

Coronavirus Screener for Sri Lankan Corporates

The coronavirus outbreak is a significant challenge to rated corporates in Sri Lanka. The speed of recovery, and companies' ability to recoup lost revenue and manage liquidity, will be critical in our assessment of the need for rating action. Ratings will be driven by the issuers' expected credit profiles by-end 2021, and assuming sufficient liquidity, in line with our "rating through the cycle" approach, rather than at the trough of the crisis (which we believe will prevail through most of 2020), provided liquidity is sufficient. For the weaker issuers, short-term liquidity can be a driver of rating action.

Seven of our publicly rated portfolio of 14 corporates in Sri Lanka are in one of the four more exposed brackets, having either a combination of a 'Low' rating headroom with 'High' or 'Moderate' sector exposure to the coronavirus; or 'Moderate' rating headroom with 'High' or 'Moderate' sector exposure. Specifically, three corporates in these brackets have 'Low' rating headroom with 'Moderate' to 'High' sector exposure, which could mean that the assumptions driving our previous expectations for deleveraging may not materialise, exerting near-term pressure on the ratings.

The ultimate impact of COVID-19 on ratings is highly uncertain; and will depend on the eventual spread of the virus, the knock-on effect of measures introduced to control it, and how long those effects last.

Fitch Ratings screened our Sri Lankan portfolio of corporates based on the exposure of an issuer's sector and the headroom at the current rating to accommodate weakening performance.

Relative Rating Vulnerability

As shown in the table below, two or 14.3% of our publicly rated portfolio of 14 corporates have both 'High' sector exposure and 'Low' rating headroom. Specifically, one such entity was already on negative outlook.

Five corporates, or 36% of the portfolio, have 'Low' rating headroom at their current rating level. However, two such issuers are government-related entities (GREs), and their 'Low' rating headroom is not driven by their standalone credit metrics but rather the negative outlook on the sovereign.

Sri Lankan Corporates COVID-19 Exposure Screener

% of publicly rated corporates		Rating headroom			
		Low	Moderate	High	
Sector exposure	High	14.3	7.1	-	21.4
	Moderate	7.1	21.4	21.4	50.0
	Low	14.3	-	14.3	28.6
		35.7	28.6	35.7	

Note: The four red- to pink-shaded cells represent the more exposed brackets, and in total account for 50% of our portfolio. Based on Fitch's portfolio of 14 publicly rated Sri Lankan corporates
Source: Fitch Ratings

Related Research

[Fitch Ratings' Approach to Maintaining Ratings during Coronavirus Outbreak \(March 2020\)](#)

[Fitch Ratings Scanning Corporate Issuers for Coronavirus Vulnerability \(March 2020\)](#)

[Coronavirus Screener for APAC Corporates \(March 2020\)](#)

Analysts



Nadika Ranasinghe
+ 94 11 254 1900
nadika.ranasinghe@fitchratings.com



Azim Nawaz
+ 94 11 254 1900
azim.nawaz@fitchratings.com

Sector Exposure and Rating Headroom

The impact of COVID-19 could mean that the assumptions driving our previous expectations for deleveraging may not materialise for some issuers.

We expect leverage of seven corporates to weaken below their negative sensitives in the financial year ending March 2021 (FY21). All seven such corporates have 'High' to 'Moderate' sector exposure. We estimate three corporates to breach their negative sensitivities even in FY22, contrary to our previous view that at least two of them would deleverage by FY21.

Retail, Construction and Hotels Most Exposed

We believe the consumer durables retailers, hotels and construction-related sectors to be the most affected by the virus, due to the immediate impact on revenues and a protracted recovery period. The rated consumer durable retailers Singer (Sri Lanka) PLC (Singer: BBB+(lka)/Negative) and Abans PLC (BBB+(lka)/Negative) are immediately affected by the social distancing measures implemented island-wide resulting in the complete closure of most or all of their store networks at present. At the same time, the Central Bank of Sri Lanka has stipulated measures to halt importation of all non-essential items into the country until end-June 2020, exerting pressure on the retailers' supply chains.

