



**CARSONS MANAGEMENT SERVICES (PRIVATE) LIMITED**  
*No. of Company PV 315*

**BY FAX/ BY HAND**

1<sup>st</sup> August 2017

Mr. Renuke Wijayawardhane  
Chief Operating Officer  
Colombo Stock Exchange  
# 4-01, West Block, World Trade Centre  
Echelon Square, Colombo 1

Our Ref.: LION/CSE/ANN/2017/NS/06

Dear Sir,  
**ANNOUNCEMENT**

**LION BREWERY (CEYLON) PLC**  
**FITCH RATINGS - REVISED RATING ON LISTED DEBENTURES OF LION BREWERY (CEYLON) PLC**

In terms of Rule 7.12 (b) of the Listing Rules of the Colombo Stock Exchange, the Company wishes to inform that its rating including that of the outstanding senior unsecured debentures has been revised to A+(lka) with a negative outlook from its previous AA-(lka) with a stable outlook.

The rating review of Fitch Ratings is attached herewith for further information.

Yours faithfully,  
For and on behalf of  
**LION BREWERY (CEYLON) PLC**  
Carsons Management Services (Private) Limited

Director  
Secretaries  
SKS/RG/KS/ns

Encl. a/s

Lion Brewery (Ceylon) PLC (/gws/en/esp/issr/90654489)



## Fitch Downgrades Lion Brewery to 'A+(lka)'; Outlook Negative

Fitch Ratings-Colombo-31 July 2017: Fitch Ratings has downgraded Sri Lanka's Lion Brewery (Ceylon) PLC's National Long-Term Rating to 'A+(lka)' from 'AA-(lka)'. The Outlook is Negative. The agency has also downgraded the National Long-Term Rating on Lion's outstanding senior unsecured debentures to 'A+(lka)' from 'AA-(lka)'.

The downgrade reflects Fitch's expectations that Lion's net leverage, defined as lease-adjusted debt net of cash/operating EBITDAR, is unlikely to fall below 2.0x over the next three years due to lower beer sales from the higher taxes imposed over the last 18 months. We do not expect Lion's EBITDA to recover to historical levels over the same period. The Negative Outlook reflects the potential for further downgrades should Lion's sales volume not recover enough in the next 18 months to reduce leverage to less than 3.0x.

Lion's net leverage worsened to 6.3x during the financial year ended-March 2017 (FY17), from 1.9x at end-FY16, as the beer volume dropped by more than 50% due to successive tax increases and a six-month halt in domestic production due to floods in 2016.

### KEY RATING DRIVERS

**Shift in Market Dynamics:** Beer industry volumes saw large contraction between 2014 to 2016, while hard-liquor volume increased by almost 27%, as excise duties per unit of alcohol of strong beer surpassed that of hard liquor due to tax increases in 2015. In addition, the reinstatement of VAT on alcohol products and the introduction of taxes on beer cans with effect from November 2016 prompted consumers to substitute strong beer, which has an alcohol content of more than 8%, with the consumption of hard liquor. Strong beer accounted for more than 75% of Lion's sales volume in FY17.

**Lower EBITDA Margins:** Fitch expects Lion's EBITDAR margins to recover to around 24% in FY18, from 20% in FY17, after they were diluted due to a decline in the demand for beer caused by multiple tax increases and floods interrupting production in mid-2016, which led to Lion resorting to costlier imports. Fitch expects production to normalise and sales volume to improve as the company regains most of the retail shelf-space it lost last year. However, margins may remain below historical levels over the medium term because the excise duties on a unit of pure alcohol in beer surpassed that of hard liquor after the back-to-back tax increases, which could pressure beer volumes. We do not expect Lion to further increase beer prices as it may impede volume growth.

**Market Leadership:** Lion has a leading market position in the domestic beer industry. Its market share is supported by its entrenched brand and widespread retail coverage, with access to more than 2,250 outlets around Sri Lanka. Lion's market share is protected to some extent by extensive industry entry barriers stemming from stringent restrictions on advertising and retail licenses. Lion also benefits from ample production capacity, which exceeds 1.5 million hectolitres per annum, and is sufficient to meet demand over the medium term.

