KHON KAEN SUGAR INDUSTRY PLC

No. 137/2019
4 September 2019

CORPORATES

Company Rating:	A-
Issue Ratings:	
Senior unsecured	A-
Outlook:	Stable

Last Review Date: 04/09/18

Company Rating History:

Date	Rating	Outlook/Alert
13/11/13	A	Stable
24/11/06	A-	Stable

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RATIONALE

TRIS Rating downgrades the company rating and the senior unsecured debenture ratings on Khon Kaen Sugar Industry PLC (KSL) to "A-" from "A" with a "stable" outlook. The downgrades reflect a further deterioration in KSL's financial performance and slower-than-expected sugar market recovery.

The ratings reflect KSL's long track record in the sugar industry and diversification into other sugar-related businesses. However, the ratings are constrained by the prolonged slump in sugar prices, the volatility of sugarcane, and the operational risk of running sugar plants in the Lao People's Democratic Republic (Lao PDR) and Cambodia.

KEY RATING CONSIDERATIONS

Operating results are softer than expected

KSL's operating results in fiscal year (FY) 2018 fell below TRIS Rating's expectation. A slump in sugar prices, caused by an oversupply of sugarcane worldwide, led to the drop in profit. KSL's operating margin, as measured by operating income before depreciation and amortization as a percentage of sales, rose to 13.8% in FY2018, compared with 10.5% in FY2017, but lower than our expectation of 17.8%. Earnings before interest, tax, depreciation, and amortization (EBITDA) tumbled to Bt2.89 billion in FY2018, below our forecast of Bt3.4 billion.

Global sugar consumption is expected to fall behind production in FY2020, which will continue putting downward pressure on prices. Nevertheless, we expect the cyclical downturn in the sugar industry to gradually recover from FY2020 onwards after the three-year lows drive out some excess supply and production. Sugar prices are forecast to average 14.0-16.0 cents per pound, compared with the average six-month FY2019 of 12.5 cents per pound. Thus, we expect KSL's operating margin to recover gradually to 15%-16% in FY2019-FY2022.

Sugar operations in neighboring countries continue to drag performance

KSL has operated sugar plants in the Lao PDR and Cambodia since FY2010. Total investment cost in the Lao PDR and Cambodia was approximately Bt1.6 billion as of October 2018 with impairment on investments totaling Bt1.4 billion. Thus, the book value of both subsidiaries was reduced to Bt200 million. The revenue contribution from the Lao PDR and Cambodia were less than 5% of total revenues.

Currently, KSL's sugar operation in Cambodia is in the process of divestment. Sugar production in the Lao PDR remained below the break-even level in the 2018/2019 growing season. Both subsidiaries have been hurt by the sharp fall in sugar price. As a result, they have continued to report net losses. The combined losses totaled Bt21 million for the first half of FY2019.

TRIS Rating foresees that sugar operations in the Lao PDR and Cambodia will continue to face challenges, such as volatility of sugarcane and sugar price, intensified competition among sugar operators, and regulatory risks.

Rising working capital requirement pushed up financial leverage

Total debt of KSL rose to Bt23.60 billion as of October 2018, up from Bt21.81 billion as of October 2017. KSL's inventory day jumped to 97 days in FY2018, from an average of 77 days in FY2016-FY2017, following a rise in a carrying inventory during the 2017/2018 crop year. Consequently, KSL required higher working capital.

On the other hand, KSL's capital spending plan is dropping. Capital expenditures are estimated to range from Bt400 million to Bt900 million per year during FY2019-FY2022. Most of the spending is earmarked for capacity expansions and maintenance. Thus, we expect the company's debt to capitalization ratio to gradually decline to 45% over the next few years, compared with 60.9% during the first six months of FY2019 and 55.9% in FY2018. Cash flow protection is forecast to improve. The EBITDA interest coverage ratio is expected to move in the range of 3-4 times during FY2019-FY2022.

Strong market position

KSL's competitive edge is reflected by its track record in the sugar industry. KSL has the third-largest market share in terms of sugar production. The company has about 7%-8% market share in sugar production. Its management team has over 70 years of experience in the sugar industry. Major customers are large-scale food and beverage manufacturers. These industrial users value service reliability and product quality due to their product-specific requirements. As a result, the company can earn some price premium on quality products.

Integration of downstream businesses

KSL's related businesses mostly stem from utilizing by-products from the sugar production process. The major by-products are bagasse, filter cake, and molasses. Bagasse is mainly used as fuel in its power plants. Filter cake is processed to make fertilizer for sugarcane. Molasses is utilized to produce ethanol. KSL's downstream businesses consist of power generation, ethanol, and fertilizer production. The company started its sugar-related businesses more than a decade ago.

