SRI TRANG AGRO-INDUSTRY PLC

No. 133/2017

27 October 2017

Company Rating: BBB+

Issue Ratings:
Senior unsecured BBB+

Outlook: Stable

Company Rating History:

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

Contacts:

Jutatip Chitphromphan
jutatip@trisrating.com

Nauwarut Temwattanangkul
nauwarut@trisrating.com

Rungrat Suntornpagasit
rungrat@trisrating.com

WWW.TRISRATING.COM

Rating Rationale

TRIS Rating lowers the company rating and the ratings of the senior unsecured debentures of Sri Trang Agro-Industry PLC (STA) to “BBB+” from “A-”. The downgrade reflects a rise in leverage and weakened cash flow protection. The ratings continue to reflect the company’s leading position in the natural rubber (NR) industry, diversified customer base, and the extensive track record of its management team in NR industry. However, these strengths are partially offset by the cyclical nature of NR prices and narrow margin of mid-stream NR producers as well as the fluctuation of foreign exchange.

STA is the world’s leading processor and merchandiser of NR. The company has 37 processing plants for block rubber, ribbed smoked sheet, concentrated latex, and gloves. The plants are located in Thailand, three plants in Indonesia, and one small plant in Myanmar. As of 30 June 2017, total optimum processing capacity was 1,875,240 tonnes per year. STA’s market share in the global NR industry in the first half of 2017 was 10.6%. Approximately 85% of its products are sold directly to end-users, which are mostly tyre manufacturers. Exports accounted for 83% of STA’s total sales volume for the first six months of 2017. China was the largest export market, accounting for 57% of export volume during the first half of 2017.

As a mid-stream NR producer, STA’s profitability is very thin and fluctuates along with NR prices. STA has entered into derivatives contracts to mitigate the risk from NR price fluctuations and foreign exchange risk. The operating margin before depreciation hovered between 0.55%-3.17% in 2012-2016. Earnings before interest, tax, depreciation, and amortization (EBITDA) ranged between Bt1,061-Bt3,506 million yearly during the same period.

STA’s operating performance has fallen below expectations in 2016. Despite a 33% rise in STA’s NR shipments and a rebound in the prices of NR in late 2016, STA’s operating margin before depreciation (including a provision or reversal on the diminution in value of inventories and gains or losses from derivatives instruments) dropped significantly to 0.55% in 2016, compared with the 1.15%-3.17% during 2012-2015. The operating margin turned negative during the first half of 2017, tumbling to -3.48%, compared with 3.25% in the first half of 2016. The plunge came because STA recorded losses from derivatives instruments of Bt921 million in 2016 and Bt266 million in the first half of 2017. In addition, STA recorded an allowance in value of inventories of Bt2,918 million during the first half of 2017. The lower operating margin, coupled with higher selling and administrative expenses (SG&A), pushed down EBITDA to Bt1,061 million in 2016 from Bt2,826 million in 2015. EBITDA including stock loss reported at a loss of Bt1,528 million in the first six months of 2017, compared with EBITDA of Bt2,000-Bt3,500 million per year during 2012-2015.

STA and Semperit Technische Produkte Gesellschaft m.b.H. (STPG), an Austrian joint venture (JV) partner in Sri Trang Gloves (Thailand) Co.Ltd. (STGT) had reached agreements to settle all legal proceedings. They decided to demerge the joint ventures they had invested in March 2017. STA acquired from STPG the additional 50% stake in STGT, with total investment of Bt6,319 million. In return, STA sold its share holdings in other jointly owned associate companies to STPG, namely Sempermed USA, Inc., Sempermed Singapore Pte. Ltd, Semperflex

Shanghai Ltd., Shanghai Sempermed Gloves Sales Co.Ltd., and Shanghai Semperit Rubber and Plastics Products Co.Ltd. After netting off the dividends received from the joint ventures before sales and other JV sales, STA paid about Bt4,400 million for STGT acquisition. STA also granted a call option to STPG for acquisition of 42.5% of total shares of Semperflex Asia Corporation Ltd. (SAC), the remaining joint venture, for approximately Bt1,800 million. The exercise period for the call option is between 30 June 2019 and 30 June 2021. STA's business profile will strengthen somewhat in the long term as it will have more contribution from STGT's grove operation, which is in a downstream operation of NR. However, the contribution from STGT will not increase significantly in the short term as STGT encountered with higher NR prices, plus a one-time expense to settle the litigation with STPG and lost some premium market of STPG. STGT reported EBITDA of Bt1,313 million during 2016, and Bt287 million in the first half of 2017, compared with EBITDA of approximately Bt1,800 million per year in 2014-2015.

