

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

September 17, 2019

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 wood coating industry, especially in the water-based wood coating segment. The Company is the largest distributor globally for Sayerlack brand, which is owned by Sherwin Williams, and has exclusive distribution rights for the entire South Asian region. Owing to the strong brand equity and higher-quality standards, JAT Holdings has the highest market share in the Sri Lankan overall wood coating sector, despite heavy competition from incumbent and new MNCs. The revenue contribution of Sayerlack products to the Company has been about 60%, leading to higher revenue concentration risks. However, with the introduction of new product categories as well as the diversification into new business avenues, the revenue contribution from Sayerlack brands/products has declined during the past two years. Moreover, considering the established relationship between JAT Holdings and Sherwin Williams and the strategic nature of the tie-up, 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 product segment in Sri Lanka. This was witnessed by the strong financial performance of the Company during FY2019, notwithstanding the weaker macro-economic conditions that prevailed during this period. This is attributable to the strong financial performance of the Company's wood coating segment in Sri Lanka, amidst the consolidations/conversions from the fragmented markets. Moreover, due to weaker macro-economic conditions, most competitors have experienced some liquidity constraints and this has also helped the Company to further increase its market share during this period. 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. During FY2019, the Company's decorative paints segment, which includes international brands such as Permoglaze & Crown, has also recorded an increase in the market share amidst the intense competition under this segment. Moreover, during FY2019, the Company has acquired the franchise rights of Harris paint brush, the globally renowned paint brush and therefore, this segment is expected to perform well going forward. This together with the new product categories, which were recently introduced, targeting the construction industry, would further help the Company to scale up its noe-core product

segments going forward. The ability of the Company to successfully implement these plans as envisaged and translate into a meaningful improvement in the overall financial performance, will remain to be reviewed in the future. ICRA Lanka also takes note of the Company's diversification into fast-growing export markets (such as India, South Asian and African market). 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 African continent as having 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 remain as a concern.

Although, over the past few years, the Company's operating profit margins had 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, during FY2019, the Company has been able to increase its operating profit margins. This is largely attributable to the Company's new strategy to import Sayerlack products as a concentrated solution, which has largely helped the Company to reduce the base-cost of the raw materials during this period. Moreover, the Company's efficiency improvements and cost control measures, have also helped to increase the overall operating profit margins during this period. During FY2019, although SL rupee has depreciated sharply, JAT has not largely passed on these cost increases onto customers due to the lower raw material cost advantage as mentioned above. This has not only helped the Company to increase its operating profit margins during this period, but also to partly increase its market share due to its stable pricing policy against the competitors. Nevertheless, the strong brand equity and the market leadership would generally help the Company to pass on partly any additional cost increases without affecting its overall market share.

JAT Holdings being the largest exclusive global distributor/ dealer of Sherwin Williams, enjoys high price discounts from the supplier. Moreover, as mentioned above, under the current market conditions, the Company could partially pass-through the cost increases onto customers without affecting the overall market share. Therefore, the Company intends to manage the foreign exchange risks to a larger extent by the above methods over the short to medium term. Further, the Company's growing export segment has also helped the Company to partially hedge the forex risks to an extent.

The rating also factors in the group's healthy profitability metrics, which is characterized by healthy profitability margins (PAT margin 13.5% in FYE March 19, vis -a-vis 11.7% in FYE March 18). Notwithstanding the healthy profit levels, 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 receivables levels to increase going forward, amidst the increasing exposure into projects segment, which has relatively long working capital cycle. The Company's capital structure is comfortable on account of increasing healthy margins and relatively low debt levels.

### 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. The 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 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 has also introduced new product categories, targeting relatively less premium wood coating segments (such as Polyurethane). The Company further intends to increase its market share by conversions from the fragmented markets (such as Nitrocellulose market). The ability of the Company to successfully diversify its new product categories and sustain the current market share as envisaged, 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, Brush Master & Harris, and Admixtures & Epoxy chemicals, 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 and 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 FY2019. Moreover, the Company's growing export segment (including Bangladesh, India, Maldives and African 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 17% over the last four years (FY2015-FY2019). However, during FY2019, the Company's revenue has increased by YOY 20% owing to the strong financial performance in the local operations. The Company has recorded a PAT of LKR 881 Mn and LKR 634 Mn in FY2019 and FY2018 respectively from LKR 902 Mn in FY2017. The improvement in profitability margins during FY2019 is attributable to the Company's new strategy (as mentioned above) and the strong cost control measures implemented during this period, despite the weaker macro-economic outlook during this period. 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 75% of the debt outstanding in FY2019. 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 (compared to the capital position). As the Company has undertaken several Capex programmes over the past two years, the Company is unlikely to further increase its capital expenditure plan in FY2020 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 and Sherwin Williams and the strategic nature of the tie-up with the supplier, and initiatives taken in the other markets (including the export segment) with new brands being

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 the 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 FY2018/19 and expansion to new business lines. Moreover, the Company's new strategies to introduce new product categories (under the project segment) are likely to exert additional pressure on the Company's working capital cycle going forward. 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 past two years, new players have also entered the local painting industry. The increased competition could result in a price war and hence, could impact the Company's overall performance going forward. However, Sayerlack products have a strong brand equity compared to that of the competitors and therefore, JAT continues to enjoy the advantages of being an early mover, the established distribution network, manufacturing set up and brand presence.

**Analytical approach:** For arriving at the ratings, ICRA Lanka has applied its rating methodologies as indicated below.

**Links to applicable criteria:** [www.icralanka.com/images/pdf/Corporate%20Rating%20Methodology.pdf](http://www.icralanka.com/images/pdf/Corporate%20Rating%20Methodology.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, paintbrushes, furniture accessories and interior products. JAT has the competitive advantage of being the sole distributor and marketer for Sayerlack premium wood coating products for the South Asian region, which includes markets such as India, Pakistan, Bangladesh, Maldives and some African markets. The exclusive distribution rights have enabled JAT to rapidly grow its export sales in much larger markets such as Bangladesh and India. Going forward, the Company is focusing on India and African markets, 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. The Company has taken a few strategic initiatives in this direction, including the introduction of Herman Miller premium furniture and Armstrong architectural products to the Sri Lankan market.

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