

# SRI TRANG AGRO-INDUSTRY PLC

No. 175/2019  
25 October 2019

## CORPORATES

<b>Company Rating:</b>	BBB+
<b>Issue Ratings:</b>	
Senior unsecured	BBB+
<b>Outlook:</b>	Negative

Last Review Date: 26/10/18

### Company Rating History:

Date	Rating	Outlook/Alert
27/10/17	BBB+	Stable
05/08/11	A-	Stable
20/11/10	BBB+	Positive
30/09/09	BBB+	Stable
14/09/07	BBB	Stable

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## RATIONALE

TRIS Rating affirms the company rating on Sri Trang Agro-Industry PLC (STA) and the ratings on its senior unsecured debentures at “BBB+”, but revises the rating outlook to “negative” from “stable”.

The “negative” outlook reflects TRIS Rating’s opinion that the currently deteriorating business conditions could materially impact STA’s operating performance and financial strength over the next one to two years.

The ratings continue to reflect STA’s leading position in the natural rubber (NR) industry, its competitive edge in vertical integration, and the strong track record of the management team. However, STA’s business profile is constrained by the cyclical and volatile nature of NR prices as well as economic slowdowns in the rubber importing countries.

## KEY RATING CONSIDERATIONS

### Challenging in the NR industry

An excess supply and softening demand in the NR industry led to subdued global NR prices in 2018 and the first half of 2019. The average NR price fell by 17% year-on-year (y-o-y) to US\$1,365 per ton in 2018 from US\$1,647 per ton in 2017. However, global NR prices rose modestly to US\$1,455 per ton in the first six months of 2019.

According to the International Rubber Study Group (IRSG), the global economic slowdown and the impacts from the trade tensions contributed to the reduction in NR consumption, which rose by a mere 1.5% in the first three months of 2019, compared with 4.2% in 2018. However, NR consumption in Thailand increased by 4.0%, higher than the global average.

TRIS Rating expects the oversupply situation to gradually ease. NR production is expected to increase at a slow pace of 1.1%-2.8% per year during 2019-2022, mainly due to the discouragement for new plantings, delays in replanting schedules, and the uprooting of rubber trees to make way for more profitable crops.

### Many NR processors in Thailand ceased operations

Facing challenges and uncertainties; some NR processors in Thailand have ceased operations. Moreover, trade tensions are now driving some Chinese tire manufacturers to relocate their manufacturing facilities from China to Thailand. Thus, STA can take advantage of its economies of scale and resource capacity.

### Softening operating margin

STA’s profit margin fluctuates along with NR prices and exchange rates. However, the company can partially mitigate these risks by utilizing hedging mechanisms. STA’s operating margin, as measured by operating income before depreciation and amortization as a percentage of sales (including gains or losses from derivatives instruments) ranged from 0.22% to 3.57% during 2016-2017.

To cope with the ongoing challenges and to improve profitability, STA has employed a profit-focused strategy emphasizing high-margin products since 2018. As a result, the company’s operating profit margin improved to 7.81% in 2018 from 0.22% in 2017. However, the operating margin dropped to 3.8% in the first half of 2019. The fall was caused by higher raw material costs of

NR, coupled with the appreciation of the Thai baht.

### **Glove business expansion**

Approximately 20% of STA's revenue was contributed by the glove business during 2018 through the first half of 2019. Recently, STA completed the amalgamation of Sri Trang Gloves (Thailand) Ltd. (STGT) and Thaikong PLC (TK), a glove producer based in Trang province with a total annual production capacity of 4 billion pieces. The amalgamation will increase the company's total glove production capacity to 21.2 billion pieces per annum. STA aims to become one of the world's top three glove producers in the next few years.

### **Acceptable capital structure**

STA's total debt to capitalization ratio rose slightly to 48.8% at the end of June 2019, up from 47.6% at the end of 2018. This was due to STA's greater need for working capital and capital expenditures. In our forecast, we expect STA's annual capital expenditures to vary in the 2019-2022 period, most of which being used for capacity expansions, specifically in glove production and block rubber processing. We view that STA still has acceptable debt servicing. The earnings before interest tax depreciation and amortization (EBITDA) interest coverage ratio is expected to remain above 4 times. We assess the company's liquidity to remain manageable with sufficient credit facilities from commercial banks and internal cash flow to meet funding needs.

### **BASE-CASE ASSUMPTIONS**

- Total revenues to drop by 18% in 2019 but to rise gradually by 4%-10% per annum in 2020-2022.
- Gross profit and operating margins to be in the 8%-10% and 5%-8% ranges, respectively.
- Total capital spending to be around Bt3 billion in 2019, and Bt0.8-Bt2 billion during 2020-2022.

