Lanka Rating Agency

Rating Report

Litro Gas Lanka

Report Contents

Rating History				
Dissemination Date	Long Term Rating	Outlook	Action	Rating Watch
09-May-2022	A-	Negative	Maintain	Yes
09-Mar-2022	A-	Stable	Initial	-

Rating Rationale and Key Rating Drivers

The global pandemic has amplified deep-rooted economic issues for most of the developing economies. Sri Lanka has been no exception. The country adopted strategies of reduction in taxes and higher public spending and subsidies in 2019. Challenges began to surface in the backdrop of two pandemic-triggered repercussions: i) shrinking foreign currency reserves, and, ii) the global commodity super-cycle resulting in very high inflation. The country’s foreign currency inflows, besides borrowing from the international market, are majorly dependent on tourism activities and workers' remittances. Tourist arrivals plunged following the pandemic-induced restrictions and only recently started to pick up. Meanwhile, a ~61% YoY decline was recorded in workers’ remittances in Jan’22 from Jan’21, despite an increase in the number of migrant workers. The country’s trade balance deteriorated resulting in a deficit of USD~8bln in CY21, a rise of ~35% from the previous year as growth in imports outpaced exports. This coupled with low inflows, widened the current account deficit and the country’s foreign currency reserves plunged dramatically to just USD~1.9bln at End-March’2022 (CY19: USD~8bln), exerting massive pressure on the local currency. The Lankan Rupee has devalued by ~50% till March’22 from March’21. The country’s CCPI (inflation) was reported at ~14% in Jan’22 and ~19% in Mar’22. The central bank, in response, tightened the monetary policy by increasing policy rate by 700 bps with SDFR and SLFR standing at record levels of 13.5% and 14.5%, respectively.
The rating reflects Litro Gas's established position as the leader in Liquid Petroleum Gas (LPG) market. While the Sponsor’s financial muscle provides comfort to the ratings, the current economic turmoil is adversely impacting the risk matrix of the company on a multiple facets. One of the key risks is the steep depreciation of currency, which has exorbitantly escalated the import cost of LPG, making it difficult to fully pass on the impact to end consumers. On the other hand, Litro's close monitoring controls by the Government keeps its prices in check, further squeezing its profitability margins. This, along with non-availability of USD, have impacted Litro's operations significantly on account of depleting gas stocks due to insufficient funds to import LPG into the country. This has also triggered instability at the management level as the Chairman and CEO, Mr. Theshara Jayasinghe, recently submitted resignation from his office on 15th April - 2022, in the backdrop of the current crisis.

The rating is dependent upon the out-turn of current economic plight in the short-term. Any delay in arrestation of gas crisis would be considered negative for the rating. The rating is also kept on "Watch" to reflect close surveillance of the unfolding of events and their impact on the risk profile of the company.
Operational revival, management stability and sustenance of profits are pertinent to keep the rating intact. Any further deterioration or substantial delay in revival of operations would lead to a downward revision in the rating.

Disclosure	
Name of Rated Entity	Litro Gas Lanka
Type of Relationship	Solicited
Purpose of the Rating	Entity Rating
Applicable Criteria	Methodology | Corporate Rating(Jun-21)
Related Research	Sector Study | Distribution | Gas(Jun-21)
Rating Analysts	Rabiya tul Athaviya Naushard | rabiya@lra.com.lk | +94 114 500099

Profile

Legal Structure Litro Gas Lanka Limited (Litro Gas or 'the Company') is a limited liability company incorporated under the Companies Act, No. 07 of 2007 of Sri Lanka and domiciled in Sri Lanka. The Company was established in 1872 and is an unlisted public limited company. The registered office of the Company is located at 267, Union Place, Colombo 02.

Background Litro Gas, established in 1872, was initially named Colombo Gas and Water Company. In 1995, the state-owned entity was privatized and 51% of its shares were sold to Royal Dutch Shell (Shell). In 2010, the government of Sri Lanka acquired ownership of the Company from Shell, through the state-owned entity Sri Lanka Insurance Corporation (SLIC).

Operations Litro Gas is principally involved in importation, processing, storing, distribution and selling of liquid petroleum gas (LPG). The Company has a maximum production capacity of 2,000 MT per day, equivalent to 730,000 MT per annum, which is sufficient to meet existing demand with annual capacity utilization standing at ~48% during CY20.

