



Fitch Assigns Bogawantalawa Tea Estates First-Time 'A(lka)' National Rating; Outlook Stable

Fitch Ratings - Colombo/Singapore - 23 Sep 2024: Fitch Ratings has assigned Sri Lanka-based Bogawantalawa Tea Estates PLC a first-time National Long-Term Rating of 'A(lka)' with a Stable Outlook. Fitch has also assigned Bogawantalawa's outstanding senior unsecured debentures a National Long-Term Rating of 'A(lka)'.

Bogawantalawa's ratings are driven by the long-term structural decline at Sri Lankan tea plantations amid regulatory overhang on costs, which is driving weak profitability and weighing on the industry's appetite for replanting. These risks are counterbalanced by Bogawantalawa's healthy financial profile that should act as a buffer against medium-term challenges.

KEY RATING DRIVERS

Volatile Demand and Prices: Global tea prices are sensitive to supply and demand, with bulk-tea sellers unable to pass on production cost increases. Most domestic tea producers are price takers, with the majority of revenue coming from bulk sales. About 45% of tea is exported in bulk, without value addition. This also raises the risk of substitution. High grown tea auction prices have fluctuated in the last four years, although Sri Lanka tea attracts better prices due to its quality. Exports are mainly to politically and economically volatile regions, like the Middle East, Russia and China.

Volatile Margin: We forecast the EBITDA margin to widen to 11% in FY25, before declining to 5% by FY28, amid structural weaknesses, including an assumption of LKR1,350/day wages from September 2024, a 35% hike. The margin will be further affected by depressed yields, with produced tea by the company falling for four consecutive years, in line with industry, due to labour and fertiliser shortages and ageing plants. The company says replanting costs are also increasing. Sri Lanka already has the lowest productivity and the highest cost among major tea producing countries.

Strong Balance Sheet: We expect Bogawantalawa to retain a net cash position, as the company, similar to most industry peers, does not expect major spending on replanting, given the industry challenges. We expect a limited drag on leverage from a narrower EBITDA margin, counterbalanced by moderating capex.

The company does not have significant borrowings, apart from outstanding debentures of LKR698 million as at end-June 2024 that mature in tranches over the next three years. The maturity in the financial year ending March 2025 (FY25) has already been settled. A sinking fund is in place to meet debenture obligations. EBITDA interest coverage is solid and we forecast it to remain above 5x over the next two years in light of the falling debt.

Weak Linkage with Stronger Parent: We believe Bogawantalawa's stronger 57% ultimate parent, Metrocorp (Private) Limited, has low incentives to provide support to its subsidiary. Legal incentives are 'Weak' due to the absence of corporate guarantees and cross-default clauses. Metrocorp accounted for 39% of Bogawantalawa's debt as of end-

June 2024 due to its investment in the subsidiary's listed debentures, but this will reduce in the next two years as the subsidiary settles its debentures.

We also assess strategic incentives as 'Weak', due to Bogawantalawa's limited contribution to the parent's EBITDA, which stood at 6% in FY23. Meanwhile, 'Weak' operational incentives stem from the low avoidance cost should Bogawantalawa's operations cease, as Metrocorp procures the tea for its tea marketing operations from the general tea auction, rather than from Bogawantalawa, as all tea sales are executed via the Colombo Tea Auction. There is also limited management overlap between the two entities.

DERIVATION SUMMARY

Sierra Cables PLC (A+(lka)/Stable), Sri Lanka's third-largest cable manufacturer, with a 20% market share, is rated one notch above Bogawantalawa. Demand for Sierra products depends on the domestic infrastructure and construction industry, with low but increasing exposure to exports. EBITDA exceeds that of Bogawantalawa and Sierra has a more stable and wider EBITDA margin. We also expect Sierra to generate more stable free cash flow (FCF) margin, while Bogawantalawa's margin is set to narrow on structural industry weakness. Bogawantalawa is a price taker, supplying a commodity with low switching costs that is exposed to climate factors and regulatory wages. Bogawantalawa has better interest coverage and leverage, but Sierras' strong business profile more than off-sets Bogawantalawa's better financial profile.

