

# EASTERN SUGAR AND CANE PLC

No. 143/2020  
24 September 2020

## CORPORATES

**Company Rating:** BBB  
**Outlook:** Negative

**Last Review Date:** 04/06/20

### Company Rating History:

Date	Rating	Outlook/Alert
04/06/20	BBB	Negative
30/01/20	BBB	Stable

Suchana Chantadisai  
suchana@trisrating.com

Jutatip Chitphromphan  
jutatip@trisrating.com

Wajee Pitakpaibulkij  
wajee@trisrating.com

Sasiporn Vajarodaya  
sasiporn@trisrating.com



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## RATIONALE

TRIS Rating affirms the company rating on Eastern Sugar and Cane PLC (ESC) at “BBB” with a “negative” rating outlook. The rating continues to reflect ESC’s long track record in the sugar industry, diverse sources of income, and reliable financial policies. These strengths are partially offset by ESC’s small size and the inherent volatility faced by producers of commodity products like sugar.

The “negative” outlook reflects our view that ESC will continue to face operational challenges through 2020-2021, as we expect tight supplies of sugarcane as a result of the acute drought in Thailand, persistently weak world sugar price, negative impacts from the imposition of a sugar tax, and the ongoing effects of the Coronavirus Disease 2019 (COVID-19) pandemic.

## KEY RATING CONSIDERATIONS

### Ongoing impact from drought and plummeting sugar price

We expect the drought and the drop in the sugar price will continue to affect the company’s performance during the coming years.

Sugarcane volume for the 2020/2021 production period is anticipated to be about the same as the 2019/2020 season (Thailand’s total sugarcane output of 75 million tonnes). Our base-case forecast assumes the world sugar price will be around 14 cents per pound in 2020 and will rise to 14.5 cents per pound in 2021-2022. As a result, ESC’s revenue is forecast to decline by 21% to around THB5.8 billion in 2020 and THB5.9 billion in 2021. Revenue is expected to climb back to the 2018 level of THB8.2 billion in 2022. Earnings before interest, tax, depreciation, and amortization (EBITDA) is projected to remain low at THB860 million in 2020 and increase to THB980 million in 2021 and THB1.3 billion in 2022.

According to Management, for the first half of 2020, ESC reported revenue and EBITDA at THB3.5 billion and THB490 million, respectively, achieving approximately 60% of our 2020 forecast which already took into account the impact of the drought and a plunge in the sugar price.

### Profitability maintained despite softening revenue

ESC has achieved relatively stable profitability despite the cyclical nature of sugar prices and sugarcane supplies partly thanks to the steady cash flow generated from sales of electricity to the Electricity Generating Authority of Thailand (EGAT) and the Provincial Electricity Authority (PEA). EBITDA margin hovered in the 14%-19% range during 2015-2019.

Nonetheless, given the lower revenue resulting from lower sugarcane output in Thailand and plummeting worldwide sugar prices, the company’s EBITDA margin is expected to be 15%-16% during the forecast years.

### Lengthy experience in the sugar industry

ESC has been active in Thailand’s sugar industry for more than 60 years. In 2019, export sales made up 84% of its revenue in the sugar business. All of ESC’s export customers are international traders. Raw sugar, the main sugar type, made up 70% of ESC’s total sugar sales.

ESC currently focuses on high-quality products such as very high polarization (VHP) sugar and refined sugar. The company is one of just eight producers in Thailand to have received the “Bonsucro” standard certificate. Premium

sugar yields a higher profit margin and attracts more customers.

### **Geographical advantage of production site**

ESC's sugar plants are located in the eastern region of Thailand. Sugarcane, the main raw material to produce sugar, is a cool-weather crop grown primarily in eastern and northeastern Thailand.

In the eastern region, ESC is the only sugar producer in Sa Kaeo province; other sugar mills are located in Chonburi province. Consequently, ESC does not have to compete with other producers to secure sufficient supplies of sugarcane to feed its mills. ESC also enjoys strong relationships with sugarcane growers. The company offers broad-based support to growers, including advances of cash and fertilizer, development of planting techniques, advanced irrigation techniques, and breeding and harvesting tools.

### **Diversified sources of income**

ESC has expanded along the sugar value chain in order to maximize the utilization of sugarcane and by-products of the sugar manufacturing process. ESC's major sugar-related businesses are electricity generation and ethanol production.