Energy and fertilizer businesses contributed around 7%-10% of KSL's total revenue, while its involvement in ethanol production is represented by its 40% equity stake in BBGI PLC (BBGI). Based on TRIS Rating's base case, we project the company will receive around Bt90-Bt120 million per annum during FY2019-FY2022 as its share of the profit from its investment in BBGI.

Sound liquidity

We expect KSL to have adequate liquidity over the next 12 months. EBITDA is projected to increase to Bt2.7-Bt3.0 billion in FY2019-F2022 following a gradual recovery in sugar price, under our estimation. In addition, the Office of the Cane and Sugar Fund (OCSF) will pay KSL around Bt300-Bt350 million per year as compensation for sugar production, based on the revenue sharing scheme. KSL had cash and cash equivalents of Bt134 million, plus unused credit facilities of Bt15.74 billion at the end of April 2019. KSL has scheduled debt repayments of Bt0.9-Bt4.9 billion per year over the period of FY2019-FY2022.

BASE-CASE ASSUMPTIONS

- Total revenue to drop by 5%-8% per annum during FY2019-FY2020, then will rise gradually by 6%-9% per annum during FY2021-FY2022.
- Gross profit margins to improve to 20% per annum and operating margins to stay around 16% per annum during FY2019-FY2022.
- Total capital spending to total around Bt900 million in FY2019, and Bt400 million during FY2020-FY2022.

RATING OUTLOOK

The "stable" outlook reflects TRIS Rating's expectation that KSL will maintain its competitive position in the Thai sugar industry. The revenue sharing system of Thailand's sugar and sugarcane as well as the revenue contribution from its power business will alleviate the effect of volatility in the sugar production business.

RATING SENSITIVITIES

An upgrade scenario could occur if KSL's operating performance and profitability recover consistently over a sustained period of time. A rating downgrade could occur if the company's performance weakens for an extended period of time. Any aggressive debt-funded expansion, which will deteriorate the balance sheet and weaken cash flow protection, would also lead to a downgrade scenario.

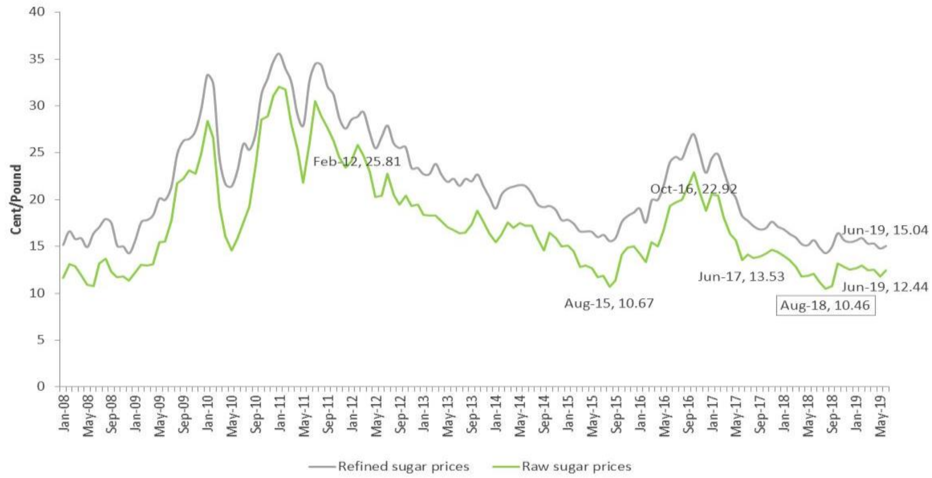
COMPANY OVERVIEW

KSL is one of the leading sugar producers in Thailand, established in 1945 by the Chinthammit family and associates. As of April 2019, the Chinthammit family collectively held 66% of the company's shares. The company owns and operates five sugar plants in Thailand, with a combined cane crushing capacity of 110,000 cane tonnes per day as of April 2019. KSL procured 10.32 million tonnes of sugarcane in the 2018/2019 crop year and produced 1.14 million tonnes of sugar. KSL's sugar production in the 2018/2019 growing season ranked third in the industry, with a market share of 7.8%. KSL trailed the Mitr Phol Group (20.6%) and the Thai Roong Ruang Group (16.6%).

