



Fitch Affirms Sunshine Holdings at 'A-(lka)'; Outlook Stable

Fitch Ratings-Colombo-14 November 2018: Fitch Ratings has affirmed Sri Lanka-based Sunshine Holdings PLC's National Long-Term Rating at 'A-(lka)'. The Outlook is Stable.

The rating on Sunshine reflects its strong market positions in its diversified portfolio of products, which has elements of relatively defensive end-market demand, and the strong brand names associated with most of its offerings. These strengths are counterbalanced by the heightening regulatory risk faced by the pharmaceutical import and distribution business and the exposure to commodity price volatility in its palm oil and tea plantation businesses.

The rating also takes into account Fitch's expectations that Sunshine's net leverage - defined as lease-adjusted net debt/operating EBITDAR including proportionate consolidation of Estate Management Services (Private) Limited (EMSPL), the holding company for the agriculture and consumer goods segments - is likely to remain below 3.0x over the medium term. The financial profile has improved following a recent equity infusion and net leverage has fallen, but over the medium term, free cash generation should improve as capex requirements have moderated.

KEY RATING DRIVERS

Equity Injection Reduces Net Leverage: Sunshine's net leverage improved to around 2.1x by end-September 2018, from 2.4x at end-March 2018, supported by LKR775 million in proceeds from an equity issuance to SBI Ven Holdings Pte Limited in July 2018. Fitch expects Sunshine to use the proceeds to pay down debt, which increased after Sunshine used debt to increase its stake in EMSPL. We expect the company's moderation in capex, resilient profitability in the palm oil business and high-margin diagnostics, wellness and beauty sectors to help maintain Sunshine's net leverage at below 3.0x over the medium term.

Healthcare Margins to Shrink: Fitch believes the second round of government price caps on 23 essential drugs and two medical devices in September 2018 and the depreciating Sri Lankan rupee will reduce Sunshine's healthcare-sector profitability. We expect healthcare EBITDA margins to fall to 5.9% in the financial year to March 2019 (FY19) from 6.5% a year earlier, but should recover from FY20 due to improvement in sales volume of drugs and growing contribution from the higher-margin diagnostics, wellness and beauty segments. Nevertheless the more frequent government price controls underscore the regulatory risk for the business.

Palm Oil Key Agri Contributor: We expect the palm oil segment to continue to be the key driver of growth in operating cash flows from the agricultural segment in the medium term. Global crude palm oil (CPO) prices decreased to average USD535/tonne in 3Q18 from around USD650/tonne in 2017 due to robust output and a more challenging export market. However Sunshine's domestic prices started to increase from 2QFY19 due to the depreciating Sri Lankan rupee and a recent increase in import duty. Fitch sees the risk of sustained pressure on global CPO prices, although the impact domestically will be softened by the higher duty and rupee weakness.

Fitch believes the segment's profitability to be supported by resilient domestic demand for palm oil. Sunshine is well-positioned to benefit from growing local demand as it is the largest palm oil producer in Sri Lanka, accounting for more than 50% of domestic output. Palm oil is the largest contributor to Sunshine's profit, making up almost 25% of the group's proportionate EBITDA in FY18.

Volatile Tea Segment: Fitch expects the tea plantations' cash flow volatility to continue over the medium term due to lower land and labour productivity, and cost pressures arising from periodic wage increases. The tea plantation business's operating performance improved significantly in FY18 as a result of persistently high auction prices, with operating margin reaching 11.1% from 3.9% in FY17. However, operating margin was just 2.6% in 1H FY19 due to

weaker prices. We expect supply-side pressures, ensuing cost escalations and volatile demand to hinder the segment's long-term viability.

Tea Retail Offsets Volatility: Fitch believes Sunshine's branded-tea segment will partly offset the volatility in the tea plantation segment's profitability. The branded-tea segment's EBITDA margin declined in FY18 to 8.4% from 8.9% FY17 as a result of higher tea prices in the Colombo Tea Auction over 2017. The situation reversed when tea prices declined in 1H FY19, enabling the segment to improve margins, which partly countered the weaker profitability in the tea plantation segment. However, we expect the intense price competition, particularly in the lower-end of the market, to keep the branded-tea segment's margins in check over the medium term.

Power, Dairy Improve Cash Generation: Fitch expects the capacity expansions in Sunshine's power and dairy segments to increasingly contribute to cash generation and as such stabilise consolidated cash flows in the long term by reducing the share of contribution from the volatile tea and palm oil businesses. We estimate that the energy segment to annually contribute LKR180 million to EBITDA in the next two years. Contribution to EBITDA from the dairy business, which we estimate to be around LKR80 million-120 million, should start from FY20 when the farm reaches its full capacity.

DERIVATION SUMMARY

Sunshine is rated one notch lower than Richard Pieris & Company PLC (RICH, A(lka)/Stable) because RICH has a stronger business risk profile due to lower exposure to the cyclical plantation segment than Sunshine, as well as substantially higher cash flow from its defensive grocery retail business and larger operating scale.

