

SUB SRI THAI PLC

No. 44/2022
29 March 2022

CORPORATES

Company Rating: BBB-
Outlook: Negative

Last Review Date: 22/03/21

Company Rating History:

Date	Rating	Outlook/Alert
21/04/20	BBB-	Negative
21/04/15	BBB-	Stable
06/12/11	BBB-	Negative
18/03/11	BBB-	Stable
26/02/10	BBB	Developing
17/02/10	BBB	Stable

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RATIONALE

TRIS Rating affirms the company rating on Sub Sri Thai PLC (SST) at “BBB-” with a “negative” outlook. The rating reflects the company’s market position in the highly competitive and fragmented chain restaurant and quick service restaurant (QSR) business as well as reliable cash flows from the storage business. The rating is weighed down by the company’s elevated financial leverage due to continued investment and depressed earnings of the restaurant business caused by the prolonged Coronavirus Disease 2019 (COVID-19) pandemic. The negative outlook reflects our concerns over the company’s sizable investments and uncertainty surrounding the COVID-19 situation which could heighten the company’s debt level and financial leverage.

KEY RATING CONSIDERATIONS

Continued pressure on restaurant segment due to prolonged pandemic

SST’s restaurant business, operated by its core subsidiary, Mud & Hound PLC (MUD), recovered slower than we previously expected due to the prolonged COVID-19 pandemic. The government implemented several measures aimed at curbing the spread of the disease together with dine-in restrictions from time to time in 2021 due to multiple surges in COVID-19 cases and the emergence of new COVID-19 variants. Among all the company’s brands, Greyhound Café (GHC) was the hardest hit as it relies mainly on dine-in sales and its delivery efforts were not particularly successful. Au Bon Pain (ABP) was also severely impacted due to the absence of tourists and the work-from-home trend. The combined sales of GHC and ABP, which accounted for about half of the company’s total restaurant business sales prior to COVID-19, were 53% below the pre-COVID-19 figure. However, revenue from Dunkin’ in 2021 recovered to the pre-pandemic level thanks to outlet expansion. Dunkin’ has shifted its expansion strategy to focus on opening smaller kiosks in gas stations and hypermarkets. The kiosk format requires lower investment per outlet and provides more flexibility to relocate. Locations in gas stations and hypermarkets were also less affected by the COVID-19 restrictions. SST’s restaurants in France and the UK started to pick up in 2021 as both countries relaxed their COVID-19 rules. However, these restaurants did not fully recover in 2021 as there were several surges in infection cases throughout the year.

Revenue from the restaurant business remained flat year-on-year (y-o-y) at THB2.3 billion in 2021, a 24% decline from the 2019 level. Earnings before interest, taxes, depreciation, and amortization (EBITDA) from the restaurant business increased by 20% y-o-y to THB425 million in 2021 thanks to cost control efforts, several rental waivers by landlords, and support from the governments of the UK and France.

Restaurant business to gradually recover with pressure on profitability

We expect the company’s restaurant operating performance to gradually recover as the COVID-19 situation improves. Under our base-case forecast, we expect SST’s revenue from restaurants to range upward from THB2.9-THB3.6 billion per annum in 2022-2024. We expect COVID-19 restrictions will be more relaxed than last year as Thailand and many parts of the world have achieved high vaccination rates and vaccines have proved effective at preventing severe illness and death.

We anticipate more pressure on the restaurant segment's profitability due to intense competition and rising costs. The EBITDA margin of the restaurant business is expected to be around 15% over the forecast period, compared with 18% in 2021, which translates into EBITDA of THB440-THB570 million per annum during 2022-2024. We view that restaurant operators may need to keep offering sales promotions and spend more on marketing activities to stay competitive. We also consider the rising popularity of delivery platforms as a threat to the company's restaurant business as competition further intensifies while its presence on delivery channels is limited. Besides, the Russia-Ukraine war has significantly pushed up utility costs, transportation costs, and the prices of raw materials, especially the price of wheat flour which is one of the major raw materials of Dunkin' and Au Bon Pain. SST is expected to be impacted moderately as the company has secured the price of wheat flour for the first half of 2022. However, rising prices could add further pressure to SST's profitability if the ongoing geopolitical conflicts are protracted.

Overseas growth plan interrupted by COVID-19

As part of an effort to diversify internationally, the company in late 2017 acquired a well-known French restaurant, "Le Grand Vefour", in Paris. The company also opened its first owned GHC restaurant outside of Thailand in London in the same period. However, the performance of both restaurants fell short of expectations pre-COVID-19 and worsened during the pandemic. In addition, the company, together with business partner, Mr. Guy Martin, the head chef of Le Grand Vefour, opened another four restaurants in Paris, namely, "Pasco", "Augustin", and "A-Noste" in 2020, and "La Mere Lachaise" in early 2022.

