

ICRA Lanka reaffirms the issuer rating of Ceylon Tea Brokers PLC

July 07, 2020

Instrument*	Current Rated Amount (LKR Mn)	Rating Action
Issuer Rating	N/A	[SL]BBB (Stable) reaffirmed;

Rating action

ICRA Lanka Limited has reaffirmed the Issuer rating of [SL]BBB (pronounced SL triple B) with Stable outlook assigned to Ceylon Tea Brokers PLC (“CTB”/“the Company”).

Rationale

The rating reaffirmation considers the improvements in the Company’s core business segments such as brokerage and warehousing operations during FY2019 and 9MFY2020, aided by the increase in the Company’s market share in the tea broking industry and increasing diversified revenue streams after the commissioning the new warehousing/third party logistic facility during this period. Although, the tea brokerage business generally remains susceptible to the cyclicity of the Sri Lankan tea industry, ICRA Lanka factors the favourable tea industry outlook in the post COVID-19 Pandemic. Despite the short term price volatilities, Ceylon tea being an essential agricultural item in the global markets, amidst its perceived health benefits, would help to drive the demand for Ceylon tea in the long term. The rating also factors favourably the long standing track-record of the Company in the tea broking business and its strong group support (as CTB is held by the ultimate shareholders of the Capital Alliance Group).

The rating is however constrained by the highly geared capital structure and moderate coverage indicators, which is primarily on account of the financing operations of the Company. During 9MFY2020, the income from the financing operation has declined YOY by 26%. This is attributable to several factors such as the Company’s new credit policy to restrict higher risk lending, reduction in the minimum lending rate and the application of IFRS-09. ICRA Lanka views the Company’s new credit policy on a positive note, as this would reduce the Company’s susceptibility to counterparty risks. This risk is also mitigated to a larger extent by being part of regulated industry associations like Colombo Tea Traders and Tea Brokers Associations. Due to exposure to financing operations, the margins also remain susceptible to volatility in interest rates. Any deterioration in the credit quality of the lending portfolio, leading to increase in bad debt provisions/write offs, would remain a rating sensitivity factor. During 9MFY2020, with the application of IFRS-09, the Company has noticeably increased its provision requirements and therefore, ICRA Lanka will continue to monitor the impact from the same going forward. In June CY2019, the Company has commissioned its new warehousing project, which was carried out under a fully owned subsidiary, Logicare (Pvt) Ltd. Going forward, this operation is expected to further aid in cost savings and provide further diversification benefits. However, the ability of the management to achieve the profitability targets of this project within the envisaged time lines, remains to be reviewed in the future.

Outlook: Stable

The Stable outlook reflects ICRA Lanka's expectations that CTB would perform well in the long term amidst the favourable industry outlook. The Company's new diversified revenue streams are expected to augment the Company's overall financial performance going forward.

Key Rating Drivers

Credit strengths

Long standing track record, strong parentage and healthy market share in tea broking industry; CTB is one of the leading tea brokers in Sri Lanka and is the only standalone tea broker listed on the Colombo Stock Exchange (CSE). CTB commenced its operations as a partnership in 1963 and was taken over by the Capital Alliance Group (flagship entity - Capital Alliance Limited rated at [SL]A-, with stable outlook) in 2005. During FY2018, Capital Alliance Group had carried out a restructuring exercise, which resulted in CTB being held directly by the ultimate shareholders of Capital Alliance Group. The Company has a healthy market share in the tea broking industry which has grown to 14.3% during 9MFYE2020, compared to 13.1%, 11.70% and 10.85% during FY2019, FY2018 and FY2017 respectively.

Favourable long term demand outlook; The long term demand outlook for Sri Lankan tea is favourable, although the production and demand remain susceptible to agro climatic risks, labour issues, government regulations in Sri Lanka and economic and political issues at key tea importing nations. The tea production in Sri Lanka had witnessed a decline during CY2019, while the average tea prices had also witnessed a moderation in CY2019 due to local as well as global factors. However, in the post COVID-19 Pandemic, the average Ceylon tea prices have increased sharply to all-time high of ~LKR 800-850/Kg amidst the global supply constraints. Going forward, although these prices are expected to moderate to an extent, considering the global economic/health crisis in the main tea importing countries/regions, the average Ceylon tea prices are expected to sustain at relatively higher prices going forward (compared to the price levels in CY2019), owing to increasing demand and depreciation of Sri Lankan Rupee. Moreover, given the current favourable weather conditions that are expected to continue in CY2020, Sri Lanka's average annual tea production is expected to recover in CY2020.

Diversified revenue streams; The Company has diversified revenue streams comprising of tea brokerage (accounting for about ~30-35% of total revenue in the last few years), storage and warehousing (accounting for ~10-16% of total revenue), interest income on lending business (~45-50% of total revenue; during 9MFYE2020, the revenue contribution from this segment has decreased to 40%) and other activities like providing advisory services etc, which account for the remaining revenue. The Company earns ~1% brokerage income on total value of tea sales, procured from the Colombo Tea Auction. The brokerage revenue has witnessed a moderate-growth of ~3% (annualized) in 9MFY2020 which is largely attributable to the Company's increasing market share despite the stagnant average tea prices during this period. The Company also provides short term advances against tea stocks as well as long term loans to tea suppliers as part of the financing operations. During 9MFY2020, the income from the financing operation has declined YOY by 26% as the Company has implemented a new credit policy, targeting to limit its higher risk lending portfolio. Moreover, the application of IFRS-09 and the reduction of average interest rates during this period have also affected the finance income during this period under review. Under the warehousing segment, the Company currently charges ~LKR 2.38/kg of tea stocks from sellers for ~40 days and also from buyers if held longer than 40 days. This segment witnessed a YOY revenue growth of 17% during 9MFY2020 owing to the diversified revenue streams from the new warehousing project. The Company has commissioned the first stage of the new warehousing project in June CY2019. This project was carried out at Logicare (Pvt) Ltd, a fully owned subsidiary of Ceylon Tea Brokers PLC. The warehousing facility has a total capacity of

