

SL Agritech Corporation Receives PRS Aa (corp.) Rating

SL Agritech Corporation (SLAC), a leading producer of hybrid rice seeds and premium rice in the Philippines, was assigned an issuer credit rating of **PRS Aa (corp.)**, with a **Stable Outlook**, by Philippine Rating Services Corporation (PhilRatings). The rating was obtained in relation to the company's commercial paper (CP) issuance of up to ₱4.0 billion. The proceeds will be used to pay the Company's short-term obligations, and to purchase rice and seed inventories from its contract growers.

A company rated **PRS Aa (corp.)** differs from the highest-rated corporates only to a small degree, and has a strong capacity to meet its financial commitments relative to that of other Philippine corporates.

Furthermore, the Outlook is an indication as to the possible direction of any rating change within a one-year period, and serves as a further refinement to the assigned credit rating for the guidance of investors, regulators, and the general public. A **Stable Outlook** is defined as: "The rating is likely to be maintained or to remain unchanged in the next 12 months."

In arriving at the rating, PhilRatings took into account the following rating factors: 1) competitive market position locally, supported by proprietary technology and vertically integrated operations; 2) potential growth in the medium- to long-run given the Company's international business expansion and; 3) SLAC's sustained profitability, albeit generally declining profit margins and interest coverage ratios. PhilRatings also took into consideration the manageable impact of the COVID-19 pandemic, despite increasing economic uncertainty, as the Company's products are considered essential.

PhilRatings' credit ratings are based on available information and projections at the time that the rating review was performed. PhilRatings shall continuously monitor developments relating to SLAC and may change the rating at any time, should circumstances warrant a change.

SLAC is involved in the production of hybrid rice seeds, and premium and non-premium rice. It has established itself as one of the leading rice companies in the Philippines and exports high quality rice seeds and premium packaged rice. SLAC's fully integrated operations from hybrid rice seed research and development, to the sale of premium rice products allow the company to maximize its resources.

Although business generation remained largely domestically driven, SLAC continues to expand its network of customers abroad. Its hybrid seeds are exported to Indonesia, Vietnam, Myanmar and India. Its rice products, on the other hand, are sent to Saudi Arabia, Bahrain, Jordan, Kuwait, Singapore, Australia, UAE and USA. In addition, the Company has taken steps to expand the production of its hybrid rice seeds in neighboring countries such as Myanmar, India and Indonesia, which are reportedly three of the world's largest rice producers. Operations abroad, however, were affected by restrictions imposed due to the COVID-19 pandemic. PhilRatings notes that while the international business provides opportunities for growth, developments and progress in relation to this have been quite slow.

Despite volatile margins over the period, SLAC's profitability was on a generally increasing trend for the past ten years. Revenues registered a compound annual growth rate (CAGR) of 24.2%. Earnings before interest, taxes, depreciation and amortization (EBITDA) and net income, on the other hand, posted a CAGR of 21.6% and 18.2%, respectively, for the past ten years.

Coverage ratios of the company, however, have been declining since FY2016. Such was attributable to the faster growth in interest charges, as well as the company's current debt. It is worth noting that SLAC's total debt was generally on an increasing trend historically. As a result, EBITDA interest coverage ratio generally declined from 4.3x in 2016 to 2.2x in 2020. It should be noted though that such is still sufficient to cover the interest expense of the company. Nevertheless, PhilRatings notes that the stability in profitability gives the Company more flexibility in managing declining interest coverage ratios.

In FY2021, SLAC's total net sales expanded by 53.3%, from ₱4.0 billion in FY2020 to ₱6.1 billion. The growth was attributable to higher sales volume of SLAC's hybrid rice seeds and rice products due to the increase in farmers' preference for SL-8H seeds in assisting the government program for rice sufficiency. As a result, however, cost of sales recorded a faster increase of 76.4%, from ₱3.4 billion in FY2020 to ₱6.0 billion in FY2021. Operating expenses rose by 12.8%, from ₱770.3 million in FY2020 to ₱869.0 million in FY2021, driven mainly by the following factors: personnel expenses, advertising and promotion, freight and other selling expenses, and depreciation. Finance cost grew by 4.7%, from ₱712.0 million in FY2020 to ₱745.5 million in FY2021, due to higher working capital requirements for the expected high sales volume during the year. As a result, SLAC recorded a net income of ₱572.2 million in FY2021, up by 8.6% from the previous year's ₱527.1 million. Gross and profit margins, however, declined to 26.0% and 7.1%, respectively.

For the next two years, SLAC expects growth to continue, mainly driven by its domestic operations. PhilRatings will continue to monitor the results of the Company's international operations as developments in relation to these markets progress. In addition, liquidity and interest coverage ratios are expected to be stable. SLAC also intends to plow back its earnings to equity and effectively lower its leverage levels.

With the lockdown restrictions imposed for most parts of the country to contain the spread of COVID-19, the Philippine economy plunged to its worst full-year recession since World War II, with Gross Domestic Product (GDP) declining by 9.5% for full-year 2020. Despite the COVID-19 pandemic, the Department of Agriculture (DA) intensified its domestic rice production using hybrid rice seeds. For the second quarter of 2021 (2Q2021), the Philippine economy grew by 11.8%, the fastest growth recorded in over three decades. Several economists noted that this was only a "base effect", where the latest GDP figure is compared to a much lower figure from the previous year. GDP contracted by 16.5% in 2Q2020

It should be noted that SLAC sold premium rice products at lower prices to accommodate the people affected by the pandemic during the last quarter of FY2020. PhilRatings notes that SLAC's products are considered as essential. Although production and delivery were affected initially when the lockdown was first imposed, such are expected to not be restricted and can be managed, moving forward. In addition, PhilRatings notes that SLAC's hybrid rice seeds may have a competitive advantage over traditional rice seed varieties, given the higher yield. Its premium rice products, however, may be substituted by consumers, with lower priced rice. With the reduction in the prices of its rice products during this pandemic and its entry into non-premium rice, though, SLAC is expected to benefit from improved demand for its rice products as well.