We hold the view that the overseas expansion adds uncertainty to the company's business risk profile as the operating environments of the restaurant industry vary widely from country to country. Headwinds caused by the pandemic are also intensifying the challenges. However, if the overseas expansion is successful, it will provide the company with more diversified sources of revenue and better opportunities for growth.

Steady cash flows from storage business

SST's storage business provides reliable cash flow for the company. During the past three years, revenue from the storage business was around THB380-THB400 million annually, with an adjusted EBITDA margin of around 50%-60%. Going forward, we expect a modest revenue growth in SST's storage business. Under our base-case forecast, storage revenue is projected to be THB400-THB430 million per annum during 2022-2024. EBITDA margin is expected to remain around 60% over the same period.

Investment in new business delayed

SST is expanding into the hotel business by investing in a project in Phuket's city center, featuring a 62-room hotel and a restaurant. The total construction cost is estimated at THB280 million. The project will be funded by debt. The initial completion date was set for the end of 2020; however, architectural revisions and the COVID-19 fallout have delayed the project. The company now aims to open the restaurant in late 2022 while timeline for the hotel has been further delayed as the COVID-19 situation remains unsettled.

Elevated financial leverage

SST's financial leverage fell y-o-y but remained elevated in 2021 due to depressed earnings in the restaurant business caused by the ongoing COVID-19 pandemic and the company's continued investment in restaurant outlet expansion. The company's debt to EBITDA ratio fell to 4.7 times in 2021, compared with 5.4 times in 2020. Under our base-case forecast, we expect SST's debt to EBITDA ratio to edge up to 5.2 times in 2022 due to expected sizable capital spendings, before gradually improving to 4.1 times in 2024 as its earnings recover to pre-COVID levels. We expect capital expenditure of around THB490 million in 2022, and around THB350 million in total in 2023-2024. We expect the capital spendings to be used for outlet expansion, especially for the Dunkin' brand, expansion of the warehouse business, and investment in other businesses.

As of December 2021, SST had consolidated debt of THB1.9 billion, of which THB1.7 billion was considered priority debt. SST's priority debt comprised secured loans at the parent company and secured and unsecured loans at subsidiaries. As its priority debt ratio was 87%, higher than the threshold of 50% according to TRIS Rating's "Issue Rating Criteria", we view that SST's senior unsecured creditors could be significantly disadvantaged to its priority debt holders with respect to claims against the company's assets.

SST's debentures have a key financial covenant that requires the company to maintain its interest-bearing debt to equity ratio below 3 times. As of December 2021, the ratio was 0.59 times. The company's long-term bank loan also has key financial covenants that require the company to maintain the total liabilities to equity ratio below 2.5 times. As of December 2021, the ratio was 1.6 times. Going forward, we view that the company has sufficient headroom to remain in compliance with both financial covenants over the forecast period.

Tight liquidity

We assess SST's liquidity to be tight during the next 12 months. The company's sources of funds comprised cash and cash equivalents of around THB320 million as of December 2021, projected funds from operations (FFO) of around THB500 million, and available credit lines of around THB180 million. The company's uses of funds include debt repayments of around THB470 million, lease obligations of around THB350 million, and expected capital expenditures of THB490 million. SST may need to refinance a major portion of its debts coming due and secure additional funding to be able to carry out its investment plan.

BASE-CASE ASSUMPTIONS

- Revenue to range upward from THB3.3-THB4.1 billion annually during 2022-2024.
- EBITDA of THB680 million in 2022 and THB790-THB840 million per annum during 2023-2024.
- Capital spending to be around THB490 million in 2022 and THB350 million in total during 2023-2024.

RATING OUTLOOK

The "negative" outlook reflects our concerns over the company's planned sizable investments coupled with uncertainty surrounding the COVID-19 situation which could heighten the company's debt level and financial leverage beyond our expectations.

RATING SENSITIVITIES

We could downgrade the rating on SST if its credit metrics are weaker than our expectations, either from a prolonged negative impact of COVID-19 or aggressive debt-funded investments, such that its adjusted debt to EBITDA ratio remains above 5 times on a sustained basis. We could revise the outlook to "stable" if the company's operating performance demonstrates signs of sustainable recovery such that the credit metric outperforms or tracks our base-case projection.

COMPANY OVERVIEW

SST was established in 1976 and listed on the Stock Exchange of Thailand (SET) in 1994. As of May 2021, the Sukhanindr family and affiliates held about 66% of SST's total shares. SST operates three lines of business: restaurant and QSR, fashion and lifestyle, and storage.

