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FitchRatings

RATING ACTION COMMENTARY

Fitch Publishes 'AAA(lka)' Rating for Hayleys' Proposed Debentures

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Fitch Ratings - Colombo/Singapore - 21 Mar 2025: Fitch Ratings has published the National Long-Term Rating of 'AAA(lka)' for Sri Lankan conglomerate Hayleys PLC's (AAA(lka)/Stable) proposed senior unsecured redeemable debentures of up to LKR7 billion.

The proposed debentures are rated in line with Hayley's National Long-Term Rating and existing unsecured notes because we believe there will be limited subordination risk to debenture holders from secured debt at the holding company and debt at subsidiaries, which will rank ahead of the debentures. The proceeds from the debentures will be used to repay the company's existing short-term debt.

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 10% in the financial year ending March 2025 (FY25), following a 12% decline in the previous financial year. This will be supported by the transportation and logistics and consumer and retail segments, which account for 38% of revenue.

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 the company's revenue. Cost-reflective energy pricing will continue to drive demand for renewable energy sources, supporting the projects and engineering segment, which contributes 5% of revenue.

Modest Leverage; Improving Coverage: We expect EBITDAR net leverage to increase to 3.5x in FY25 (FY24: 3.3x), driven by capex and a higher dividend payout. We forecast capex of around LKR22 billion during FY25-FY28, with the majority allocated to the logistics and projects divisions. However, we expect EBITDAR net leverage to decrease from FY26-FY28, supported by improving cash flows. Hayleys' financing costs should decline amid falling interest rates, leading to an improvement in EBITDAR fixed charge coverage to approximately 3.0x over the next few years, up from around 2.0x in FY24.

Geographic and Business Diversification: Eight businesses generate 80% of group EBIT. Direct and indirect exports account for 54% of revenue, with only 30% 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 prominent 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, to weigh on margins. Costs will rise due to climate change's effect on the coconut supply chain, only part of which may be passed on to customers.

The plantation sector's margin will also be squeezed by a proposed daily wage hike. High domestic energy costs will also pressure 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.

DERIVATION SUMMARY

Domestic conglomerate Melstacorp PLC (AAA(lka)/Stable) has more defensive cash flow than Hayleys, 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 operations are largely concentrated in Sri Lanka.

We believe Melstacorp has a stronger business profile, leading to strong positive free cash flow generation. 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.

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, which are counterbalanced by its stronger financial profile with lower leverage. Sunshine is more conservative with its expansion strategy than Hayleys, with a focus on expanding only its core businesses without pressuring its balance sheet. In contrast, Hayleys has been opportunistically expanding into cyclical end-markets to improve diversification, with the mostly debt-funded strategy weighing on its balance sheet.

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 various economic sectors.

KEY ASSUMPTIONS

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

- Revenue to rise by 10.0% in FY25 and 8.0% in FY26, supported by the stronger domestic economy and recovery in export markets.

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

- Net working-capital cycle to remain stable at 120 days in FY25 and improve to 115 days afterwards on better inventory days.

- Annual capex of around LKR22 billion, or 4% of revenue, from FY25-FY28.

RATING SENSITIVITIES

Factors that could, individually or collectively, lead to negative rating action/downgrade:

- Group EBITDAR net leverage increasing above 4.0x on a sustained basis.

- Group EBITDAR fixed-charge coverage falling below 2.0x on a sustained basis.

Factors that could, individually or collectively, lead to positive rating action/upgrade:

- There is no scope for an upgrade, as the company is already at the highest rating on the Sri Lankan National Rating scale.

LIQUIDITY AND DEBT STRUCTURE

Hayleys had LKR51 billion of unrestricted cash as of end-December 2024, against LKR133 billion of debt maturing within the next 12 months. Most of the near-term maturities, around LKR103 billion, consist of short-term working-capital lines, which we expect domestic banks to roll over, as they are backed by around LKR148 billion in net working-capital assets, while the cash conversion cycle is healthy and should moderate to around 115 days.

Hayleys had unused, but uncommitted, credit lines of around LKR56 billion 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.

ISSUER PROFILE

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

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 (AA-(lka)/Stable).

- In assessing Hayleys' financial profile, we remove debt associated with its step-down regulated finance subsidiary Singer Finance (Lanka) PLC (BBB+(lka)/Stable) from its interim subsidiary Singer (Sri Lanka)'s balance sheet, and therefore from Hayleys. This is because corporate cash flow is not used to service finance company debt. However, to factor in potential support from Singer (Sri Lanka) to Singer Finance, we add back debt of LKR29.6 billion onto Singer (Sri Lanka) and Hayleys' balance sheet, which is deemed to fund a hypothetical equity injection to support a capital structure commensurate with the finance subsidiary's risk profile. This adjustment adds about 0.3x to Hayleys' EBITDAR net leverage.

DATE OF RELEVANT COMMITTEE

21 January 2025

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		
Hayleys PLC			
senior unsecured	Natl LT	AAA(lka)	Publish

VIEW ADDITIONAL RATING DETAILS

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APPLICABLE CRITERIA

National Scale Rating Criteria (pub. 22 Dec 2020)

Corporate Rating Criteria (pub. 07 Dec 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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