

ICRA Lanka revises the rating of E B Creasy & Company PLC to [SL]BBB(Negative) from [SL]BBB+(Negative)

Aug 14, 2020

Instrument*	Current Rated Amount (LKR Mn)	Rating to Action
Issuer Rating	N/A	Revised to BBB (Negative) from BBB+ (Negative)
Proposed Senior Unlisted Unsecured Redeemable Debentures Programme	LKR 700 Mn	Revised to BBB (Negative) from BBB+ (Negative); Withdrawn

Rating action

ICRA Lanka Limited has revised the issuer rating of E.B. Creasy & Company PLC ("EBCR"/"the Company") to [SL]BBB (pronounced S L triple B) with Negative Outlook from [SL]BBB+ (pronounced S L triple B plus) with Negative Outlook. At the request of the Company, ICRA Lanka has withdrawn the rating outstanding for the Proposed Senior Unlisted Unsecured Redeemable Debentures Programme, amounting to LKR 700 Mn.

Rationale

ICRA Lanka has taken a consolidated view on EBCR given the dependence of the Group entities on the Company and the increasing contractual obligations for Group entities, which are currently reporting financial losses/recovering from past financial losses. ICRA Lanka draws comfort from the Company's long track record and 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 professional management team adds further comfort for the rating.

However, the revision in the rating and reaffirmation of the Negative outlook take into consideration the deterioration of the profitability and the debt metrics at the consolidated level during FY2019 and 9MFY2020, notwithstanding the recovery witnessed in some of the Group entities during the period under review. Although, in the past, the Company had maintained a policy to maintain priority of cash flows for its own debt obligations and growth needs over that of its subsidiaries, during the past two years, the Company's contractual obligations/direct financial supports for its Group entities have increased significantly, as several Group entities during this period have reported financial losses. ICRA Lanka notes during FY2020, the Company has provided new Corporate Guarantees, amounting to~ LKR 850 Mn for Lankem Ceylon PLC (LCEY), although, currently (LCEY) is treated as an associate company as against a subsidiary. Going forward, ICRA Lanka will continue to monitor the Company's support for LCEY (rated, [SL] D by ICRA Lanka) and this remains a key rating sensitivity factor. ICRA Lanka also takes note of the moderation in the financial profile of EBCR at the standalone level during FY2019 and 9MFY2020. EBCR's operating margins have moderated to an extent during 9MFY2020, and this is largely attributable to the changes in the Company's margin policy for its distribution arm, Darly Butler in addition to the weaker macro-economic conditions that prevailed during this period. The moderation in other incomes, increase in other expenditures and interest expenses have affected net margins during this period. However, the impact was moderated to an extent due to the Company's strong brand name, leading market share in the consumer product segments, and the launch of new product categories. The rating factors in the moderation in market value of investments, which has led to erosion in the buffer provided by market value over cost of investments. The rating also factors the increasing competition prevalent in the consumer product segments from incumbents as well as new entrants, which moderates pricing flexibility. Further, EBCR's dependence on shorter tenor loans also exposes the Company to refinancing risks.

Outlook: Negative

The Negative outlook reflects the moderation in EBCR's financial profile at the consolidated level and the increasing financial support for its Group entities given the weaker macro-economic conditions in the post COVID-19 Pandemic.

Key rating drivers

Credit strengths

The Company's strong track record and the strength of the Group: Over the years, EBCR has grown by strategic acquisitions and now constitutes a diversified group with 40 Group entities which are into manufacturing of FMCG products, import/export of agricultural inputs/commodities, distribution and freight forwarding, trading of chemicals/auto components and power equipment (solar), managing hotels and plantations. The Colombo Fort Land & Building PLC (CFLB) is the parent company of E B Creasy & Company PLC (holding 52.98% stake). Lankem Ceylon Group was EBCR's largest subsidiary till FY2017. However, LCEY is currently treated as an associate company of EBCR after a Rights Issue that was concluded in FY2018. ICRA Lanka also draws comfort from the Group's track record and 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. EBCR's professional management team adds further comfort for the rating.