In 2012, SST expanded into the restaurant and QSR segment by acquiring MUD, the master franchisee of the "Dunkin' Donuts", "Au Bon Pain", and "Baskin Robbins" brands in Thailand. In July 2014, SST, through MUD, acquired the Greyhound Group (Greyhound). Greyhound operates the GHC restaurant chain and produces and distributes Greyhound fashion and lifestyle products. The company also has five restaurants in France including Le Grand Vefour, Pasco, Augustin, A-Noste, and La Mere Lachaise. As of December 2021, the company operated 558 QSR and restaurant outlets and one food court.

KEY OPERATING PERFORMANCE

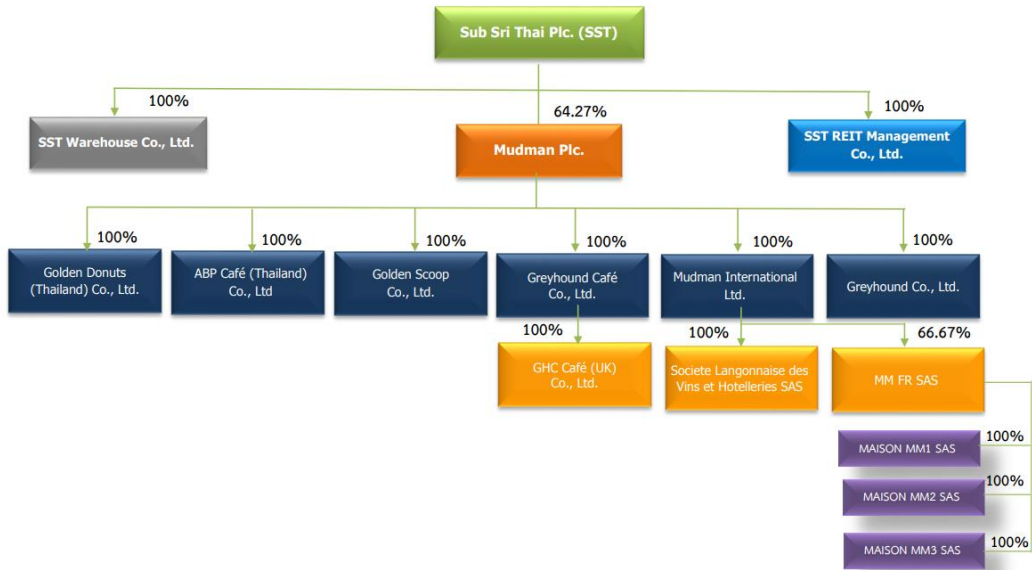
Table 1: SST's Revenue by Line of Business

Unit: %

Business	2015	2016	2017	2018	2019	2020	2021
Storage	9	10	11	11	12	15	15
Food	83	84	85	85	84	79	79
Fashion	8	6	4	4	4	6	6
Total revenues (million THB)	3,074	3,214	3,159	3,476	3,317	2,565	2,551

Source: SST

Chart 1: SST's Group Structure



Source: SST

FINANCIAL STATISTICS AND KEY FINANCIAL RATIOS
Unit: Mil. THB

	-----Year Ended 31 December -----				
	2021	2020	2019	2018	2017
Total operating revenues	2,716	2,730	3,479	3,652	3,304
Earnings before interest and taxes (EBIT)	100	(42)	138	210	137
Earnings before interest, taxes, depreciation, and amortization (EBITDA)	666	575	776	755	719
Funds from operations (FFO)	476	387	574	573	528
Adjusted interest expense	173	182	174	162	169
Capital expenditures	238	279	195	189	281
Total assets	6,985	6,964	5,581	5,707	6,217
Adjusted debt	3,140	3,118	2,894	2,649	2,615
Adjusted equity	2,679	2,812	3,244	3,290	3,269
Adjusted Ratios					
EBITDA margin (%)	24.51	21.08	22.31	20.69	21.75
Pretax return on permanent capital (%)	1.60	(0.68)	2.20	3.31	2.29
EBITDA interest coverage (times)	3.84	3.17	4.46	4.65	4.25
Debt to EBITDA (times)	4.72	5.42	3.73	3.51	3.64
FFO to debt (%)	15.17	12.40	19.85	21.63	20.18
Debt to capitalization (%)	53.96	52.58	47.14	44.60	44.44

RELATED CRITERIA

- Key Financial Ratio and Adjustments for Corporate Issuers, 11 January 2022
- Issue Rating Criteria, 15 June 2021
- Rating Methodology – Corporate, 26 July 2019

Sub Sri Thai PLC (SST)

Company Rating:	BBB-
Rating Outlook:	Negative

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