**Volatile Regulatory Framework:** Frequent tax hikes and introductions inhibit the industry's profitability. The government has consistently used excise taxes as a tool to boost revenue to bridge budget deficits; consequently, from October 2015 to November 2016 the industry - especially beer makers - was taxed from multiple fronts through higher excise duties, the introduction of beer-can taxes and reinstatement of VAT, dampening the competitiveness of beer. Fitch does not expect further drastic tax increases that could weaken demand, especially given the sector's large contribution to government's tax revenue.

### DERIVATION SUMMARY

Lion's rating is supported by its leading market position in the domestic beer industry, but counterbalanced by high regulatory risks in the form of frequent tax policy revisions that have caused operating cash flow volatility. Lion's business risk profile is weaker compared with its closest rating peer, Hemas Holdings PLC (AA-(lka)/Stable). Hemas is a well-diversified conglomerate with exposure to the defensive healthcare and fast-moving consumer goods sectors. Hemas also has a conservative approach to acquisitions and expansions and has lower leverage than Lion, supporting its higher rating.

Lion is placed four notches below the Distilleries Company of Sri Lanka PLC (DIST, AAA(lka)/Rating Watch Negative) - the country's largest spirit manufacturer - reflecting DIST's stronger market position as well as its stronger margins and lower leverage than Lion. The Rating Watch Negative reflects potentially higher financial risks following a September 2016 group restructure.



Sunshine Holdings PLC (A(lka)/Stable) and Richard Pieris & Company PLC (A(lka)/Stable) are rated one notch below Lion, reflecting their significant exposure to the structurally declining agriculture segment and lower EBITDA margins. Sunshine also faces regulatory risks in its pharmaceutical distribution division, which act as a short-term rating constraint.

#### KEY ASSUMPTIONS

Fitch's key assumptions within the rating case for Lion include:

- revenue to recover with a 1.5-fold increase over FY18 and FY19
- EBITDAR margins to normalise at 24% over the next two years, but remain lower than historical levels of the high twenties due to heavy taxation on beer inhibiting volume and profitability
- excise duty on strong and mild beer to remain unchanged during FY18 and increase by over 5% on average during in FY19 and FY20
- capex at 12% of net revenue in FY18 then remain low at 2.5% on average over FY19 and FY20, as Lion's production is only likely to ramp-up to FY16 levels of around 96 million litres in FY21
- no dividends during FY18, then reverting to historical levels

#### RATING SENSITIVITIES

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

- If Lion is unable to lower its adjusted net debt/operating EBITDAR to 3.0x by FY19

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

- We may revise the Outlook to Stable if there is a meaningful improvement in sales volume that leads to adjusted net debt/operating EBITDAR falling below 3.0x on a sustained basis

#### LIQUIDITY

Adequate Liquidity: Lion has a comfortable liquidity position, with an unrestricted cash balance of LKR7.6 billion as of FYE17 and unutilised credit lines of LKR5.1 billion to meet LKR4.5 billion of contractual maturities falling due in the next 12 months. Lion's strong market position in the domestic beer industry and consistent access to bank funding because it is one of Sri Lanka's largest listed corporates further support liquidity.

Of total gross debt of LKR18.9 billion as at end-March 2017, 41% relates to revolving loans - including the overdraft facility- and term loan facilities account for 34%. Lion had LKR3.9 billion of debentures in issue as at FYE17 (21% of total gross debt), with maturities ranging between FY19 and FY20. Debentures with a face value of LKR799.4 million were redeemed during FY17.

Contact:

Primary Analyst

Rishikesh Sivakumar

Analyst

Fitch Ratings Lanka Ltd.

15-04 East Tower, World Trade Centre

Colombo 01, Sri Lanka

+ 94 11 254 1900

Secondary Analyst

Dilranie Mudannayake

Analyst

+ 94 11 254 1900

Committee Chairperson

Hasira De Silva, CFA

Director

+65 6796 7240

Summary of Financial Statement Adjustments:

As of end-FY17, trade receivables amounting to LKR886 million were sold by Lion to a financial institution without recourse to the company. In line with Fitch's methodology, we have made the following adjustments to reflect the factoring arrangement:

- trade receivables and short-term debt increased by LKR886 million on the balance sheet
- change in working capital has been decreased (increased) by the year-on-year increase (decrease) in outstanding factoring,



while proceeds from short-term financing have been increased (decreased) by the same amount in the cash-flow statement

EBITDAR for FY17 is adjusted to add back brand impairment charges of LKR1.7 billion as reported in financials.

