CARABAO GROUP PLC

No. 184/2019
31 October 2019

CORPORATES

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

Last Review Date: 30/10/18

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) and the ratings on CBG's senior unsecured debentures at "A-" with a "stable" outlook. The ratings reflect CBG's strong position in the energy drink market in Thailand and its strengthening balance sheet. However, these strengths are partially offset by CBG's reliance on a narrow range of products, limited growth prospects in the Thai energy drink market, and limited success in expanding to the United Kingdom (UK) market, which might continue to put pressure on the company's profitability over the next few years.

KEY RATING CONSIDERATIONS

Strong position in the Thai energy drink market

CBG has gained market share in the Thai energy drink market during the past decade. Its product is currently the second most popular energy drink in Thailand. The company's market share stood at 23% as of the first half of 2019, quite stable compared with the same period last year. CBG's strong market position is underpinned by the company's well-known brand, its effective marketing strategies, and its extensive distribution network covering more than 180,000 retail outlets. CBG's domestic energy drink sales came in at Bt6.05 billion in 2018 and Bt2.78 billion in the first half of 2019, relatively stable compared with the same period last year.

We see limited growth prospects in the domestic market as the Thai energy drink market is quite saturated and history suggests that penetrating new consumer groups is difficult. The Thai energy drink market grew marginally by 0.6% in 2018, after experiencing a drop of 2%-3% per annum during 2016-2017. Growth then accelerated to 5.5% in the first half of 2019.

The new excise tax and sugar tax which came into effect in September 2017 is expected to cause related taxes to gradually rise during 2019-2023. During the past years, we have not seen price increases to offset the additional tax cost as energy drink producers have managed to reformulate their products to avoid the additional taxes. How consumers will embrace the changes remains to be seen.

Slowdown in export growth

We expect energy drink exports to continue to grow but at a slower rate compared with the last few years, due to a higher base. CBG exports its energy drinks to several countries such as Cambodia, Myanmar, Vietnam, and China. Export revenue grew by an average of 42% per annum during 2016-2018 reaching Bt6.48 billion in 2018. The growth slowed down in the first half of 2019 as exports grew 7% year-on-year (y-o-y) to Bt3.4 billion. Export sales accounted for 48% of CBG's total revenue, and Cambodia, the major overseas market, contributed more than half of total export sales.

Limited success in the UK

We expect sponsorship and marketing expenses in an attempt to gain market share in the UK to continue to put pressure on CBG's profitability over the next few years until the full benefits of its brand-building effort are realized. CBG's energy drink sales in the UK remain very small, accounting for less than 2% of sales outside Thailand in the first half of 2019. Its spending on marketing activities and promotional campaigns in the UK also drove up overall marketing and selling expenses in 2017-2018. The market has proven more difficult to penetrate than the company previously anticipated, and has been a drag on CBG's overall performance.

CBG has been spending heavily on sponsorship of Chelsea Football Club (FC) and the English Football League Cup (renamed the "Carabao Cup") since it entered the UK market in 2016. The sponsorship expenses will gradually decline to around GBP7.5 million in 2021 from around GBP12 million in 2019, relieving the financial burden on future cash flows. These football sponsorships are expected to not only help the company gain more presence in the UK but also bolster the company's brand globally.

Reliance on a limited range of products

We see that CBG relies on energy drink products, a small segment of the overall beverage market, which makes the company relatively vulnerable to shifts in consumer preferences and behavior. CBG derived 87% of its revenue from energy drink products in the first half of 2019. Most of its energy drink sales are from traditional energy drink products, with lower-income workers constituting the main consumer group. CBG has been trying to launch flavored energy drinks to capture a new consumer base but the long-term success of these products remains to be seen.

Improved profitability

CBG's profitability recently improved thanks to lower key raw material costs, lower packaging costs from a newly owned aluminum can production facility which commenced commercial operations in late 2018, and improved economies of scale. As a result, the company's gross profit margin improved to 37% in the first half of 2019 from 32.7% in 2018. Going forward, we expect that the company will continue to benefit from the cost saving of vertical integration. Gross profit margin is expected to be around 35%-37% during the next three years.

Improved financial leverage

CBG's financial leverage improved in the first half of 2019 thanks to minimal capital expenditures and growing cash flow after its leverage rose in 2017-2018 to fund expansion of production capacities. The debt to earnings before interest, tax, depreciation and amortization (EBITDA) ratio improved to 1.7 times in the first half of 2019 from 2.4 times in 2018 and the ratio of funds from operations (FFO) to debt increased to 48% in the first half of 2019 from 31% in 2018.

TRIS Rating forecasts CBG's FFO to range around Bt2.4-Bt2.5 billion per annum and we expect modest capital expenditures of around Bt600 million per annum during 2019-2022 as the company already has sufficient production capacities to support growth for the next several years. As a result, the debt to EBITDA ratio is expected to trend downward to 1.1 times from 1.4 times and the FFO to debt ratio is expected to improve to 70% from 60% during 2019-2022.

