ICRA Lanka revises the outlook of Softlogic Holdings PLC to Negative

May 01, 2020

Instrument	Rated Amount (LKR Mn)	Outstanding Amount (LKR MN)	Rating Action
Issuer rating	N/ A	N/A	[SL]BBB+ reaffirmed; outlook revised to Negative from Stable
Senior, unsecured, non-listed, redeemable, debentures programme	2,000	1,000	[SL]BBB+ reaffirmed; outlook revised to Negative from Stable
Senior, unsecured, non-listed, redeemable, debentures programme	2,000	1,000	[SL]BBB+ with Negative outlook; Withdrawn

Rating action

ICRA Lanka Limited, subsidiary of ICRA Limited, a group company of Moody's Investors Service, has reaffirmed the issuer rating of Softlogic Holdings PLC (SHL or the Company) at [SL]BBB+ (pronounced SL triple B plus) while revising the outlook to Negative from Stable. ICRA Lanka has also reaffirmed the issue rating of [SL]BBB+ (pronounced SL triple B plus) assigned to the outstanding amount of LKR 1,000 Mn senior, unsecured, unlisted redeemable debentures program while revising the outlook to Negative from Stable. ICRA Lanka has also withdrawn the issue ratings of [SL]BBB+ (pronounced SL triple B plus) assigned to the unissued amount of LKR 1,000 Mn senior, unsecured, unlisted redeemable debentures of the Company at the request of the Company.

Rationale

The outlook revision factors in the challenging business outlook for the key sectors of the Group, including retail and leisure, increasing debt levels and gearing indicators at the holding company level, delays in anticipated fundraising initiatives (including disposal of non-core assets) at various sector levels, and stretched liquidity profile in light of current macro conditions in the country. As of December 2019, the combined retail and leisure sectors accounted for about 54% of group turnover, while the two sectors accounted for the bulk of group investments over the last 3-4 years. ICRA Lanka's Negative outlook reflects the significant business interruption experienced after the terrorist events last year and the likely interruptions due to the pandemic and the resultant lock-down and the anticipated drop in demand by the various sectors of the Group (especially for consumer durables), over short to medium term.

ICRA Lanka takes cognizance of the increase in debt level at the standalone holding company level that is largely attributable to the financial support provided for the retail and leisure sectors by the holding company over the last 18M. ICRA Lanka takes cognizance of the on-going fundraising exercises at various sectors of the Group that, in turn, are likely to reduce the debt at the holding company level. However, the anticipated timelines of these transactions have been extended at various times due to macro-political challenges that prevailed in the country; ICRA Lanka expects these transactions to be delayed further due to the COVID-19 pandemic and the resultant economic downturn to follow.

The ratings also factor the stretched liquidity profile of the holding company, given the challenging market conditions. As in December 2019, on a standalone level, SHL had about LKR 8.4 Bn short term non-bank debt (primarily commercial papers) becoming due over the next 12M. While ICRA Lanka expects the banks to roll-over these short term loan maturities as they have done in the past, a high refinancing risk stems from non-bank commercial paper maturities. The ratings continue to take comfort from SHL's good relationships with banks and other financial institutions and pipe-line of bank funding lines that will provide some comfort over the short term.

Going forward, SHL's ability to complete the planned fundraising exercises within a reasonable timeline, dispose of non-core assets, reduce the debt at the holding company level, and improve the overall earnings profile of the retail sector will be crucial from a rating point of view.

Outlook: Negative

The outlook may be revised to "Stable" based on SHL's ability to reduce the Holding company debt level, improve liquidity profile, and if there is a notable performance improvements in core sectors, including retail. The ratings may be downgraded in case of a further increase in debt level, lower than expected support from funding partners, and further deterioration in group performance.

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 economic cycles, 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. At the holding company level, the primary source of income of SHL is dividends and interest and other service income from group entities. The Group recorded consolidated revenue of LKR 59.3 Bn for the 9M ended December 2019, a 11% increase compared to the same period previous fiscal.

Access to funding with good relationships with banks and other funding partners: SHL group has demonstrated a good track record of raising both debt and equity funding through its strong relationships with leading banks and other funding partners. During FY2018, SHL 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. Currently, SHL is involved in raising additional equity capital at various group company levels that will improve the overall capitalization profile of the Group and the holding company. In addition, the leading banks have demonstrated their willingness to extend support to the Group during challenging business cycles. The ratings take some comfort from the continued support from banks and a pipe-line of bank funding lines that is expected to provide liquidity support over the immediate to short term.

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.

Credit challenges

Challenging business outlook for the key sectors of the Group: Over the last 3 - 4 years, the contribution of the retail sector to the SHL group has gradually increased due to increased investments and expansion in the retail sector. The retail sector, which primarily consists of consumer durable, mobile devices, grocery, and fashion clothing, collectively accounts for about 51% of group revenue. The sector which faced numerous challenges in the last 18 months will be further impactd adversely over the short to medium term due to the COVID-19 pandemic and its aftermath, on multiple fronts - store closures, reduction in discretionary income, supply chain distruptions (including imports), and loss of consumer confidence. The leisure sector, which accounts for about 4% of group revenue, has also been affected affected by the events. ICRA Lanka notes that a larger portion of the group capital expenditure over the last 3 - 4 years has been directed toward these two sectors and inter-company lending to these two sectors account for bulk of the debt at the holding company level. With the adverse business outlook for retail and leisure sectors, ICRA Lanka expects increasing pressure on the holding company to extend further support.

