

THAI UNION GROUP PLC

No. 126/2018
28 August 2018

CORPORATES

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

Company Rating History:

Date	Rating	Outlook/Alert
24/06/15	AA-	Stable
23/12/14	AA-	Alert Developing
08/01/13	AA-	Stable
14/01/11	A+	Stable
29/07/10	A+	Alert Developing
30/08/06	A+	Stable

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RATIONALE

TRIS Rating downgrades the company rating and issue ratings on Thai Union Group PLC (TU) to “A+” from “AA-”. The downgrades reflect TU’s weaker financial profile following a large debt-funded investment. Cash flow protection is rebounding more slowly than expected. The ratings continue to reflect TU’s strong market position as one of the world’s largest tuna processors, the diversity of its products and markets, and the well-known brands in Europe and the United States (US). These factors are constrained by several industry risk factors, such as volatile raw material prices, the risks of disease outbreaks, trade barriers, and regulations covering the fishing industry. Fluctuations in foreign exchange rates also have a significant effect on TU’s profits.

KEY RATING CONSIDERATIONS

Financial profile weakened following the debt-funded acquisition of the Red Lobster restaurant business

TU’s total debt surged as a result of the debt-funded investment in “Red Lobster”, a seafood restaurant chain in North America in late 2016. At the end of June 2018, total debt stood at Bt67.7 billion, up from Bt41.0 billion at the end of 2015. While, Earnings before interest, tax, depreciation, and amortization (EBITDA) was approximately Bt11 billion in 2015-2016 with a slight decrease to Bt10 billion in 2017. Consequently, the net debt to EBITDA ratio increased to 6.6 times in 2017 from 3.3 times in 2015.

Cash flow protection weakened significantly as profit fell and debt soared. The ratio of funds from operations (FFO) to total debt dropped to 14.1% in 2017 from 23.1% in 2015. The EBITDA interest coverage ratio declined to 4.7 times in 2017 from 7.2 times in 2015.

Since the US consumers’ behaviors have changed, the Red Lobster restaurant business was not able to support the expected performance. The said company is currently reporting a loss. We believe that their synergies will take time to materialize.

The world’s largest tuna canner with a diverse range of seafood products

TU’s strong business profile is underpinned by its status as the world’s largest tuna canner. The company processes about 290,000 tonnes of tuna per annum, approximately one-fifth of the canned tuna produced worldwide. TU is also one of the world’s leading seafood companies. Apart from tuna, TU’s portfolio of seafood products comprises shrimp, salmon, sardines, and mackerel.

TU has large production facilities which give it lower production costs and greater negotiating power with raw material suppliers. TU also utilized its by-product which enhances its competitive position. For example, fish bones, skins, and oil, as well as the by-products of tuna canning, are processed into more value added products such as pet food, shrimp feed, and its recent innovative product, fish oil.

In 2017, tuna products were the company’s largest revenue contributor, providing 35% of total sales, followed by shrimp and shrimp-related products (28%), salmon (9%), sardines and mackerels (8%), pet food (7%), and value added and other products (13%).

Geographic diversification

TU's business risk is partly mitigated through the geographic diversity of its operations and markets. Production facilities are spread across 13 countries on four continents. TU has geographically diversified sources of revenue. Sales in the US, TU's major market, represented 38% of total revenue in 2017. Customers in Europe accounted for 32%, followed by Thailand (10%) and Japan (6%). TU's ongoing effort to broaden its geographic coverage will alleviate the impact of disease outbreaks, trade barriers, and regulations covering the fishing industry.

Strong market positions in Europe and well-known brand in the US

TU has strong market presences with well-known branded products in the US and the European Union (EU). Thai Union Europe (TUE), formerly named MW Brands SAS, has several well-accepted brands in Europe, such as John West, Petit Navire, Mareblu, and Hyacinthe Parmentier. The John West brand ranked first in the UK, Ireland, and the Netherlands. In terms of sales in 2017, John West had a 41% market share in the United Kingdom (UK), 69% in Ireland, and 28% in the Netherlands, according to data from AC Nielsen provided by TUE's management. Petit Navire, another well-recognized brand, had a 45% market share in France.