### **RATING OUTLOOK**

The "negative" outlook reflects TRIS Rating's view that the currently deteriorating business conditions could materially impact STA's operating performance and financial strength over the next one to two years.

### **RATING SENSITIVITIES**

The rating outlook could be revised back to "stable" if STA is able to improve its operating performance on a sustained basis. On the contrary, STA's rating could be downgraded if the company's profitability and cash flow continue to deteriorate, resulting in the adjusted net debt to EBITDA ratio exceeding 8.0 times on a sustained basis.

### **COMPANY OVERVIEW**

STA is a worldwide leading processor and merchandiser of NR. The company has 40 rubber processing plants for block rubber, ribbed smoked sheet, concentrated latex, and gloves. The company's plants are located in Thailand, Indonesia, and Myanmar. As of 30 June 2019, the company's total optimum NR processing capacity was 2,204,460 tonnes per year and glove production capacity was 21.2 billion pieces per year.

Approximately 83% of its NR products are sold directly to customers, which are mostly tyre manufacturers. Exports accounted for 83% of total sales volume. China was the largest export market, accounting for 41% of export volume during the first half of 2019.

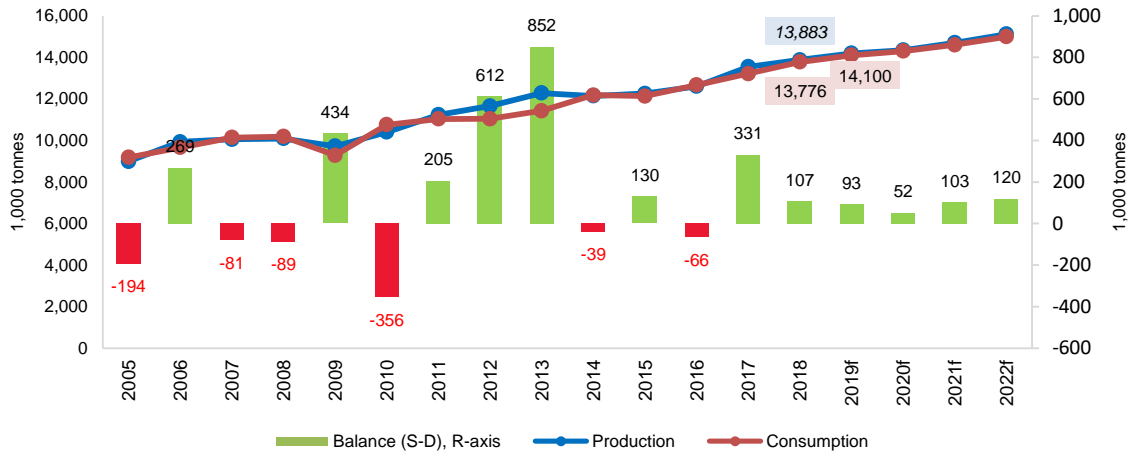
Currently, the major NR producing nations are Thailand, Indonesia, Vietnam, and Malaysia. In the first three months of 2019, these four countries accounted for 75% of the NR produced worldwide. Thailand was the largest producer, with a total production volume of 1.32 million tonnes, followed by Indonesia (0.84 million tonnes), Vietnam (0.26 million tonnes), and Malaysia (0.18 million tonnes). In terms of consumption, demand for NR worldwide has increased to 13.78 million tonnes in 2018 from 10.76 million tonnes in 2010. It grew at an average of 3.1% per annum. China consumes around 38.6% of the global NR consumption. However, worldwide NR consumption rose by only 1.5% in the first three months of 2019 following slower demand growth in the global automotive sector.

STA's rubber glove segment is split into two product types, latex gloves and nitrile examination gloves. Latex gloves made up 70% of sales volume in this segment during the first half of 2019. The vast majority, around 85%-89% of output, is sold under private label brands. STA sells the balance under its own brand names, such as "Sri Trang Gloves", "I'M GLOVE", and other brands.

STA exports gloves to over 100 countries around the world. The main markets are America and European markets, which have typically accounted for 50% of glove sales volume.