STA's balance sheet was increasingly leveraged. Total debt rose to Bt36,031 million as of June 2017 from Bt19,126 million as of December 2015 owing to higher working capital needs, continued capacity expansion, investments in plantation, and the recent investment in STGT. The total debt to capitalization ratio was 67.07% at the end of June 2017, compared with 40%-49% during 2012-2015. Even though the company received Bt2,555 million from a successful capital increase in October 2017, total debt to capitalization is projected to be high at around 60% during 2017-2020 following high level of STA's working capital needs and continued capacity expansion for both rubber processing plants and glove production plants. The rising leverage and losses from derivative instruments noticeably weakened cash flow protection in 2016. A huge stock loss further dampened its debt serviceability to be at an abnormally low level. The EBITDA interest coverage ratio was 1.50 times in 2016 and turned negative in the first six months of 2017, slipping to -2.59 times, compared with 3.26-3.45 times in 2013-2015. The funds from operations (FFO) to total debt ratio declined to 2.06% in 2016 and -1.27% (annualized, from the trailing 12 months) in the first six months of 2017, compared with 7.74%-16.46% in 2013-2015.

Looking forward, STA's performance is expected to gradually improve in 2018-2020. In TRIS Rating's base case forecast, FFO is expected to hover around Bt650 million in FY2017, and then gradually recover to Bt1,500-Bt2,500 million during FY2018-2020 following increase in NR selling volumes, SG&A reduction efforts, and improving glove operation. FFO to total debt ratio is expected to gradually improve to around 10% in medium to long term as improving earnings. Liquidity is considered manageable. Almost 70% of STA's debts, or Bt28,514 million, are short-term debts, which are utilized to finance inventory and accounts receivable. NR inventory is typically highly liquid and marketable. It can be easily liquidated to pay down debts. STA has scheduled long-term debt and debentures repayments of Bt5,234 million in 2017 and Bt800-Bt1,000 million per year in FY2018-FY2020. In 2017, STA will repay Bt5,166 million in long-term loans by using the proceeds from the company's capital increase of Bt1,500 million and long-term loan of Bt3,000 million funded by bank loan. Furthermore, STA has market access and undrawn credit facilities of more than Bt10,000 million from various banks to help it manage these repayments.

Rating Outlook

The "stable" outlook reflects the expectation that STA will maintain its competitive position in the NR industry. The company is also expected to use hedging instruments prudently to mitigate NR price risk and foreign exchange risk. STA should maintain sufficient liquidity enough to withstand the effects of volatile NR prices.

STA's credit upside could occur if the balance sheet becomes healthier and debt serviceability improves noticeably on a sustained basis. The downside risk could occur if its profitability or performance is below expectation. Rising leverage is also a negative factor for the credit profile.

Sri Trang Agro-Industry PLC (STA)

Company Rating:	BBB+
Issue Ratings:	
STA182A: Bt600 million senior unsecured debentures due 2018	BBB+
STA195A: Bt810 million senior unsecured debentures due 2019	BBB+
STA215A: Bt1,455 million senior unsecured debentures due 2021	BBB+
Rating Outlook:	Stable

Financial Statistics and Key Financial Ratios *

Unit: Bt million

	Jan-Jun 2017	2016	2015	2014	2013	2012
		---------------------- Year Ended 31 December				-------------------
Sales	51,395	77,266	61,292	75,530	92,185	99,639
Gross interest expense	589	707	857	663	1,075	710
Net income from operations	(2,721)	(659)	889	706	1,534	534
Funds from operations (FFO)	39	652	1,480	1,868	3,218	803
Total capital expenditures and investments	6,412	2,409	2,617	3,011	3,664	2,963
Total assets	57,133	55,959	43,879	37,791	44,320	36,696
Total debt	36,031	31,711	19,126	13,975	19,547	14,853
Shareholders' equity	17,687	19,912	21,334	20,592	20,066	18,937
Operating income before depreciation and amortization as % of sales	(3.48)	0.55	3.17	2.07	2.95	1.15
Pretax return on permanent capital (%)	(7.35)**	(0.58)	4.72	3.80	7.56	3.98
Earnings before interest, tax, depreciation, and amortization (EBITDA) interest coverage (times)	(2.59)	1.50	3.30	3.45	3.26	2.83
FFO/total debt (%)	(1.27)**	2.06	7.74	13.36	16.46	5.40
Total debt/capitalization (%)	67.07	61.43	47.27	40.43	49.34	43.96

* *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