At present, consumer durable retailers hold around three to five months of inventory, which should allow them to meet sales through to beyond mid-2020 amidst lower demand. We believe it will take another 12-18 months for the demand environment to normalise, even if the lockdown is lifted and supply-chain pressures ease by 2HFY20, as consumers may continue to defer discretionary purchases until the economy recovers. The recent negative rating action on the two consumer durable retailers reflects this view.

Companies in construction and related sectors such as Sierra Cables PLC which was downgraded on coronavirus stresses (Sierra: BB(lka)/Rating Watch Negative) will face a prolonged decline in cash flows as both state and private-sector construction projects will face delays until economic conditions stabilise. The Government's debt to GDP levels (which are already high) and lower revenues stemming from slower economic activity could leave little fiscal room for infrastructure development in the next two years in our view. Fitch expects the budget deficit to increase from 6.5% in 2019 to about 10% by 2020 before receding to around 6% in 2021. We do not expect any meaningful activity in the residential construction sector either in 1HFY20 amidst social distancing measures and lower capital spending by households.

Hotels will be one of the hardest-hit sectors, with tourist arrivals unlikely to resume to pre-pandemic levels until the COVID-19 spread is contained worldwide. Sri Lanka has already closed its borders to foreigners since mid-March 2020. Local tourism has also come to a standstill due to island-wide lockdowns. However, Fitch-rated corporates in have only a limited exposure to hotels, with those who do also have exposure to other diversified business segments and/or high rating headroom, which mitigates the impact.

Export-oriented manufacturing sectors and logistics and related services should also see a significant slowdown during most of FY21 because of weak global trade. Export demand from North America and Europe will undergo significant declines in the coming months, and factory closures locally could lead to a material drop in production at least for a few months. Declines in both imports and exports would lead to large idle capacity in the domestic logistics sector.

However, the risks to the rated corporates exposed to these sectors – such as Melstacorp PLC (AAA(lka)/Stable) and

Distilleries Company PLC (DIST, AAA(lka)/Stable), Hemas Holdings PLC (Hemas: AA-(lka)/Stable), Richard Pieris & Company PLC (RPC: A(lka)/Stable) and DSI Samson Group (Private) Limited (DSG: BBB(lka)/Positive) – are largely mitigated by the lower cash flow contributions from these sectors due to their more diversified operations.

We believe the impact on other consumer-related sectors such as food and beverage, fast moving consumer goods (FMCG) and small-ticket items such as footwear retail to be less severe – given the relatively defensive demand for these products even during periods of sharp economic slowdown. Periods when consumers are in lockdown should have an impact on demand for these products, while we believe demand will recover to normalised levels within a few quarters – depending on how soon the virus is contained and livelihoods are restored.

Sri Lankan corporates in these sectors – such as DIST, Hemas and DSG – do not yet face any significant supply-chain constraints on imported inputs. The impact of supply-chain disruptions are softened at least in the near-term by sufficient stocks held by manufacturers and the commoditised nature of most inputs, which allows for their sourcing from alternative suppliers.

Utilities, Telecoms and Healthcare Least Affected

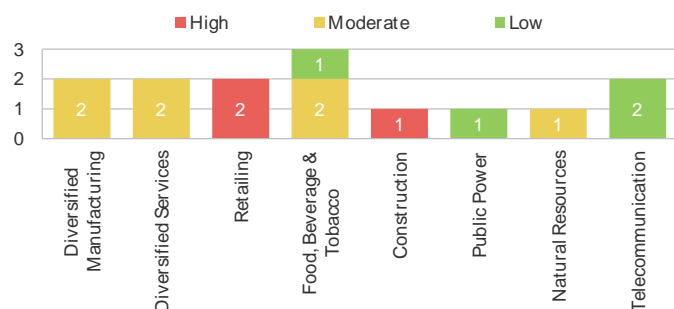
We view the impact on utilities companies such as the Ceylon Electricity Board (CEB: AA+(lka)/Negative), telecommunications providers such as Dialog Axiata PLC (Dialog: AAA(lka)/Stable) and Sri Lanka Telecom PLC (SLT: AA+(lka)/Negative), and companies exposed to the healthcare and pharmaceutical sectors such as Hemas and Sunshine Holdings PLC (Sunshine: A-(lka)/Stable), to be largely neutral, given the essential nature of these services.

