FitchRatings

Fitch Affirms Singer Sri Lanka PLC at 'A-(lka)'; Outlook Stable

Fitch Ratings-Colombo-02 May 2017: Fitch Ratings has affirmed Sri Lanka-based consumer durables retailer Singer (Sri Lanka) PLC's National Long-Term Rating at 'A-(lka)' with a Stable Outlook. Fitch has also withdrawn the expected rating assigned to Singer's proposed senior unsecured debentures as the debt issuance is no longer expected to convert to final ratings in the near future. A full list of rating actions is at the end of this commentary.

Singer's rating reflects its strong market leadership, extensive product and brand portfolio across different price points and a well-managed hire purchase (HP) business, which gives its business model more stability across economic cycles. These strengths are counterbalanced by a moderate level of leverage (defined as adjusted net debt/EBITDAR) excluding its subsidiary Singer Finance PLC, amid high capex and shareholder returns.

KEY RATING DRIVERS

Strengthening Market Position: Singer is one of two market leaders in consumer durables retailing in Sri Lanka. Its market position has improved in the last few years, led by the increasing penetration of home appliances and mobile phones in the country. Consequently Singer's EBITDA, excluding its subsidiary Singer Finance PLC, increased to LKR3.9 billion in 2016 from LKR1.8 billion in 2014.

Fitch expects demand for white goods and consumer electronics to weaken in the next 12-18 months, following the increase in value added tax (VAT) rate to 15% from November 2016 from 11%, and rising interest rates. However, we believe Singer has the ability to mitigate these challenges, aided by its extensive product portfolio across different price points and its strong brand presence.

Sustained Growth in Digital Media: Fitch expects growth for Singer's IT and mobile products to be sustained in the medium term, albeit at a slower pace. We believe the segment will continue to benefit from increasing penetration of 3G and 4G mobile services in the country, higher smartphone usage by the younger population and digitisation spreading across most sectors in the economy. IT and mobile products also tend to be at lower price points with shorter life cycles, making the demand for them more stable across economic cycles. Fitch expects Singer to significantly benefit from this trend in the medium term, underpinned by its leading market position in smart-phone retail.

Pressure on Margins Manageable: We expect Singer's EBITDA margin to contract slightly in the next 12-18 months because of cost pressures, which the company may not be able to fully pass on to customers amid intense competition. Singer's sourcing costs have risen because of the increase in raw-material costs globally, with the impact to appear in margins after a four to six month lag, in line with the company's cycle for import orders. The weakening Sri Lankan rupee in the last year has also made Singer's imported inventory more expensive.

The cost of Singer's locally manufactured inventory has also risen due to higher labour costs. However, we expect the margin contraction to slow in the medium term. This is because we expect smart-phone sales to increase, and Singer to benefit from improving economies of scale and operating efficiencies as its business grows.

Leverage to Stabilise: We expect Singer's leverage to remain at around 4.5x over the next two years compared with 4.3x at end-2016. The company is likely to spend around LKR800 million a year to increase and refurbish its store network, while new stores may take longer to be profitable in an environment of slower demand. The company is also likely to maintain its dividend payout policy of around 60% of net income in the medium term. This would keep its free cash flow (FCF) generation negative, leaving limited room for meaningful deleveraging.

However, Singer has sufficient headroom to increase leverage while maintaining its current ratings.

Manageable Investments in Singer Finance: Singer expects to invest around LKR300 million in its finance subsidiary Singer Finance in the short term to support its new ventures. We do not consider the planned capital injection to be significant enough to have a negative impact on Singer's rating. In addition we do not expect the subsidiary to require support from the parent in the medium term due to its strong capitalisation, above-average asset quality and strong funding profile.

DERIVATION SUMMARY

Singer is a leader in consumer durable retail in Sri Lanka, with a strong portfolio of well-known brands and an extensive distribution network. Singer is rated one notch above its closest peer Abans PLC (BBB+(lka)/Stable). This is because Singer's financial profile is stronger than Abans'. Abans' business profile has also weakened relative to Singer due to investments in non-core businesses.

Singer is rated one notch higher than DSI Samson Group (Private) Limited (BBB+(lka)/Stable) because DSI's business profile is weaker due to the intense competition in its domestic footwear business. Diversified conglomerates Sunshine Holdings PLC (A(lka)/Stable) and Richard Pieris & Company PLC (A(lka)/Stable) are rated one notch above Singer to reflect their better business risk profile through cash flow diversity and lower leverage.

KEY ASSUMPTIONS

Fitch's key assumptions within our rating case for the issuer include:
- Revenue growth to slow in the next 12-18 months due to weakening demand
- EBITDAR margins to contract by about 100bp in the next two years due to cost pressures and weaker demand
- Capex to average around LKR800 million a year in the medium term
- Capital injection of LKR300 million to Singer Finance (Lanka) PLC in 2018

RATING SENSITIVITIES

Developments that may, individually or collectively, lead to positive rating action include:
- Singer's leverage (measured as adjusted net debt/EBITDAR excluding Singer Finance) falling below 4.5x on a sustained basis (end-2016: 4.3x)
- Fixed-charge coverage (measured as operating EBITDAR/ interest paid + rent) sustained above 1.5x (end-2016: 2.0x)

Developments that may, individually or collectively, lead to negative rating action include:
- A sustained increase in Singer's leverage to over 5.5x
- Fixed-charge coverage falling below 1.2x on a sustained basis
- Any significant equity support to Singer's 80% subsidiary, Singer Finance (Lanka) PLC

LIQUIDITY

Comfortable Liquidity Position: Singer had LKR1.3 billion of cash and LKR7.4 billion in unutilised credit facilities at end-2016 to meet LKR2.2 billion of long-term debt maturing in 2017, leaving the company in a comfortable liquidity position. We do not expect the company to generate positive FCF in the next 12 months because of higher-than-historical capex and high shareholder returns. Singer has a further LKR7.9 billion of short-term working capital debt, which we expect will be rolled over by lenders in the normal course of business, given Singer's growing business and stable operating profile.

FULL LIST OF RATING ACTIONS

Singer (Sri Lanka) PLC

- National Long-Term Rating affirmed at 'A-(lka)'; Outlook Stable
- National Long-Term Rating on outstanding senior unsecured debentures affirmed at 'A-(lka)'
- National Short-Term Rating on commercial paper affirmed at 'F2(lka)'
- Expected National Long-Term Rating of 'A-(EXP)(lka)' on proposed senior unsecured debentures withdrawn

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Note to editors: Fitch's National ratings provide a relative measure of creditworthiness for rated entities in countries with relatively low international sovereign ratings and where there is demand for such ratings. The best risk within a country is rated 'AAA' and other credits are rated only relative to this risk. National ratings are designed for use mainly by local investors in local markets and are signified by the addition of an identifier for the country concerned, such as 'AAA(lka)' for National ratings in Sri Lanka. Specific letter grades are not therefore internationally comparable.

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Additional information is available on www.fitchratings.com

Applicable Criteria
Criteria for Rating Non-Financial Corporates (pub. 10 Mar 2017)
National Scale Ratings Criteria (pub. 07 Mar 2017)

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