CARABAO GROUP PLC

No. 171/2018
30 October 2018

CORPORATES

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

Company Rating History:

Date	Rating	Outlook/Alert
20/11/17	A-	Stable

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RATIONALE

TRIS Rating affirms the company rating on Carabao Group PLC (CBG) at "A-" and also affirms the ratings on CBG's outstanding senior unsecured debentures at "A-". The ratings reflect CBG's strong position in the energy drink market in Thailand and growing export sales. However, these strengths are partially offset by CBG's reliance on a limited range of products, limited growth prospects in the Thai energy drink market, and the uncertainty of success in expanding to the United Kingdom (UK) market, which might put pressure on its profitability over the next few years.

KEY RATING CONSIDERATIONS

Strong position in energy drink market

"Carabao Dang" is the second most popular energy drink in Thailand, maintaining a 24% market share as of the first half of 2018. The strong market position is supported by the company's well-known brand "Carabao Dang" and its extensive distribution network covering more than 200,000 retail outlets.

Apart from the domestic market, CBG also exports its energy drinks to several countries, such as Cambodia, Myanmar, Vietnam, and China. Export revenue has been growing rapidly, with an average growth rate of 34% per annum during 2013-2017 to Bt5,050 million in 2017. Export revenue continued to grow at 29% year-on-year (y-o-y) to Bt3,191 million in the first half of 2018, accounting for 46% of CBG's total revenue from sales in that period. We expect the energy drink exports to be CBG's main growth driver in the next few years.

Limited growth prospects in domestic market

We see limited growth prospects in domestic market as the Thai energy drink market is quite saturated and history suggests that penetrating to new groups of consumers is difficult. The Thai energy drink market shrank 2% in 2017 and further dropped 1% y-o-y in the first half of 2018. In addition, the new sugar tax is expected to cause related taxes to increase from late 2019 onwards. If the additional costs cannot be passed on to consumers, industry profit margins will be affected. However, if prices are raised to offset the additional taxes, it is unclear how the demand for energy drinks would be affected given the historical price stickiness of energy drinks in Thailand. Alternatively, the products could be reformulated to reduce the sugar content to avoid additional taxes. How the consumers would embrace the change remains to be seen.

Uncertainty from expansion in the UK

CBG is committed to huge marketing expenses in the UK to sponsor the Chelsea FC and the English Football League Cup (renamed "Carabao Cup") over 2016-2021. The sponsorship expenses, based on current terms and conditions, will be around Bt600 million in 2018 and gradually decline to Bt65 million in 2021. These moves are expected to help CBG expand its market presence both in the UK and globally.

CBG's energy drink sales volume in the UK is still small, averaging 1.2 million cans per month in the first half of 2018, due to intense competition in the UK market. On top of the sponsorship expenses, the company also spent on marketing activities and promotional campaigns in the UK which drove up overall marketing and selling expenses. These factors will put pressure on CBG's profitability over the next few years until the full benefits of global brand building are realized.

Reliance on limited range of products

CBG derived 87% of its revenues from energy drinks in the first half of 2018. Reliance on a small segment of the beverage market makes the company relatively vulnerable to shifts in consumers' preferences and behaviors. The proportion has been declining in recent years as CBG launched non-energy drink products including an electrolyte drink, ready-to-drink coffee, 3-in-1 coffee powder, and drinking water a few years ago. CBG's long-term success in non-energy drink products remains to be seen.

Rising level of leverage

CBG's financial leverage has been rising over the past two years from the considerable amount of capital expenditures, around Bt6,800 million over the period of 2016 to the first half of 2018, to expand production capacities. The investment was funded by long-term loans from financial institutions, issuance of debentures, and free cash flow from operations. Consequently, debt to capitalization rose to 42% in the first half of 2018. In addition, the huge sponsorship expenses in the UK put pressure on the company's profitability and cash flow as CBG is trying to gain brand recognition and ramp up sales in the new markets. As a result, operating income as a percentage of total operating revenues declined to 11% in the first half of 2018, from 20% in 2016.

TRIS Rating forecasts CBS's revenue growth of 5%-8% per annum during 2018-2021, driven by energy drink exports mainly to the CLMV countries and China. We expect profitability to improve from lower football sponsorship expenses. Operating income as a percentage of total operating revenues will increase to 16% in 2021 from 11% in 2018 and funds from operations (FFO) will range between Bt1,000-Bt2,000 million per annum during the same period. We expect capital expenditures of Bt2,400 million in 2018 which covers new energy drink filling lines and an aluminum can manufacturing plant. In 2019-2021, we expect the maintenance capital expenditures of only Bt400 million per year as the company already has sufficient production capacity to support growth in the next several years. As a result, the level of leverage is expected to peak in 2018 with a debt to capitalization ratio of 46% and gradually decrease to 30% in 2021. The FFO to adjusted net debt is forecast to improve to 60% in 2021 from 18% in 2018.