Strong brand names and dominant market share in relatively stable consumer product segments: EBCR is a market leader in several consumer product categories and enjoys comfortable margins from most of the product categories. The BIC brand is a globally renowned brand and given the preference of disposable razors in Sri Lanka, BIC is also a leading product in Sri Lanka. The Company's joss stick products, marketed under the brand name of Amritha, and Denta tooth brush are other key products of the Company. Ninja mosquito coils is another leading product and under the Ninja brand, the Company has a leading market share in the mosquito coil market. The Company intends to further strengthen the growing segments of mosquito repellent products such as mosquito liquid vaporizers, aerosol, and refills product segments, which have a higher demand in the urban areas. During FY2020, the Company has acquired few leading consumer brands/ products categories from LCEY. This would in turn help the Company to diversify its consumer product portfolio going forward. Despite the strong market share across product segments, the competitive pressures from incumbents and new entrants exert some pressure on pricing flexibility, although this impact is partly mitigated by lower price ticket size of products and strong brand equity of key product categories of the Company.

Credit challenges

Moderation in financial profile in recent years marked by negative profitability, increase in gearing and weakening of coverage indicators: EBCR Group's revenue during FY2018 and FY2019 has moderated sharply as EBCR's largest subsidiary, Lankem Ceylon PLC was classified as an associate company rather than a subsidiary during this period. During 9MFY2020, the Group's revenue has declined marginally on annualized basis due to weaker macro-economic conditions that prevailed during this period. The Group's PAT has moderated sharply from a net loss of LKR 2.5 Mn in FY2018 to net loss of LKR 749 Mn in FY 2019 and net loss of LKR 304 Mn in 9MFY2020 respectively. The Group's gearing levels have also moderated from 1.35(x) in FY2018 to 2.51(x) and 3.30(x) in FY2019 and 9MFY2020 respectively. The debt service coverage indicators remained moderate on account of increased debt levels against the weaker operating profit margins.

At the standalone level, the Company had maintained a healthy revenue growth in excess of around 10% or more overall for the period of FY2013 to FY2017. This was on the back of sustained brand building efforts which had enabled the Company to garner a large share of the product segments during this period. However, since FY2018, the operating income growth was largely flat at LKR 4.0-4.10 Bn. This is largely attributable to the weaker macro-economic conditions that prevailed in Sri Lanka, the growing competition under key product categories, and the impact from the increased VAT. While, the operating margin remained subdued amidst the increasing support for the weaker Group entities, the net margin has also moderated over the past two years, due to impact of lower other incomes, increase in other expenditures and interest expenses. The Company's gearing levels have gradually increased to ~1.1-1.2x during past two years owing to increase in working capital debt levels and weaker accretion to reserves. The coverage indicators have also witnessed some moderation.

Group's exposure to foreign currency and other macroeconomic volatilities: The macro economic conditions such as volatile interest rates, depreciation of Sri Lankan rupee and other policy directives of the consumer markets, would likely have an impact on the overall performance of the Company. The Company's revenues and profits are vulnerable to foreign exchange risks (given the large dependence on imports which are not hedged fully) and the regulatory risks such as imposition of new taxes. During the past two years, due to sharp depreciation of SL rupee, the Company's raw material costs have increased noticeably. Although, the Company was able to pass-through some of these increases to the end customers during this period due to strong brand equity of the key product categories, the Company remains vulnerable to steep volatility in forex rates.

Underperformance of Group companies: During FY2019 and 9MFY2020, several Group companies continued to underperform given the weaker macro-economic conditions that prevailed during this period. The negative financial performance of Darley Butler during past few years has exerted additional pressure on EBCR to support this operation. During FY2020, the Company has converted Darley Butler's trade payables of ~LKR 950 Mn into equity. Moreover, during this period, the Company has provided additional 5% margin for Darley Butler, as a measure to turnaround its financial performance. During 9MFY2020, several group-companies like Candy Delights, E B Creasy Logistics, Darley Butler, Ceyflex and Muller & Phipps have witnessed a moderation in their financial performances due to factors like changes in product strategy, weaker market conditions and debt funded capex incurred. ICRA Lanka also notes that there has been some recovery in some of the Group companies such as Lanka Special Steel and Laxapanna Batteries during this period. The financial performance of Lanka Special Steel Ltd, a fully owned subsidiary of EBCR, is expected to further improve due to strong business pipeline/order book. Moreover, the Company's recent investment, Ceyflex Rubber is also expected to perform well given the increasing demand for its product categories in the post COVID-19 Pandemic. Therefore, the Company's direct financial support for these entities is likely to be limited to an extent in the future.