CEB's cash flows should benefit from the prevailing low oil prices which could help bridge the gap between the tariffs stipulated by the government and generation costs, reversing the EBITDA losses seen in the past. However further pressure on the domestic currency could offset such gains to an extent. Around 35% of CEB's power generation is based on imported heavy fuel oils.

The telecoms sector will benefit from strong demand for 4G data and fixed-broadband as online connectivity and remote access will be boosted due to the COVID-19 pandemic. However, both SLT and Dialog would need to increase their capex investments to address the demand for 4G data and fixed-broadband, should social distancing rules continue over an extended period.

The healthcare sector continues to benefit from rising demand for both in- and out-patient care and demand for pharmaceuticals and diagnostics. The lockdown has curtailed the pharmaceutical distribution business to an extent, but the distributors together with the government are looking at alternative methods to deliver drugs directly to the consumer. The large pharmaceutical distributors say they hold three to four months of inventory, and are yet to experience significant supply-chain disruptions.

COVID-19 Exposure: By Market Sector

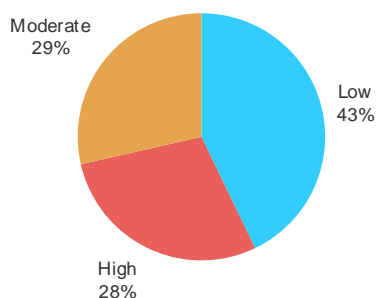


Source: Fitch Ratings

Exposure to Currency Fluctuation

Most Sri Lankan corporates that Fitch rates could see substantial currency-related cost pressures in the next 12-18 months, with the Sri Lanka rupee already having depreciated by 7% since the beginning of the pandemic to LKR194 versus the US dollar. Fitch expects the exchange rate to average LKR190 per US dollar in 2020 compared with LKR181 in 2019. Even though most corporates had previously been able to pass on the currency-related cost increases to end-customers over a period of time, we believe it will be more difficult in the current environment due to weak demand. We have factored this into our forecast by way of weaker margins for the affected sectors – including consumer durable retail, FMCG manufacturing and pharma distribution.

Sri Lankan Corporate Portfolio FX Risk Distribution



Source: Fitch Ratings

Our portfolio of rated corporates does not issue cross-border bonds, and therefore the currency mismatch between debt and cash flows is minimal. Those with exposure to foreign-currency debt via banks usually have varying degrees of exposure to foreign-currency cash flows, providing a natural hedge.

Rating Headroom, Liquidity, Key to Near-Term Rating Risk

As well as assessing sector risk, we categorised companies by examining how close they were to breaching our company-specific negative rating sensitivities (typically leverage, but not always, and can include various other measures of financial or operating performance and financial flexibility) prior to the COVID-19 threat. Companies with limited rating headroom compared with

their sector peers could be subject to negative rating action if we expect rating sensitivities to be breached for a sustained period.

Issuers with 'Low' headroom, however, may not experience any rating impact if our expectations for deleveraging are unaffected or only slightly delayed. Conversely, if an issuer with 'High' headroom is severely affected and is unable to mitigate the risks, then its headroom could be consumed fairly quickly. Companies often breach these rating sensitivities temporarily without triggering rating action where we expect conditions to improve again within the next 18 to 24 months. However, this could leave them with little rating headroom to absorb any further weakening in their businesses.

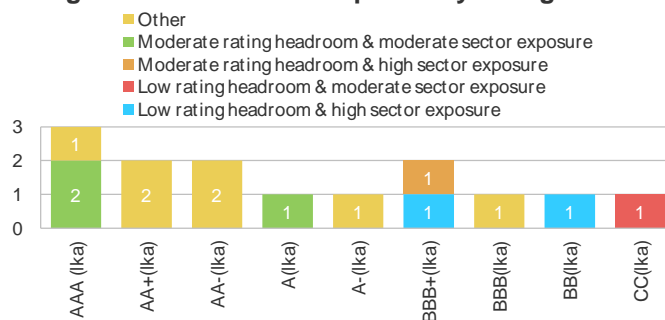
For the Screener we defined:

'Low' headroom: leverage before the COVID-19 virus threat emerged was already near or higher than the negative sensitivity, or other important parameters – such as profitability and free cash flow (FCF) generation – were weak for the rating level.