12,450 pallets and the total internal capacity requirement of the Company is about 80%. The excess capacity is expected to be utilized for third party logistic companies. The ability of the management to successfully achieve its profitability targets of this project within the envisaged time line, is key in augmenting the overall operation of the Company and therefore, this remains to be reviewed in the future.

Healthy profit margins; The Company's financial profile is generally characterized by healthy profit margins with OPM in the range of 40-55% in the last five years and NPM in the range of 8 -15% during the same period. However, during 9MFY2020, the OPM has moderated to 35% and this is largely attributable to the impact from the application of IFRS-09. The operational losses of the new warehousing operation and the slowdown in the financing operation have also affected the Company's overall financial performance during this period under review. However, going forward, ICRA Lanka forecasts a recovery of the Company's overall financial performance, considering the favourable industry outlook as well as the diversified revenue streams from the new warehousing project (other than from the internal tea storage requirement of CTB).

Credit challenges

Performance is susceptible to demand cyclicity, forex fluctuations, regulations and adverse weather conditions: CTB's performance is susceptible to demand cyclicity in tea industry, volatility in forex rates and impact of any adverse weather conditions. During CY2017/18 and CY2019, Sri Lanka's tea production was lower by ~10-13 %, compared to the average production levels during CY2010-CY2016, impacted by adverse weather conditions, labour issues and changes in government policies. Further, any moderation in demand from Middle Eastern and CIS countries due to economic cycles or other exogenous factors (like war/economic sanctions) would also have adverse impact on CTB's performance. Moreover, any regulatory changes with regard to labour cost, usage of fertilizers/weedicides etc. could also have an adverse impact on the performance of the tea industry.

Highly geared capital structure due to the financing operation: The Company's capital structure remains highly geared with gearing of 2.9(x), 3.8(x) and 4.1(x) for FY2018, FY2019 and 9MFY2020 respectively. The increased gearing levels were mainly driven by growth in lending portfolio as well as partly debt funded capex, undertaken for the new warehousing project. During 9MFY2020, the Company's financing operation has slowed down to an extent, resulting in a reduction in short term loan facilities. However, the Company's overall debt levels have still remained higher amidst the additional debts taken up for the construction of the new warehousing project during this period. Therefore, the consolidated entity has recorded a gearing of 4.1(x) as on Dec 31, 2019. The interest coverage and debt service indicators have also remained moderate during this period, with interest coverage of 1.1 times and TD/OPBDITA of 8.3%. However, the Company's gearing level adjusted for the financing operation, which is largely secured by the tea-stocks from the regular tea-suppliers, remains comfortable during this period.

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:

Ceylon Tea Brokers was founded in 1963 as a partnership firm, which was converted into a private limited Company in June 1999. The Company was taken over by the Capital Alliance Group in February 2005 and renamed as Ceylon Tea Brokers Ltd. It was subsequently listed on the Colombo Stock Exchange (CSE) in Feb 2010 and is the first standalone listed tea broking company. The Company provides wide range of

services such as tea brokerage, warehousing and financing. During 9MFYE2020, the Company has commissioned its first stage of warehousing project that was carried out under a fully owned subsidiary, Logicare (Pvt) Ltd, which also holds the lease-hold rights for a land in Muthurajawela Zone for 39 years.

Key consolidated financial indicators (audited)

Revenue and profitability indicators (Figs are in LKR Mn)	FY15	FY16	FY17	FY18	FY19	9MFY20
Operating Income	435.5	334.0	419.7	655.9	767.6	527.3
OPBDITA	158.6	98.1	168.3	357.1	408.1	184.6
PAT	54.7	25.9	41.5	100.0	113.6	-21.0
ROCE (%)	15.2%	12.1%	17.8%	23.3%	19.1%	9.2%
NWC / OI(%)	140.8%	146.2%	183.7%	200.1%	223.4%	215.0%
Total Debt	622.4	493.2	877.6	1,390.2	2,191.3	2,035.3
Networth	212.4	208.7	237.7	464.5	574.1	491.8
Gearing (x)	2.93	2.36	3.69	2.99	3.82	4.14
OPBDITA/Interest & Finance Charges(x)	1.95	1.72	1.65	1.81	1.70	1.05
Total Debt/OPBDITA (x)	3.93	5.03	5.22	3.89	5.37	8.27

*-Unaudited Financials, Note;- Consolidated Financial Indicators are presented from FY2019 onwards

Rating history for last three years:

Instrument	Type	Amount Rated (LKR Mn)	Current Rating (FY2020) June 2020	Chronology of Rating History for the past 3 years		
				Rating in FY2019 Feb 2019	Rating in FY2018 Mar 2018	Rating in FY2017 Jan 2017
Issuer Rating	N/A	N/A	[SL]BBB (Stable)	[SL]BBB (Stable)	[SL]BBB (Stable)	[SL]BBB- (Stable)

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