Stretched capital structure and coverage indicators at group level: The holding Company has availed loans to fund acquisitions as well as to extend support to group entities, mainly in the retail and leisure sectors. This has put pressure on the gearing and coverage indicators of the holding company. Although SHL witnessed some improvement in the capital structure following the private placement and the rights issue during Q1 FY2019, the debt level of the holding company has increased again during the last 18M due to the incremental financial support extended to retail and leisure sectors. ICRA Lanka notes the sharp increase in net debt at the holding company level, from about LKR 20.9Bn in March 2019 to about LKR 26.2Bn in December 2019; standalone gearing stood at 1.81x as in December 2019 vis-à-vis 1.31x in March 2019 and 1.36x in March 2018. The gearing (excluding public deposits) of the consolidated entity was 3.16x in December 2019 vis-s-vis 2.50x in March 2019 and 2.63x in March 2018. The adjusted gearing[1] of the consolidated entity (excluding public deposits, revaluation reserve and deferred tax) was 5.06x as in December 2019 vis-s-vis 3.91x in March 2019 and 3.58x in March 2018.

ICRA Lanka expects both standalone and consolidated gearing to somewhat moderate when the on-going capital raising exercises and disposal of some of the non-core assets are completed. However, timely completion of these initiatives will be a key monitorable from a rating perspective. Also, it is crucial for SHL to improve the overall profitability and cash flow generation of its retail sector and stabilize new projects, so the pressure on the holding company moderates.

Higher short term debt servicing requirement exerting pressure on the liquidity profile: As in December 2019 at standalone level, SHL had term loan repayment of LKR 4.2 Bn due over the next 12 months and short term non-bank debt (commercial papers) of LKR 8.4 Bn maturing over the same period. While ICRA Lanka expects the banks to roll-over these short term loan maturities as they have done in the past, a high refinancing risk stems from non-bank commercial paper maturities. As in April 2020, SHL had unutilized bank lines of about LKR 2.5 Bn, and also, ICRA Lanka expects the Company to leverage on its good banking relationships to secure funding to meet immediate liquidity requirements. This will be a key monitorable going forward.

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

[1] Gearing adjusted for revalution reserves and deferred tax gains

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 75 Bn (LKR 66 Bn in FY2018) during FY2019 and has strong market positions in segments such as healthcare, financial services and retail. SHL was founded by the prominent Sri Lankan entrepreneur Mr. Ashok Pathirage, who has controlling stake of the Company.

On a consolidated basis, for the year ended March 31, 2019, SHL reported a PAT of LKR 2,990 Mn on revenue of LKR 75,143 Mn vis-à-vis a PAT of LKR 2,278 Mn on a revenue of LKR 66,019 Mn during the previous fiscal. On a standalone basis, for the year ended March 31, 2019, SHL reported a net loss of LKR 668 Mn on a total operating income of LKR 2,692 Mn vis-à-vis a PAT of LKR 3,698 Mn (inclusive of capital gains) on a total income of LKR 2,666 Mn during the previous period fiscal.

On a consolidated basis, for the 9M ended December 31, 2019, SHL reported a net loss of LKR 518 Mn on revenue of LKR 59,386 Mn. On a standalone basis, for the 9M ended December 31, 2019, SHL reported a loss of LKR 930 Mn on a total operating income of LKR 2,187 Mn.

Key Financial Indicators (Consolidated)

LKR Mn	FY18	FY19	9MFY2020*
Operating Income	66,019	75,143	59,386
OPBDITA	10,950	11,222	9,848
PAT	2,278	2,990	-518
Net Debt (Excluding Public Deposits)	55,075	62,591	75,052
Reported Networth	20,917	24,990	23,762
Reported Gearing (x)	2.63	2.50	3.16
Adjusted Gearing[1] (x)	3.58	3.91	5.06
OPBDITA/Interest & Finance Charges(x)	2.92	2.60	1.95
Total Debt/OPBDITA (x)	5.89	6.27	6.05

**-Unaudited Financials*

Note 01: Gearing adjusted for deferred tax and revaluation gains

Key Financial Indicators (Standalone)

LKR Mn	FY18	FY19	9MFY2020*
Operating Income	2,666	2,692	2,187
OPBDITA	1,982	2,052	1,652
PAT	3,699[1]	-668	-930
Net Debt	18,202	20,937	26,222
Networth	13,388	15,990	14,464
Gearing (x)	1.36	1.31	1.81
OPBDITA/Interest & Finance Charges(x)	0.74	0.78	0.65
Total Debt/OPBDITA (x)	10.66	10.21	12.23

**-Unaudited Financials*

Note 01: PAT of FY2018 includes one-of capital gains from group restructuring

Rating history for the last three years:

Instrument	Current Rating (FY2021)			Chronology of Rating History for the past 3 years		
	Amount Rated (LKR Mn)	Amount Outstanding (LKR Mn)	Date & Rating in FY2021 May 2020	Date & Rating in FY2020	Date & Rating in FY2019 Oct 2018	Date & Rating in FY2018 April 2018
Issuer rating	N/A	N/A	[SL]BBB+ (Negative)	[SL]BBB+ (Stable)	[SL]BBB+ (Stable)	[SL]BBB (&)
Senior Unsecured Unlisted Redeemable Debenture	2,000	1,000	[SL]BBB+ (Negative)	[SL]BBB+ (Stable)	NA	NA
Senior Unsecured Unlisted Redeemable Debenture	1,000	N/A	Rating Withdrawn			

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

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