Plantations, logistics and construction materials businesses are the market leaders in their respective fields in Sri Lanka. Hayleys Agro equipment is the market leader in Sri Lanka and Hayley's Pickle products command a 60% market share in Japan. The recently acquired Singer Sri Lanka Plc, is the market leader in several segments such as sewing machines, refrigerators, smart phones and consumer durable segments. Therefore, the favourable growth outlook for these sectors provide revenue visibility over the medium term and consequently increased dividend income for the group.

Singer acquisition; generally, consumer durable industry is expected to perform well when the disposable income levels in a country increases. Moreover, Sri Lanka now being a middle income country and progressing towards upper middle income status, will result in increased business potential in the consumer durable market in the future. Therefore, Singer (Sri Lanka) being the market leader in the consumer durable market in Sri Lanka, would help the group to leverage on this potential going forward. Moreover, as Singer group's revenue targets are expected to reach ~ LKR 60 Bn, the group intends to bring about efficiency improvement measures in their product procurement process/system/sources to further increase operating profit margins.

Access to capital markets with several listed companies in the group; presence of institutional investors in few of the businesses provides incremental comfort; As compared to the historical value of investments, the market values of investments provide a significant buffer as on date. In the case of the Company's effective holding in listed entities, the buffer over book value of investments currently stands at over 70%. Moreover, most of group companies are listed in Colombo Stock Exchange and therefore, the capital support from the holding company level is relatively limited. The same, coupled with the promoter group's past inclination to divest/dilute stake provides comfort on debt servicing, as some of these investments (including some of lower yielding investments such as Global beverage and Amaya Beach) could be liquidated to service debt obligations.

Strong balance sheet with a moderate capital structure; the company has the largest asset bank across its group companies, including larger unlisted entities such as Agriculture and Transport & Logistics sectors, although these assets are not reflective of the market values. Hence, the group is currently in the process of a restructuring exercise to optimize the returns on these assets.

Experienced Management team with access to financing options; The company's experienced management team, strong professional setup and its sound corporate governance practices as key positives, have helped the company to access financial institutions as well as capital markets, besides the Company's access to undrawn sanctioned lines, provide comfort on the overall liquidity position.

Credit challenges

The moderation in debt service indicators (amidst the increased debt levels to fund the Singer acquisition), exposing the company to refinancing risks; On account of increased debt levels in the aftermath of the Singer acquisition; the gearing level of Hayleys PLC has increased swiftly from 0.8(x) as on FYE March 2017 to ~1.8(x) as on 9M ending FYE March 2018. Nevertheless, as mentioned earlier, the company would settle part of the debt through monetizing some of its physical / financial assets in the near/medium term. The balance debt will be long term with maturity periods extending upto 2025. ICRA Lanka will continuously monitor the same. However, healthy relations with financial institutions and capital market participants and healthy investment buffer, mitigate the refinancing risk.

Underperformance of certain businesses and continued support from Hayleys likely to further moderate the capital structure; the company's new investments such as global beverage operation has sustained losses. Therefore, the implementation of the company's plans to bring in strategic investors/partners for these investments need to be fast-tracked to minimize the continued support from Hayleys. On a positive note, the company's Maldives hotel project (Amaya Kudara) is currently turning around as the refurbishment of the hotel has been completed during 9MFY18. Therefore, the ability of the company to turnaround these investments in the medium term would remain as a rating sensitivity.

Company's and Group's exposure to foreign currency and other macroeconomic volatility; Since Hayleys's consolidated revenue accounts for more than 1% of Sri Lanka's GDP, the macro economic conditions such as increasing interest rate, depreciation of Sri Lankan rupee and other policy directives of other sectors would likely to have an impact on the overall performance of the group. However, given that over 50% of revenues are derived from outside of Sri Lanka, the risk is mitigated to an extent.

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:

Hayleys PLC ("Hayleys"/"the Company") is one of Sri Lanka's largest multinational business conglomerates with a history spanning 135 years. Initially commencing commercial operations in 1878 as Chas. P. Hayley and Company, the entity was incorporated as Hayleys Limited in 1952 and subsequently converted to a PLC. Hayleys acts as a holding company and does not have any significant operations on its own. However, through over 160 direct and step down subsidiaries as well as associates, the Company controls businesses spanning across Transportation & Logistics, Agricultural Inputs, Construction Materials, Power, Fiber, Rubber Glove Manufacturing, Leisure, FMCG, Purification products (activated carbon), Power, Plantations, Textiles and BPO. The Company's consolidated revenues are well diversified with no sector (barring transportation & logistics and consumer) contributing to more than 15% of total revenues. Group's operations are also well spread geographically, with export revenues (Asia, Europe, Americas and indirect deemed exports) contributing to over 55% of revenues. During Sep CY2017, the group has acquired the controlling stake of Singer (Sri Lanka) PLC, the market leader in the consumer durable market in Sri Lanka.

Key consolidated financial indicators (audited)

Revenue and profitability indicators-Figs are in LKR Mn	FY14	FY15	FY16	FY17	9MFY18*
Operating Income	1,276.8	1,601.1	1,797.5	1,925.1	1,009.6
OPBDITA	1047.1	1331.2	1524.2	1682.4	851.4
PAT	537.5	754.4	867.8	938.4	-236.3
ROCE (%)	10.13%	8.86%	8.92%	9.53%	4.55%
NWC / OI(%)	-62.92%	-44.59%	-42.63%	-41.52%	-69.94%
Total Debt	6,523	6,920	6,586	7,832	19,467
Networth	8,269	10,522	10,999	11,570	10,772
Gearing (x)	0.79	0.66	0.60	0.68	1.81
OPBDITA/Interest & Finance Charges(x)	1.2	2.0	2.3	2.1	0.8
Total Debt/OPBDITA (x)	6.23	5.20	4.32	4.65	22.86

*-Unaudited Financials, Note; the net worth in FYE 2017 and 9MFYE2018 was adjusted for the revaluation of lands

Rating history for last three years:

Current Rating (FY2018)			Chronology of Rating History for the past 3 years				
Instrument	Type	Amount Rated (LKR Mn)	Date & Rating April 2018	Date & Rating Sep 2017	Date & Rating in March FY2017	Date & Rating in FY2016	Date & Rating in FY2015
Issuer rating	N/A	N/A	[SL]AA-(Negative)	[SL]AA-(Negative)	[SL]AA-(Stable)	[SL]AA-(Stable)	NA
Issue rating	Debenture	2,000	[SL]AA-(Negative)	[SL]AA-(Negative)	[SL]AA-(Stable)	[SL]AA-(Stable)	NA
Issue rating	Debenture	2,000	[SL]AA-(Negative)	[SL]AA-(Negative)	[SL]AA-(Stable)	[SL]AA-(Stable)	NA
Issue rating	Proposed Debenture	4,000	[SL]AA-(Negative)	NA	NA	NA	NA

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