FitchRatings

Fitch Affirms Hayleys at 'AAA(lka)'; Outlook Stable

Fitch Ratings - Colombo/Singapore - 15 Aug 2024: Fitch Ratings has affirmed Sri Lankan conglomerate Hayleys PLC's National Long-Term Rating of 'AAA(lka)'. The Outlook is Stable. Fitch has also affirmed the company's outstanding LKR3 billion senior unsecured debentures.

Hayleys' rating reflects its large operating scale and diversification across several prominent businesses. Its significant export earnings drive sustainable operating cash flow, despite temporary challenges in some segments. We forecast the company's financial profile to remain commensurate with its rating over the next two years.

KEY RATING DRIVERS

Revenue to Rise: We expect revenue to rise by about 7% in the financial year ending March 2025 (FY25), following a 10% decline in the prior financial year. This will be supported by the defensive segments, such as hand protection, agriculture and purification, which account for 28% of revenue. Up to 70% of purification segment revenue is from water purification and gold mining, with demand for both increasing due to the scarcity of drinking water and for gold as a safe haven.

Furthermore, a recovering domestic economy is reviving construction, tourism and retail demand, which bodes well for the construction material, leisure and consumer and retail segments, which comprise 22% of revenue. Cost reflective energy pricing will continue to drive demand for renewable energy sources, supporting the projects and engineering segment, at 5% of revenue.

Geographic and Business Diversification: 80% of group EBIT is generated via eight verticals. Direct and indirect exports account for 54% of revenue, with only 30% coming from Europe and the US, indicating low exposure to slower-growth developed markets. Hayleys' manufacturing locations are also diversified beyond Sri Lanka. Only 55% of its purification segment capacity is in Sri Lanka, with the rest in Thailand and Indonesia. The hand protection segment, which produces rubber gloves, also operates in Thailand, the world's largest source of natural rubber.

Strong Market Presence: Hayleys is a leader in Sri Lanka's logistics, consumer-durable retail and tea export industries. It also has a large share of the fragmented global hand protection and coconut shell-based activated carbon purification markets. It has strong relationships with customers, but with significant customer concentration in some businesses, although the risk is mitigated by high switching costs and its established relationships. Hayleys' competitive position is strengthened by its vertical integration and strong relationships with suppliers.

High Costs Weigh on Margin: We expect higher charcoal prices in the purification segment, which contributes 14% of EBIT, due to climate change affecting the coconut supply chain, only part of which may be passed on to customers. The plantation sector margin will also be squeezed by a proposed daily wage hike. High domestic energy costs will also squeeze Hayleys' margin amid the implementation of cost-reflective tariffs. However, the negative factors may be mitigated by a more stable domestic currency and rising adoption of renewable energy at most manufacturing locations.

Modest Leverage; Improving Coverage: We expect EBITDAR net leverage to reach 3.6x in FY25, driven by high capital expenditure. We forecast capex of close to LKR28 billion during the financial year, with the majority allocated to the logistics and projects divisions. Annual capex should normalise to around LKR20 billion thereafter, as capacity expansion and new projects moderate. We factor in M&A outflow of LKR3 billion for FY25, after the hand-protection subsidiary, Dipped Products PLC, expressed its intention to acquire a Thailand-based rubber glove manufacturer.

Hayleys' cost of financing should fall further amid a moderating interest rate environment, with EBITDAR fixed-charge cover improving to around 2.3x over the next few years as a result, from 1.9x in FY24, assuming stable debt levels due to planned capital expenditure.

DERIVATION SUMMARY

Compared with Hayleys, domestic conglomerate Melstacorp PLC (AAA(lka)/Stable) has more defensive cash flow, supported by its market leadership in the protected spirits market. Meanwhile, Hayleys is exposed to cyclical end-markets in some of its segments with volatile demand, but benefits from greater product and geographic diversification, which boosts its operating scale in terms of EBITDA, while Melstacorp's operation is largely concentrated in Sri Lanka. Overall, we believe Melstacorp has a stronger business profile, leading to strong positive free cash flow generation. Comparatively, Hayleys' free cash flow is mostly negative, reflecting tighter margins from stiff competition and high capex. Consequently Hayleys' rating sensitivities are tighter than those of Melstacorp for the 'AAA(lka)' rating.

We rate domestic conglomerate Hemas Holdings PLC (AAA(lka)/Stable) at the same level as Hayleys on account of it better financial risk profile, with minimal debt and strong liquidity. This offsets Hemas's smaller scale and geographic concentration. Hemas takes a conservative approach to expansion to ensure its balance sheet is not unduly stretched, and almost 90% of its EBITDA is generated from the defensive healthcare and consumer market, although it faces regulatory risk in the healthcare sector. Hayleys' stronger business risk profile offsets Hemas's better financial risk profile, warranting both companies being rated at the same level.

Domestic conglomerate Sunshine Holdings PLC (AA+(lka)/Stable) is rated one notch below Hayleys to reflect its smaller operating scale, limited geographic diversification and the regulatory risk at some of its businesses, despite a better financial profile with lower leverage. Sunshine is more conservative with its expansion strategies, with a focus on expanding only its core businesses and without pressuring its balance sheet. In contrast, Hayleys has been expanding into cyclical end-markets to improve diversification, with the mostly debt-funded strategy weighing on its balance sheet.

