

ICRA Lanka reaffirms the issuer rating of [SL]A+ with Stable Outlook for JAT Holdings (Pvt) Ltd

Sep 09, 2020

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

Rating action

ICRA Lanka Limited has reaffirmed the Issuer rating of [SL]A+ (pronounced S L A plus) with Stable outlook for JAT Holdings (Pvt) Ltd ("JAT" / "the Company").

Rationale

The reaffirmation of the rating primarily factors in the Company's strong brand name and dominant market position in the Sri Lankan wood coating industry, especially in the water-based wood coating segment. The Company is the largest distributor globally for Sayerlack brand, which is owned by Sherwin Williams, and has exclusive distribution rights for the entire South Asian region. Given the strong brand equity and higher-quality standards, JAT Holdings has the highest market share in the Sri Lankan overall wood coating sector, despite competition from incumbent and new MNCs. Although, the revenue contribution of Sayerlack products to the Company has been relatively high, leading to higher revenue concentration risks, over the past two years, the Company's growing business development/other product segments have mitigated this risk to a larger extent. Nevertheless, considering the established relationship between JAT Holdings and Sherwin Williams and the strategic nature of the tie-up, ICRA Lanka views the Company's risk of dependency on Sayerlack brand as moderate.

The rating also factors in the strong growth potential for wood care product segment in Sri Lanka, although this industry in Sri Lanka has experienced a slowdown during FY2020, due to exceptional events that have taken place during this period. Notwithstanding the challenging market conditions, the Company has sustained its market shares of the wood coating segments during this period. Going forward, the Company's market share in the local wood coating industry is expected to further strengthen as most competitors, in the post COVID-19 Pandemic, have experienced liquidity constraints due to slowdown in the overall wood coating industry. During past two years, the Company has diversified significantly into the other related industries such as premium interior design segment through tie-ups with a German based SEA Group company, Harris paint brush, Ceiling products, and some construction materials. However, in the post COVID-19 Pandemic, the business development and the export segments have experienced a slowdown owing to the import restrictions locally and lockdowns in key export markets. Therefore, the ability of the Company to successfully recover these operations as envisaged, will remain to be reviewed in the future. The rating also factors in the Group's healthy profitability metrics, which is characterized by healthy profitability margins (PAT margin 11.3% in FYE March 20, vis -a-vis 13.5% in FYE March 19). The Company's capital structure is comfortable on account of relatively low debt levels. Notwithstanding the healthy profit levels, the Company's trade receivables has deteriorated sharply owing to the subdued market conditions and lockdowns imposed by the Governments in the post COVID-19 Pandemic. However, considering the credit risks of key business segments, ICRA Lanka expects the Company would recover its higher trade receivables in the medium term with the recovery of the economic activities in Sri Lanka as well as other key export markets.

Outlook: Stable

The Stable outlook reflects ICRA Lanka's expectations that JAT would recover its financial performance in the long term despite the subdued market conditions in the post COVID-19 Pandemic.

Key Rating Drivers

Credit strengths

Experience of the promoter/s and the management: The experience of the promoters, the Company's strong track record and reputation in the industry have enabled the Company to enjoy steady access to funding from financial institutions. The Company's professional management team coupled with relatively strong governance structure adds further comfort to the rating.

Leading market share and strong brand equity: JAT is synonymous with the water-based wood coating market in Sri Lanka due to strong brand equity as well as higher-quality standards of the Sayerlack products. Currently, JAT dominates the water-based premium wood coating market in Sri Lanka. The core product segments of JAT, particularly Sayerlack wood coating products, enjoy relatively high gross margins, resulting in strong profitability for the Company. This is attributable to strong brand equity that JAT commands, as most of the premium products sold by the Company are relatively less susceptible to the price competition in the industry. Moreover, Sayerlack products have high-quality standards and are suitable to the local conditions compared with that of the competitors. As a lateral diversification strategy, the Company has also introduced new product categories, targeting different wood coating segments (such as Polyurethane). Notwithstanding the moderation of the revenue contributions of the Company's wood coating segments during FY2020, the Company has been able to sustain its market shares of the wood coating segments during this period. ICRA Lanka also draws comfort from growing water-based wood coating market in Sri Lanka amidst the conversions from the fragmented markets as Sri Lanka's formal water-based wood coating segment currently remains relatively under penetrated. In the post COVID-19 Pandemic, with the challenging market conditions, most competitors in Sri Lanka have experienced some cash flow constraints. This would also help the Company to further strengthen its market share of this industry going forward.

