

ICRA Lanka reaffirms the issuer rating of [SL]A+ with Stable Outlook for ACL Cables PLC

November 5, 2018

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

Rating action

ICRA Lanka Limited, Subsidiary of ICRA Limited, group company of Moody's Investors Service has reaffirmed the Issuer rating of [SL]A+ (pronounced S L A plus¹) with stable outlook for ACL Cables PLC ("ACL" / "the company").

Rationale

ICRA Lanka has taken a consolidated view on ACL Cables PLC and its subsidiaries as a whole, given the significant operational and business dependencies among them. The reaffirmed rating primarily factors in the company's strong brand and its dominant market position in the local cable industry. The company's strong distribution dealer network has enabled ACL group to establish a strong presence in the local retail cable market. Moreover, ACL has also been able to secure a leading market share in the utility market due to strong execution track record, along with relatively high value addition. The company has introduced new innovative product categories such as covered cables, fire resistant/low voltage transmission cables and recently, the conductors, which reduces the corona effect/power losses, especially in the coastal areas through their R&D Testing Laboratory. Given the recovery of the local construction industry (including the private and state sectors), which has a direct bearing on the cable market and the implementation of new development projects such as Megapolis and Port City, ACL's future outlook in the Sri Lankan operation remains positive. ICRA Lanka also 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. The company's professional management team coupled with a good governance structure adds further comfort for the rating. These apart, the reaffirmed rating also factors in the group's positive cash accruals, which is characterized by healthy profit margins (PAT margin 4.7% in FY2018 Vis a Vis 8.5% in FY2017 and 9.9% in FY2016) and relatively lower overhead cost structure. Moreover, ICRA Lanka views the company's established and growing export markets such as Maldives, Mauritius, and some African counties on a positive note.

The above rating strengths are partly constrained by the volatility in the global metal prices (including Copper, Aluminum and PVC Resins) and the exposure of the company's margins to the same. ICRA Lanka also notes the deterioration in the operating profit margins during FY2018 and Q1FY2019, which is largely attributable to the increased raw material costs owing to the increased global metal prices and the depreciation of Sri Lankan Rupee. Therefore, the ability of the company to successfully manage the increased raw material prices, in the event of a commodity price rally, and improve the margins in the short to medium term remains a key rating sensitivity.

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

ICRA Lanka notes positively the growth in export revenue contribution in FY2018 and FY2017 as against the de-growth witnessed in FY2016. However, the ability of the company to explore new export markets (such as Ethiopia) and further expand export sales going forward remains to be seen. The Company's operations are exposed to regulatory risks, including changes in interest rates and duties imposed to curb imports. ACL's profits are also exposed to currency risks, with imports forming a large portion of sourcing and no formal currency hedging mechanism in place to mitigate any sharp volatility in exchange rates.

The Group has also diversified into renewable energy and recently into sugar plantation industries, with experienced German and Indian partners, through its fully owned subsidiary, Ceylon Copper (Pvt) Ltd. Though the management does not anticipate any major funding support (at the standalone level), any adverse operational performance of these investments/projects, would necessitate funding support from ACL and will also moderate the overall return on capital employed. Hence, ICRA Lanka will continue to monitor the Group's new diversification initiatives and the corresponding impact on the financial profile.

Credit strengths

Leading market share, new product innovation and brand equity: ACL Cables PLC is enjoying a dominant market position in the cable industry with a share of more than 70% in Sri Lanka (including the Kelani Cables PLC). The acquisition of Kelani Cables PLC has helped the group to further strengthen their market position. The company has been able to maintain a strong brand equity owing to the high quality standards maintained in their products compared to the imported products and the strong distribution dealer network. The weaknesses of the competitors in local cable industry has also helped the company to further increase its market share during FY2018. Moreover, ACL Cables has also been expanding its presence in the world by exporting mainly to countries such as Maldives, Mauritius, Bangladesh, Australia and few African countries.

ACL Cables PLC is the only local cable manufacturer with a research and development centre which has enabled the company to diversify their product portfolio over the past. As a result, ACL is also capable of manufacturing cables and conductors which adhere to the British Standard (BS) as well as the National French Standard. Thus, ACL Cables enjoys the competitive advantage of being the preferred cable contractor by state authorities and private institutions.