Ownership

Ownership Structure The company is majority (~99.9%) owned by Sri Lanka Insurance Corporation Limited (SLIC). The remaining shares are collectively owned by 4 individuals who hold a 0.064% stake.

Stability Litro Gas draws stability from the ownership of SLIC which has had a major stake in the Company for over a decade and is, in turn, a ~100% government-owned entity. The ownership structure of the Company is likely to remain unchanged in the foreseeable future.

Business Acumen SLIC is Sri Lanka's national insurance services provider and the country's pioneer in insurance. It is backed by decades of industry expertise and has a strong performance track record. In addition, SLIC also has investments in the healthcare and hospitality sectors through various subsidiaries and group companies.

Financial Strength Sri Lanka Insurance Corporation today manages an asset base of over LKR 235bn which is the largest in the industry, the largest life insurance fund in the local insurance industry amounting in excess of LKR 134bn, and LKR 63bn strong total equity.

Governance

Board Structure The board of Litro Gas consists of 4 directors, 3 of whom are non-executive along with 1 executive director, Mr. Thesara Jayasingha, who acts as both the CEO & the Chairman of the Company.

Members' Profile The Board of Directors comprises individuals with diversified skills and backgrounds. They have decades of experience and hold directorships at other firms across various industries.

Board Effectiveness The board has formed three committees, namely (i) Remuneration Committee, (ii) Audit Committee, and, (iii) Grievance Committee. The presence of these committees gives assurance of adequate oversight.

Financial Transparency PwC is the external auditor of the Company. They have given an unqualified opinion on the financial statements for the year-end December 31, 2020.

Management

Organizational Structure The company has a well-defined organizational structure that is divided into eleven main departments, all of whom report to the CEO/Chairman. The highest level of Authority lies with the Chairman/Board of Directors.

Management Team The Company's management team spearheaded by its CEO, Theshara Jayasinghe, comprises of highly qualified individuals with vast experience in the industry.

Effectiveness There is a Management Committee in place, which comprises of each head of department. The management team meets regularly to discuss performance in terms of sales, production, KPI, and strategies.

MIS The Company employs two softwares, GBS (Gas Business System) which was implemented in 2000 and is dedicated to the LPG distribution process and SUN (System Union) which covers various accounting functions.

Control Environment Effective control systems are in place which is followed and enforced at all levels of the organization. Daily control measures are in place to ensure a smooth flow of operations and risk mitigation for various processes. However, it was observed that certain controls at the operational level need to be followed more closely.

Business Risk

Industry Dynamics Demand for Liquified Petroleum Gas (LPG) currently emanates from 03 main business segments which are the domestic, commercial and industrial segments. Demand for LPG continues to grow on the back of increasing requirements by commercial and domestic customers. LPG prices in Sri Lanka have historically been regulated by the government, and are usually a combined decision taken by the Central Bank of Sri Lanka (CBSL), the Ministry of Finance, and the Ministry of Energy. In October 2021, the government controls were lifted and pricing decisions are now in the hands of Litro Gas.

Relative Position Currently, there are two LPG distribution companies operating in Sri Lanka, namely Litro Gas Lanka Ltd and Laugf Gas. Litro Gas dominates the market and as of May 21, the total market share of Litro Gas and Laugf Gas stood at 78% & 22% respectively.

Revenues The domestic segment accounts for 85% of the Company's sales mix in CY20 (CY19: 84%) while the Industrial segment stands second with a 9% share of revenue during both CY20 and CY19. During CY21, the sales revenue reached LKR 52bn, a significant increase of ~30% from LKR 40bn revenue earned during CY20 (CY19: LKR 43bn). The revenues were boosted particularly during the last quarter of CY21 due to the removal of price control in Oct-21.

Margins Profitability has further eroded during CY21 with gross margin falling to negative ~13.8% (CY20: 5.8%), operating margins to negative ~19.0% (CY20: -1.0%), and net margin to negative ~14.2% (CY20: 0.2%). This decline has come on the back of continued price controls during the first three quarters of the calendar year along with rising costs and currency depreciation.

Sustainability Litro Gas' sustainability is dependent on its ability to pass on increases in cost by increasing prices. With the lifting of price controls in Oct-21, the Company's revenues and profitability are expected to increase, going forward. Moreover, the Company has long-term plans to expand capacity in order to maintain its strong position in the market.