TRIS Rating views CBG's liquidity as adequate. Sources of liquidity include cash on hand of around Bt388 million and expected FFO of around Bt2.4 billion per annum, which should be adequate to cover bank loans and debentures of around Bt2 billion coming due in the next 12 months.

According to the key financial covenant on its debentures, CBG has to maintain its interest-bearing debt to equity ratio below 2.5 times. The ratio was 0.62 times as of June 2019, in compliance with the financial covenant. We expect that the company should have no problem complying with its financial covenants over the next 12 to 18 months.

BASE-CASE ASSUMPTIONS

- CBG's revenues to grow around 4% per annum over the next three years.
- Gross profit margin to stay at around 35%-37% and operating margin (before depreciation and amortization) to stay around 19%-21% during 2019-2022.
- Total capital spending to be Bt600 million per annum during 2019-2022.

RATING OUTLOOK

The "stable" outlook is based on our expectation that CBG will be able to maintain its strong market position in the domestic energy drink market while maintaining reasonable growth in the export market. We expect CBG to continue delivering strong profitability and solid operating performance while maintaining sound financial leverage.

RATING SENSITIVITIES

The ratings could be revised downward if CBG's profitability is weaker than expected for a prolonged period or if its financial policy becomes more aggressive. The ratings could be revised upward if CBG's operating performance and cash flow base rise significantly and/or the company has more meaningfully diversified sources of income while maintaining sound financial 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 that 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 2019, the three co-founders together controlled 67% 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 has become 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 June 2019, CBG had 31 distribution centers and more than 300 cash vans covering over 180,000 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. Besides, the company invested in a joint venture with “Showa Denko”, a Japanese business partner experienced in manufacturing aluminum products, to build an aluminum can manufacturing facility to supply CBG the cans necessary for their energy drink products. The plant commenced commercial operations in late 2018.

In addition to energy drinks, CBG offers a few other branded products including electrolyte drink, ready-to-drink coffee, 3-in-1 coffee powder, and drinking water, all under the “Carabao” trademark. CBG also provides distribution services for third-party products to fully utilize its distribution network.

KEY OPERATING PERFORMANCE

Table 1: Revenue Contribution by Product Line

Product	2016		2017		2018		Jan-Jun 2019	
Line	Bt Mil.	%	Bt Mil.	%	Bt Mil.	%	Bt Mil.	%
Energy drinks	9,371	94	11,058	86	12,523	87	6,184	87
Branded products	386	4	985	8	821	5	299	4
3rd products	203	2	834	6	1,058	7	631	9
Others	5	0	27	0	20	1	0	0
Total	**9,965**	**100**	**12,904**	**100**	**14422**	**100**	**7,114**	**100**

Source: CBG

Table 2: International Sales Contribution

	2016		2017		2018		Jan-Jun 2019	
	Bt Mil.	%	Bt Mil.	%	Bt Mil.	%	Bt Mil.	%
Domestic	6,598	66	7,854	61	7,948	55	3,712	52
International	3,362	34	5,050	39	6,474	45	3,402	48
Total	**9,965**	**100**	**12,904**	**100**	**14,422**	**100**	**7,114**	**100**

Source: CBG

FINANCIAL STATISTICS AND KEY FINANCIAL RATIOS

Unit: Bt million

	Jan-Jun 2019	---------------Year Ended 31 December ---------- 2018	2017	2016	2015
Total operating revenues	7,170	14,581	13,023	10,047	7,835
Operating income	1,584	2,030	1,438	1,968	1,717
Earnings before interest and taxes (EBIT)	1,266	1,440	1,128	1,688	1,472
Earnings before interest, taxes, depreciation, and amortization (EBITDA)	1,585	2,015	1,481	1,974	1,718
Funds from operations (FFO)	1,273	1,520	1,151	1,675	1,497
Adjusted interest expense	76	127	69	21	11
Capital expenditures	309	2,069	3,035	2,146	202
Total assets	14,517	14,320	12,520	9,778	7,361
Adjusted debt	4,681	4,932	3,604	174	0
Adjusted equity	7,696	7,365	7,005	7,100	6,333
Adjusted Ratios					
Operating income as % of total operating revenues (%)	22.09	13.92	11.04	19.59	21.91
Pretax return on permanent capital (%)	17.65	12.42	11.73	22.48	23.23
EBITDA interest coverage (times)	20.75	15.91	21.47	94.46	155.66
Debt to EBITDA (times)	1.66	2.45	2.43	0.09	0.00
FFO to debt (%)	47.78	30.82	31.95	962.47	n.a.
Debt to capitalization (%)	37.82	40.11	33.97	2.39	0.00

RELATED CRITERIA

- Rating Methodology – Corporate, 26 July 2019
- Key Financial Ratios and Adjustments, 5 September 2018

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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