Media Relations: Bindu Menon, Mumbai, Tel: +91 22 4000 1727, Email: bindu.menon@fitchratings.com.

Note to editors: Fitch's National ratings provide a relative measure of creditworthiness for rated entities in countries with relatively low international sovereign ratings and where there is demand for such ratings. The best risk within a country is rated 'AAA' and other credits are rated only relative to this risk. National ratings are designed for use mainly by local investors in local markets and are signified by the addition of an identifier for the country concerned, such as 'AAA(lka)' for National ratings in Sri Lanka. Specific letter grades are not therefore internationally comparable.

Additional information is available on [www.fitchratings.com](http://www.fitchratings.com)

#### Applicable Criteria

Criteria for Rating Non-Financial Corporates (pub. 10 Mar 2017) (<https://www.fitchratings.com/site/re/895493>)

National Scale Ratings Criteria (pub. 07 Mar 2017) (<https://www.fitchratings.com/site/re/895106>)

#### Additional Disclosures

Solicitation Status (<https://www.fitchratings.com/site/pr/1027208#solicitation>)

Endorsement Policy (<https://www.fitchratings.com/regulatory>)

ALL FITCH CREDIT RATINGS ARE SUBJECT TO CERTAIN LIMITATIONS AND DISCLAIMERS. PLEASE READ THESE LIMITATIONS AND DISCLAIMERS BY FOLLOWING THIS LINK:

[HTTPS://WWW.FITCHRATINGS.COM/UNDERSTANDINGCREDITRATINGS](https://www.fitchratings.com/understandingcreditratings)

(<https://www.fitchratings.com/understandingcreditratings>). IN ADDITION, RATING DEFINITIONS AND THE TERMS OF USE OF SUCH RATINGS ARE AVAILABLE ON THE AGENCY'S PUBLIC WEB SITE AT [WWW.FITCHRATINGS.COM](http://WWW.FITCHRATINGS.COM) (<https://www.fitchratings.com>). PUBLISHED RATINGS, CRITERIA, AND METHODOLOGIES ARE AVAILABLE FROM THIS SITE AT ALL TIMES. FITCH'S CODE OF CONDUCT, CONFIDENTIALITY, CONFLICTS OF INTEREST, AFFILIATE FIREWALL, COMPLIANCE, AND OTHER RELEVANT POLICIES AND PROCEDURES ARE ALSO AVAILABLE FROM THE CODE OF CONDUCT SECTION OF THIS SITE. DIRECTORS AND SHAREHOLDERS RELEVANT INTERESTS ARE AVAILABLE AT [HTTPS://WWW.FITCHRATINGS.COM/SITE/REGULATORY](https://www.fitchratings.com/site/regulatory) (<https://www.fitchratings.com/site/regulatory>). FITCH MAY HAVE PROVIDED ANOTHER PERMISSIBLE SERVICE TO THE RATED ENTITY OR ITS RELATED THIRD PARTIES. DETAILS OF THIS SERVICE FOR RATINGS FOR WHICH THE LEAD ANALYST IS BASED IN AN EU-REGISTERED ENTITY CAN BE FOUND ON THE ENTITY SUMMARY PAGE FOR THIS ISSUER ON THE FITCH WEBSITE.