In the US, Chicken of the Sea brand ranked third in canned tuna market with 13% market share in 2017. Starkist is the largest canned tuna processor (45%), followed by Bumble Bee (25%).

Volatile profit margin

TU's operating performance largely hinges on the prices of tuna and shrimp, its main products, and the cost of raw materials. The gross margin hovered in the range of 13%-16% during the past five years. Despite TU has a cost-plus pricing policy, the company faces difficulty in passing through cost increases to customers when raw material costs are volatile and foreign exchange rates are fluctuating. During 2017 through the first half of 2018, the cost of tuna rose and the Thai baht appreciated against the euro and the US dollar. Intense competition also squeezed the gross margin. As a result, gross margin was 13.3% in 2017 and 12.6% in the first half of 2018.

Profits were also affected by one-time charge. TU's US subsidiary reached a settlement with a major retailer in the US in the ongoing antitrust litigation and in process of negotiations with other pending cases. However, TU estimated total risks of US\$44 million (or Bt1.4 billion) during the second quarter of 2018. As a result, the operating profit margin before depreciation and amortization declined to 5.5% in 2017 and slumped to 1.8% in the first half of 2018, compared with 7.3%-8.4% in 2014-2016. EBITDA slipped by 8.5% year-on-year (y-o-y) to Bt10.1 billion in 2017 and plunged by 50.6% y-o-y to Bt2.5 billion in the first half of 2018.

Performance will continue to be under pressure

TU's operating results will remain under pressure for the remainder of the year. The cost of tuna and exchange rates will stay volatile. Other factors, such as stiff competition in the US and EU, a steep increase of salmon cost, poor operating results at Red Lobster, and ongoing litigation costs will keep a lid on profits. As a strategy to improve its operating result, TU is focusing on innovative products in an effort to boost revenue and the profit margin.

Under TRIS Rating's base case scenario, TU's revenue will grow to Bt148.6 billion in 2021 from Bt136.5 billion in 2017, excluding any sizable acquisitions. We expect the operating margin will stay around 6%-8% in 2018-2021. EBITDA is projected to increase gradually to Bt13.5 billion in 2021 from Bt10.1 billion in 2017. The total debt to capitalization ratio is expected to decline gradually to approximately 50% over the next few years.

RATING OUTLOOK

The "stable" outlook reflects our expectation that TU will maintain its competitive advantage stemming from economies of scale and production efficiencies.

RATING SENSITIVITIES

TU's rating could be revised upward if cash flow protection improves significantly. Prospects for a downgrade are limited over the next 12-18 months. A downgrade could occur if the operating performance is much weaker than expected or if TU makes any sizable debt-funded investments, which will further deteriorate the balance sheet and weaken cash flow protection.

COMPANY OVERVIEW

TU was established in 1977 by the Chansiri family. TU is one of the leading seafood companies in the world. Its product lines cover tuna, shrimp, sardines, salmon, pet food, and more. TU's tuna major production facilities are located in Thailand, the US, Ghana, and the Seychelles islands. TU also has production facilities in Vietnam, France, and Papua New Guinea.

As part of its growth strategy, TU is broadening its portfolio of seafood products and adding new distribution channels through mergers and acquisitions. For example, TU bought MW Brands SAS, a leading canned seafood company in Europe in 2010. Other acquisitions followed, such as Meralliance, a European smoke salmon producer in 2014; King Oscar, a producer of premium canned sardine in 2014; Rugen Fisch, a German ambient and chilled fish company in 2016, and Red Lobster, a chain of casual dining seafood restaurants in North America in 2016.