Hayleys has a larger scale and more diversified cash flow sources than Ceat Kelani Holdings Pvt Limited (CKH, AA+(lka)/Stable), warranting its one-notch higher rating. CKH faces competitive pressure from imports, is exposed to cyclical demand for vehicle tyres and has a small addressable market. CKH's business risk is mitigated by its exceptionally low leverage of below 1.0x.

Our rating assessment of Hayleys results in a higher rating than that for large domestic banks, non-bank financial institutions and insurance companies, which are more exposed to sovereign stress due to holdings of large sovereign-issued securities for regulatory reasons. The large financial institutions also have a broader exposure to the various economic sectors.

KEY ASSUMPTIONS

-- Revenue to rise by 7.0% in FY25 and 8.5% in FY26, supported by the domestic economic recovery and a late-FY25 recovery in export markets.

-- EBITDAR margin of around 11.0% in FY25 (FY24: 12.0%), before stabilising at around 12.5% thereafter.

-- Net working capital cycle to improve to 115 days in FY25 and stabilise at 110 days afterwards (FY24: 120 days) on better receivable and inventory days.

-- FY25 capex of LKR28 billion due to investments, stabilising at around 4% of revenue from FY26.

-- M&A investments of LKR3 billion in FY25 for the acquisition of a rubber glove manufacturing facility in Thailand. We assume around LKR2 billion of annual M&A thereafter on opportunities that align with the group's strategy, although the company has not provided specific guidance.

-- Annual dividend payment of LKR3.9 billion in FY25 as already announced and 50% of net income paid thereafter, which is at management's discretion.

RATING SENSITIVITIES

Developments that may, individually or collectively, lead to positive rating action:

- There is no scope for an upgrade, as the company is already at the highest rating level.

Developments that may, individually or collectively, lead to negative rating action:

- Group EBITDAR net leverage increasing above 4.0x for a sustained period.

- Group EBITDAR fixed-charge coverage falling below 2.0x for a sustained period.

LIQUIDITY AND DEBT STRUCTURE

Manageable Liquidity, Strong Credit Access: Hayleys had LKR45 billion of unrestricted cash as at FYE24, against LKR90 billion of debt maturing within the next 12 months. A majority of its near-term maturities consist of short-term working capital lines, which we expect domestic banks to roll over, as they are backed by KR125 billion of net working capital assets, while the cash conversion cycle should moderate to around 110 days.

Hayleys had unused, but uncommitted, credit lines of LKR56 billion as at FYE24, which also support liquidity in the normal course of business. We believe Hayleys will retain strong access to banks, given its diversified sources of cash flow and large scale compared with most other rated corporates with predominantly Sri Lankan exposure. Some of the facilities may be scaled down with the implementation of revised single-borrower limits on domestic banks from 1 January 2026, but the issuer is already pursuing alternative funding sources via its overseas subsidiaries, which may lower effective borrowing costs compared with Sri Lankan rupee-denominated facilities.

ISSUER PROFILE

Hayleys is a large listed domestic conglomerate with leading market positions in transportation, consumer and retail, textiles, rubber gloves and plantations, among others.

SUMMARY OF FINANCIAL ADJUSTMENTS

- We use EBITDAR-based leverage and coverage ratios to assess Hayleys' financial profile, due to the presence of large lease obligations, mainly through the retail showroom network of its domestic consumer and retail subsidiary, Singer (Sri Lanka) PLC (A(lka)/Stable).

-In assessing Hayleys' financial profile, we remove debt associated with the regulated finance subsidiary, Singer Finance (Lanka) PLC (BBB(lka)/Stable), from Hayleys' balance sheet, as corporate cash flow is not used to service finance company debt. However, to factor in Singer Finance's credit risk on Hayley's credit profile, we add debt of LKR12 billion onto Hayleys' balance sheet, which is deemed to fund a hypothetical equity injection to support a capital structure commensurate with the subsidiary's risk profile. This adjustment adds about 0.25x to Hayleys' EBITDAR net leverage.

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.

MACROECONOMIC ASSUMPTIONS AND SECTOR FORECASTS

Click here to access Fitch's latest quarterly Global Corporates Macro and Sector Forecasts data file which aggregates key data points used in our credit analysis. Fitch's macroeconomic forecasts, commodity price assumptions, default rate forecasts, sector key performance indicators and sector-level forecasts are among the data items included.

RATING ACTIONS

ENTITY / DEBT	RATING			PRIOR
Hayleys PLC	Natl LT	AAA(lka)	Affirmed	AAA(lka)
senior unsecured	Natl LT	AAA(lka)	Affirmed	AAA(lka)

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VIEW ADDITIONAL RATING DETAILS

Additional information is available on www.fitchratings.com

PARTICIPATION STATUS

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)
- Corporate Rating Criteria (pub. 04 Nov 2023) (including rating assumption sensitivity)
- Sector Navigators – Addendum to the Corporate Rating Criteria (pub. 22 Jun 2024)
- Corporate Recovery Ratings and Instrument Ratings Criteria (pub. 03 Aug 2024) (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

Hayleys PLC -

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