Financial Risk

Working Capital The Company receives payments largely on a cash basis while availing an approximate 30-day credit period for its payables thus maintaining an adequate cushion for its working capital cycle. During CY21, the net working capital days stood at -13 days due to an increase in trade payables amount.

Coverages Litro Gas has maintained strong coverages in prior years due to a minimal level of borrowings as a result of which the Company incurs very little finance costs. However, during CY21, Free Cash Flow from Operations (FCFO) significantly reduced due to loss reported during the period and was recorded at LKR -8,981mn. As a result, interest coverage during CY21 was entirely eroded and stood at -340.

Capitalization Litro Gas is almost entirely financed by equity. During the 4th quarter of the CY21, Litro Gas obtained financing of LKR 3.6bn from Litro Terminal at an interest rate of 5% resulting in leveraging of 26.3%. The plans of expansion are mainly focused on investments in a fleet of bowsers which would require an investment of around LKR 600mn. The plan of the company is to fund the investment through either the disposal of underperforming assets or internally generated cash flows. The Company would only incur borrowing as the last preference, therefore, capital structure is expected to remain strong.

LRA

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Financial Summary

LKR mln

Litro Gas Lanka Limited Oil & Gas	Dec-21 12M *Management*	Dec-20 12M Audited	Dec-19 12M Audited
A BALANCE SHEET			
1 Non-Current Assets	15,091	13,023	11,097
2 Investments	-	-	-
3 Related Party Exposure	5,014	5,014	5,014
4 Current Assets	9,903	13,106	13,933
a Inventories	*1,921*	*1,770*	*1,380*
b Trade Receivables	*1,033*	*1,099*	*1,007*
5 Total Assets	30,008	31,143	30,044
6 Current Liabilities	7,222	3,655	3,256
a Trade Payables	*6,760*	*2,700*	*2,660*
7 Borrowings	-	200	213
8 Related Party Exposure	3,713	164	181
9 Non-Current Liabilities	8,997	11,114	10,461
10 Net Assets	10,076	16,010	15,934
11 Shareholders' Equity	10,076	16,010	15,934
B INCOME STATEMENT			
1 Sales	52,309	39,715	43,730
a Cost of Good Sold	*(59,554)*	*(37,392)*	*(36,489)*
2 Gross Profit	(7,245)	2,322	7,241
a Operating Expenses	(2,717)	(2,712)	(3,269)
3 Operating Profit	(9,961)	(390)	3,973
a Non Operating Income or (Expense)	*(181)*	*522*	*988*
4 Profit or (Loss) before Interest and Tax	(10,142)	132	4,961
a Total Finance Cost	*(27)*	*(48)*	*(33)*
b Taxation	*2,749*	*(0)*	*(1,401)*
6 Net Income Or (Loss)	(7,421)	84	3,526
C CASH FLOW STATEMENT			
a Free Cash Flows from Operations (FCFO)	*(9,292)*	*983*	*6,224*
b Net Cash from Operating Activities before Working Capital Changes	*(8,981)*	*1,703*	*7,102*
c Changes in Working Capital	*3,717*	*(621)*	*(1,023)*
1 Net Cash provided by Operating Activities	(5,265)	1,082	6,079
2 Net Cash (Used in) or Available From Investing Activities	(1,166)	(2,654)	82
3 Net Cash (Used in) or Available From Financing Activities	3,433	(99)	(1,249)
4 Net Cash generated or (Used) during the period	(2,998)	(1,672)	4,912
D RATIO ANALYSIS			
1 Performance			
a Sales Growth (for the period)	31.7%	-9.2%	12.5%
b Gross Profit Margin	-13.8%	5.8%	16.6%
c Net Profit Margin	-14.2%	0.2%	8.1%
d Cash Conversion Efficiency (FCFO adjusted for Working Capital/Sales)	-10.7%	0.9%	11.9%
*e Return on Equity [Net Profit Margin * Asset Turnover * (Total Assets/Sh*	-56.9%	0.5%	23.9%
2 Working Capital Management			
a Gross Working Capital (Average Days)	20	24	19
b Net Working Capital (Average Days)	-13	0	-1
c Current Ratio (Current Assets / Current Liabilities)	1.4	3.6	4.3
3 Coverages			
a EBITDA / Finance Cost	-349.3	8.9	173.9
b FCFO / Finance Cost+CMLTB+Excess STB	-340.4	7.0	65.9
c Debt Payback (Total Borrowings+Excess STB) / (FCFO-Finance Cost)	-0.4	0.2	0.0
4 Capital Structure			
a Total Borrowings / (Total Borrowings+Shareholders' Equity)	26.3%	1.2%	1.3%
b Interest or Markup Payable (Days)	0.0	0.0	0.0
c Entity Average Borrowing Rate	3.3%	23.2%	15.7%