'Moderate' headroom: leverage with headroom better than the above category, but not comfortably higher for the rating level considering industry risk/issuer-specific characteristics.

'High' headroom: comfortable leverage headroom considering industry risk, or where leverage is not currently a key factor in the rating, including where the rating is driven by government support.

Rating Headroom & Sector Exposure by Rating Level

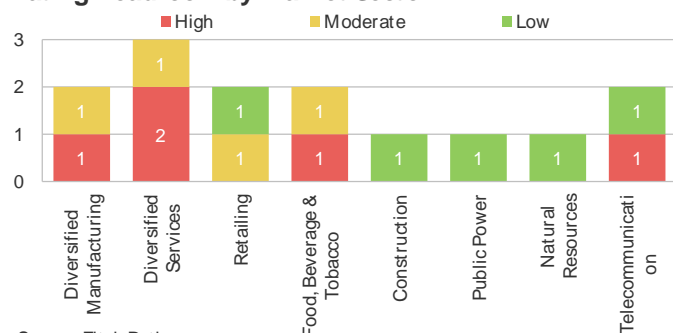


Source: Fitch Ratings

We expect seven of the 12 rated corporates (excluding two GREs) to see leverage weakening below their negative sensitivities in FY21 due to the COVID-19 impact. However, we believe four will deleverage to levels commensurate with their current rating by FYE22 amidst a gradual recovery in demand starting 2H20. We estimate three of the seven corporates with 'Low' rating headroom and 'Moderate-to-High' sector exposure to see leverage remaining above their negative sensitivity even in FY22, contrary to our previous view that at least two of them would materially deleverage by FY21.

Negative rating momentum could materialise on some of these corporates in the near term, while the ratings of many could come under pressure should the impact of the COVID-19 pandemic intensify beyond our current expectations.

Rating Headroom by Market Sector



Source: Fitch Ratings

We forecast the majority of the rated corporates to generate neutral to negative FCF in the next 12 months amidst weaker EBITDA generation. However, most corporates could see some level of working-capital inflows during the downturn due to inventory liquidation and longer supplier credit periods which could more than offset difficulties in collecting customer receivables on time. We expect all corporates to defer expansionary capex and dividends to beyond FY21 in order to preserve cash and to shore up liquidity.

As of end-December 2019, around one third of the near-term maturities of our rated issuers consisted of contracted maturities of around LKR17.0 billion, while the remainder were working-capital lines. We believe banks will be willing to roll over the working-capital lines so long as the disruption is considered temporary and underlying assets are mostly liquid during normalised economic conditions. However, corporates with lower ratings or exposure to high-risk sectors may face difficulty in refinancing their contracted maturities as banks have become more cautious in their lending practices.

The government has already stipulated certain relief measures for corporate borrowers, including moratoriums for sectors such as leisure, construction, export manufacturing and plantation. Government has also mandated banks to restructure existing bad loans by providing extended repayment periods and to defer payments of unpaid interest write-offs. This should provide relief to a few issuers in our portfolio but not to all.

Rating Approach

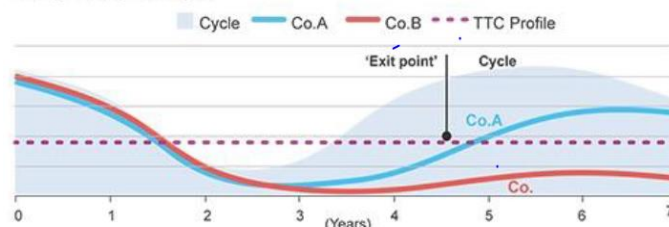
The period through April-May 2020 will be important, but not definitive, in setting the course for the remainder of the pandemic. Rather than base our next steps on a deterministic macro case, we are prioritising corporates for review based on their relative vulnerability at the current rating level.

