DOUBLE A (1991) PLC

No. 116/2018
10 August 2018

CORPORATES

Company Rating: BBB-

Issue Rating:
Senior unsecured BBB-

Outlook: Negative

Company Rating History:

Date	Rating	Outlook/Alert
25/11/16	BBB-	Negative
26/10/15	BBB-	Stable
12/09/13	BBB	Stable
21/08/12	BBB	Negative
16/05/08	BBB	Stable
09/11/07	BBB	Alert Developing
28/02/06	BBB	Stable
16/11/05	BBB	Alert Developing
20/10/04	BBB	Stable

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RATIONALE

TRIS Rating affirms the company rating on Double A (1991) PLC (DA) at "BBB-", with a "negative" outlook. At the same time, we assign the rating of "BBB-" to DA's proposed issue of up to Bt2,350 million in senior unsecured debentures. The proceeds from the new debentures will be used to repay the debentures due in February 2019.

The "BBB-" ratings reflect DA's position as one of the leading printing & writing (P&W) paper producers in Thailand, strong competitiveness, and the solid brand name of "Double A" products. These strengths are partially offset by the inherent volatility of the pulp and paper industry, DA's exposure to exchange rate risk, stagnant global demand for P&W paper due to a shift in consumer behavior towards digital media, as well as concerns about ongoing related-party transactions.

KEY RATING CONSIDERATIONS

Fully integrated operations keep the competitive edge

TRIS Rating believes DA will be able to maintain its strong competiveness and position as one of the leading paper producers in Thailand. The company's fully integrated pulp and paper operations create synergy and help control costs. Pulp is the major raw material of paper production (about 50%). As a commodity, pulp prices fluctuate widely. Hence, a paper producer who owns its own pulp mill typically has a cost advantage. DA has its own pulp production facilities, which are integrated with the company's paper mills. DA uses nearly all the pulp produced as the raw material for its paper production.

Exposure to exchange rate risk

DA will continue to be exposed to fluctuations in currency, as about 70% of total sales come from international markets. For exporting, the company sells its products in US$ and local currencies, but over half of its costs are in Thai baht. A rapid appreciation in Thai baht may weaken profits. In order to mitigate the exchange rate risk, DA has entered into currency forward contracts. Despite the hedges, the company could still incur significant gains or losses from exchange rates. DA experienced exchange rate losses of Bt403 million in 2016. It realized exchange rate gains of about Bt400 million in 2017 and Bt85 million in the first quarter of 2018.

Group restructuring

TRIS Rating sees DA's recent divestment of the Alizay paper mill (Alizay) as a group restructuring. In the first quarter of 2018, DA sold Alizay to Double A Holdings Limited (DAH), the parent company of the DA group. Both DA and DAH have the same ultimate shareholder, Mr. Yothin Dumnernchavanit and related parties.

In 2013, DA spent about EUR35 million or Bt1,400 million to acquire and restart the nonoperational Alizay paper mill in France. The mill had ceased operations in 2010. Alizay has suffered operating losses since resuming operations. It recorded cumulative losses of about Bt3,000 million from 2013 through the first quarter of 2018. Alizay serves markets in Europe, the Middle East, Africa, and North America. However, the "Double A" brand in these markets is not as strong as it is in Asian markets. Also, demand for paper in developed countries has continued to drop due to a shift in consumer behavior towards digital media. The unfavorable market situation has forced Alizay to produce and sell low-margin products. At the same time, Alizay has the highest cost of production among all of DA's paper mills because it is not integrated with a pulp mill. Despite continued losses from operations, Alizay's operating performance has improved during the last three years, mainly due to DA's improvement plan.

Although Alizay is no longer part of DA after the group restructuring, Alizay and DA remain under the same ultimate shareholder, raising concerns over ongoing related-party transactions. The share sale and purchase agreement between DA as the seller and DAH as the buyer specifies that DA shall not assist and/or proceed any transactions that may cause any financial connections to Alizay.

The divestment of Alizay cost DA a net Bt339 million. DA received Bt2,687 million for the sale. At the same time, DA paid Bt3,026 million in dividends to DAH to fund the purchase of Alizay. Ultimately, the group restructuring reduced both assets and equity of DA.

Profitability will continue to improve

TRIS Rating expects the positive earnings momentum will continue, boosted by DA's improvement plan. In 2016, DA initiated an improvement plan, including the rebalancing of product mix, the enhancement of production efficiency, and the reduction of operating costs. As a result of the plan, the operating margin (operating income before depreciation and amortization as percentage of sales) increased steadily to 9.7% in 2017, from a low of 3.4% in 2015.