LCEY is as an associate company of E B Creasy & Co PLC, and is engaged in the manufacturing and distribution of Agro Chemicals, Decorative Paint products, and Industrial Chemical & Bitumen Products. During past few years, LCEY, has sustained heavy financial losses owing to several reasons including adverse weather conditions in the past, working capital constraints and regulatory related issues with its agro chemical segment. Although, EBCR's support for its subsidiaries and associates were restricted to a larger extent according to its internal policy, during FY2020, the Company has supported LCEY's debt restructuring exercise by providing new Corporate Guarantees, amounting to ~LKR 850 Mn. Going forward, ICRA Lanka will continue to monitor the financial performance of the Group companies and any changes in support policy towards weaker Group entities such as LCEY will be a rating sensitivity factor.

Analytical approach: For arriving at the ratings, ICRA has applied its rating methodologies as indicated below.
Links to applicable criteria: <https://www.icralanka.com/issuer-rating-methodology/>

About the Group:

Established in 1878, E B Creasy & Company PLC (“EBCR”/“the Company”), was converted to a limited liability company and listed on the Colombo Stock Exchange (CSE) in 1968. It is one of the oldest companies in Sri Lanka. The Company is among the pioneers of the Ceylon Chamber of Commerce, having joined it in 1890. Over the years, EBCR has expanded by organic growth as well as by strategic acquisitions and now constitutes a diversified group. The Company on a standalone basis manufactures, markets and distributes a range of homecare, personal care and household products. The range offered includes imported and manufactured disposable razors, toothbrushes, mosquito coils, and mosquito liquid vaporizers. During FY2020, the company has exited from its hardware and automotive batteries segment. Besides, own operations, the Company also acts as the key holding company for the Group entities. The Group business entities include logistics and transport, distribution of pharmaceutical items, manufacturer of surgical gloves, manufacturer of galvanized wire and a variety of steel wires, manufacturer of a range of confectionery products, and Alkaline type batteries & CFL bulbs. Since FY2018, Lankem Ceylon PLC (LCEY) was treated as an associate company of EBCR. LCEY had grown by strategic acquisitions and now constitutes a diversified group with 27 subsidiaries, which are into manufacturing of FMCG products, import/export of agricultural inputs/commodities, distribution and freight forwarding, trading of chemicals/auto components and, managing hotels and plantations. Currently, Colombo Fort Land & Building PLC (CFLB) is the immediate parent of Lankem Ceylon PLC, which is also the largest subsidiary (including its stepdown subsidiaries) of CFLB.

Key Consolidated financial indicators (audited)

Revenue and profitability indicators-Figs are in LKR Mn	FY14	FY15	FY16	FY17	FY18	FY19	9MFY20*
Operating Income	34,634.8	20,446.7	25,008.9	26,450.9	15,535.1	10,819.2	7,928.1
OPBDITA	1,806.0	1,342.6	1,775.1	2,195.2	663.2	335.1	536.7
PAT	-320.1	98.6	240.9	260.0	-2.5	-749.3	-304.1
ROCE (%)	6.1%	4.5%	8.4%	10.9%	5.6%	-2.9%	3.8%
Total Debt	12,627.2	8,540.6	9,616.7	11,051.0	3,430.9	3,976.3	4,104.6
Networth	3,693.7	2,942.6	3,036.7	2,630.3	2,361.2	1,304.9	987.5
Gearing (x)	1.40	1.39	1.52	2.10	1.35	2.51	3.30
OPBDITA/Interest & Finance Charges(x)	1.26	2.57	2.10	1.64	1.23	0.51	1.22
Total Debt/OPBDITA (x)	6.99	6.36	5.42	5.03	5.17	11.86	5.74

Note:-* Unaudited Financials

Rating history for last three years:

Instrument	Current Rating (FY2020)		Chronology of Rating History for the past 3 years			
	Amount Rated	Date & Rating in July 2020	Date & Rating in April 2019	Date & Rating in Sep 2018	Date & Rating in FY 2018 May 2018	Date & Rating in FY 2017 April 2017
Issuer rating	N/A	[SL]BBB (Negative)	[SL]BBB+ (Negative)	[SL]BBB+ (Stable)	[SL]BBB+ (Stable)	[SL]BBB+ (Stable)
Proposed Senior Unsecured Unlisted Redeemable Debentures	LKR 700 Mn	[SL]BBB (Negative); withdrawn	[SL]BBB+ (Negative)	[SL]BBB+ (Stable)	NA	NA

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