Experience of the promoter/s and the management: The Company and the Group as a whole has been driven by the rich promoter experience and the strong and experienced management team in place, which has guided the Company through several business cycles. The Company has a relatively strong corporate structure in place with well-planned succession management policies and also has a better corporate governance structure. This has ensured business continuity over the past several decades.

Healthy demand dynamics: Ceylon Electricity Board (CEB) is the single largest customer of ACL Cables PLC. CEB's present tendering process favours local cable manufacturers with highest level of value addition. Hence, ACL being a reliable and technologically advanced cable manufacturer (with the R&D facility), has been able to secure major electrification contracts from CEB over the past several years. The company's utility segment has performed well during FY2017 and FY2018 due to increased demand for ABC Cables (Aerial Bundle Cables). Going forward, the cable demand from CEB is expected to further increase due to replacement and maintenance requirements of its distribution lines with the ABC cables, which has higher conductivity than conventional aluminium conductors.

ICRA Lanka also takes comfort from the growing demand from the institutional market in Sri Lanka. ACL is the cable supplying contractor for most leading real estate/mixed development projects in the country. Generally, the demand for electrification cables for real estate development projects increases during the

final phase of the construction. Hence, going forward, this segment is expected to perform well as the company's major client projects are currently in the final phase of the construction. However, during FY2018, the revenue contribution from the distribution segment has recorded a marginal de-growth due to subdued macro-economic outlook that prevailed in the country. Therefore, during FY2018, the company has realigned its distribution network to further increase its market penetration/coverage in the island.

Diversification into new business segments: The rating also considers positively the company's recent investments such as renewable power generation and sugar plantations. The sugar manufacturing operation is expected to be carried out in Q4FY2019 and the recent imposition of new duties on imported sugar will help this operation to reach turnaround targets earlier than previously envisaged. However, ICRA Lanka will continue to monitor the financial performance of this investment and the ability of the management to attain their return targets without additional capital support. During FY17, the financial performance of Resus Energy was negatively affected by the adverse weather conditions that prevailed in the country and the reduction of three tier tariff system. However, during FY2018, the company's catchment areas received better rain fall than the year before and therefore, the financial performance of Resus Energy has improved during FY2018.

Healthy Financial Profile: ACL Group's revenues have increased at a compounded annual growth rate of 8.46% over the last six years (FY2012-FY2018). Moreover, during FY2018 and Q1FY2019, the company's revenue has increased by YOY 8.20% and YOY 2.8 % respectively, owing to the strong performance of key segments. The company has recorded a PAT of LKR 479 Mn and LKR 1,001 Mn in FY2017 and FY2018 respectively from LKR 544 Mn in FY2016. The moderation in profitability margins during FY2018 is attributable to the increased metal prices, and weaker macro-economic outlook that prevailed in the country. The company's capital structure is comfortable on account of healthy margins and relatively low debt level. The debt profile of the Company is largely skewed towards long term loans, with the same contributing to over 60% of the debt outstanding in FY2018. ACL's cash flows and coverage metrics have improved in the last few years, stemming from increased profitability, and consequently, the moderation in debt levels. The company is unlikely to further increase its capital expenditure plan in FY2019 and therefore, this would help the company to further improve on the debt coverage metrics to an extent.

Credit challenges

Price volatility in Global metal prices: ACL Cables PLC's profitability is directly correlated with the global copper/aluminium prices, which have increased sharply during H1CY2018 (albeit a reduction in prices thereafter to date). Moreover, the Sri Lankan rupee depreciation has also exerted additional pressure on the company's profitability margins. The company has only limited options to mitigate the risk of raw material price volatility. Generally, the company does not enter into any commodity hedging arrangements. Nevertheless, the company enters into price-locking agreements for confirmed long term orders from CEB (when the raw material prices are increasing). Moreover, the company is currently negotiating with CEB to replace the existing aluminum transmission cables (unarmored) with new ABC Cables after further value additions from the company's recycle plant. This arrangement will not only help the company to source raw materials from the CEB (as scarp metals) but also to avoid any raw material price volatilities on this assignment.

Generally, the company would pass-through the raw material cost increases onto end customers especially in the retail/institutional segments. However, the revision of sales prices (due to raw material price increases) are generally effected with a time lag, and the same is largely dependent on the operating market conditions. Therefore, the company's profitability margins are likely to be affected during such periods. Conversely, in the event of a reduction in the global metal prices, the company's sales prices (especially in

the retail segment) are generally not revised and therefore, the company's profitability margins are expected to noticeably increase during such periods. Therefore, the ability of the management to successfully manage the raw material price cycles and minimize the impact from the adverse price movements, will remain as a key rating sensitivity to the reaffirmed rating.