The diversification Strategy: The rating also considers positively the Company's recent diversification into innovative new product categories such as Ceiling products & Harris paint brushes, and Admixtures & Epoxy chemicals, which have been posting volume growths over the past few years. JAT envisages itself as a leading player in the broader interior and living spaces market and has continued with its tie-ups with premium international brands such as Herman Miller, Armstrong and etc. The Company has also diversified into the premium interior design segment in the recent past through tie-ups with a German based SEA Group, to provide furnishing solutions in the premium real-estate sector in Sri Lanka. This together with the new product categories, which were recently introduced during past two years, targeting the construction industry, have helped the Company to scale up its non-core product segments. During FY2020, although, the Company's core business segment has slowed down, the increasing revenue contribution from the Company's business development segment has helped the Company to cushion this impact to a larger extent. Moreover, the Company's growing export segment (including Bangladesh, India, Maldives and African markets), have helped the Company to diversify its operations over the past few years. However, these markets have experienced a slowdown in the post COVID-19 Pandemic due to import restrictions and lockdowns imposed in their key export markets. Therefore, the ability of the management to achieve the revenue targets of these segments as envisaged remain to be reviewed in the future.

Comfortable Financial Profile: JAT's revenues have increased at a compounded annual growth rate of 17% over the last four years (FY2015-FY2020). However, during FY2020, the Company's revenue has moderated YOY by 3.8% owing to the slowdown in the local wood coating market. Although the Company's gross profit margins under the wood coating segment have increased in FY2020, the overall gross profit margins during this period have moderated to an extent. This is attributable to the change in the composition of the sales mix, where the revenue contribution from the business development segment has increased during the year, which operates on volume and relatively low margin levels compared to the wood coating and other segments. JAT has recorded a PAT of LKR 709 Mn and LKR 881 Mn in FY2020 and FY2019 respectively from LKR 634 Mn in FY2018. The Company's capital structure is comfortable on account of healthy net worth and relatively low debt level. The debt profile of the Company is largely skewed towards short term loans, with the same contributing to over 90% of the debt outstanding in FY2020. The Company's debt service coverage indicators currently remain healthy amidst the lower debt levels against the comfortable operating profit margins. The Company's trade receivables in the post COVID-19 Pandemic have stretched especially in the export markets. The strong distributor & dealer network and the formal business contracts mitigate the credit risks of the Company's local operations to a larger extent. Going forward, ICRA Lanka expects a release in working capital amidst the slowdown in the overall sales of the Company. This together with relatively lower capex programme and the debt repayments during FY2021, would help the Company to improve its liquidity position further.

Credit challenges

Relatively high dependency on Sayerlack brand/products: Notwithstanding the Company's ongoing diversification initiatives, the Company's dependency on Sayerlack products still remains at a relatively high level. However, ICRA Lanka also notes that JAT is the largest exclusive distributor for Sayerlack brand, (which is owned by Sherwin Williams), for the South Asian region. Considering the established mutual relationship between JAT Holdings and Sherwin Williams, the strategic nature of the tie-up with the supplier, and the initiatives taken in the other markets (including the export segment) with the new brands being introduced to the product portfolio, as mentioned above, ICRA Lanka views the risk of dependency on Sayerlack products by JAT Holdings as moderate.