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Scale – Credit Rating

Credit Rating

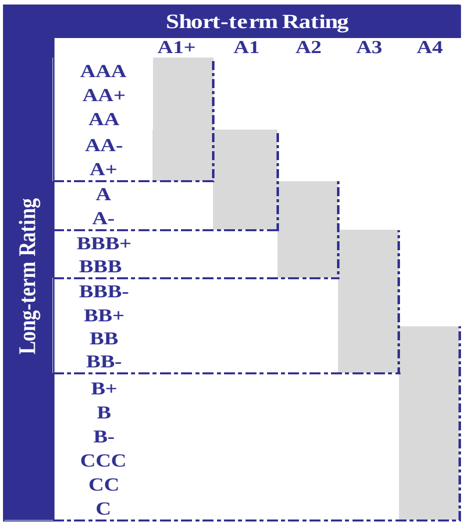
Credit rating reflects forward-looking opinion on credit worthiness of underlying entity or instrument; more specifically it covers relative ability to honor financial obligations. The primary factor being captured on the rating scale is relative likelihood of default.

Long-term Rating

Scale	Definition
AAA	**Highest credit quality.** Lowest expectation of credit risk. Indicate exceptionally strong capacity for timely payment of financial commitments
AA+ AA AA-	**Very high credit quality.** Very low expectation of credit risk. Indicate very strong capacity for timely payment of financial commitments. This capacity is not significantly vulnerable to foreseeable events.
A+ A A-	**High credit quality.** Low expectation of credit risk. The capacity for timely payment of financial commitments is considered strong. This capacity may, nevertheless, be vulnerable to changes in circumstances or in economic conditions.
BBB+ BBB BBB-	**Good credit quality.** Currently a low expectation of credit risk. The capacity for timely payment of financial commitments is considered adequate, but adverse changes in circumstances and in economic conditions are more likely to impair this capacity.
BB+ BB BB-	**Moderate risk.** Possibility of credit risk developing. There is a possibility of credit risk developing, particularly as a result of adverse economic or business changes over time; however, business or financial alternatives may be available to allow financial commitments to be met.
B+ B B-	**High credit risk.** A limited margin of safety remains against credit risk. Financial commitments are currently being met; however, capacity for continued payment is contingent upon a sustained, favorable business and economic environment.
CCC CC C	**Very high credit risk.** Substantial credit risk "CCC" Default is a real possibility. Capacity for meeting financial commitments is solely reliant upon sustained, favorable business or economic developments. "CC" Rating indicates that default of some kind appears probable. "C" Ratings signal imminent default.
D	Obligations are currently in default.

Short-term Rating

Scale	Definition
A1+	The highest capacity for timely repayment.
A1	A strong capacity for timely repayment.
A2	A satisfactory capacity for timely repayment. This may be susceptible to adverse changes in business, economic, or financial conditions.
A3	An adequate capacity for timely repayment. Such capacity is susceptible to adverse changes in business, economic, or financial conditions.
A4	The capacity for timely repayment is more susceptible to adverse changes in business, economic, or financial conditions. Liquidity may not be sufficient.



**The correlation shown is indicative and, in certain cases, may not hold.*

Outlook (Stable, Positive, Negative, Developing) Indicates the potential and direction of a rating over the intermediate term in response to trends in economic and/or fundamental business/financial conditions. It is not necessarily a precursor to a rating change. 'Stable' outlook means a rating is not likely to change. 'Positive' means it may be raised. 'Negative' means it may be lowered. Where the trends have conflicting elements, the outlook may be described as 'Developing'.

Rating Watch Alerts to the possibility of a rating change subsequent to, or, in anticipation of some material identifiable event with indeterminable rating implications. But it does not mean that a rating change is inevitable. A watch should be resolved within foreseeable future, but may continue if underlying circumstances are not settled. Rating watch may accompany rating outlook of the respective opinion.

