ICRA Lanka upgrades the issuer rating of Softlogic Holdings PLC; watch with developing implications removed

October 18, 2018

Instrument	Rated Amount (LKR Mn)	Rating Action
Issuer rating	N/A	Upgraded to [SL]BBB+ (stable) from [SL]BBB; rating watch with developing implications removed

Rating action

ICRA Lanka Limited, subsidiary of ICRA Limited, a group company of Moody's Investors Service has upgraded the issuer rating of Softlogic Holdings PLC (SHL/" the company") to [SL] BBB+ (pronounced SL triple B plus) from [SL]BBB (pronounced SL triple B) and rating watch with developing implications has been removed. The outlook on the long term rating is 'Stable'.

Rationale

The rating upgrade considers the improvement in capital structure of SHL subsequent to fund raising of LKR 3.1 billion during FY18 through a private placement and LKR 3.9 billion through a rights issue during Q1 FY2019, which resulted in the standalone gearing[1] moderating from 2.3x as on March 31, 2017 to 1.4x as on March 31, 2018 and 0.9x as on June 30, 2018. ICRA Lanka also takes note of the restructuring undertaken by the group of its retail operations, with the creation of a retail holding company under which fund raising for expansion purposes are envisaged.

The rating takes into account SHL's position as the primary holding company of one of Sri Lanka's leading conglomerates with several group entities holding leading market positions in sectors such as healthcare, financial services and retail. The group's revenue had grown at a CAGR of 21% in the five years upto FY2018, aided by organic growth as well as several acquisitions. ICRA Lanka also takes note of the experienced and competent management team at the holding company level and at various group companies; and SHL's strong relationship with large financial institutions, proven access to capital markets, and liquid investment portfolio of LKR 1.6 Bn (at standalone company level), besides the company's access to undrawn sanction lines of ~LKR 3.1 billion which provides comfort on the overall liquidity position. The rating also factors in the substantial market buffer over the book value of SHL's investments in quoted subsidiaries, however the comfort is mitigated to an extent due to a large portion of investments being pledged for funding facilities.

However, the rating is constrained by SHL's high repayment obligations in the near to medium term and primary dependence on dividend income from subsidiaries, exposing it to risk of cash flow/dividend volatility from key sectors such as healthcare, retail and financial services and may require refinancing to meet its obligations. Further, ICRA Lanka notes that the group has followed aggressive debt funded capex and acquisitions in the past and has high capex plans under the retail entity in the medium term. This has resulted in the consolidated group having a stretched capital structure and coverage indicators, although with the recent fund raising the gearing has witnessed some moderation, though it remains at elevated levels. SHL has also periodically raised debt for acquisitions as well as to provide support to group entities

[1] Gearing is calculated as net borrowings (total borrowings less cash) divided by net worth

for acquisitions, capex or for cashflow shortfalls, putting pressure on the capital structure. Going forward, the ability of the group to raise capital at subsidiary level to meet capex requirements and improve profitability/divest loss making subsidiaries, such that there is limited funds requirement from SHL and loans extended by SHL to subsidiaries are gradually repaid, will be pivotal for improvement in the credit profile of SHL.

Outlook: Stable

ICRA Lanka expects SHL to get dividends from group entities, which have leading market positions in healthcare, financial services and retail segments and also benefit from flexibility enjoyed with lenders for any refinancing requirements, if needed. ICRA Lanka expects gradual improvement in the capital structure of SHL. The outlook may be revised to 'positive' in case of better than expected dividends and repayment of debt to SHL from group entities, backed by improved financial performance or fund raising; leading to improvement in capital structure and coverage indicators of SHL, in conjunction with a resumption in Sri Lanka's stalling macroeconomic position. Conversely, in case of a significant weakening in the profitability levels of group entities leading to lower dividend payment and additional debt support requirement from SHL, resulting in stretched gearing and coverage indicators; the outlook may be revised to negative.

Key rating drivers

Credit strengths

Leading market position of group entities in several diverse sectors: Softlogic group is a conglomerate in Sri Lanka and has leading presence across several sectors such as healthcare (Asiri group), financial services (Softlogic Life Insurance and Softlogic Finance) and retail (Softlogic retail and Odel PLC). ICRA Lanka takes note of the long term growth potential of these segments, although they remain vulnerable to forex volatility, interest rate movements and changes in government policies. Apart from the core sectors, the group also has presence in several other sectors including leisure, restaurants and automobile dealerships. The main source of income of SHL is dividends and payment for other services from group entities. The group has witnessed revenue growth at a CAGR of 21.1% during the five years upto FY2018, with topline of LKR 66 billion driven by organic growth as well as debt funded acquisitions.