Companies whose trajectory has already been clearly affected by coronavirus-related developments are being expedited for rating action. This will be followed by a review of companies that entered 2020 with 'Low' or 'Moderate' rating headroom, combined with 'High' or 'Moderate' exposure sectors or sub-sectors. Companies whose rating headroom and sector exposure place them at less immediate risk will be reviewed in line with current schedules over the balance of the year.

Our considerations at committee will be consistent with our overall approach, but will focus in particular on distinguishing

between issuers whose downturn would be likely to exhibit some or a majority recovery of lost top-line growth; those with limited or no recovery of lost top-line growth; and those where the downturn coincides with liquidity pressure.

Rating Through the Cycle



Sri Lanka Corporates COVID-19 Screener

Company	Sector	Rating	Outlook	Sector exposure	Rating headroom before outbreak	FX exposure
DSI Samson Group (Private) Limited	Diversified Manufacturing	BBB(Ika)	Positive	Moderate	High	Moderate
Richard Pieris & Company PLC	Diversified Manufacturing	A(Ika)	Stable	Moderate	Moderate	Moderate
Hemas Holdings PLC	Diversified Services	AA-(Ika)	Stable	Moderate	High	High
Sunshine Holdings PLC	Diversified Services	A-(Ika)	Stable	Moderate	High	Moderate
Singer (Sri Lanka) PLC	Retailing	BBB+(Ika)	Negative	High	Low	High
Distilleries Company of Sri Lanka PLC	Food, Beverage & Tobacco	AAA(Ika)	Stable	Moderate	Moderate	Low
Melstacorp PLC	Diversified Services	AAA(Ika)	Stable	Moderate	Moderate	Low
Abans PLC	Retailing	BBB+(Ika)	Negative	High	Moderate	High
Sierra Cables PLC	Construction	BB(Ika)	RWN	High	Low	High
Ceylon Electricity Board	Public Power	AA+(Ika)	Negative	Low	Low	Moderate
Lion Brewery (Ceylon) PLC	Food, Beverage and Tobacco	AA-(Ika)	Stable	Low	High	Low
Kotagala Plantations PLC	Natural Resources	CC (Ika)		Moderate	Low	Low
Dialog Axiata PLC	Telecommunications	AAA(Ika)	Stable	Low	High	Low
Sri Lanka Telecom PLC	Telecommunications	AA+(Ika)	Negative	Low	Low	Low

Source: Fitch Ratings

ALL FITCH CREDIT RATINGS ARE SUBJECT TO CERTAIN LIMITATIONS AND DISCLAIMERS. PLEASE READ THESE LIMITATIONS AND DISCLAIMERS BY FOLLOWING THIS LINK: <https://fitchratings.com/understandingcreditratings>. IN ADDITION, RATING DEFINITIONS AND THE TERMS OF USE OF SUCH RATINGS ARE AVAILABLE ON THE AGENCY'S PUBLIC WEB SITE AT www.fitchratings.com. PUBLISHED RATINGS, CRITERIA, AND METHODOLOGIES ARE AVAILABLE FROM THIS SITE AT ALL TIMES. FITCH'S CODE OF CONDUCT, CONFIDENTIALITY, CONFLICTS OF INTEREST, AFFILIATE FIREWALL, COMPLIANCE, AND OTHER RELEVANT POLICIES AND PROCEDURES ARE ALSO AVAILABLE FROM THE CODE OF CONDUCT SECTION OF THIS SITE. FITCH MAY HAVE PROVIDED ANOTHER PERMISSIBLE SERVICE TO THE RATED ENTITY OR ITS RELATED THIRD PARTIES. DETAILS OF THIS SERVICE FOR RATINGS FOR WHICH THE LEAD ANALYST IS BASED IN AN EU-REGISTERED ENTITY CAN BE FOUND ON THE ENTITY SUMMARY PAGE FOR THIS ISSUER ON THE FITCH WEBSITE.

