CARABAO GROUP PLC

No. 157/2017

20 November 2017

Company Rating: A-

Outlook: Stable

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Rating Rationale

TRIS Rating assigns the company rating of Carabao Group PLC (CBG) at "A-". The rating reflects CBG's well-recognized brand name and strong position in the energy drink market in Thailand, growing distribution network, and moderate but rising level of leverage. The rating is constrained by CBG's reliance on a limited range of products, and the uncertainty surrounding the expansion efforts in the United Kingdom (UK), which might put pressure on profitability over the next few years.

The company started its operation to manufacture, market, and sell energy drink products under the "Carabao Dang" trademark in 2002, as a joint investment by Mr. Sathien Setthasit, Ms. Nutchamai Thanombooncharoen, and Mr. Yuenyong Opakul. CBG was incorporated as a holding company in 2013, owning subsidiaries which handle energy drink production, amber glass bottle manufacturing, and domestic distribution. The company was listed on the Stock Exchange of Thailand (SET) in 2014. As of August 2017, the three co-founders together controlled 71% of the company's outstanding shares.

The strength of the "Carabao Dang" brand has been built around the popularity of the legendary musical band, "Carabao". With savvy marketing campaigns and on-the-ground marketing activities, Carabao Dang is the second most popular energy drink in Thailand, capturing a 24.6% market share as of the first half of 2017. Apart from the domestic market, CBG exports energy drinks to several countries, such as Cambodia, Myanmar, Vietnam, Afghanistan, and China. Export revenue has been growing rapidly, accounting for 40% of CBG's total revenue in 1H2017.

Another strength lies in CBG's distribution network. Traditional trade (TT) accounts for the company's majority of domestic sales, 78% in the first half of 2017, while the rest is distributed through modern trade (MT). Distribution in the TT channel uses a multi-tier agent model. Recently, in an attempt to broaden coverage in the TT channel, CBG has set up regional distribution centers (DC) so that it can reach more rural retail outlets via a cash van operation. CBG has 31 distribution centers and 337 cash vans, covering over 220,000 retail outlets in 73 provinces. We expect cash van sales to be the main factor driving an increase in domestic market share.

In addition to energy drinks, CBG offers a few other branded products. The electrolyte drink "Start Plus" was launched in 2014. It has also marketed ready-to-drink coffee, 3-in-1 coffee powder, and drinking water, all under the "Carabao" trademark. Moreover, to fully utilize its distribution network, CBG provides distribution services for third party products. However, these non-energy drink products comprise only a fraction of CBG's income. CBG's reliance on the energy drink market is one of the factors weighing on its risk profile.

The energy drink market in Thailand shrank by 3.1% in 2016 and declined by 2.5% year-on-year (y-o-y) in the first half of 2017. We see limited growth prospect for the domestic energy drink market as it is quite saturated. In addition, the new tax on sugar, effective in September 2017, is expected to cause the related taxes to increase from 2020 onwards. If the additional cost cannot be passed on to consumers, profit margins across the industry will be negatively affected. On the other hand, if the energy drink prices are raised by enough to offset the additional taxes, it is unclear how demand for energy drinks would be affected given that energy drinks in Thailand have a history of price stickiness.

Expansions to overseas markets are crucial to CBG's growth prospect, especially to China and to the UK since both countries are the large energy drink markets. CBG aims to capture sizable market shares in these two countries. For the UK market, in late 2016, CBG acquired 51% of the shares in UK-based Intercarabao Ltd. (ICUK). ICUK's main activities are the marketing, sale, and distribution of CBG's energy drinks in the UK. CBG has been spending major marketing expenses by entering into agreements to sponsor Chelsea Football Club (Chelsea FC) during 2016-2021 and to sponsor the English Football League Cup (EFL Cup), which was renamed "Carabao Cup", during 2017-2020. The sponsorships cost around £50 million over the sponsorship period. Expanding into China, on the other hand, entails less risk for CBG. The company does not plan to make any big investments in marketing and distribution on its own. Instead, a group of CBG's major shareholders will make the investments, buying energy drink products from CBG to market in China. CBG will be offered the first right to buy the operation in China when it starts to make a profit. As a result, there is limited downside risk from the expansion in China at this stage.

