

ICRA Lanka reaffirms the ratings of Bogawantalawa Tea Estates PLC

July 20, 2020

Instrument*	Current Rated Amount (LKR Mn)	Rating Action
Issuer Rating	N/A	[SL]BBB+(Negative); reaffirmed
Proposed Senior Convertible Unsecured Redeemable Debentures Programme	LKR 850 Mn	[SL]BBB+(Negative); reaffirmed

Rating action

ICRA Lanka Limited has reaffirmed the issuer rating of [SL]BBB+ (pronounced SL triple B plus) with Negative Outlook for Bogawantalawa Tea Estates PLC ("BTE"/"the Company). ICRA Lanka has also reaffirmed the Issue Rating of [SL]BBB+(pronounced SL triple B plus) for the Company's Senior Convertible Unsecured Redeemable Listed Debenture programme, amounting to LKR 850 Mn. The outlook of the rating is Negative.

Rationale

ICRA Lanka has taken a consolidated view on Bogawantalawa Tea Estates PLC and its subsidiary-Bogawantalawa Tea Ceylon (Pvt) Ltd, given the significant operational and financial linkages among them.

The reaffirmed ratings primarily factor in the favourable industry outlook in the post COVID-19 Pandemic although the Company's financial performance during 9MFY2020 has deteriorated significantly due to negative industry outlook that prevailed during the period under review. ICRA Lanka also takes note of the Company's efficiency improvements/cost saving measures, implemented during FY2020, that have cushioned the impact to an extent from the negative industry outlook that prevailed during the period. Historically, the Company's high grown tea segment has accounted for ~95% of the total revenue and ICRA Lanka takes note of the Company's recent/ongoing diversification initiatives into new segments such as specialty tea varieties, spices, timber plantations, and oil palm cultivations. The ratings also factor favourably the recovery of the financial performance of Bogawantalawa Tea Ceylon (Pvt) Ltd (BTC) during 9MFY2020. ICRA Lanka views positively the Company's strong brand name, which is synonymous with high quality Ceylon Tea and the leading position in the Sri Lankan tea plantation industry. The ratings take into account the experience of the promoters, the Company's strong track record and reputation in the industry, which have enabled the Company to enjoy steady access to funding from financial institutions as well as capital markets. The reaffirmed ratings factor in Metrocorp group's (rated at A+, with Stable outlook by ICRA Lanka) consolidated financial strength and the ability of the Metrocorp Group to provide financial support towards the plantation sector.

However, these rating strengths are constrained by the moderation in the financial profile of BTE at the consolidated level during FY2019 and 9MFY2020. During this period, the Company's PAT has moderated to a net loss of LKR 249 Mn compared to a net loss of LKR 45 Mn in FY2019. The Company's capital structure remains weak due to declining profitability margins and increasing debt levels, with gearing of 1.40x in FY2019 and 2.50x in 9MFY2020.

Outlook: Negative

The Negative outlook reflects the moderation of the Company's financial profile during 9MFY2020 notwithstanding the favourable industry outlook in the post COVID-19 Pandemic.

Key Rating Drivers

Credit Strengths

Experience of the promoters and the group support: The assigned ratings consider favourably the experience of the management team and BTE's strong operational track record, which have enabled the Company to record healthy growth in revenues over the past several years. ICRA Lanka also draws comfort from the experience of the promoters, who are actively engaged in the strategic decision making level of Bogawantalawa Tea Estates PLC and the reputation in the industry, which have helped the Company to enjoy steady access to funding both from the capital markets as well as financial institutions that have supported its growth over the years. The Company's corporate governance structure adds further comfort for the reaffirmed ratings.

Attractive NSAs and the favourable Industry Outlook in the post COVID -19 Pandemic; Bogawantalawa tea estates are situated in the Golden Valley located in the central hills of Sri Lanka. This has helped the Company to produce high quality tea and also to command premium prices over other tea plantation companies in Sri Lanka. The Company's NSAs are among the top three plantations companies in Sri Lanka and further, BTE's estate level NSAs are well diversified.

Recently, the Colombo tea auction prices have increased sharply as the global tea supply continued to tumble due to labour deployment issues as a result of COVID-19 Pandemic and adverse weather. Weaker local currency, demand induced by the perceived health benefits of black tea and higher tea consumption amidst lockdowns have also helped the Ceylon tea prices to stay buoyant during this period. Although, these prices are expected to moderate due to global economic slowdown, Ceylon tea prices are expected to stay buoyant in CY2020 (compared with the price levels in CY2019). Although, Sri Lanka's tea production levels have sharply declined, immediately after the spread of COVID-19 Pandemic in April 2020, the plantation sector has fully recovered after early May, 2020. Therefore, Sri Lanka's overall tea production level is expected to sustain ~300 Mn Kgs in CY2020, as currently prevailing favourable weather conditions is expected to continue during CY2020. Moreover, given the Company's ongoing replantation programme, BTE's yield levels are expected to further improve/sustain in the future.

