

KHON KAEN SUGAR INDUSTRY PLC

No. 113/2017

11 September 2017

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

Company Rating History:

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

Contacts:

Jutatip Chitphromphan
jutatip@trisrating.com

Nauwarut Temwattanangkul
nauwarut@trisrating.com

Rungrat Suntornpagasit
rungrat@trisrating.com

WWW.TRISRATING.COM**Rating Rationale**

TRIS Rating affirms the company rating and the ratings of the senior unsecured debentures of Khon Kaen Sugar Industry PLC (KSL) at "A". The ratings reflect the company's long track record in the sugar and sugarcane industry, as one of the leading sugar producers in Thailand, and diversification into sugar-related businesses. The ratings are partially offset by the cyclical nature of sugar prices and the volatility of sugarcane, the operational risks of KSL's sugar operations in the Lao People's Democratic Republic (Lao PDR) and Cambodia, as well as a relatively high level of its leverage.

KSL is one of the leading sugar producers in Thailand, established in 1945 by the Chinthammit family and associates. As of April 2017, the Chinthammit family collectively held 68% 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 May 2017. KSL Group procured 6.8 million tonnes of sugarcane in the 2016/2017 crushing period and produced 724,549 tonnes of sugar. KSL's sugar production in the 2016/2017 growing season ranked it fourth in the industry, with a market share of 7.2%, trailing the Mitr Phol Group (19.7%), the Thai Roong Ruang Group (14.1%), and the Thai Ekkalak Group (9.4%).

Since fiscal year (FY) 2006, KSL has expanded along the sugar value chain to maximize the utilization of sugarcane. KSL's sugar-related businesses include generating electricity and producing ethanol. During FY2016, revenue from the energy segment (electricity and ethanol) accounted for 17% of total sales.

Sugar prices have fallen during the past two years. The key contract reference price, set by Thai Cane and Sugar Corp Ltd. (TCSC), fell gradually from 18.4 cents per pound in the 2013/2014 production season to 15.4 cents per pound in the 2015/2016 season. In addition to the lower sugar prices, a severe drought in Thailand cut the amount of cane that KSL crushed. KSL crushed 7.61 million tonnes of cane in the 2015/2016 season, down from 8.47 million tonnes in the 2013/2014 season. The falling prices of ethanol and power tariff along with the falling fuel transfer (Ft) also hurt KSL's operating performance in 2015 and 2016. KSL's operating income before depreciation and amortization as a percentage of total sales declined to 13.9% in FY2015 and 12.9% in FY2016 from 18.3% in FY2014. As a result, KSL's earnings before interest, taxes, depreciation, and amortization (EBITDA) gradually declined from Bt3,879 million in 2014 to Bt2,473 million in 2016. Funds from operations (FFO) also declined, sliding from Bt2,916 million to Bt1,381 million over the same time period.

For the first six months of FY2017, KSL's revenues declined to Bt7,533 million, a 3% year-on-year (y-o-y) decrease over the same period of the prior year. The profit margin rose to 24.1% in the first six months of FY2017, from 21.3% in the first six months of FY2016, following a rise in the average selling price of sugar. KSL, as well as most sugar millers in Thailand, has locked in some contracts during the high sugar prices. The pick-up in the sugar segment outweighed the weak profitability in the company's energy segment. The recent rise in sugar prices improved KSL's financial performance of the Lao PDR and Cambodia. Sugar operations in the Lao PDR and Cambodia reported small gain for the first time in the first half of FY2017. KSL's EBITDA rose to Bt2,368 million, a 39% y-o-y increase, from Bt1,701 million over the same period of FY2016.

KSL's debt level improved modestly, but the total debt to capitalization ratio declined to 53.1% at the end of FY2016 from 58.1%-59.8% during FY2013-FY2016. This improvement came mainly from gains on the revaluation of assets and reclassification of financial statement of Thai Sugar Terminal PLC (TSTE) from consolidation to equity method. Cash flow protection is cyclically down following the swings in sugar prices. The EBITDA interest coverage ratio was 3.48 times in FY2016, down from 3.61 times in FY2015 and 4.65 times in FY2014. The FFO to total debt ratio was 7.3% in FY2016, compared with 9.1% in FY2015 and 13.2% in FY2014.

In July 2017, KSL announced the amalgamation of KSL Green Innovation PLC (KSLGI) and BBP Holding Co., Ltd. (BBH), the subsidiaries of Bangchak Corporation PLC (BCP). The two companies will be combined into a new company, a business alliance for bio-based products. BCP will hold 60% of the new merged company, the remaining 40% will be held by KSL. The amalgamation will strengthen the position in the bio-based products as the new company will become Thailand's largest producer of bio-fuel. The earnings of the new company will be less volatile as ethanol is made from molasses and tapioca while having earnings from biodiesel from palm oil. The amalgamation will be completed on 31 October 2017. The new company has planned an initial public offering (IPO) sometime from November 2017 through October 2018. The new company will raise the funds it needs to expand after being listed on the stock market. The amalgamation will affect insignificantly KSL's debt level. However, KSL will report a gain from selling KSLGI and reclassify KSLGI on its financial statements, shifting from the full consolidation to the equity method.