TU invested a significant amount of money in Red Lobster in late 2016. TU spent US\$230 million for a 25% equity stake and US\$345 million to buy 10-year convertible preferred shares. The total investment was US\$575 million (Bt20,125 million). The preferred shares can be converted at any time into an additional 24% equity stake or redeemed at a predetermined amount at the end of 10 years. The Red Lobster investment is an attempt to enter the food service industry, a move toward forward integration and more direct access to consumers.

TU has made small acquisitions in seafood companies in 2018. For example, it bought 25% of a seafood retailer in Thailand (Thammachart Seafood Retail) and a 45% stake in TUMD Luxemburg S.a.r.l, a Russian leading canned tuna.

Recently, TU's subsidiary, Chicken of the Sea, reached a settlement with Walmart in an ongoing antitrust case in the US. The company is in advanced negotiations in other pending cases. During the second quarter of 2018, Chicken of the Sea recorded a US\$44 million (or Bt1.4 billion) one-time accruals to reflect a settlement fee with Walmart and potential risks that might be occurred from the negotiations in other pending cases.

KEY OPERATING PERFORMANCE
Table 1: TU's Sales Breakdown by Geographic Area
Unit: %

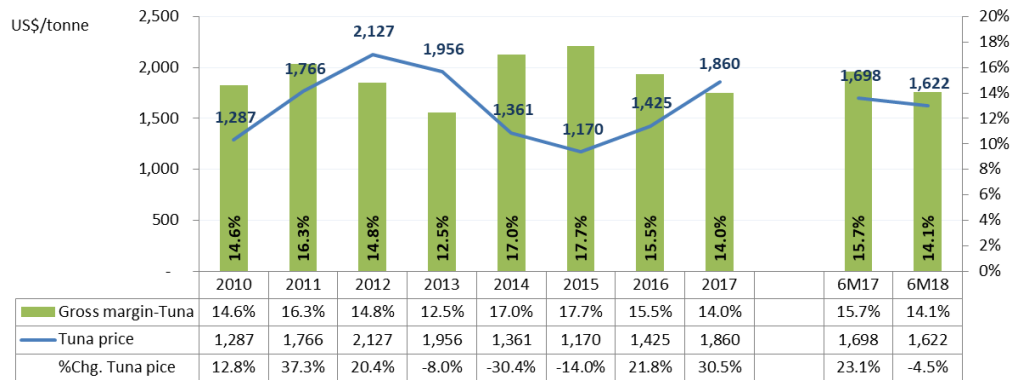
Market	2013	2014	2015	2016	2017	Jan-Jun 2018
USA	40	44	42	39	38	38
EU	30	29	29	33	32	32
Thailand	8	7	8	8	10	10
Japan	8	7	7	6	6	6
Others	14	13	14	14	14	14
Total	100	100	100	100	100	100
Total sales (Bt million)	112,813	121,402	124,904	134,375	136,535	63,839

Source: TU
Table 2: TU's Sales Growth by Product
Unit: Bt million

Product	2013	2014	2015	2016	2017	Jan-Jun 2018
Tuna	53,366	53,827	46,396	46,522	47,645	23,708
% change, y-o-y	4	1	-14	0	2	0
Shrimp and related products	28,167	32,209	36,229	37,868	37,577	16,067
% change, y-o-y	17	14	12	5	-1	-8
Pet food	8,002	8,894	8,159	9,377	10,177	4,846
% change, y-o-y	12	11	-8	15	9	-2
Sardines & mackerel	6,465	6,525	7,411	11,321	10,661	4,717
% change, y-o-y	-14	1	14	53	-6	-11
Salmon	4,541	6,180	11,346	12,789	12,853	5,715
% change, y-o-y	-5	36	84	13	0	-7
Value-added and other products	12,272	13,767	15,643	16,499	17,622	8,787
% change, y-o-y	2	12	14	5	7	2
Total sales	112,813	121,402	124,904	134,375	136,535	29,703
% change, y-o-y	6	8	3	8	2	-4