Higher revenue visibility amidst the diversified revenue streams: During 9MFY2020, BTE has raised ~LKR 850 Mn through a Convertible Listed Debenture Programme. This has also helped the Company to further accelerate its replanting exercises (for tea and other crops including spices). Currently, the Company is developing its highly demanded specialty tea varieties (such as oolong and organic tea varieties although this market segment is still at an initial stage. The Company also continues to invest in timber plantations in its low country estates; these biological assets are valued on annual basis and the fair value of these trees were valued at ~LKR 900 Mn as at 31st March, 2019. Going forward, this segment would be a major income generator of the Company, as certain regulations preventing the harvesting of timber trees, have now been resolved by the Company. Given, the Company's tea plant-age profile is relatively on the older side, ICRA Lanka envisages that the Company's ongoing replantation/infilling exercises should be further accelerated as envisaged. Therefore, ICRA Lanka will continue to monitor the progress of the Company's capital development programmes going forward.

Credit challenges

Cyclical nature of the plantation industry, leading to risk of volatile cash flows: Plantation industry is cyclical in nature and the exposure to adverse weather conditions impacts the net realizations (due to quality variations) as well as tea production. During past three years, Sri Lanka's tea production has declined by 10-13% (from the normal production levels during CY2010-CY2016) due to adverse weather conditions that prevailed during these periods. Moreover, during Q1CY2020, with the spread of COVID-19 Pandemic and the adverse weather that prevailed during this period, Sri Lanka's tea production level has declined noticeably. However, the plantation sector has recovered after early May, 2020.

The Company's operations are also exposed to regulatory risks, including changes in interest rates, changes in agricultural practices and policies etc. However, ICRA Lanka notes Sri Lankan tea plantation industry's position as a major foreign exchange earner and employer in the country and therefore, the government's policy towards this industry will tend to be supportive, as in the past. Moreover, given that the tea plantation industry in Sri Lanka is an export oriented industry, the Company's net realizations (NSAs) are indirectly benefited by the Sri Lankan Rupee depreciation.

Increased cost of Production due to periodic wage hikes: Generally, the increased labour costs and lower productivity levels have negatively affected the performance of the tea plantation industry over the past several years. The labour cost represents around 60-70% of the Company's production cost. The collective labour agreement (between the plantations workers' unions and the Regional Plantation Companies -RPCs) was renewed in early CY2019. The plantations unions had agreed for a total wage of LKR 855/day, whilst the productivity based incentive scheme, introduced in Oct 2016, has been scrapped under this wage hike. Going forward, although, the future wage hikes are expected to be negotiated with productivity based incentive scheme, the implementation of such incentive schemes remain as a formidable challenge due to highly unionized nature of this industry. Notwithstanding, the Company's recent efficiency improvement measures, the risk of margin erosion due to periodical wage hikes is high and is accentuated by BTE's volatile operating profit margins. Therefore, the ability of the management to manage the increased labour costs without affecting the Company's tea productions is key towards improving the overall profitability indicators and therefore, this is a rating sensitivity to the reaffirmed ratings.

Sharp moderation in Financial Profile: BTE's consolidated revenues have increased at a compounded annual growth of 1.2% over the last five years (FY2012-FY2019) amidst the volatile average tea prices and tea productions of the Company. At the consolidated level, the Company has recorded a PAT of LKR 41 Mn in FY2018 and a net loss of LKR 45 Mn in FY2019, as against a net loss of LKR 249 Mn in 9MFY2020. This is largely attributable to the negative industry outlook that prevailed over the past three years. The Company's capital structure has moderated on account of declining profitability margins and relatively high debt levels. BTE's cash flows and coverage metrics have also moderated during 9MFY2020, stemming from weaker profitability, and consequently, the moderation in debt levels. However, during FY2021, the Company's profitability levels are expected to improve given the currently prevailing higher average tea prices and the favourable weather conditions. Notwithstanding the expected recovery of the Company's financial performance, BTE intends to further increase its capital expenditure plan on replantation and revenue diversification projects through the proceeds of convertible debenture programme. Therefore, this would in turn exert some pressure on the Company's liquidity position to an extent in the medium term.

Financial performance of the Subsidiary: Financial performance of Bogawantalawa Tea Ceylon (Pvt) Ltd (BTC) had been negative over the past several years largely due to operational losses in the local division. This was attributable to the increased competitive landscape in Sri Lankan market. During 9M FY2020, BTE has provided direct capital support for Tea Ceylon (Pvt) Ltd. During 9MFY2019, with the subdued tea

prices, the financial performance of BTC has improved noticeably. Therefore, the ability of the Company to sustain its profitability targets as envisaged, is key in augmenting the overall operations of the Company and therefore, this remains to be reviewed in the future.

