

ICRA Lanka reaffirms the issuer rating of [SL]A+ with Stable Outlook for JAT Holdings Pvt Ltd

September 03, 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 plus) with stable outlook for JAT Holdings (Pvt) Ltd ("JAT" / "the company").

Rationale

The reaffirmation of the rating primarily factors in, the company's strong brand name and dominant market position in the Sri Lankan and Bangladeshi wood coating industry, especially in the water based, PU and UV wood coating segments. The company is the largest exclusive distributor globally for the Sayerlack brand of wood coatings, which is owned by Sherwin Williams USA, the number one Coating Company in the World. JAT Holdings has distribution rights for Sayerlack for the entire South Asian region. Owing to its strong brand equity, intense marketing efforts and higher quality standards, JAT Holdings, has the highest market share in the Sri Lankan and Bangladesh overall wood coating sector despite heavy competition from incumbent and new MNCs. The revenue contribution of Sayerlack products to the company has been higher than 60%, leading to relatively high revenue concentration risks. However, with the increased revenue contribution from the project market, led by brands such as SEA Kitchens from Germany and Armstrong Ceilings from USA as well as the recent acquisition of "Harris" brand, the market leader in the Sri Lankan painting brush segment, the dependency on Sayerlack brands/products is expected to reduce going forward. Moreover, considering the established relationship between JAT Holdings & Sherwin Williams and the strategic nature of the tie-up (JAT being the largest distributor in the world for Sherwin Williams), ICRA Lanka views the company's risk of dependency on Sayerlack brand as moderate.

The rating also factors in the strong growth potential for wood care products in Sri Lanka, notwithstanding the de-growth in the company's revenue contribution from the local operation in FY2018 due to the weaker macro-economic outlook that prevailed during this period. The deterioration in the company's financial performance during FY2018 was on account of largely the compounding effect of the weaker macro-economic outlook during FY2017/18, as well as the lead-lag effect between the market demand and the sales volumes during these periods. However, ICRA Lanka takes note of the company's lateral-revenue diversification initiatives, which are aimed at penetrating into relatively less premium segments of the wood coating market in Sri Lanka. Moreover, ICRA Lanka draws comfort from the company's continued focus on increasing its market share in regions where its reach has been sub-optimal till date. The Company has also diversified into the premium interior design segment in the recent past through tie-ups with a German based SEA Group company, to provide furnishing solutions in the premium real estate sector in Sri Lanka. This segment has noticeably gained a leading market share during this period. However, during FY2017/18, the Company's decorative paints segment, which includes international brands such as Permoglaze & Crown, has experienced a deterioration of market share amidst the intense competition. Therefore, the ability of the company to successfully translate the new business strategies into a meaningful improvement in the overall financial performance, will remain as a key rating sensitivity to the reaffirmed rating.

ICRA Lanka also takes note of the company's diversification into fast growing export markets (such as India, Bangladesh and Maldives). JAT has become the leading player in the Bangladesh wood coating segment by distributing Sayerlack products through its strong distribution network and effective marketing initiatives. The management has recognized India, Maldives and Pakistan as more promising growth opportunities and has continued its significant brand building efforts to penetrate into these markets. Notwithstanding the company's rapid scale-up in the Bangladesh market, ICRA Lanka views its success in the Indian operation as a formidable challenge. The extent of financial investments to be made towards the Indian market foray will also remain as a concern.

Over the past few years, the company's operating profit margins have moderated noticeably due to cost increases (including sustained SL Rupee depreciation), increased competition with higher price discounts, and higher revenue contribution from the projects segment, which has relatively lower profit margins. During FY2018, the impact on the operating profit margins were relatively high due to the compound effect of the above mentioned factors amidst the weaker macro-economic outlook that prevailed during this period. JAT's strong brand equity and the market leadership have enabled the company to pass on partly any additional cost increases despite the growing competition.

Moreover, JAT Holdings being the largest global distributor/dealer of Sherwin Williams, enjoys the maximum price discounts from the supplier. Therefore, ICRA Lanka expects the impact of the cost increases due to foreign exchange risks on the company's revenue and consequently the profitability will be marginal in the short to medium term. ICRA Lanka also notes the company's new strategies to sustain/increase the profitability margins going forward by further increasing the efficiency within the overall operation.

The rating also factors in the group's positive cash accruals, which is characterized by relatively healthy profit margins (PAT margin 11.7% in FYE March 18 vi -a-vis 15.6% in FYE March 17). Notwithstanding the positive cash accruals, the company's working capital position has deteriorated over the past few years. The receivables levels over the last 5 years have increased owing to the growing nature of the business, weaker macro-economic conditions as well as increasing competition in Sri Lanka. Given the expansion of business and the industry practices, ICRA Lanka expects the company's receivable levels to improve further in the short/medium term with the full recovery of the macro-economic conditions in Sri Lanka. The company's capital structure is comfortable on account of increasing healthy margins and relatively low debt level.