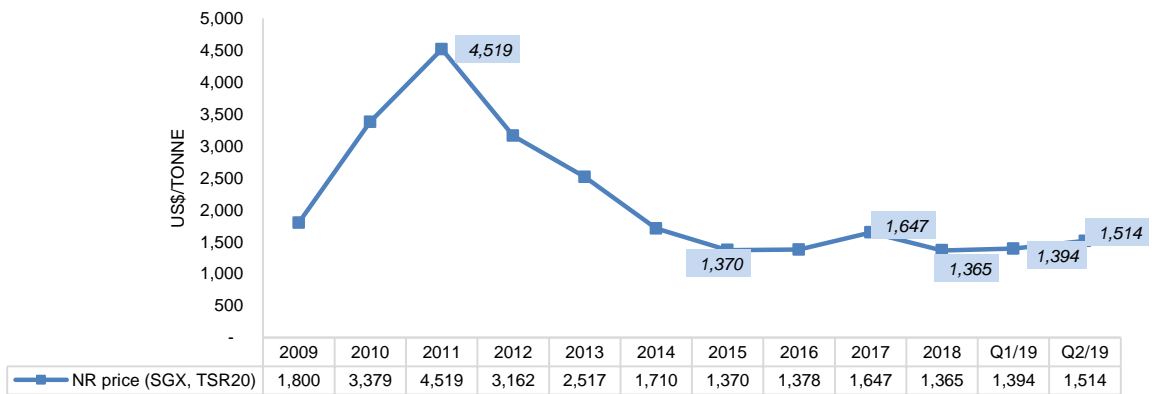
**KEY OPERATING PERFORMANCE**

**Chart 1: World Production and Consumption of Natural Rubber**



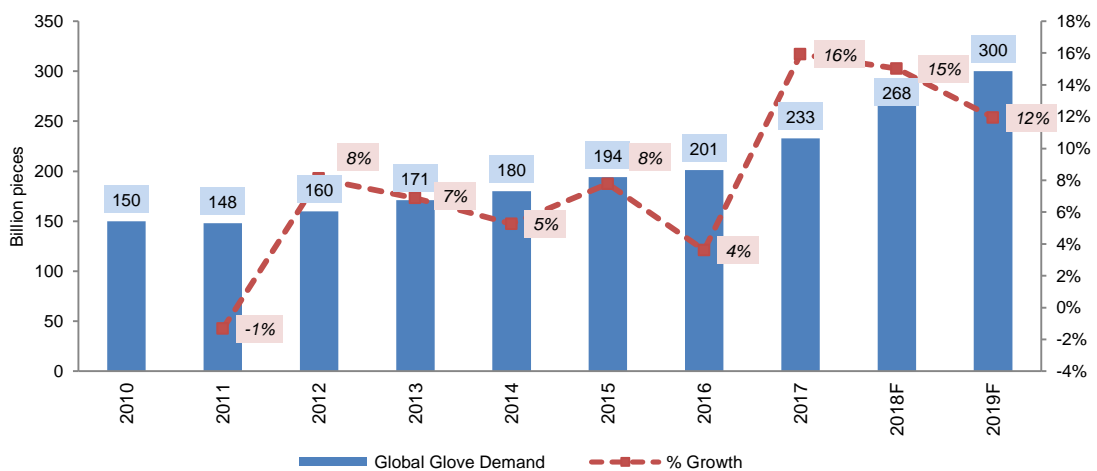
Source: International Rubber Study Group (IRSG)

**Chart 2: Natural Rubber Prices**



Source: IRSG

**Chart 3: Global Glove Consumption**



Source: Malaysia Rubber Glove Manufacturers Association (MARGMA)

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

Unit: Bt million

	Jan-Jun 2019	-----Year Ended 31 December -----			
		2018	2017	2016	2015
Total operating revenues	30,158	73,661	89,565	77,410	61,439
Operating income	1,147	5,752	198	536	2,194
Earnings before interest and taxes (EBIT)	222	3,260	(1,076)	(306)	2,004
Earnings before interest, taxes, depreciation, and amortization (EBITDA)	1,481	5,683	3,070	579	2,493
Funds from operations (FFO)	944	4,500	1,818	130	1,584
Adjusted interest expense	494	942	1,231	732	878
Capital expenditures	2,046	2,786	3,167	2,295	2,617
Total assets	55,326	55,748	59,708	55,959	43,879
Adjusted debt	24,139	22,923	30,600	30,469	17,326
Adjusted equity	25,300	25,100	23,277	19,912	21,334
<b>Adjusted Ratios</b>					
Operating income as % of total operating revenues (%)	3.80	7.81	0.22	0.69	3.57
Pretax return on permanent capital (%)	2.69 **	6.02	(1.99)	(0.66)	5.29
EBITDA interest coverage (times)	3.00	6.03	2.49	0.79	2.84
Debt to EBITDA (times)	6.01 **	4.03	9.97	52.66	6.95
FFO to debt (%)	12.13 **	19.63	5.94	0.43	9.14
Debt to capitalization (%)	48.83	47.73	56.80	60.48	44.82

\* 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

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**Sri Trang Agro-Industry PLC (STA)**

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<b>Company Rating:</b>	BBB+
<b>Issue Rating:</b>	
STA215A: Bt1,455 million senior unsecured debentures due 2021	BBB+
<b>Rating Outlook:</b>	Negative

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**TRIS Rating Co., Ltd.**

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