Copyright © 2020 by Fitch Ratings, Inc., Fitch Ratings Ltd. and its subsidiaries. 33 Whitehall Street, NY, NY 10004. Telephone: 1-800-753-4824, (212) 908-0500. Fax: (212) 480-4435. Reproduction or retransmission in whole or in part is prohibited except by permission. All rights reserved. In issuing and maintaining its ratings and in making other reports (including forecast information), Fitch relies on factual information it receives from issuers and underwriters and from other sources Fitch believes to be credible. Fitch conducts a reasonable investigation of the factual information relied upon by it in accordance with its ratings methodology, and obtains reasonable verification of that information from independent sources, to the extent such sources are available for a given security or in a given jurisdiction. The manner of Fitch's factual investigation and the scope of the third-party verification it obtains will vary depending on the nature of the rated security and its issuer, the requirements and practices in the jurisdiction in which the rated security is offered and sold and/or the issuer is located, the availability and nature of relevant public information, access to the management of the issuer and its advisers, the availability of pre-existing third-party verifications such as audit reports, agreed-upon procedures letters, appraisals, actuarial reports, engineering reports, legal opinions and other reports provided by third parties, the availability of independent and competent third-party verification sources with respect to the particular security or in the particular jurisdiction of the issuer, and a variety of other factors. Users of Fitch's ratings and reports should understand that neither an enhanced factual investigation nor any third-party verification can ensure that all of the information Fitch relies on in connection with a rating or a report will be accurate and complete. Ultimately, the issuer and its advisers are responsible for the accuracy of the information they provide to Fitch and to the market in offering documents and other reports. In issuing its ratings and its reports, Fitch must rely on the work of experts, including independent auditors with respect to financial statements and attorneys with respect to legal and tax matters. Further, ratings and forecasts of financial and other information are inherently forward-looking and embody assumptions and predictions about future events that by their nature cannot be verified as facts. As a result, despite any verification of current facts, ratings and forecasts can be affected by future events or conditions that were not anticipated at the time a rating or forecast was issued or affirmed.

The information in this report is provided "as is" without any representation or warranty of any kind, and Fitch does not represent or warrant that the report or any of its contents will meet any of the requirements of a recipient of the report. A Fitch rating is an opinion as to the creditworthiness of a security. This opinion and reports made by Fitch are based on established criteria and methodologies that Fitch is continuously evaluating and updating. Therefore, ratings and reports are the collective work product of Fitch and no individual, or group of individuals, is solely responsible for a rating or a report. The rating does not address the risk of loss due to risks other than credit risk, unless such risk is specifically mentioned. Fitch is not engaged in the offer or sale of any security. All Fitch reports have shared authorship. Individuals identified in a Fitch report were involved in, but are not solely responsible for, the opinions stated therein. The individuals are named for contact purposes only. A report providing a Fitch rating is neither a prospectus nor a substitute for the information assembled, verified and presented to investors by the issuer and its agents in connection with the sale of the securities. Ratings may be changed or withdrawn at any time for any reason in the sole discretion of Fitch. Fitch does not provide investment advice of any sort. Ratings are not a recommendation to buy, sell, or hold any security. Ratings do not comment on the adequacy of market price, the suitability of any security for a particular investor, or the tax-exempt nature or taxability of payments made in respect to any security. Fitch receives fees from issuers, insurers, guarantors, other obligors, and underwriters for rating securities. Such fees generally vary from US\$1,000 to US\$750,000 (or the applicable currency equivalent) per issue. In certain cases, Fitch will rate all or a number of issues issued by a particular issuer, or insured or guaranteed by a particular insurer or guarantor, for a single annual fee. Such fees are expected to vary from US\$10,000 to US\$1,500,000 (or the applicable currency equivalent). The assignment, publication, or dissemination of a rating by Fitch shall not constitute a consent by Fitch to use its name as an expert in connection with any registration statement filed under the United States securities laws, the Financial Services and Markets Act of 2000 of the United Kingdom, or the securities laws of any particular jurisdiction. Due to the relative efficiency of electronic publishing and distribution, Fitch research may be available to electronic subscribers up to three days earlier than to print subscribers.

For Australia, New Zealand, Taiwan and South Korea only: Fitch Australia Pty Ltd holds an Australian financial services license (AFS license no. 337123) which authorizes it to provide credit ratings to wholesale clients only. Credit ratings information published by Fitch is not intended to be used by persons who are retail clients within the meaning of the Corporations Act 2001.