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:

Bogawantalawa Tea Estates has been producing predominantly high grown tea since 1869 from the Golden Valley located in the central hills of Sri Lanka and manages over 6,000 hectares of land (with 11 estates). After the privatization of the plantation estates in 1992 by the Sri Lankan Government, Metrocorp group, through Metropolitan Resource Holdings Plc (MRH) acquired the Bogawantalawa tea estates (along with some rubber estates). However, during CY2002/03, the management decided to fully focus on the tea plantation business and therefore, 17 rubber estates were subleased to Lalan Rubber (Pvt) Ltd. Currently, the Company's operation is largely limited to the production of high grown tea (the Company has only one low grown tea estate, and the low grown tea production of this estates is about 5-7% of the total tea production). BTE was incorporated in 1992, and is today a public quoted Company listed on the Colombo Stock Exchange. Metropolitan Resource Holdings PLC (MRH) is the plantation agent of Bogawantalawa Tea Estates PLC and currently owns a 79% stake in Bogawantalawa Tea Estates PLC.

Bogawantalawa Tea Ceylon (Pvt) Ltd (BTM) is the marketing arm and a fully owned subsidiary of Bogawantalawa Tea Estates PLC. BTC markets a wide range of black and green tea in packets and tea bags. The Company's product range includes flavoured, herbal and bulk forms. BTC is one of the largest and preferred suppliers of tea and herbs from Sri Lanka to many prestigious global supermarket chains and large scale food & beverage distributors.

About the Group:

Metrocorp (Pvt) Ltd, formerly known as Metropolitan Investment (Pvt) Ltd, was established in 1994 and has diversified interests in Agro Industries, Plantations, Hydro power, Water and Environment, Office Automation and Leisure Sectors. The mini-hydropower segment (through Eco Power Holdings (Pvt) Ltd), is the largest operating profit contributor of Metrocorp Group (rated at A+, with Stable Outlook by ICRA Lanka). Going forward, Eco Power Holdings (Pvt) Ltd intends to expand its operations rapidly in the overseas market, particularly in the African region. Eco Power has a total installed capacity of 50 MW of which 37 MW installed capacity (12% of Sri Lanka's installed mini hydro power capacity) is based in Sri Lanka, while the balance is in overseas projects. Metrocorp has recently diversified its businesses into related synergistic businesses such as water management/consultancy and leisure sectors. Currently, under the leisure sector, Metrocorp group manages 40 tourism related bungalows based in their tea estates. The group has continuously expanded its businesses through organic as well as inorganic growth. Metrocorp Group, including BTE, currently had an asset base of LKR 23.4 Bn and consolidated revenues of LKR 7.20 Bn in FY2019.

Key Consolidated financial indicators (audited)

Revenue and profitability indicators-Figs are in LKR Mn	FY14	FY15	FY16	FY17	FY18	FY19	9MFY20*
Operating Income	4,109.5	4,464.9	4,327.7	4,368.2	4,933.0	4,667.8	3,530.4
OPBDITA	115.2	209.5	178.9	308.5	435.5	254.7	5.4
PAT	-28.7	131.5	-1.3	61.8	41.7	-45.6	-249.9
ROCE (%)	9.7%	12.3%	5.4%	9.5%	14.3%	6.6%	-2.1%
NWC / OI(%)	-27.7%	-26.7%	-25.0%	-26.6%	-15.7%	-24.7%	-20.5%
Total Debt	1,231.1	1,261.6	1,420.0	1,340.6	1,399.5	1,818.6	2,669.8
Networth	1,007.0	1,096.7	1,204.0	1,383.0	1,482.3	1,312.8	1,063.0
Gearing (x)	1.2	1.2	1.2	1.0	1.0	1.4	2.5
OPBDITA/Interest & Finance Charges(x)	1.2	1.9	1.5	1.9	2.3	1.1	0.03
Total Debt/OPBDITA (x)	10.7	6.0	7.9	4.3	3.2	7.1	367.7

Note;-* Unaudited Financials

Rating history for last three years:

	Current Rating (FY2020)	Chronology of Rating History for the past 5 years				
	Amount Rated	Date & Rating in July 2020	Date & Rating in April 2019	Date & Rating July 2018	Date & Rating March	Date & Rating
Issuer rating	N/A	[SL]BBB+ (Negative)	[SL]BBB+ (Negative)	[SL]BBB+ (Stable)	[SL]BBB+ (Stable)	NA
Senior Convertible Unsecured Redeemable Debentures	LKR 850 Mn	[SL]BBB+ (Negative)	[SL]BBB+ (Negative)	[SL]BBB+ (Stable)	NA	NA

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