Cyclical nature of the Construction industry and relatively high working capital position: Since the demand for the Company's core product categories are driven by the growth in the local construction industry, the macro-economic conditions such as increasing interest rate, depreciation of Sri Lankan rupee and other policy directives of the Govt. on the construction industry would likely have an impact on the overall performance of the Company. The Company's working capital position currently remains stretched due to subdued market conditions in the post COVID-19 Pandemic. Moreover, the Company's trade receivables from the export markets would be further stretched owing to the slowdowns in the key export markets such as Bangladesh. Therefore, the ability of the Company to successfully recover its operations in both local and export markets, while controlling relatively high debtor position remains to be reviewed in the future. JAT Holdings being the largest exclusive global distributor/dealer of Sherwin Williams, enjoys high price discounts from the supplier. Moreover, as mentioned above, under the current market conditions, the Company could partially pass-through the cost increases onto customers without affecting the overall market share. This would likely to exert some pressure on the Company's operating profit margins in the short to medium term.

Increasing Competition: The painting industry is generally characterized by intense competition from a larger number of competitors in Sri Lanka. Moreover, during past two years, new players have also entered the local painting industry. The increased competition could result in a price war and hence, could impact the Company's overall performance going forward. However, Sayerlack products have a strong brand

equity compared to that of the competitors and therefore, JAT continues to enjoy the advantages of being an early mover, the established distribution network, manufacturing set up and brand presence.

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

About the Company:

Incorporated in 1993, JAT Holdings (Pvt) Ltd has become a dominant player in the Sri Lankan wood coating, decorative painting and interior living spaces market segments. The Company has a commanding market position in the Sri Lankan wood coating industry, mainly due to its brand equity. While wood coating products is its core business segment, the Company has successfully ventured into adjacent market segments, such as decorative paints, paint brushes, furniture accessories and interior products. JAT has the competitive advantage of being the sole distributor and marketer for Sayerlack premium wood coating products for the South Asian region, which includes markets such as India, Pakistan, Bangladesh, Maldives and some African markets. The exclusive distribution rights have enabled JAT to rapidly grow its export sales in much larger markets such as Bangladesh and India. Going forward, the Company is focusing on Indian and African markets, as its key growth markets, where JAT will focus most of its marketing efforts. In addition to its core wood coating and decorative products, JAT envisages to position itself as the leading player in the broader interior and living spaces market. The Company has taken some strategic initiatives in this direction, including the introduction of Herman Miller premium furniture and Armstrong architectural products to the Sri Lankan market.

Key Consolidated financial indicators (Audited)

<i>Revenue and profitability indicators</i>					
<i>Figs are in LKR Mn</i>	FY16	FY17	FY18	FY19	FY20*
Operating Income	4,904.8	5,783.0	5,446.7	6,547.2	6,295.5
OPBDITA	1,065.3	1,148.1	747.6	1,133.7	871.7
PAT	849.1	902.6	634.8	881.0	709.8
NWC / OI(%)	41.1%	48.2%	55.2%	60.0%	58.0%
Total Debt	777.3	946.7	977.5	1,407.1	879.3
Networth	2,467.0	3,377.7	3,830.9	4,568.7	4,978.0
Gearing (x)	0.32	0.28	0.26	0.31	0.18
OPBDITA/Interest & Finance Charges(x)	25.34	11.66	6.32	8.77	7.87
Total Debt/OPBDITA (x)	0.73	0.82	1.31	1.24	1.01

Note; Gearing-(Total Debts/Networth),*-Unaudited

Rating history for last three years: JAT Holdings Pvt Limited

Instrument	Current Rating (FY2020)			Chronology of Rating History for the past 3 years		
	Type	Amount Rated (LKR Mn)	Date & Rating	Rating in FY2019	Rating in FY2018	Rating in FY2017
			Aug 2020			
Issuer rating	N/A	N/A	[SL]A+ (Stable)	[SL]A+ (Stable)	[SL]A+(Stable)	[SL]A+(Stable)

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