FitchRatings

Fitch Downgrades Singer (Sri Lanka) PLC to 'A(lka)'; Outlook Stable

Fitch Ratings - Colombo - 29 Nov 2023: Fitch Ratings has downgraded Sri Lankan consumer-durable retailer Singer (Sri Lanka) PLC's National Long-Term Rating to 'A(lka)' from 'A+(lka)'. The Outlook is Stable.

The downgrade reflects the sustained deterioration in Singer's financial profile such that Fitch-forecasted EBITDAR fixed-charge cover will fall to 0.7x in the financial year ending 31 March 2024 (FY24), compared with 1.1x in FY23.

The Stable Outlook reflects Singer's adequate liquidity supported by its access to domestic banks, and our expectations that the company's EBITDA will recover gradually in the next two years supported by a slow improvement in demand amid falling interest rates and the removal of the ban on consumer durable imports since October 2023. However, we do not expect fixed charge cover to improve to above 1.2x - the level commensurate with a higher rating - until after FY25.

KEY RATING DRIVERS

Prolonged Weak Demand: Fitch expect sales volumes to rise in the low single digits in FY24 as consumer spending, especially on non-essentials such as consumer electronics, will remain weak in the next 12-18 months. Consumer income has yet to adjust to the higher cost of living while the increase in taxes in early 2023 weakened purchasing power. Fitch expects Sri Lanka's GDP to contract by 1.4% in 2023 (2022: 7.8% decline), before growing modestly by 3.3% in 2024, indicating only a gradual recovery in economic activity.

We forecast Singer's sales volumes to grow by double digits in FY25, due to a gradual recovery in income supported by a revival in the agriculture sector, which accounts for 30% of the population, salary increments across the public and private sectors, and a full year's impact of pent-up demand after the removal of a ban on consumer-durables imports in October 2023. Hire-purchase (HP) and credit sales should also rise with interest rates almost halving from the highs in FY23, and we expect Singer will selectively grow its HP book, which shrank in the last few years, to cater to this demand.

Slow Margin Recovery: We expect Singer's EBITDAR margin to improve to around 9% in FY25, from 3.3% in 1HFY24, benefitting from revenue growth, prudent inventory management, and a shift towards high-margin product categories. Margins contracted in 1HFY24 due to markdowns to clear high-cost inventory that was procured when the Sri Lankan rupee was at a low, and the non-availability of high margin products due to the import ban, resulting in a one-time pre-tax loss of LKR2.0 billion. Singer is replacing this stock at a lower cost and with fast-moving products, which should bode well for margins.

Finance Subsidiary Weighs on Leverage: Fitch views the risks stemming from SFL on Singer may rise given the weak domestic operating environment. Fitch adds LKR27 billion of additional debt above its reported borrowings, which is equal to the value of SFL's entire customer deposits and borrowings, in calculating Singer's leverage. This is deemed to fund a hypothetical capital injection into SFL to support a capital structure commensurate with the subsidiary's risk profile. We believe this adjustment increases Singer's EBITDA net leverage by 3.0x-4.0x.

Negative Operating Cashflows: We expect Singer's largely negative cash flow from operations (CFFO) in FY24-FY27 on working-capital investments to support revenue growth. We expect the net working-capital cycle to improve to 180 days by FY25 from 240 days in FY23 as the end of the import ban removes the need to hold substantial inventory. Also, we expect trade payable days to rise to 45 days (FY23: 30), with supplier credit terms normalising. We expect Singer to incur capex of LKR800 million and resume dividend payouts of 40% of net income from FY25, once operating performance improves.

Easing Interest Burden: We estimate Singer's cash interest to reduce by 35% in FY24 as interest rates fall. Market interest rates have fallen to 13% by November 2023, from 30% a year ago. Given most of Singer's debt is short-term, the company should be able reprice faster at favourable rates. However, we do not believe EBITDAR generation in FY24 will be sufficient to cover the reduced interest costs.

No Notching for Parental Support: Singer's rating is not notched for support from its stronger parent, Hayleys PLC, as we believe Hayleys has limited incentive to provide support, according to our Parent and Subsidiary Linkage Rating Criteria. The 'Low' legal incentive stems from the absence of corporate guarantees from Hayleys on Singer's debt, and the lack of cross-default clauses between the two entities.

Fitch expects Singer to contribute around 10% to Hayleys' group EBITDA, once its operating performance improves from FY25. Even so, competitive advantages to the parent and Singer's growth potential remain weak, resulting in a 'Low' strategic support incentive. Hayleys is a highly diversified group, resulting in limited operational synergies with Singer Furthermore, Singer has an independent management team and its brand is separate from that of Hayleys. Therefore, the operational incentive to support is also regarded as 'Low'.

DERIVATION SUMMARY

Singer's rating is comparable with that of peers such as Abans PLC (Abans, AA-(lka)/Negative), Sierra Cables PLC (Sierra, A+(lka)/Stable), Oxford College of Business (Private) Limited (A(lka)/Stable) and Resus Energy PLC (Resus, BBB(lka)/Negative).