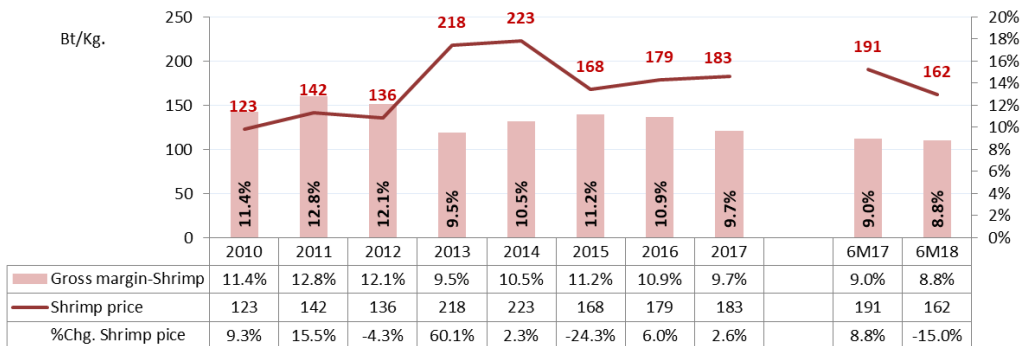
Source: TU
Note: Percentage is based in terms of Thai baht.

Chart 1: Global Price of Skipjack Tuna and Gross Margin of TU's Tuna Segment



Source: TU

Chart 2: Average Shrimp Price and Gross Margin of TU's Shrimp Segment



Note: Shrimp price is based on vannamei shrimp, 60 pieces/kg.

Source: TU

FINANCIAL STATISTICS AND KEY FINANCIAL RATIOS*

Unit: Bt million

	Jan-Jun 2018	Year Ended 31 December			
		2017	2016	2015	2014
Sales	63,839	136,535	134,375	124,904	121,402
Gross interest expense	1,006	2,141	1,440	1,589	1,673
Net income from operations	(105)	4,836	5,442	5,215	4,808
Funds from operations (FFO)	3,681	9,580	9,301	9,487	8,198
Total capital expenditures and investments	2,640	5,062	17,269	3,260	6,478
Total assets	143,390	146,092	142,365	110,911	115,443
Total debt	67,693	67,940	67,553	41,026	46,534
Shareholders' equity	46,114	48,051	47,436	47,970	47,467
Operating income before depreciation and amortization as % of sales	1.84	5.47	7.28	8.42	7.83
Pretax return on permanent capital (%)	4.09 **	6.36	7.91	9.59	8.98
Earnings before interest, tax, depreciation, and amortization (EBITDA) interest coverage (times)	2.51	4.72	7.68	7.23	6.40
FFO/total debt (%)	12.77 **	14.10	13.77	23.13	17.62
Total debt/capitalization (%)	59.48	58.57	58.75	46.10	49.50

* Consolidated financial statements

** Annualized from trailing 12 months

Thai Union Group PLC (TU)

Company Rating:	A+
Issue Ratings:	
TU192A: Bt3,150 million senior unsecured debentures due 2019	A+
TU197A: Bt6,000 million senior unsecured debentures due 2019	A+
TU201A: Bt3,500 million senior unsecured debentures due 2020	A+
TU212A: Bt1,550 million senior unsecured debentures due 2021	A+
TU217A: Bt1,500 million senior unsecured debentures due 2021	A+
TU217B: Bt2,000 million senior unsecured debentures due 2021	A+
TU221A: Bt2,000 million senior unsecured debentures due 2022	A+
TU237A: Bt2,000 million senior unsecured debentures due 2023	A+
TU241A: Bt2,500 million senior unsecured debentures due 2024	A+
TU242A: Bt1,050 million senior unsecured debentures due 2024	A+
TU271A: Bt4,000 million senior unsecured debentures due 2027	A+
Rating Outlook:	Stable

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