KGI, a subsidiary of KSL, merged with BBP Holding Co., Ltd. (BBH), a subsidiary of Bangchak Corporation PLC (BCP). The merged operation under BBGI represents a business alliance for bio-based products. BCP holds 60% of BBGI; the remaining 40% is held by KSL. The total investment in BBGI was Bt3.24 billion. BBGI was established in October 2017 and became Thailand's largest producer of bio-fuel with total production capacity of 1,710,000 litres per day, consisting of ethanol production capacity of 900,000 litres per day and biodiesel production capacity of 810,000 litres per day. BBGI has planned an initial public offering (IPO) in FY2020 to secure the funds it needs for business expansion.

KEY OPERATING PERFORMANCE

Chart 1: Raw Sugar Prices Worldwide



Note: Monthly prices of Futures Contract No. 11
Source: New York Board of Trade, United States Department of Agriculture (USDA)

Table 1: Sugar Production in Thailand

Unit: Million tonnes

Sugar Producer	Growing Season 2014/ 2015	2015/ 2016	2016/ 2017	2017/ 2018	2018/ 2019
Mitr Phol	2.30	1.96	1.98	2.73	2.92
Thai Roong Ruang	1.60	1.37	1.42	2.13	2.42
KSL Group	0.91	0.77	0.72	1.20	1.14
Thai Ekkalak	0.99	0.72	0.94	1.19	1.03
Wangkanai	0.56	0.51	0.39	0.79	0.69
Banpong	0.44	0.44	0.44	0.52	0.58
Eastern Sugar	0.38	0.35	0.38	0.51	0.49
Kumpawapee	0.40	0.30	0.28	0.41	0.39
Khonburi	0.24	0.29	0.27	0.44	0.37
Others	3.48	3.07	3.21	4.79	4.55
Total	**11.30**	**9.78**	**10.03**	**14.71**	**14.58**

Source: Office of the Cane and Sugar Board (OCSB)

Table 2: KSL's Revenue Breakdown by Business

Unit: %

Product	2015	2016	2017	2018	Nov 18-Apr 19
Sugar sales					
- Thailand	69.0	74.9	73.2	83.7	78.1
- Laos & Cambodia	1.9	5.3	3.9	2.5	0.5
Ethanol and fertilizer sales	13.3	11.9	13.4	-	-
Electricity sales	5.4	4.8	4.8	6.8	10.0
Service and others	10.4	3.1	4.7	7.0	11.4
Total sales	**100**	**100**	**100**	**100**	**100**

Source: KSL

FINANCIAL STATISTICS AND KEY FINANCIAL RATIOS

Unit: Bt million

	Nov 2018- Apr 2019	---------------Year Ended 31 October ------------- 2018	2017	2016	2015
Total operating revenues	6,541	18,705	16,186	17,186	17,946
Operating income	1,743	2,585	1,699	2,605	2,569
Earnings before interest and taxes (EBIT)	908	1,751	1,028	2,585	1,363
Earnings before interest, taxes, depreciation, and amortization (EBITDA)	1,739	2,890	2,114	3,785	2,468
Funds from operations (FFO)	1,339	2,009	1,438	2,695	1,602
Adjusted interest expense	348	737	675	720	827
Capital expenditures	538	1,177	3,123	1,963	591
Total assets	51,755	45,542	42,991	38,375	37,517
Adjusted debt	29,341	23,597	21,811	19,016	21,273
Adjusted equity	18,830	18,639	18,092	16,650	14,442
Adjusted Ratios					
Operating income as % of total operating revenues (%)	26.65	13.82	10.50	15.16	14.31
Pretax return on permanent capital (%)	2.98	4.25	2.71	7.22	3.74
EBITDA interest coverage (times)	4.99	3.92	3.13	5.26	2.99
Debt to EBITDA (times)	11.33	8.17	10.32	5.02	8.62
FFO to debt (%)	5.74	8.51	6.59	14.17	7.53
Debt to capitalization (%)	60.91	55.87	54.66	53.32	59.56

Note: *All ratios have been adjusted by operating leases*
*　　　　* Consolidated financial statements*
*　　　　** Annualized with trailing 12 months*

RELATED CRITERIA

- Rating Methodology – Corporate, 26 July 2019
- Key Financial Ratios and Adjustments, 5 September 2018
- Group Rating Methodology, 10 July 2015

Khon Kaen Sugar Industry PLC (KSL)

Company Rating:	A-
Issue Ratings:	
KSL199A: Bt1,000 million senior unsecured debentures due 2019	A-
KSL202A: Bt1,000 million senior unsecured debentures due 2020	A-
KSL27DA: Bt2,000 million senior unsecured debentures due 2027	A-
Rating Outlook:	Stable

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