Successful fund raising resulted in some improvement in capital structure: During FY2018, SHL had raised LKR 3.1 billion through a private placement and subsequently, it raised an additional LKR 3.9 billion through a rights issue during Q1 FY2019. This has resulted in moderation in gearing[2] of SHL from 2.3x as on March 31, 2017 to 1.4x as on March 31, 2018 to 0.9x as on June 30, 2018. ICRA Lanka also takes note of the restructuring of the retail segment, with the creation of a new retail holding entity under SHL, which will hold all retail companies. The management plans to fund the future capex requirements of the segment at subsidiary level and to repay some of the debt extended by SHL.

Experienced and professional management team: The promoter/group chairman who is one of the company's founders is actively involved in business operations and provides strategic guidance to the group, while each of the core sectors is led by a professional management team. Over the last few years, the group has inducted experienced industry professionals under key business segments, which is a positive.

[2] Gearing is calculated as net borrowings (total borrowings less cash) divided by net worth

Credit challenges

High repayment obligation of SHL in medium term; may need refinancing; SHL has availed loans to fund acquisitions as well as to extend support to group entities for debt funded acquisitions. This had previously put pressure on the capital structure, although same has witnessed some moderation in the recent period due to capital raised. Nonetheless, SHL (standalone company) has high repayment obligations in the range of LKR 2.8 -3.0 billion per annum over next three years and is vulnerable to volatility in dividends/service income from group entities, which are its main income stream and in case of shortfall may need refinancing. However, the risk is partly mitigated by healthy financial flexibility enjoyed by the group with lenders as witnessed in the past.

Stretched capital structure and coverage indicators at group level; The group has been following rapid debt funded capex and acquisitions in the last few years leading to a stretched capital structure and coverage indicators. The gearing[3] of the consolidated entity was 3.2x (adjusted gearing[4] 4.5x) as on March 31, 2017 which moderated to 2.6x (adjusted gearing 3.4x) as on March 31, 2018 and 2.2x (adjusted gearing 2.7x) as on June 30, 2018, subsequent to fund raising. With aggressive capex plans in the medium term, the capital structure and coverage indicators are expected to witness some pressure and any improvement will be dependent on the group's ability to raise equity capital, improve profitability of its core operations and the ability to stabilize new projects. Further, any additional support requirements from SHL, may have an adverse impact on SHL's credit profile.

Performance susceptible to broader economic cycle and changes in government policies; The group's financial performance remains susceptible to the broader economic cycle, interest rate movements, forex volatility and changes in government policies.

Analytical approach: For arriving at the ratings, ICRA has applied its ratings methodologies as indicated below.
Links to applicable criteria: ICRA Lanka's Issuer Credit Rating Methodology

Company Profile:

Softlogic Holdings PLC (SHL /"the Company") was founded in 1991 and was listed on the Colombo Stock Exchange in June 2011. The Company acts as the primary holding company for the Softlogic Group of entities with businesses across healthcare, financial services, retail, information and communication technology (ICT), leisure/hotels and automobile dealerships. The Group had a top line of LKR 66 Bn (LKR 59 Bn in FY2017) during FY2018 and has market leading positions in segments such as healthcare, financial services and retail. SHL was founded by the prominent Sri Lankan entrepreneur Mr. Ashok Pathirage, who has the controlling stake of the company.

On a consolidated basis, for the year ended March 31, 2018, SHL reported a PAT of LKR 2,278 Mn on a revenue of LKR 66,019 Mn vis-à-vis a PAT of LKR 920 Mn on a revenue of LKR 58,882 Mn during the previous fiscal. On a standalone basis, for the year ended March 31, 2018, SHL reported a PAT of LKR 3,699 Mn (inclusive of capital gains) on revenue of LKR 1,543 Mn vis-à-vis a PAT of LKR 1,025 Mn (inclusive of capital gains) on a revenue of LKR 1,972 Mn during the previous period fiscal.

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[3] Gearing is calculated as net borrowings (total borrowings less cash) divided by net worth. Excludes public deposits taken by financial services entity
[4] Gearing is adjusted for re-valuation reserves

Rating history for last three years:

Instrument	Current Rating (FY2018)				Chronology of Rating History for the past 3 years		
	Amount Rated (LKR Mn)	Amount Outstanding (LKR Mn)	Date & Rating in FY 2019	Date & Rating in FY 2018	Date &Rating (FY2017)	Date & Rating (FY2015)	Date & Rating (FY2014)
			Oct 2018	Apr 2018	May 2017	Feb 2016	-
Issuer rating	N/A	N/A	[SL]BBB+; Stable	[SL]BBB &	[SL]BBB; Stable	[SL]BBB; Stable	N/A
Senior Unsecured Redeemable Debenture	1000	-	-	-	Withdrawn	[SL]BBB; Stable	N/A

Note – The symbol '&' in parenthesis suffixed to a rating symbol indicates that rating is under watch with developing implications.

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