Copyright © 2017 by Fitch Ratings, Inc., Fitch Ratings Ltd. and its subsidiaries. 33 Whitehall Street, NY, NY 10004. Telephone: 1-800-753-4824, (212) 908-0500. Fax: (212) 480-4435. Reproduction or retransmission in whole or in part is prohibited except by permission. All rights reserved. In issuing and maintaining its ratings and in making other reports (including forecast information), Fitch relies on factual information it receives from issuers and underwriters and from other sources Fitch believes to be credible. Fitch conducts a reasonable investigation of the factual information relied upon by it in accordance with its ratings methodology, and obtains reasonable verification of that information from independent sources, to the extent such sources are available for a given security or in a given jurisdiction. The manner of Fitch's factual investigation and the scope of the third-party verification it obtains will vary depending on the nature of the rated security and its issuer, the requirements and practices in the jurisdiction in which the rated security is offered and sold and/or the issuer is located, the availability and nature of relevant public information, access to the management of the issuer and its advisers, the availability of pre-existing third-party verifications such as audit reports, agreed-upon procedures letters, appraisals, actuarial reports, engineering reports, legal opinions and other reports provided by third parties, the availability of independent and competent third-party verification sources with respect to the particular security or in the particular jurisdiction of the issuer, and a variety of other factors. Users of Fitch's ratings and reports should understand that neither an enhanced factual investigation nor any third-party verification can ensure that all of the information Fitch relies on in connection with a rating or a report will be accurate and complete. Ultimately, the issuer and its advisers are responsible for the accuracy of the information they provide to Fitch and to the market in offering documents and other reports. In issuing its ratings and its reports, Fitch must rely on the work of experts, including independent auditors with respect to financial statements and attorneys with respect to legal and tax matters. Further, ratings and forecasts of financial and other information are inherently forward-looking and embody assumptions and predictions about future events that by their nature cannot be verified as facts. As a result, despite any verification of current facts, ratings and forecasts can be affected by future events or conditions that were not anticipated at the time a rating or forecast was issued or affirmed.

The information in this report is provided "as is" without any representation or warranty of any kind, and Fitch does not represent or warrant that the report or any of its contents will meet any of the requirements of a recipient of the report. A Fitch rating is an opinion as to the creditworthiness of a security. This opinion and reports made by Fitch are based on established criteria and



methodologies that Fitch is continuously evaluating and updating. Therefore, ratings and reports are the collective work product of Fitch and no individual, or group of individuals, is solely responsible for a rating or a report. The rating does not address the risk of loss due to risks other than credit risk, unless such risk is specifically mentioned. Fitch is not engaged in the offer or sale of any security. All Fitch reports have shared authorship. Individuals identified in a Fitch report were involved in, but are not solely responsible for, the opinions stated therein. The individuals are named for contact purposes only. A report providing a Fitch rating is neither a prospectus nor a substitute for the information assembled, verified and presented to investors by the issuer and its agents in connection with the sale of the securities. Ratings may be changed or withdrawn at any time for any reason in the sole discretion of Fitch. Fitch does not provide investment advice of any sort. Ratings are not a recommendation to buy, sell, or hold any security. Ratings do not comment on the adequacy of market price, the suitability of any security for a particular investor, or the tax-exempt nature or taxability of payments made in respect to any security. Fitch receives fees from issuers, insurers, guarantors, other obligors, and underwriters for rating securities. Such fees generally vary from US\$1,000 to US\$750,000 (or the applicable currency equivalent) per issue. In certain cases, Fitch will rate all or a number of issues issued by a particular issuer, or insured or guaranteed by a particular insurer or guarantor, for a single annual fee. Such fees are expected to vary from US\$10,000 to US\$1,500,000 (or the applicable currency equivalent). The assignment, publication, or dissemination of a rating by Fitch shall not constitute a consent by Fitch to use its name as an expert in connection with any registration statement filed under the United States securities laws, the Financial Services and Markets Act of 2000 of the United Kingdom, or the securities laws of any particular jurisdiction. Due to the relative efficiency of electronic publishing and distribution, Fitch research may be available to electronic subscribers up to three days earlier than to print subscribers.

For Australia, New Zealand, Taiwan and South Korea only: Fitch Australia Pty Ltd holds an Australian financial services license (AFS license no. 337123) which authorizes it to provide credit ratings to wholesale clients only. Credit ratings information published by Fitch is not intended to be used by persons who are retail clients within the meaning of the Corporations Act 2001

#### **Solicitation Status**

Fitch Ratings was paid to determine each credit rating announced in this Rating Action Commentary (RAC) by the obligator being rated or the issuer, underwriter, depositor, or sponsor of the security or money market instrument being rated, except for the following:

**Endorsement Policy** - Fitch's approach to ratings endorsement so that ratings produced outside the EU may be used by regulated entities within the EU for regulatory purposes, pursuant to the terms of the EU Regulation with respect to credit rating agencies, can be found on the EU Regulatory Disclosures (<https://www.fitchratings.com/regulatory>) page. The endorsement status of all International ratings is provided within the entity summary page for each rated entity and in the transaction detail pages for all structured finance transactions on the Fitch website. These disclosures are updated on a daily basis.