Our forecast assumes the operating margin will stay about 13% over the next three years, rising from below 10% during 2014-2017. FFO (funds from operations) will increase to about Bt2,500 million per annum, from Bt700-Bt2,200 million during 2014-2017.

The divestment of the high-cost Alizay paper mill bolstered the operating margin to 17.2% in the first quarter of 2018. The auditor reclassified Alizay as discontinued operations for the period. Even including Alizay, the operating margin still improved to about 12% in the first quarter of 2018, from below 10% during 2014-2017.

Capital structure deteriorates after the sale of Alizay

TRIS Rating forecasts DA's capital structure will deteriorate over the next three years. The group restructuring lowered DA's equity base. In addition, as we expect the operating performance will continue to improve, DA may increase its dividend payments to its shareholders during 2018-2020. TRIS Rating projects the total debt to capitalization ratio to increase but remain below 65%. The total debt to capitalization ratio stood at 59.8% as of March 2018.

Our forecast assumes DA's cash flow in relation to debts will improve as the operating performance improves. Over the next three years, the FFO to total debt ratio should range between 12%-15%, climbing from 3%-11% during 2014-2017. The FFO to total debt ratio has improved during the last two years.

Liquidity should be manageable

TRIS Rating believes DA will be able to manage its liquidity for the next 12 months. Debts of about Bt2,700 million will come due during the remaining nine months of 2018. Approximately Bt2,200 million were short-term loans for working capital. At the end of March 2018, DA had undrawn credit facilities of about Bt2,200 million, plus cash and marketable securities of about Bt800 million. Sources of cash are hence estimated at about Bt3,000 million, sufficient to support the debts coming due. Accounts receivable, standing at nearly Bt4,300 million as of March 2018, could be used as another source of cash. No debentures come due this year, but some are due in 2019. DA plans to replace the Bt2,350 million in debentures due in February 2019 with new debentures. Annual FFO forecast at about Bt2,500 million over the next three years should be sufficient to support the debenture redemption. DA has no plans for major capital expenditures during 2018-2020.

A key financial covenant in DA's debentures requires the net interest-bearing debt to equity ratio to stay below 2.0 times. The ratio as of March 2018 was 1.4 times. Thus, the company was in compliance with this key financial covenant. TRIS Rating believes that the company will stay in compliance for the next 12 to 18 months.

RATING OUTLOOK

The "negative" outlook reflects the fact that DA's profitability and cash flow generating ability are on the path of recovery but remain below our expectations. Potential ongoing supports to Alizay remain our concerns.

RATING SENSITIVITIES

The outlook could be revised to "stable" if the improvements in DA's profitability and cash flow continue as expected and on a sustainable basis and if there is no evidence of any supports to Alizay. In contrast, the ratings could be revised downward if the operating performance, as well as cash flow, fall below expectations or if the capital structure deteriorates more than expected. According to TRIS Rating's group rating methodology, the credit profile of the Group and the Group's members will have an impact on the company rating and the issue rating of DA.

COMPANY OVERVIEW

DA, previously named Advance Agro PLC or AA, was established in 1989 by the Dumnernchanvanit family (the Soon Hua Seng Group) as a pulp and paper producer. The company was listed on the Stock Exchange of Thailand (SET) in 1995, but was delisted on 17 April 2008. Mr. Yothin Dumnernchanvanit and affiliated parties remain the ultimate shareholders, holding a 98.39% of stake in the company as of March 2018.

