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Fitch Assigns Expected 'BBB+(Ika)(EXP) to Abans' Proposed Debentures

Fitch Ratings-Colombo-06 November 2019:

Fitch Ratings has assigned Sri Lankan retailer Abans PLC's (BBB+(Ika)/Stable) proposed senior unsecured redeemable debenture issue of up to LKR2.0 billion an Expected National Long-Term Rating of 'BBB+(Ika)(EXP)'.

The debentures will be listed on the Colombo Stock Exchange, have a fixed coupon rate with a tenor of five years, and the proceeds will be used to refinance existing debt.

The 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. This is because we expect prior ranking debt to remain below 2.5x EBITDA (FY20 forecast: 1.7x) over the medium term. The final rating of the proposed debentures is subject to the receipt of final documents conforming to information already received.

Key Rating Drivers

Strong Market Position: 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, and also its high leverage.

Margins to Strengthen: We expect Abans' EBITDAR margin to widen by around 100bp by financial year ending March 2021 (FY21) from 8.4% in FY19 as the company continues to reduce discount sales, align sales commissions with product profitability, and introduces automation and technology. Margins should also benefit from a shift in the product mix towards high-margin brands. The EBITDAR margin widened by 300bp to 8.4% in FY19 and 30bp yoy to 9.5% in 1Q20, despite weak revenue growth.

Demand to Recover: We expect revenue to grow in the 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, affordable mobile brands, and the rapid penetration of smart phones in Sri Lanka. Abans' 1QFY20 revenue growth of 1% yoy was dragged down by the Easter Sunday terrorist attacks.

Leverage to Spike in FY20: We expect 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 Real Estate: Abans expects to complete its USD184 million real-estate JV, Colombo City Center (CCC), by mid-2020. Political instability and security risks resulted in construction being halted for a few months in 2019 and weak presales 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. The company has indicated that it will not inject further capital, and additional requirements will be funded by entities outside of ARH.

The project needs LKR2.5 billion to complete the apartments by end-2019, compared with 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 of receivables can be used to fund the majority of the hotel's construction costs, with new apartment sales funding the remainder.

However, 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 into Abans Finance (AF) in the next two years to meet its minimum regulatory capital, if 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 number two player in terms of revenue in consumer durables retail in Sri Lanka, with a strong portfolio of well-known brands and an extensive distribution network. The company 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 due to its better-capitalised finance subsidiary, which limits the parent's need to inject fresh equity over the medium term. Abans' business profile has also weakened relative to Singer due to investments in a large real-estate project.

Despite the larger operating scale, we rate Abans one notch below Sunshine Holdings PLC (A-(lka)/Stable) due to its higher net leverage and more volatile cash flows because of 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 both in the local footwear and tyre markets.

Fitch's Parent and Subsidiary Rating Linkage methodology was used to derive Abans' rating. The ratings of ARH and its stronger subsidiary, Abans, are aligned due to strong linkage between the two entities. No Country Ceiling or operating environment aspects affect the ratings.

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 stabilize at around 9.5% in the medium term helped by lower discount sales, a 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 LKR275 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 injections into the 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 (FY19: 187days) 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) declining to 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 has 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.

Date of Relevant Committee

31 October 2019

Abans PLC

---senior unsecured; National Long Term Rating; Expected Rating; BBB+(EXP)(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 \(pub. 02 May 2019\)](#)

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