WindForce PLC (BBB+(lka)/Stable) is rated two notches below Bogawantalawa, due to its speculative strategy and higher execution risk. This stems from its high counterparty risk exposure to Ceylon Electricity Board (BB+(lka)/Stable), the state-owned utility provider. Furthermore, its cash flow is negative on continuous capacity additions, which also weakens its interest coverage and leverage. We believe Bogawantalawa's better business and financial profiles warrants the two-notch higher rating.

Kotagala Plantations PLC (B+(lka)/Negative) has a weak liquidity profile with no committed or uncommitted funding lines. This makes a liquidity crisis unavoidable without new banking facilities or renegotiated loan repayments. Kotagala derives 80% of its revenue from tea, 14% from rubber and the remainder from palm oil.

Bogawantalawa's credit strengths lead to a higher rating than that of some 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 various economic sectors.

KEY ASSUMPTIONS

-Revenue to rise by 6% during FY25, before declining in FY26 and FY27 on a decline in the cultivated area and normalising yields.

-EBITDA margin to reach 11% in FY25, before normalising to mid-single-digit levels on inflation-driven cost increases.

-Capex of above LKR200 million in FY25, as the company continues to invest in ancillary crops before normalizing to about LKR150 million to maintain plantations.

-Net working capital cycle of around 35 days, in line with FY24.

RATING SENSITIVITIES

Factors that Could, Individually or Collectively, Lead to Negative Rating Action/Downgrade

-There is no scope for an upgrade, given exposure to the structurally weakening tea industry. We also do not expect crop diversification to reach commercial scale in the medium term.

Factors that Could, Individually or Collectively, Lead to Positive Rating Action/Upgrade

-Sustained negative FCF, leading to a weakening of the liquidity position or banking access

-EBITDA interest coverage falling below 2x for a sustained period

LIQUIDITY AND DEBT STRUCTURE

Sufficient Liquidity: Bogawantalawa had LKR1.3 billion in unrestricted cash as at end-June 2024, which it can use to meet around LKR400 million of debt maturing within the next 12 months. The majority of near-term maturities consist of short-term working capital lines and a LKR241 million tranche of its outstanding LKR700 million listed debentures. The LKR241 million debenture maturing in FY25 was settled in July 2024. We expect the banks to rollover the working capital lines, which are backed by around LKR803 million of net working capital assets with a healthy cash conversion cycle of around 35 days.

Bogawantalawa had unused but uncommitted credit lines of LKR200 million as at end-June 2024, which also supports liquidity in the normal course of business. We expect Bogawantalawa to maintain access to its banking network, given its long operating history and being a prominent tea producer that generates export income for Sri Lanka. The Central Bank of Sri Lanka has reiterated the government's focus on the agriculture sector in its June2022 directive, which recognised agriculture, including tea plantations, as a priority sector for sustainable financing by licensed commercial banks.

ISSUER PROFILE

Bogawantalawa is listed on the Colombo Stock Exchange and is predominantly an high elevation-based tea producer. Metrocorp, the controlling shareholder, holds an effective stake of 57% via Metropolitan Resource Holdings PLC. Metrocorp is a diversified investment holding company with interests in office automation, renewable energy, plantations, water management and investment banking.

DATE OF RELEVANT COMMITTEE

13 September 2024

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.

ESG CONSIDERATIONS

Fitch does not provide ESG relevance scores for Bogawantalawa Tea Estates PLC.

In cases where Fitch does not provide ESG relevance scores in connection with the credit rating of a transaction, programme, instrument or issuer, Fitch will disclose any ESG factor that is a key rating driver in the key rating drivers section of the relevant rating action commentary. For more information on Fitch's ESG Relevance Scores, visit <https://www.fitchratings.com/topics/esg/products>

RATING ACTIONS

ENTITY / DEBT ↕	RATING ↕
<input type="text"/>	<input type="text"/>
Bogawantalawa Tea Estates PLC	Natl LT A(Ika) ● New Rating
senior unsecured	Natl LT A(Ika) New Rating

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[VIEW ADDITIONAL RATING DETAILS](#)

Additional information is available on www.fitchratings.com

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APPLICABLE CRITERIA

- [National Scale Rating Criteria \(pub. 22 Dec 2020\)](#)
- [Parent and Subsidiary Linkage Rating Criteria \(pub. 17 Jun 2023\)](#)
- [Corporate Rating Criteria \(pub. 04 Nov 2023\) \(including rating assumption sensitivity\)](#)

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

Bogawantalawa Tea Estates PLC -

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