Credit strengths

Experience of the promoter/s and the management: The experience of the promoters, the company's strong track record and reputation in the industry have enabled the company to enjoy steady access to funding from financial institutions. The company's professional management team coupled with relatively strong governance structure adds further comfort.

Leading market share and strong brand equity: JAT is synonymous with the water based wood coating market in Sri Lanka due to strong brand equity as well as higher quality standards of the Sayerlack products. Currently, JAT dominates the water based premium wood coating market in Sri Lanka. Core product segments of JAT, particularly Sayerlack wood coating products, enjoy relatively high gross margins, resulting in strong profitability for the company. This is attributable to strong brand equity that JAT commands, as most of the premium products are sold by the company are relatively less susceptible to the price competition in the industry. Moreover, Sayerlack products compared with that of the

competitors have relatively high quality standards and are suitable to the local conditions. As a lateral diversification strategy, the company intends to introduce new Sayerlack product categories to penetrate into relatively less premium wood coating segments going forward. Therefore, the ability of the company to successfully diversify its new product categories and improve the financial performance will remain to be reviewed going forward.

Higher revenue visibility amidst the diversification Strategy: The rating also considers positively the company's recent diversification into innovative new product categories such as Ceiling products, Sand Papers, Master Brush, Fire Resistant Paints etc, which have been posting volume growths over the past few years. JAT envisages itself as a leading player in the broader interior and living spaces market and has continued with its tie-ups with premium international brands such as Herman Miller, Armstrong etc. The Company has also diversified into the premium interior design segment in the recent past through tie-ups with a German based SEA Group, to provide furnishing solutions in the premium real estate sector in Sri Lanka. This segment has performed well during FY2018. Moreover, the company's growing export segment (including Bangladesh, India, Maldives and Pakistan markets), would further enable the company to diversify its operations going forward.

Comfortable Financial Profile: JAT's revenues have increased at a compounded annual growth rate of 16.25% over the last four years (FY2014-FY2018). However, during FY2018, the company's revenue has declined by YOY 5.8% owing to the de-growth in the local operation. The underperformance of the local operation was cushioned by the increasing revenue contribution from the export market during FY2018. The company has recorded a PAT of LKR 902 Mn and LKR 634 Mn in FY2017 and FY2018 respectively from LKR 849 Mn in FY2016. The moderation in profitability margins during FY2018 is attributable to the weaker macro-economic outlook, increased competition and diversification initiatives. 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 short term loans, with the same contributing to over 65% of the debt outstanding in FY2018. JAT'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

Relatively high dependency on Sayerlack brand/products: Notwithstanding the company's ongoing diversification initiatives, the company's dependency on Sayerlack products still remains at a relatively high level. However, ICRA Lanka also notes that JAT is the largest exclusive distributor for Sayerlack brand, which is owned by Sherwin Williams, for the South Asian region. Considering the established mutual relationship between JAT Holdings & Sherwin Williams and the strategic nature of the tie-up with this supplier, and initiatives taken on the export market and project market with new brands introduced to the product portfolio, as mentioned above, ICRA Lanka views the risk of dependency on Sayerlack products by JAT Holdings as moderate.

Cyclical nature of the Construction industry and relatively high working capital position: Since the demand for company's core 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 the construction industry would likely have an impact on the overall performance of the company. The company's working capital position currently remains relatively stretched due to weaker macro-economic outlook that prevailed during FY2017/18. Moreover, the company's new strategies to introduce new product categories and efficiency improvement measures are

likely to exert additional pressure on the company's working capital cycle in the short to medium term. Therefore, the ability of the company to successfully implement the diversification initiatives, while controlling the relatively high working capital position remains as a concern.

Increasing Competition: The painting industry is generally characterized by intense competition from a larger number of competitors in Sri Lanka. Moreover, during FY2017/18, new players have also entered the local painting industry. Increased competition could result in a price war and hence, could impact the company's overall performance going forward. However, Sayerlack products have a higher brand equity compared to that of competitors and therefore, continue to enjoy the advantages of being an early mover, established distribution network, manufacturing set up and brand presence.

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:

Incorporated in 1993, JAT Holdings (Pvt) Ltd has become a dominant player in Sri Lankan wood coating, decorative painting and interior living spaces market segments. The Company has a commanding market position in the Sri Lankan wood coating industry, mainly due to its brand equity. While wood coating products is its core business segment, the company has successfully ventured into adjacent market segments, such as decorative paints, paint brushes, furniture accessories and interior products. JAT has the competitive advantage of being the sole distributor and marketer for Sayerlack premium wood coating product for the South Asian region, which includes markets such as India, Pakistan, Bangladesh, and Maldives. The distribution rights have enabled JAT to rapidly grow its export sales in much larger markets such as India and Bangladesh. Going forward, the company is focusing on India and Pakistan, as its key growth markets, where JAT will focus most of its marketing efforts. In addition to its core wood coating and decorative products, JAT envisages to position itself as the leading player in the broader interior and living spaces market. Company has taken few strategic initiatives on this direction, including the introduction of Herman Miller premium furniture and Armstrong architectural products to the Sri Lankan market.

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