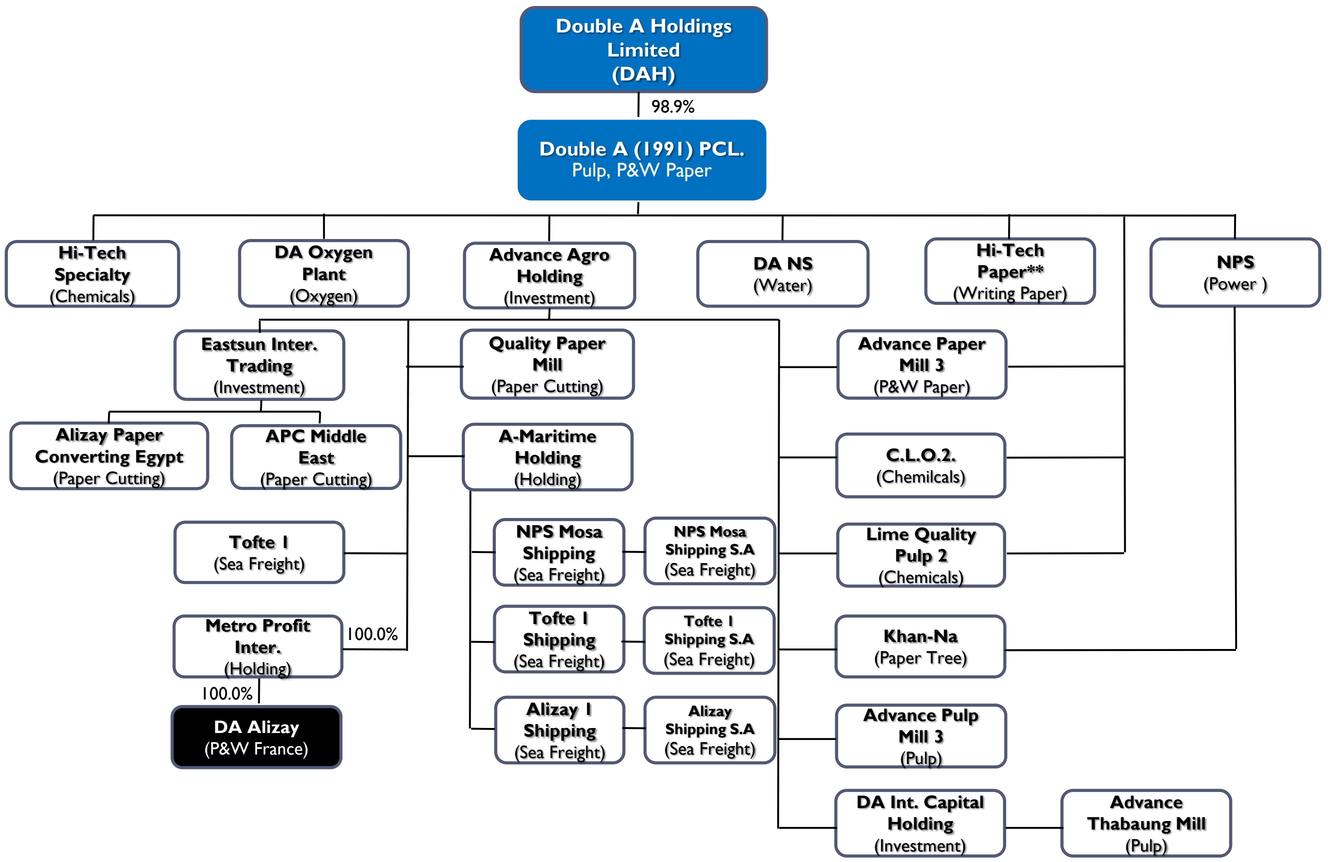
DA currently owns and operates four paper mills and two pulp mills, all of which are located in Tha Toom district, Prachinburi Province. The four paper mills have a total design capacity of 745,000 tonnes per annum (tpa), while the two pulp mills have a total design capacity of 427,000 tpa. Most pulp produced at the mills is used as raw material for the company's paper production. The pulp and paper operations are fully integrated.

DA owned five paper mills before it sold the Alizay paper mill to its parent company, DAH. The sale transaction was made in the first quarter of 2018 and finished in the following quarter. As a result, the paper production capacity dropped to 745,000 tpa from 1,045,000 tpa.

Currently, paper sales accounted for about 92% of DA's annual sales, followed by sales of pulp (4%), revenue from services (2%), as well as sales of wood chips (2%).

