Fitch Ratings

01 Nov 2019 | Affirmation

Fitch Affirms Abans PLC at 'BBB+(lka)'; Outlook Stable

Fitch Ratings-Colombo-01 November 2019:

Fitch Ratings has affirmed Sri Lanka-based consumer-durables retailer Abans PLC's (Abans) National Long-Term Rating at 'BBB+(lka)' with a Stable Outlook.

Abans' ratings reflect its strong market position in consumer durables retail in Sri Lanka, its extensive brand portfolio, wide distribution network and well-managed hire-purchase (HP) business, which are partly offset by investments in riskier non-core operations, such as real estate and financial services. The affirmation also reflects Fitch's view that Abans will maintain leverage - defined as net lease adjusted debt/operating EBITDAR excluding its finance subsidiary - at below 5.5x over the medium term. Leverage was 4.7x at the end of the financial year to 31 March 2019 (FYE19).

Abans' debentures are rated at the same level as Abans' National Long-Term Rating because its senior unsecured debt is not materially subordinated to prior-ranking debt, which will remain below 2.5x EBTIDA (FY20 forecast: 1.7x).

Fitch rates Abans based on the consolidated profile of its weaker parent Abans Retail Holdings (Pvt) Limited (ARH) due to strong operational linkages between the two entities. ARH has full ownership and control of Abans, which is the main contributor to group consolidated EBITDAR.

Key Rating Drivers

Margins to Strengthen: We expect Abans' EBITDAR margin to widen by around 100bp by FY21 from 8.4% in FY19 as the company continues to reduce discount sales, align sales commissions with product profitability and introduce automation and technology. Margins should also benefit from a shift in the product mix towards high-margin brands. Abans' EBITDAR margin widened 300bp to 8.4% in FY19 and 30bp yoy to 9.5% in 1Q20, despite weak revenue growth.

Demand to Recover: We expect Abans' revenue to grow at high-single digits from 2HFY20, helped by higher disposable income after a recovery in the agriculture sector, salary increases for state employees and potential benefits to voters ahead of two main elections. The 250bp cut in the central bank's base interest rates during 2019 and the recently introduced cap on lending rates should drive higher credit-financed sales of consumer durables.

In addition, Abans' sales in the IT products segment should benefit in the medium term from the introduction of new mobile brands that are affordable, and the rapid penetration of smart phones in the country. Abans' 1QFY20 revenue growth of 1% yoy was dragged down by the Easter Sunday terrorist attacks.

Leverage to Spike in FY20: We expect Abans' net adjusted leverage to weaken to around 5.3x by FYE20, from 4.5x based on a trailing 12-months EBITDAR to end-1QFY20. This is because we expect the company to support its non-core operations and lower dividends from associates. Trailing 12-month leverage includes a LKR500 million dividend from an associate that we do not expect to recur from FY20. However, we expect leverage to fall below 5.0x from FY21 from improved operating performance, better working capital management and moderating capex.

Weaker Parent: Abans is fully owned by ARH, which is a 100% owned subsidiary of the founding family's investment holding company Abans International (Pvt) Limited. ARH has auto retail, printing and environmental service businesses, apart from Abans. Based on Fitch's Parent and Subsidiary Rating Linkage criteria, we assess Abans to be the stronger entity as it has much larger scale, and an entrenched market position.

Potential Pressure from CCC: Abans expects to complete its USD184 million real-estate joint venture, Colombo City Center (CCC), by mid-2020. Political instability and security risks in the country resulted in construction being halted for a few months in 2019 and weak pre-sales of apartments at the project. As a result, the JV raised additional debt to meet cost over-runs and temporary funding shortages. Abans also injected LKR350 million, which is in line with its original capital commitment. Abans has indicated that it will not infuse further capital into this project, and further requirements will be funded by entities outside of ARH.

The project needs LKR2.5 billion to complete the apartments by end-2019, compared to the LKR2.2 billion already raised. The shortfall will be met through part of the LKR2 billion outstanding receivables from pre-sold apartments which can be collected as the construction of the apartments approach completion. The balance receivables can be used to fund the majority of the hotel's construction costs, with new apartment sales funding the remainder. The project will need to complete the sale of all of its remaining apartments by FY21 if it is to meet debt repayments, which will start from early FY22. Coverage of interest payments on project debt, which is mainly met through rent from the mall, should improve from 0.7x in FY20 to 1.0x in FY22 as we expect the occupancy of the mall to increase over that period.