The ongoing revision of the Cane and Sugar Act poses some uncertainty ahead for the Thai sugar millers. In February 2017, the Cane and Sugar Board of Thailand agreed in principle to revoke the current quota system. The domestic prices of sugar will no longer be fixed. The working group is still discussing the related details. The potential effects of the regulatory changes are not yet clear as the details have not been finalized.

Looking forward, KSL's performance in 2017 will be under pressure because a drought has reduced the supply of sugar cane and pushed cane cost higher. In TRIS Rating's base case forecast, FFO is expected to hover around Bt1,500 million in FY2017, and then gradually recover to Bt2,000 million in FY2018 and Bt2,500 million in FY2019 as crushed cane and sugar production both increase. Higher rainfall in Thailand and an expansion of cane crushing capacity at the mill in Loei province will reduce KSL's cost and increase sugar volume. The cost reduction and higher sugar volume should outweigh the weak sugar prices in FY2018. KSL's capital expenditures, which are mainly for expansions of cane crushing plants at the Loei and Nampong projects, are completed in FY2017. Capital spending will then fall to about Bt500 million per year from Bt3,000 million per year in 2017. With FFO and lower capital expenditures as forecast, KSL's debt level will be lower. Cash flow protection as measured by the FFO to total debt ratio, is expected to gradually improve to range from 10%-15% in FY2018-FY2019 as earnings rise and outstanding debt declines. Liquidity is considered manageable. Even though KSL has scheduled the long-term debt repayments and debentures redemptions totaling Bt3,400-Bt4,600 million per year in FY2017-FY2020 plus outstanding bills of exchange (B/E) of Bt500 million, KSL has market access and undrawn credit facilities of more than Bt9,000 million from various banks to help it manage these repayments.

Rating Outlook

The "stable" outlook reflects TRIS Rating's expectation that KSL will maintain its competitive position in the Thai sugar industry even after the sugar industry is restructured. The company is also expected to gradually realize returns from the expansion projects and manage its debt level properly.

KSL's rating upside is limited in the short term due to weak sugar prices and ongoing industry reforms. In contrast, KSL's ratings could be revised downward, should operating profitability and earnings fall short of expectation. An aggressive debt-funded investment and persistently weak cash flow protection are also negative factors for KSL's credit ratings.

Khon Kaen Sugar Industry PLC (KSL)

Company Rating:	A
Issue Ratings:	
KSL189A: Bt1,000 million senior unsecured debentures due 2018	A
KSL192A: Bt1,000 million senior unsecured debentures due 2019	A
KSL198A: Bt1,000 million senior unsecured debentures due 2019	A
KSL199A: Bt1,000 million senior unsecured debentures due 2019	A
KSL202A: Bt1,000 million senior unsecured debentures due 2020	A
Rating Outlook:	Stable

Financial Statistics and Key Financial Ratios*

Unit: Bt million

	----- Year Ended 31 October -----					
	Nov 2016 -Apr 2017	2016	2015	2014	2013	2012
Sales and service revenues	7,533	16,911	17,278	19,185	18,941	22,212
Gross interest expense	334	710	817	834	672	556
Net income from operations	813	472	974	1,645	1,456	2,300
Funds from operations (FFO)	2,062	1,381	1,919	2,916	2,595	3,279
Total capital expenditures and investment	1,597	1,685	651	2,702	6,186	4,379
Total assets	47,407	38,375	37,517	40,134	36,017	29,617
Total debt	26,414	18,824	21,213	22,021	19,003	14,022
Shareholders' equity	17,304	16,650	14,442	14,833	13,703	12,032
Operating income before depreciation and amortization as % of sales	23.54	12.93	13.89	18.32	15.23	19.06
Pretax return on permanent capital (%)	5.08 **	3.81	4.99	7.90	7.64	15.63
Earnings before interest, tax, depreciation, and amortization (EBITDA) interest coverage (times)	7.14	3.48	3.61	4.65	4.75	8.15
FFO/total debt (%)	8.79 **	7.33	9.05	13.24	13.66	23.38
Total debt/capitalization (%)	60.42	53.06	59.49	59.75	58.10	53.82

* Consolidated financial statements

** Annualized with trailing 12 months

TRIS Rating Co., Ltd.

Tel: 0-2231-3011 ext 500 / Silom Complex Building, 24th Floor, 191 Silom Road, Bangkok 10500, Thailand www.trisrating.com

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