Suspension It is not possible to update an opinion due to lack of requisite information. Opinion should be resumed in foreseeable future. However, if this does not happen within six (6) months, the rating should be considered withdrawn.

Withdrawn A rating is withdrawn on a) termination of rating mandate, b) the debt instrument is redeemed, c) the rating remains suspended for six months, d) the entity/issuer defaults., or/and e) PACRA finds it impractical to surveill the opinion due to lack of requisite information.

Harmonization A change in rating due to revision in applicable methodology or underlying scale.

Surveillance. Surveillance on a publicly disseminated rating opinion is carried out on an ongoing basis till it is formally suspended or withdrawn. A comprehensive surveillance of rating opinion is carried out at least once every six months. However, a rating opinion may be reviewed in the intervening period if it is necessitated by any material happening.

Note. This scale is applicable to the following methodology(s):

a) Broker Entity Rating
b) Corporate Rating
c) Debt Instrument Rating
d) Financial Institution Rating
e) Holding Company Rating
f) Independent Power Producer Rating
g) Microfinance Institution Rating
h) Non-Banking Finance Companies Rating

Rating Team Statements
(1) Credit Rating Agency means a body corporate engaged in the business of assessing and evaluating the credit- worthiness of any issuer or a specific issue of securities. (https://www.sec.gov.lk/index.php/credit-rating-agency/)

2) **Conflict of Interest**
i. LRA shall not engage in any other business which in the view of the Commission creates a conflict of interest unless prior written approval of the Commission is obtained (Section 33- Draft Rules Credit Rating Agency - 2021)

Restrictions
(3) LRA is not entitled to outsource any part of its work, which has a direct bearing on the act of rating. However, if any other function other than the core function of rating is to be outsourced, such fact shall be brought to the attention of the Client and be included in the Credit Rating Agreement entered into with the Client. (Section 22- Draft Rules Credit Rating Agency - 2021)
(4) LRA cannot appoint any individual as a member of the Rating Committee who has a business development function of the Credit Rating Agency, or who initiates or participates in discussions regarding fees or payments with any Client of Credit Rating Agency. (Section 26- Draft Rules Credit Rating Agency -2021)

Conduct of Business
(5) Prior to the commencement of a rating, LRA does not promise, assure or guarantee to a client that a particular rating will be assigned.
(6) LRA performs a rigorous and formal periodic review of all its methodologies. Such methodologies shall be made available to the Commission for perusal, upon request. (Section 39- Draft Rules Credit Rating Agency -2021)

Independence & Conflict of interest
(7)LRA receives compensation from the entity being rated or any third party for the rating services it offers. The receipt of this compensation has no influence on LRA´s opinions or other analytical processes. In all instances, LRA is committed to preserving the objectivity, integrity and independence of its ratings.
(8)LRA does not engage in any other business activity which in the view of the Commission creates a conflict of interest unless prior written approval of the Commission is obtained (Section 33- Draft Rules Credit Rating Agency -2021)
(9) LRA structures its rating teams and processes to promote continuity, consistency and avoid bias in the rating process. (Section 45 - Draft Rules Credit Rating Agency -2021)

Monitoring and review
(10) For purposes of transparency, LRA publishes sufficient information about an entity/security rated, frequency of default and whether a rating grade assigned has changed over time. The definitions and computation methods for the default rates stated in the default studies are also be disclosed. (Section 42- Draft Rules Credit Rating Agency -2021) LRA monitors below factors specifically, (a) all internal records to support our credit rating opinions; (b) all particulars relating to Clients at our office which shall include the name and registered address and contact numbers of such Client's, names and addresses of their Directors as at the date of rating, its issued share capital and the nature of business; and (c) a comprehensive written record of all complaints received from Clients and action taken thereon by LRA.
(11) LRA ensures confidentiality of all information at all times relating to Clients including such Client's identity and transactions carried out for such Client unless and to the extent such disclosure is required by law. (Section 48 - Draft Rules Credit Rating Agency -2021)
(12) LRA does not destroy, conceal or alter any records, property or books relating to the business of the LRA which are in its possession or under its control with the intention of defeating, preventing, delaying or obstructing the carrying out of any examination. (Section 51 - Draft Rules Credit Rating Agency - 2021).
Probability of Default
(13) LRA's Rating Scale reflects the expectation of credit risk. The highest rating has the lowest relative likelihood of default (i.e., probability).
Proprietary Information
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