Equity into Abans Finance: We conservatively expect Abans to inject around LKR550 million in new capital to Abans Finance (AF) in the next two years to meet its minimum regulatory capital, if the management fails to bring in capital through other means, such as a merger or stake sale. AF says it is in advanced discussions with interested parties for a potential merger, but Fitch has no certainty when a transaction will be completed. AF's Tier 1 capital was LKR1.5 billion at FYE19, but it will be required to maintain minimum Tier 1 capital of LKR2.0 billion and LKR2.5 billion from the start of 2020 and 2021, respectively.

Derivation Summary

Abans is the second-largest consumer durables retailer in Sri Lanka by revenue. It has a strong portfolio of well-known brands and an extensive distribution network. Abans is rated one notch below its closest peer and market leader Singer Sri Lanka PLC (A-(lka)/Negative), despite similar financial risk profiles. This is because Singer has a stronger business-risk profile than Abans due to Singer's better-capitalised finance subsidiary, which limits the parent's need to inject fresh equity over the medium term. Abans' real estate project also undermines its business risk profile relative to that of Singer.

Abans is rated one notch below Sunshine Holdings PLC (A- (lka)/Stable) despite having a larger operating scale. This is because Abans has higher net leverage and more volatile cash flows due to the higher discretionary demand for consumer durables than for Sunshine's products. Abans is rated one notch above DSI Samson Group (Private) Limited (BBB(lka)/Stable) to reflect its more robust business profile, while DSI's sales remain under pressure from increasing competition in its core businesses.

Key Assumptions

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

Revenue growth to average 4% in FY20 and recover to a high single-digit percentage from FY21 amid improvement in discretionary income levels.

EBITDAR margins to stabilise around 9.5% in the medium term helped by lower discount sales, revenue mix shift towards higher-margin brands and cost-saving measures.

Capex to average around LKR160 million a year, primarily for store refurbishments

Abans to inject LKR27 5 million and LKR250 million to Abans Finance in FY20 and FY21, respectively to meet the minimum capital requirement

No dividend income from associates

No further capital infusions to CCC project

Dividend pay-out ratio of 25% of net income over the medium term

Working capital cycle to improve to 165 days by FYE22 owing to better inventory management

RATING SENSITIVITIES

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

Sustained improvement in Abans' adjusted net debt/operating EBITDAR excluding Abans Finance to less than 4.5x (FY19: 4.7x). This sensitivity has been tightened to be comparable with peers that own regulated finance companies

Fixed-charge coverage (ratio of EBITDAR to gross interest + rent excluding Abans Finance) improving above 1.5x on a sustained basis (FY19: 1.5x).

Sustained improvement in ARH's credit profile

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

Sustained increase in Abans' adjusted net debt/operating EBITDAR to over 5.5x. This sensitivity has been tightened to be comparable with peers that own regulated finance companies

Fixed-charge coverage (ratio of EBITDAR to gross interest + rent excluding Abans Finance) reducing below 1.3x on a sustained basis

Significant investments in non-core operations or large cash outflows to companies outside of ARH.

Sustained weakening in ARH's credit profile

Liquidity and Debt Structure

Manageable Liquidity Position: Abans had LKR400 million of unrestricted cash and LKR7.7 billion of unutilised but committed credit lines at FYE19 to meet LKR9.3 billion of debt maturing in the next 12 months. However, around LKR6.7 billion of these maturities are short-term working capital lines, which are supported by LKR14 billion of net working capital. Abans maintained a healthy cash conversion cycle in the past, and we expect it to improve in the next 12 months due to better inventory management measures. Thus we expect banks to roll over the working capital debt as they fall due in the normal course of business.

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. Abans Finance, which is 50%-owned by Abans, is a regulated finance company and not a bank, but local regulations for finance companies are similar to those applicable to local banks. Therefore, Fitch has deconsolidated Abans Finance from Abans' consolidated financials.

Abans PLC; National Long Term Rating; Affirmed; BBB+(lka); RO:Sta
----senior unsecured; National Long Term Rating; Affirmed; BBB+(lka)
----senior unsecured; National Short Term Rating; Affirmed; F2(lka)

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Applicable Criteria

Corporate Rating Criteria (pub. 19 Feb 2019)
Corporates Notching and Recovery Ratings Criteria (pub. 14 Oct 2019)
National Scale Ratings Criteria (pub. 18 Jul 2018)
Parent and Subsidiary Rating Linkage (pub. 27 Sep 2019)
Short-Term Ratings Criteria (pub. 02 May 2019)

Additional Disclosures

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