19 Aug 2019 | Affirmation

Fitch Revises Outlook on Singer Sri Lanka to Negative; Affirms at 'A-(lka)'

Fitch Ratings-Colombo-20 August 2019: Fitch Ratings has revised the Outlook on consumer-durables retailer Singer (Sri Lanka) PLC's National Long-Term Rating to Negative from Stable. Fitch has simultaneously affirmed the National Long-Term Rating at 'A-(lka)' as well as the 'A-(lka)' rating on Singer's outstanding senior unsecured debentures and 'F2(lka)' National Short-Term Rating on its commercial paper.

KEY RATING DRIVERS

Difficulty in Reducing Leverage: The Negative Outlook reflects the challenges Singer may face in reducing its leverage, defined as net adjusted debt/EBITDAR, to below 5.5x - the level at which we would consider negative rating action - by the financial year ending March 2021 (FY21), from 6.1x in the trailing 12 months to end-June 2019 and 6.4x at FYE19. The ban on Huawei Technologies by the US authorities is likely to weaken Singer's mobile phone sales from a high of around 25% of revenue in FY19. Singer will aim to diversify sales across other brands if the ban continues, but the efficacy of its strategy remains to be seen. It also plans to cut operating costs in the next two years, but this is subject to execution risk.

Leverage fell in the year ending June 2019 following the removal of cash margin requirements on imports in mid-March 2019. This saw the resumption of Singer's supplier credit cycle, with a cash inflow of LKR750 million from improved creditor days in 1QFY20. The cash margin was introduced in November 2018 to discourage imports in a bid to combat pressure on the local exchange rate. The company had to increase debt and incur higher interest costs to fund the cash margin requirement so long as letters-of-credit remained unpaid. Consequently, Singer opted to repay suppliers early to reduce financing costs at the expense of higher working capital.

Weak Sales Volume: Fitch expects sales volume to decline in FY20 due to poor consumer sentiment, but there is a possibility that volume may pick up in FY21 if the recovery seen in the agricultural sector continues and domestic interest rates continue to fall. Approximately 40% of Singer's revenue is financed by its in-house hire-purchase scheme, which is highly sensitive to domestic interest rates. Rising smartphone penetration and a shorter replacement cycle for mobile phones should also support sales volume growth over the longer term.

Leading Market Position, Distribution Network: The affirmation of the National Long-term Rating is underpinned by Singer's leading market position in consumer durables retail, its portfolio of products and brands, which are diversified across price points, its large island-wide distribution and retail store network and the well-managed hire-purchase book with limited delinquencies.

Cost Efficiencies Support Margin: Fitch expects the EBITDA margin to improve by 50bp to 7.1% in FY20 and to stabilise at 7.6% in FY21 owing to the implementation of cost-saving measures in early FY20; Singer has improved its warehousing process and logistical operation and has optimised its inventory-management system. However, a weakening local exchange rate poses risk to margins, as 80%-85% of the products Singer sells are imported. Singer's EBITDA margin contracted by 50bp in FY19 due to the absorption of currency-related costs as a means to compete, rather than fully passing on the cost escalation to customers.

No Extraordinary Support from Parent: Fitch will continue to rate Singer based on its Standalone Credit Profile due to our assessment of the weak linkages between Singer and its parent, Hayleys PLC, under Fitch's Parent and Subsidiary Rating Linkage methodology. We do not expect Hayleys to provide any extraordinary support to its subsidiary, despite its 90.4% stake, due to the size of Singer's balance sheet and significant debt as of FYE19.

Criteria Variation: Fitch's Corporate Rating Criteria allows for the deconsolidation of subsidiaries that are regulated banks from the financials of an industrial parent company when assessing the parent's credit rating. Singer Finance (Lanka) PLC (SFL, BBB(lka)/Stable), which is 79.93%-owned by Singer, is a regulated finance company rather than a bank. However, local regulations for finance companies are similar to those applicable to local banks. Therefore, Fitch has removed SFL's borrowings, cash balance and EBITDA from Singer's consolidated financials. We do not expect Singer to inject new capital into SFL in light of the subsidiary's adequate capital adequacy ratio.

DERIVATION SUMMARY

Singer is the market leader in Sri Lanka's consumer-durable retail industry, backed by 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), despite the latter's better financial profile. This is because Singer has a stronger business-risk profile than Abans due to its higher mix of domestically manufactured products that insulates Singer's inventory costs from a weakening local exchange as well as Singer's better-capitalised finance subsidiary, which limits the parent's need to inject fresh equity over the medium term.

Singer is rated two notches higher than DSI Samson Group (Private) Limited (BBB(lka)/Stable) due to its more robust business profile, while DSI's sales remain under pressure from increasing competition in the local market.

Singer has a stronger business-risk profile than Sunshine Holdings PLC (A-(lka)/Stable) due to its leading market position in consumer durables and significantly larger operating scale. However, this is offset by Singer's higher net leverage and more volatile cash flow because of the higher discretionary demand for consumer durables than for Sunshine's products. Therefore we rate Singer and Sunshine at the same level.

KEY ASSUMPTIONS

- Revenue to decline by 6.8% in FY20 due to weaker sales in Singer's digital media segment as a result of the Huawei ban and dampened consumer demand for consumer durables in the short term.
- Annual revenue growth of 8% during FY21-FY23 assuming a gradual improvement in consumer sentiment, particularly if the recovery in the agriculture segment continues.
- EBITDA margin to increase by 50bp in FY20 due to internal cost saving measures.
- Capex to average around LKR790 million a year over the next couple of years on account of investments in store network and maintenance.
- No capital infusions into the financial subsidiary.

RATING SENSITIVITIES

Developments that May, Individually or Collectively, Lead to the Outlook being revised to Stable
- Net adjusted debt/EBITDAR on track to fall to below 5.5x by FY21
- EBITDAR/(interest paid + operating lease rentals) on track to increase to more than 1.2x by FY21 (FY19: 1.1x)

Developments that May, Individually or Collectively, Lead to Negative Rating Action
- Inability to make meaningful progress to reduce net adjusted debt/operating EBITDAR to below 5.5x or improve EBITDAR/(interest paid + operating lease rentals) to more than 1.2x over the next 12-18 months

LIQUIDITY

Tight but Manageable Liquidity: Singer had LKR1.5 billion of cash and LKR4.5 billion in unutilised credit facilities at FYE19 to meet LKR14.9 billion of debt maturing in the next 12 months, leaving the company in a tight liquidity position. However, LKR9.1 billion of near-term debt maturities related to working-capital loans, which we believe Singer will be able to roll over during the normal course of business in given its healthy working-capital cycle.

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Applicable Criteria

[Corporate Rating Criteria (pub. 19 Feb 2019)]

[Corporates Notching and Recovery Ratings Criteria (pub. 23 Mar 2018)](#)
[National Scale Ratings Criteria (pub. 18 Jul 2018)](#)
[Parent and Subsidiary Rating Linkage (pub. 16 Jul 2018)](#)

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