Singer has stronger core operations than consumer-durable goods peer, Abans, as it has a broader portfolio of products and brands across multiple price points and better local manufacturing capabilities. Its stronger business profile is countered by Singer's weaker financial profile than Abans, reflecting the aggressive loan growth at SFL amid the weak operating environment. Furthermore, Singer's EBITDAR fixed-charge coverage below 1.0x is weaker than that of Abans, which is likely to maintain coverage above 1.0x. This results in Abans being rated two notches above Singer.

Sierra is rated one notch higher than Singer, despite its smaller scale and more cyclical demand in the construction and infrastructure sectors compared with that for consumer durable goods. Sierra's revenue and cash flow benefitted significantly in the past 12-18 months as import restrictions boosted demand for its locally manufactured cables, which improved its financial and liquidity profile. In comparison, we expect Singer to continue to face demand pressure as consumers have yet to adjust to the rise in cost of living and weakened disposable income. Therefore, we expect Singer's leverage and coverage ratios to remain significantly weaker than Sierra's in the next 12-18months.

Oxford College of Business is rated at the same level as Singer. Singer's scale is much larger and financial access is much stronger than Oxford College of Business, reflecting its position as the largest consumer durable retailer in the country. The college also has high counterparty risk as it is affiliated with only one university for its education programmes. However, this is more than offset by Oxford College of Businesses' better financial profile with EBITDA interest cover estimated to be around 3.0x in the next 12-24 months.

Singer is rated three notches above domestic renewable energy producer, Resus. Despite Singer's larger scale, Resus has a better leverage and coverage metrics and cash flows from long-term power purchase agreements. However, Resus is exposed tighter liquidity stemming from the deterioration in the credit profile of its sole counterparty, Ceylon Electricity Board (CEB, BB+(lka)/Stable). Resus' Negative Outlook reflects the risk of further payment delays from CEB, which could further erode its liquidity.

Singer, given its credit strength, is rated higher than a number of large banks, non-bank financial institutions and insurance companies in the country. The large financial institutions are more exposed to sovereign stress than Singer despite their individual credit strengths, due mainly to substantial sovereign-issued securities held for regulatory reasons, while the banks and non-bank financial institutions have broader exposure to numerous sectors in the local economy amid the weak operating environment.

KEY ASSUMPTIONS

Fitch's Key Assumptions Within Our Rating Case for the Issuer

- Revenue growth of 15.9% in FY24, 12.1% in FY25 and 19.4% in FY26

- EBITDAR margin to contract to 7.2% in FY24 before increasing to 9.1% in FY25 and 10.1% in FY26

- No dividends paid in FY24 due to net losses, LKR350 million in FY25

- Higher interest rates of around 17.5% in FY24 to decrease to an average of 12% in FY25 and FY26

- Hypothetical annual capital infusion into SFL of around LKR17 billion in FY24 and LKR2 billion in FY25

- Capex to average around 1.3% of total revenue from FY24-FY26

RATING SENSITIVITIES

Factors that could, individually or collectively, lead to positive rating action/upgrade:

- Leverage, measured as total adjusted net debt/operating EBITDAR, below 10.0x for a sustained period;

- Fixed-charge coverage, measured as EBITDAR/interest paid plus rent, above 1.2x.

Factors that could, individually or collectively, lead to negative rating action/downgrade:

- Fixed-charge coverage, measured as EBITDAR/interest paid plus rent, below 1.0x.

LIQUIDITY AND DEBT STRUCTURE

Manageable Liquidity: Singer had LKR2.2 billion in cash as of end-September 2023, against short-term debt of LKR17 billion due in the next 12 months. Short-term maturities include LKR12.2 billion in working-capital debt and LKR4.8 billion in maturing long-term loans. We believe Singer will be able to roll over working-capital debt, in line with its track record, supported by its improving working-capital cycle. As of September 2023, Singer has unutilized uncommitted facilities of LKR14.9 billion.

ISSUER PROFILE

Singer is the largest domestic consumer-durable retailer by revenue in Sri Lanka with a network of over 400 stores.

REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING

The principal sources of information used in the analysis are described in the Applicable Criteria.

RATING ACTIONS

ENTITY / DEBT	RATING			PRIOR
Singer (Sri Lanka) PLC	Natl LT	A(lka)	Downgrade	A+(lka)
senior unsecured	Natl ST	F1(lka)	Downgrade	F1+(lka)

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VIEW ADDITIONAL RATING DETAILS

Additional information is available on www.fitchratings.com

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The rated entity (and/or its agents) or, in the case of structured finance, one or more of the transaction parties participated in the rating process except that the following issuer(s), if any, did not participate in the rating process, or provide additional information, beyond the issuer's available public disclosure.

APPLICABLE CRITERIA

- National Scale Rating Criteria (pub. 22 Dec 2020)
- Parent and Subsidiary Linkage Rating Criteria (pub. 17 Jun 2023)
- Corporate Rating Criteria (pub. 04 Nov 2023) (including rating assumption sensitivity)

APPLICABLE MODELS

Numbers in parentheses accompanying applicable model(s) contain hyperlinks to criteria providing description of model(s).

- Corporate Monitoring & Forecasting Model (COMFORT Model), v8.1.0 (1)

ADDITIONAL DISCLOSURES

- Solicitation Status
- Endorsement Policy
- Potential Conflicts Resulting from Revenue Concentrations

ENDORSEMENT STATUS

Singer (Sri Lanka) PLC -

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