Singer (Sri Lanka) PLC (A-(lka)/Stable) is a leading consumer durables retailer that has a stronger business-risk profile than Sunshine and a significantly larger operating scale, despite greater operating cash flow volatility. However, this is offset by Singer's much higher leverage, which results in both companies having the same rating.

DSI Samson Group (Private) Limited (DSG, BBB+(lka)/Stable) is the market leader in the domestic rubber tyre and footwear markets and has a business-risk profile similar to that of Sunshine. However, DSG is rated one notch below Sunshine due its significantly higher leverage.

KEY ASSUMPTIONS

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

- Revenue to rise by 20% in FY19 (FY18: 12.7%) reflecting Sunshine's larger stake in EMSPL; and then to increase by mid-single digits over the next two years
- EBITDAR margins to be maintained in the low-double-digit range over FY18-FY21 (FY18: 12.0%)
- Capex of LKR3.4 billion over FY19-FY22 for expansion across the board
- Dividend pay-out to be 30% of net profits over FY19-FY22

RATING SENSITIVITIES

Developments that May, Individually or Collectively, Lead to Positive Rating Action

- A sustained reduction in Sunshine's lease-adjusted debt net of cash/EBITDAR (including proportionate consolidation of EMSPL) to below 1.5x

Developments that May, Individually or Collectively, Lead to Negative Rating Action

- An increase in Sunshine's lease-adjusted debt net of cash/EBITDAR (including proportionate consolidation of EMSPL) to over 3.0x for a sustained period
- Sunshine's EBITDAR coverage of gross interest + rent (including proportionate consolidation of EMSPL) falling below 2.0x for a sustained period
- Adverse impact on growth and profitability arising from sustained regulatory pressure in the healthcare and agriculture segments

LIQUIDITY

Satisfactory Liquidity: Sunshine had LKR1.1 billion of unrestricted cash and LKR2.6 billion in unutilised credit facilities as at end-March 2018 to meet LKR1.5 billion of debt repayment falling due in the next 12 months, which places the company in a comfortable liquidity position. More than 50% of the debt maturities in the next 12 months are short-term working capital lines and we expect banks to roll over these facilities as they fall due in the normal course of business.

Contact:

Primary Analyst
Rishikesh Sivakumar, CFA
Analyst
Fitch Ratings Lanka Limited
Level 15-04 East Tower, World Trade Centre
Colombo 01, Sri Lanka
+94 11 254 1900

Secondary Analyst
Nadika Ranasinghe, CFA
Director
+94 11 254 1900

Committee Chairperson
Vicky Melbourne
Senior Director
+61 2 8256 0325

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.

Media Relations: Bindu Menon, Mumbai, Tel: +91 22 4000 1727, Email: bindu.menon@fitchratings.com

Additional information is available on www.fitchratings.com
Applicable Criteria
Corporate Rating Criteria (pub. 23 Mar 2018)
National Scale Ratings Criteria (pub. 18 Jul 2018)

Additional Disclosures
Solicitation Status
Endorsement Policy

ALL FITCH CREDIT RATINGS ARE SUBJECT TO CERTAIN LIMITATIONS AND DISCLAIMERS. PLEASE READ THESE LIMITATIONS AND DISCLAIMERS BY FOLLOWING THIS LINK: [HTTPS://WWW.FITCHRATINGS.COM/UNDERSTANDINGCREDITRATINGS](https://www.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. DIRECTORS AND SHAREHOLDERS RELEVANT INTERESTS ARE AVAILABLE AT [HTTPS://WWW.FITCHRATINGS.COM/SITE/REGULATORY](https://www.fitchratings.com/site/regulatory). 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 © 2018 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

Fitch Ratings, Inc. is registered with the U.S. Securities and Exchange Commission as a Nationally Recognized Statistical Rating Organization (the "NRSRO"). While certain of the NRSRO's credit rating subsidiaries are listed on Item 3 of Form NRSRO and as such are authorized to issue credit ratings on behalf of the NRSRO (see <https://www.fitchratings.com/site/regulatory>), other credit rating subsidiaries are not listed on Form NRSRO (the "non-NRSROs") and therefore credit ratings issued by those subsidiaries are not issued on behalf of the NRSRO. However, non-NRSRO personnel may participate in determining credit ratings issued by or on behalf of the NRSRO.

SOLICITATION STATUS

The ratings above were solicited and assigned or maintained at the request of the rated entity/issuer or a related third party. Any exceptions follow below.

ENDORSEMENT POLICY

Fitch's approach to ratings endorsement so that ratings produced outside the EU may be used by regulated entities within the EU for regulatory purposes, pursuant to the terms of the EU Regulation with respect to credit rating agencies, can be found on the EU Regulatory Disclosures page. The endorsement status of all International ratings is provided within the entity summary page for each rated entity and in the transaction detail pages for all structured finance transactions on the Fitch website. These disclosures are updated on a daily basis.