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Media Release

RAM Ratings Lanka assigns corporate ratings of BBB/P3 to Sierra Cables PLC

RAM Ratings Lanka has assigned respective long- and short-term corporate credit ratings of BBB and P3 to Sierra Cables PLC ("Sierra" or "the Group"); the long-term rating has a stable outlook. The ratings reflect Sierra's good brand and established track record as well as satisfactory financial profile. Meanwhile, the ratings are moderated by the Group's vulnerability to fluctuations in raw material prices, intensive working capital requirements which has rendered a moderate liquidity position as well the Group's dependence on the cyclical construction sector. The ratings are further moderated by the gestation periods of the Group's planned new businesses.

Sierra is involved in the manufacture and sale of low-voltage cables, primarily for electrification and for the purposes of the telecommunications industry. The Group's product range includes earth wires, domestic and industrial wiring cables, power cords, antenna wires and telecommunication distribution cables. Incorporated in 1978, Sierra has an established track record and a good brand name, particularly in the construction industry. The Group derives its name from its parent, Sierra Holdings (Pvt) Ltd ("Sierra Holdings"), a leading player in the Sri Lankan construction industry. Sierra is currently the second-largest player in the domestic cable industry, and is estimated to hold a market share of around 20%. The Group's market position is supported by its island-wide network of distributors and vast array of products.

Meanwhile, the ratings are also supported by the Group's satisfactory financial profile. Although total borrowings increased over five-fold to LKR 766.15 million by end-March 2011, to fund higher working capital requirements the Group's gearing levels clocked in at 0.59 times. In tandem with its rising debt level, the Group's funds from operations ("FFO") debt coverage declined to 0.20 times, albeit still considered good. Supported by its stronger overall performance in 1Q FYE 31 March 2012 ("FY Mar 2012"), the Group's FFO debt coverage improved to an annualised 0.40 times as of end-June 2011.

On the other hand, the ratings are pressured by Sierra's vulnerability to raw material prices, mainly copper, aluminium and polyvinyl chloride ("PVC"). This is exacerbated by the fact that Sierra is unable to fully pass on cost increases to its customers owing to intense competition. This is reflected in Sierra's volatile margins. Meanwhile, Sierra is also exposed to foreign-exchange risk as all its raw materials are imported.

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On a separate note, RAM Ratings Lanka notes that the Group's operating cash cycle is lengthy, of late averaging at around 9 months. This is primarily due to Sierra's inventory cycle, which has increased to around 8 months. In working-capital terms, this translated into an inventory level of LKR 978.39 million as of end-March 2011, rising further to LKR 1.06 billion by end-June 2011. As such, Sierra has resorted to using more short-term debts to fund its intensive working-capital requirements, which has in turn resulted in a moderate liquidity position.

The Group is exposed to the inherent cyclicality of the construction sector, particularly housing and commercial developments. That said, Sri Lanka's construction sector has a positive long-term outlook. Looking ahead, higher disposable income against the backdrop of stronger economic growth is anticipated to support the expansion of the housing industry. This, coupled with government-led infrastructure projects, is expected to propel the overall growth of the domestic construction sector.

Looking ahead, the management plans to venture into the manufacture of PVC pipes, primarily for irrigation-related activities. In addition, the Group plans to venture into the power sector by constructing a hydro-power plant. While acknowledging that the new ventures will diversify Sierra's cashflow sources, we also note that the requisite gestation periods may hamper the Group's performance in the immediate term.

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