ESC's power plants have a combined installed power generation capacity of 123.6 megawatts (MW). Bagasse, a by-product of sugar production, is used as biofuel for electricity generation. The company sells electricity to two state-owned enterprises under long-term power purchase agreements (PPA). EGAT purchases 40 MW of electricity under the Small Power Producer (SPP) scheme while PEA buys 11 MW under the Very Small Power Producer (VSPP) scheme.

ESC has an ethanol production capacity of up to 150,000 litres per day. Buyers of ethanol are the major oil companies in Thailand.

Revenue from the energy business (electricity and ethanol) has increased steadily and now comprises a significant portion of the company's total revenue. In 2019, revenue from the energy segment accounted for 23% of ESC's total revenue; the sugar business made up the balance.

### **Better leverage and cash flow protection expected**

Under our base-case scenario, we expect ESC's leverage to gradually drop over the next three years. No major capital expenditures are expected since the investments needed for new plants and a capacity increase were already made during the past five years. Most of the capital expenditures will go to develop process improvements such as energy saving, implementation of a new software system, and to buy sugarcane harvesters. We expect the company's debt to capitalization ratio to fall below 50% in 2020 (vs. 53% in December 2019), and the net debt to EBITDA to be 6 times in 2020 before gradually improve to 5 times in 2021 and 3.5 times in 2022.

We assess ESC to have adequate liquidity over the next 12 months. The ratio of funds from operations (FFO) to total debt will likely increase to 25% in 2022 from 14% in 2020. We expect the EBITDA interest coverage ratio to be in the range of 5-10 times during 2020-2022. We also expect ESC to have sufficient credit facilities from commercial banks and internal cash flow to fund future capital expenditures.

### **BASE-CASE ASSUMPTIONS**

- Revenues in 2020 to drop by 20% and only slightly increase in 2021, primarily due to a poor harvest leading to a significant decline in volume. Revenues are expected to increase by more than 38% in fiscal year 2022, given a more normalized harvest and stable sugar prices.
- Process improvements to maintain EBITDA margin at 15%-16% over the forecast period.
- Capital expenditure to be THB500 million annually in 2020-2022.

### **RATING OUTLOOK**

The "negative" outlook reflects our concerns over ESC's weakening financial profile as a result of the prolonged and severe drought in Thailand and the plunge in the worldwide sugar price.

### **RATING SENSITIVITIES**

The outlook could be revised back to "stable" if ESC is able to recover its operating performance on a sustained basis while maintaining an acceptable capital structure. On the other hand, the rating downside case could emerge if profitability and earnings fall short of expectations. Any overly aggressive, debt-funded investments that would weaken the debt to capitalization ratio would also be a negative factor for the rating.

## COMPANY OVERVIEW

ESC was established in 1959 by the Wattanavekin family. As of December 2019, the Wattanavekin family collectively held 98.6% of the company's shares.

ESC's first sugar mill, located in Pluak Daeng, Rayong province, had a production capacity of 12,000 tonnes of cane per day (TCD). In 1994, the company relocated to Watthana Nakhon, Sa Kaeo province. Current production capacity is 40,000 TCD. ESC received approval in July 2018 to build a second mill at Wang Sombun, Sa Kaeo province. The new mill has a capacity of 18,000 TCD. The first phase of 8,000 TCD started up in December 2018.

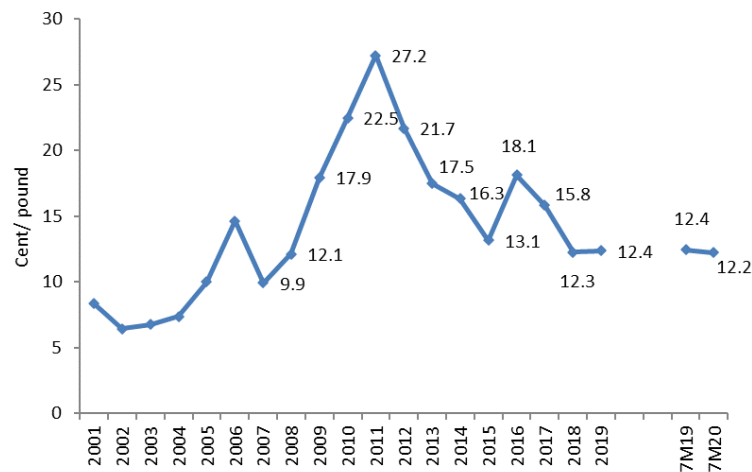
ESC procured 3 million tonnes of sugarcane in the 2019/2020 production period and produced 338,097 tonnes of sugar. For the 2019/2020 production period, ESC's market share, in terms of tonnes of sugar produced in Thailand, was 4%. For comparison, the two market leaders held market shares of around 18.4% and 16.8%, respectively.