CBG's financial profile has been strong, but it is expected to weaken over the next few years. The huge sponsorship expenses in the UK will help the expansion in the UK and internationally. However, the huge expenses will put pressure on CBG's profitability over the next few years until the full benefits of the global brand building are realized. In addition, CBG has planned a considerable amount of capital expenditures to expand production capacities. CBG will spend approximately Bt6,800 million over 2016-2018. The investment will increase the capacity for bottling, canning, and producing amber glass bottles. The budget also includes the opening of a new aluminum can production facility, as a joint venture with Showa Denko Group, a Japanese partner experienced in aluminum products.

CBG's revenue has grown strongly at an 18% compound annual growth rate (CAGR) over the last five years, reaching Bt9,965 million in 2016. The growth was mainly driven by the effective domestic distribution network, a well-established brand, and success overseas, notably in Cambodia. Revenue for the first nine months of 2017 continued to grow to Bt9,724 million, a 37% increase y-o-y, driven by growth in overseas markets. The balance sheet is strong, with the total debt to capitalization ratio of 36% as of September 2017, but the level of leverage is rising.

Under the base case assumptions, TRIS Rating forecasts CBG's revenue CAGR will be above 20% over the next four years, as it starts to penetrate the markets in China and the UK. We forecast the operating margin will decline, sliding to 11%-14% during 2017-2020, down from 19% in 2016. The drop is due to the high sponsorship expenses for the Chelsea FC and the Carabao Cup. We project leverage to increase significantly because of the planned capital expenditures and the sponsorship expenses. The total debt to capitalization ratio, at its peak, will stay below 45% in 2018, before declining below 38% by 2020. The company will have adequate liquidity, considering cash on hand and marketable security, free cash flow from operation, and available credit lines with financial institutions relative to planned capital expenditures and near-term debt obligations. The ratio of funds from operations (FFO) to total debts will stay at acceptable level over 25% and the ratio of earnings before interest, tax, depreciation, and amortization (EBITDA) interest coverage will range between 10-17 times during 2017-2020.

Rating Outlook

The "stable" outlook is based on the expectation that CBG will be able to maintain its market position in the domestic market, while successfully expanding in the UK market as planned. CBG's operating performance and leverage should both improve in 2019 after a possible deterioration in 2017 and 2018.

The rating could be revised downward if CBG's profitability is weaker than expected for a prolonged period of time or if the company implements more aggressive financial policies. A rating upgrade is unlikely in the near term, given the sizable investment plan and the expansion efforts in the UK.

Carabao Group PLC (CBG)

Company Rating:	A-
Rating Outlook:	Stable

Financial Statistics and Key Financial Ratios*

Unit: Bt million

	Jan-Sep 2017	---------------- Year Ended 31 December ---------- 2016	2015	2014	2013
Sales	9,724	9,965	7,753	7,448	6,863
Gross interest expense	29	4	2	112	136
Net income from operations	722	1,405	1,256	1,012	626
Funds from operations (FFO)	753	1,727	1,526	1,198	819
Total capital expenditures	2,169	2,142	199	1,202	930
Total assets	12,635	9,778	7,361	7,064	5,310
Total debt	3,570	1,000	0	30	2,913
Total debt (operating lease adjusted)	3,854	1,283	152	66	2,919
Shareholders' equity	6,913	6,873	6,333	6,029	943
Operating income before depreciation and amortization as % of sales	11.5	18.9	21.1	19.0	14.5
Pretax return on permanent capital (%)	13.8 **	22.9	23.4	26.8	25.4
Earnings before interest, tax, depreciation, and amortization (EBITDA) interest coverage (times)	28.1	105.2	209.1	13.6	7.5
FFO/total debt (%)	30.6 **	139.3	1,008.6	1,818.2	28.1
Total debt/capitalization (%)	35.5	15.3	2.3	1.1	71.8

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

Note: *All ratios are operating lease adjusted.*

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