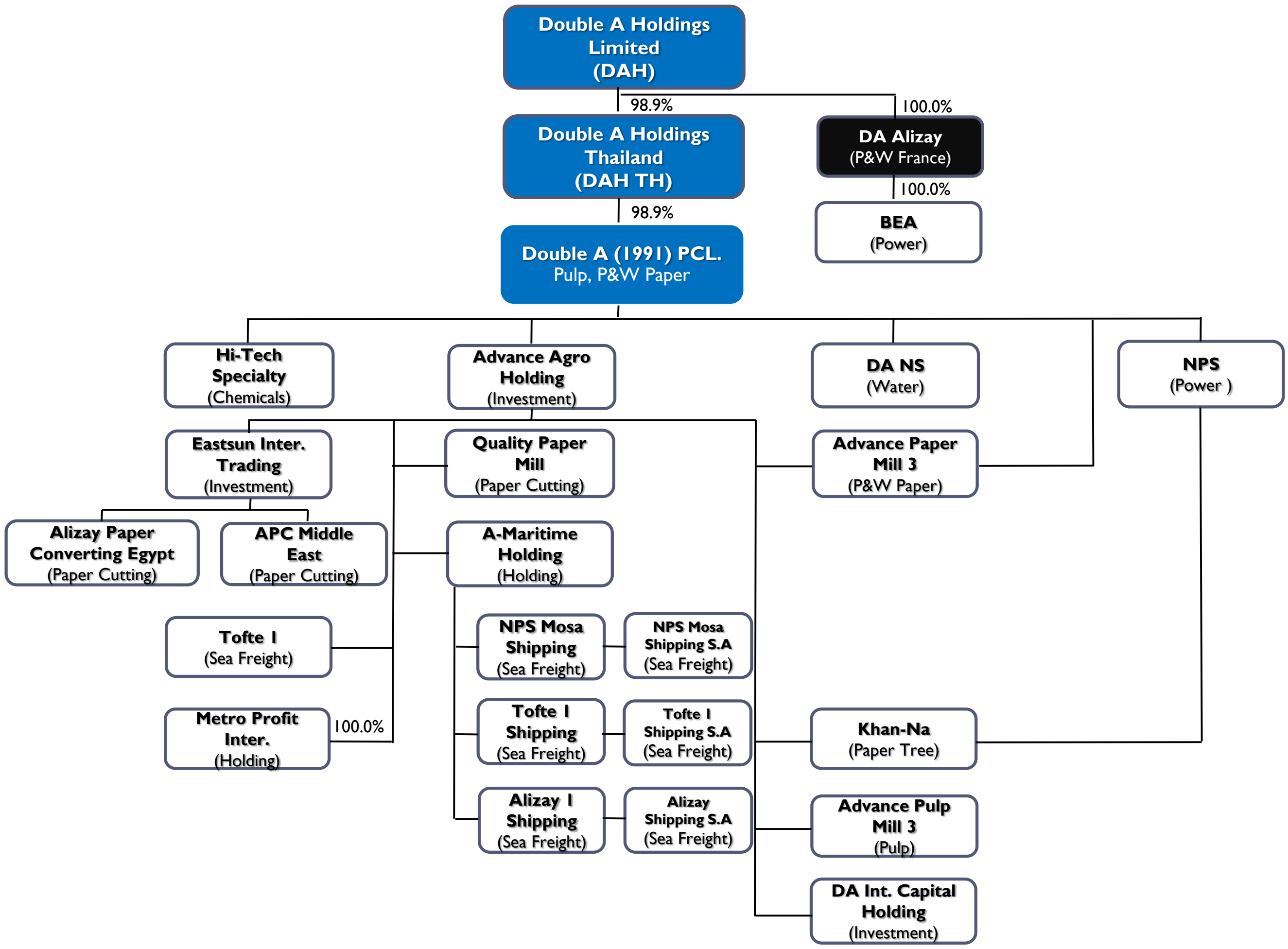
THE DA's GROUP STRUCTURE

Before the group restructuring



Source: DA

After the group restructuring



Source: DA

KEY OPERTING PERFORMANCE

Table 1: Revenue Breakdown

Unit: %

	2014	2015	2016	2017	Jan-Mar 2018
Revenue (Bt mil.)	**22,963**	**23,370**	**26,121**	**25,231**	**5,607**
Paper	96.2	92.5	89.0	94.0	92.6
Pulp	1.8	1.5	2.4	2.9	3.7
Wood chips	2.0	4.4	7.5	1.7	1.5
Services	-	1.6	1.1	1.4	2.1
Total	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**

Source: DA

FINANCIAL STATISTICS AND KEY FINANCIAL RATIOS*

Unit: Bt million

	Jan-Mar 2018	-------------- Year Ended 31 December -------------- 2017	2016	2015	2014
Revenue	5,607	25,231	26,121	23,370	22,963
Gross interest expense	247	1,000	1,171	1,232	1,298
Net income from operations	249	(1,013)	(1,346)	(2,387)	(1,116)
Funds from operations (FFO)	774	2,229	1,124	867	677
Capital expenditures	116	671	950	1,244	1,171
Total assets	39,493	39,743	42,692	43,109	45,170
Total debts	19,194	19,667	20,530	22,308	23,185
Shareholders' equity	12,892	15,545	17,352	16,142	17,084
Operating income before depreciation and amortization as % of sales	17.15	9.70	8.18	3.35	5.87
Pretax return on permanent capital (%)	(0.25)**	(0.71)	(1.04)	(3.57)	(0.11)
Earnings before interest, tax, depreciation, and amortization (EBITDA) interest coverage (times)	4.28	2.36	1.80	0.85	1.75
FFO/total debt (%)	11.95 **	11.33	5.48	3.89	2.92
Total debt/capitalization (%)	59.82	55.85	54.20	58.02	57.58

* *Consolidated financial statements*
** *Adjusted with trailing 12 months*

Double A (1991) PLC (DA)

Company Rating:	BBB-
Issue Rating:	
Up to Bt2,350 million senior unsecured debentures due within 10 years	BBB-
Rating Outlook:	Negative

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