ESC's sugar package size is 50 kilograms (kg) while the sale size is 100 kg. Currently, ESC sells white and refined sugar in the domestic market. It exports raw sugar, VHP sugar, and refined sugar.

ESC's sugar-related businesses include the production of electricity, ethanol, and fertilizer, as well as research and development and logistics services.

## KEY OPERATING PERFORMANCE

**Chart 1: Raw Sugar Price 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: Mil tonnes

Sugar Producer	Growing Season					
	2014/2015	2015/2016	2016/2017	2017/2018	2018/2019	2019/2020
Mitr Phol	2.30	1.96	1.98	2.73	2.92	1.61
Thai Roong Ruang	1.60	1.37	1.42	2.13	2.42	1.34
KSL Group	0.91	0.77	0.72	1.20	1.14	0.58
Thai Ekkalak	0.99	0.72	0.94	1.19	1.03	0.60
Wangkanai	0.56	0.51	0.39	0.79	0.69	0.22
Banpong	0.44	0.44	0.44	0.52	0.58	0.38
Kumpawapee	0.40	0.30	0.28	0.41	0.39	0.24
ESC	0.38	0.35	0.38	0.51	0.49	0.34
Buriram Sugar	0.23	0.24	0.25	0.38	0.35	0.22
Others	3.49	3.12	3.23	4.85	4.57	2.76
<b>Total</b>	<b>11.30</b>	<b>9.78</b>	<b>10.03</b>	<b>14.71</b>	<b>14.58</b>	<b>8.29</b>

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

**Table 2: ESC's Revenue Breakdown by Business**

*Unit: %*

Product	2015	2016	2017	2018	2019
Sugar sales	70	74	74	66	68
Ethanol sales	13	12	11	15	14
Electricity sales	8	6	7	9	9
Fertilizer sales	6	5	5	6	5
Service and others	3	3	3	4	4
<b>Total sales</b>	<b>100</b>	<b>100</b>	<b>100</b>	<b>100</b>	<b>100</b>
<b>Total sales (mil. THB)</b>	<b>7,091</b>	<b>7,815</b>	<b>8,472</b>	<b>7,897</b>	<b>7,154</b>

*Source: ESC*

**FINANCIAL STATISTICS AND KEY FINANCIAL RATIOS\***

*Unit: Mil. THB*

	-----Year Ended 31 December -----				
	2019	2018	2017	2016	2015
Total operating revenues	7,338	8,200	8,557	7,911	7,182
Earnings before interest and taxes (EBIT)	128	683	919	745	456
Earnings before interest, taxes, depreciation, and amortization (EBITDA)	1,051	1,421	1,604	1,368	1,051
Funds from operations (FFO)	780	1,144	1,294	1,128	766
Adjusted interest expense	246	228	225	203	265
Capital expenditures	677	1,755	973	1,588	685
Total assets	12,833	13,628	12,038	10,525	10,791
Adjusted debt	6,108	6,234	4,417	4,926	5,622
Adjusted equity	5,364	5,515	5,072	4,460	3,942
<b>Adjusted Ratios</b>					
EBITDA margin (%)	14.32	17.34	18.75	17.29	14.63
Pretax return on permanent capital (%)	1.10	6.33	9.51	7.77	4.86
EBITDA interest coverage (times)	4.27	6.23	7.13	6.72	3.97
Debt to EBITDA (times)	5.81	4.39	2.75	3.60	5.35
FFO to debt (%)	12.77	18.34	29.30	22.90	13.63
Debt to capitalization (%)	53.24	53.06	46.55	52.48	58.79

\* *Consolidated financial statements*

**RELATED CRITERIA**

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

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Eastern Sugar and Cane PLC (ESC)

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<b>Company Rating:</b>	BBB
<b>Rating Outlook:</b>	Negative

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**TRIS Rating Co., Ltd.**

Silom Complex Building, 24th Floor, 191 Silom Road, Bangkok 10500, Thailand Tel: 0-2098-3000

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