RATING OUTLOOK

The "stable" outlook is based on our expectation that CBG will be able to maintain its market position in the domestic market while maintaining reasonable growth in the export market. We expect CBG's operating performance and leverage to start improving in 2019 after a deterioration in 2018.

RATING SENSITIVITIES

The ratings could be revised downward if CBG's profitability is weaker than expected for a prolonged period of time or if its financial policy becomes more aggressive. A rating upgrade is unlikely in the near term, given its rising level of leverage.

COMPANY OVERVIEW

CBG started its operation to manufacture, market, and sell energy drink products under the "Carabao Dang" trademark in 2002, as a joint investment between 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, glass bottle manufacturing, and domestic distribution. The company was listed on the Stock Exchange of Thailand (SET) in 2014. As of August 2018, 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. CBG distributes its products through traditional trade (TT) and modern trade (MT) channels. Distribution in the TT channel uses a multi-tier agent model. CBG also operates cash vans to reach retail outlets in more rural areas. As of March 2018, CBG had 31 distribution centers and 331 cash vans covering over 220,000 retail outlets nationwide.

CBG's production includes bottled energy drink filling lines, canned energy drink filling lines, and amber glass bottle producing lines. The annual production capacities were 1,600 million bottles of energy drinks, 1,500 million cans of energy drinks, and 1,300 million amber glass bottles. In addition, the company invested in a joint venture with "Showa Denko", a Japanese business partner experienced in manufacturing aluminum products, to build an aluminum can factory to supply CBG the cans necessary for their energy drink products. Production is set to begin by the end of 2018.

In addition to energy drinks, CBG offers a few other branded products. The electrolyte drink “Carabao Sport” 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, CBG also provides distribution services for third party products to fully utilize its distribution network.

KEY OPERTING PERFORMANCE

Table 1: Revenue Contribution by Product Line

Product Line	2015		2016		2017		Jan-Jun 2018	
	Bt Mil.	%	Bt Mil.	%	Bt Mil.	%	Bt Mil.	%
Energy drinks	7,654	99	9,371	94	11,058	86	5,976	87
Branded products	98	1	386	4	985	8	472	7
3rd products	2	0	203	2	834	6	432	6
Others	-	0	5	0	27	0	12	0
Total	**7,753**	**100**	**9,965**	**100**	**12,904**	**100**	**6,892**	**100**

Source: CBG

Table 2: International Sales Contribution

	2015		2016		2017		Jan-Jun 2018	
	Bt Mil.	%	Bt Mil.	%	Bt Mil.	%	Bt Mil.	%
Domestic	5,477	71	6,598	66	7,854	61	3,701	54
International	2,276	29	3,362	34	5,050	39	3,191	46
Total	**7,753**	**100**	**9,965**	**100**	**12,904**	**100**	**6,892**	**100**

Source: CBG

FINANCIAL STATISTICS AND KEY FINANCIAL RATIOS

Unit: Bt million

		-------------Year Ended 31 December ------------			
	Jan-Jun 2018	2017	2016	2015	2014
Total operating revenues	7,036	13,023	10,047	7,835	7,526
Adjusted interest expense	62	69	21	11	116
Operating income	770	1,438	1,968	1,717	1,495
Earnings before interest and taxes (EBIT)	509	1,128	1,688	1,472	1,357
Earnings before interest, taxes, depreciation, and amortization (EBITDA)	780	1,481	1,974	1,718	1,535
Funds from operations (FFO)	557	1,151	1,675	1,497	1,181
Capital expenditures	1,599	3,035	2,146	202	1,212
Total assets	14,342	12,520	9,778	7,361	7,064
Adjusted debt	4,952	3,604	174	0	0
Adjusted equity	6,892	7,005	7,100	6,333	6,029
Adjusted Ratios					
Operating income as % of total operating revenues (%)	10.94	11.04	19.59	21.91	19.87
Pretax return on permanent capital (%)	9.30	11.73	22.48	23.23	26.53
EBITDA interest coverage (times)	12.66	21.47	94.46	155.66	13.27
Debt to EBITDA (times)	3.36	2.43	0.09	0.00	0.00
FFO to debt (%)	22.25	31.95	962.47	n.a.	n.a.
Debt to capitalization (%)	41.81	33.97	2.39	0.00	0.00

n.a. Not available

Carabao Group PLC (CBG)

Company Rating:	A-
Issue Ratings:	
CBG206A: Bt1,700 million senior unsecured debentures due 2020	A-
CBG216A: Bt720 million senior unsecured debentures due 2021	A-
CBG216B: Bt370 million senior unsecured debentures due 2021	A-
Rating Outlook:	Stable

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