Macro-economic outlook and government policies; Since the demand for company's key product categories are driven by the growth in the local construction industry, the macro economic conditions such as increasing interest rate, depreciation of Sri Lankan rupee and other policy directives of the government on this industry would likely have an impact on the overall Performance of the company. The importation of cables is highly restricted by the SL government, as this is currently in the negative list of imports due to national security concerns. Therefore, this industry currently is protected from the imports. According to the recently signed free trade agreement, between Singapore and Sri Lanka, the importation of cables is still maintained in the negative list. Similarly, the proposed free trade agreement, between China and Sri Lanka is also expected to maintain such protection. However, in the event the government reverses its policy, resulting in increased imports, ACL Cables would face increasing price competition and the threat of imports from new incumbents and foreign cable manufacturers due to the new free trade agreements and therefore, this is a key rating sensitivity to the reaffirmed rating.

Increasing trade Creditors; The working capital position of the company during FY2018 has moderated marginally due to two factors. One reason is high debtor's level from the distribution segment and the same is largely attributable to the weaker macro-economic outlook that prevailed during this period. The second is the increased inventory levels as a result of increasing global metal prices during this period. However, going forward, the management intends to manage its debtors (in the retail segment) given the realignment of the company's distribution system. Moreover, the recent reduction in the global metal prices, is expected to normalize the company's inventory holding position going forward. Therefore, the ability of the company to successfully implement these strategies, while containing the relatively higher debtor levels, will remain to be reviewed going forward.

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:

ACL Cables PLC was founded in 1962. The company was formerly known as Associated Cables Ltd and changed its name to ACL Cables PLC in 1990. ACL Cables PLC is engaged in the manufacture and sale of cables and electrical conductors both in Sri Lanka, as well as internationally. Being the market leader and having acquired the second largest manufacturer of cables in the year 1998, ACL today, is a Group of cable manufacturing companies holding a robust 70% market share of the local cable industry. Kelani Cables PLC, a subsidiary of ACL Group, the second largest cable and conductor manufacturer in Sri Lanka, was owned and managed by OLEX Cables of Pacific Dunlop Group of Australia till the year 1998. ACL Group owns 65.2% and 31.71% stakes in ACL Plastic PLC and Resus Energy PLC respectively.

On a consolidated basis, ACL reported a net profit of LKR 763 Mn on a total income of LKR 16,368 Mn in FYE March 2018, compared to a net profit of LKR 1,255 Mn reported on a total income of LKR 14,722 Mn in FYE March 2017. During 3M ended FYE March 2019, ACL has registered a net profit of LKR 87.2 Mn on a total income of LKR 3,542Mn.

Key standalone financial indicators (audited)

<i>Figs are in LKR Mn</i>	FY14	FY15	FY16	FY17	FY18	Q1FY19
Operating Income	6,396	8,059	7,064	8,431	9,118	2,344
OPBDITA	415	899	927	1,426	784	81
PAT	98	491	544	1,001	479	20
ROCE (%)	6.9%	14.2%	14.1%	21.1%	11.6%	3.5%
Total Debt	2,009	2,755	2,078	2,176	1,824	1,319
Networth+MI	2,936	3,609	4,098	4,884	5,172	5,192
Gearing (times)	0.7	0.8	0.5	0.4	0.4	0.3
OPBDITA/Interest & Finance Charges	1.8	4.3	5	6.9	3.2	3.4
NCA/Total Debt (%)	5.7%	18.6%	24.8%	42.0%	21.3%	13.0%
Total Debt/OPBDITA (times)	4.8	3.1	2.2	1.5	2.3	4.0

Note; Gearing-(Total debts/ Networth)

Rating history for last three years: ACL Cables PLC

Instrument	Type	Amount Rated (LKR Mn)	Current Rating (FY2019)	Chronology of Rating History for the past 3 years		
				Rating in FY2018	Rating in FY2017	Rating in FY2016
			Oct-18	Jul-17	Jan-16	N/A
Issuer rating	N/A	N/A	[SL]A+ (Stable)	[SL]A+ (Stable)	[SL]A+(Stable)	N/A

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