THAI UNION GROUP PLC

No. 138/2019
4 September 2019

CORPORATES

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

Last Review Date: 28/08/18

Company Rating History:

Date	Rating	Outlook/Alert
28/08/18	A+	Stable
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 affirms the company rating on Thai Union Group PLC (TU) and the ratings on TU's senior unsecured debentures at "A+". The ratings continue to reflect TU's strong market position as one of the world's leading seafood processors, the diversity of its products and markets, and the well-known brands of its supplies in Europe and the United States (US). However, the ratings are constrained by several industry risk factors such as volatile raw material prices, disease outbreaks, trade barriers, fishing regulations, and fluctuations in foreign exchange rates.

KEY RATING CONSIDERATIONS

Slow deleveraging

Slower earnings growth during the past few years has deterred the progress of the company's deleveraging plan. TU's leverage surged following its debt-funded investment in Red Lobster, costing around Bt20.1 billion in 2016. Over the past few years, TU's deleveraging plan has been hindered by sluggish operating results, attributed to volatile tuna costs, Thai baht appreciation, and litigation expenses as well as weaker than expected Red Lobster operation. As a result, adjusted net debt declined slightly to Bt65.9 billion at the end of June 2019, from Bt68.0 billion in 2016. The net debt to earnings before interest, taxes, depreciation, and amortization (EBITDA) ratio weakened to 6-7 times in 2016 through the first half of 2019, compared with 3-5 times during 2013 and 2015.

However, TRIS Rating views TU's leverage should improve gradually along with its recovering operating performance and lower capital spending plan. Moreover, TU expects to improve its balance sheet from the planned spin-off of its aqua feed subsidiary, Thai Union Feedmill PLC. (TFM). Upon the completion of the initial public offering (IPO) of TFM by 2020, TU will reduce its stake in TFM from 66.9% to 51%. The proceeds from the IPO will be partially used to repay TU's debt.

Strong market position with a diverse range of seafood products

As the world's largest tuna canner, the company processes about 0.3 million tonnes of tuna per annum, approximately one-fifth of 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.

The large scale of TU's operation allows it to achieve cost competitiveness and greater negotiating power with raw material suppliers. TU also utilizes its by-products to enhance its competitive position. For example, fish bones, skins, and fish oil, are processed into more value-added products such as pet food, shrimp feed, and high-grade tuna oil.

In 2018, tuna products were the company's largest revenue contributor, providing 36% of total sales, followed by shrimp and shrimp-related products (28%), salmon (8%), pet food (8%), sardines and mackerels (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 2018. Customers in Europe accounted for 31%, followed by Thailand (11%) and Japan (6%). TU's ongoing efforts to broaden its geographic coverage will alleviate the impact of disease outbreaks, trade barriers, and regulations governing the fishing industry.

Leading brands in Europe and 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 MW Brands SAS, has several well-accepted brands in Europe, such as John West, Petit Navire, Mareblu, and Parmentier. The John West brand is ranked first in the United Kingdom (UK), Ireland, and the Netherlands. In terms of sales in 2018, John West had a 37% market share in the UK, 66% in Ireland, and 30% in the Netherlands, according to data from AC Neilsen provided by TUE's management. Petit Navire, another well-recognized brand, had a 46% market share in France.

In the US, TU's Chicken of the Sea brand was ranked third in canned tuna market with 10% market share in terms of sale value in 2018, according to data from IRI report which have been changed from AC Nielsen, provided by Thai Union North America's management. Starkist is the largest canned tuna processor (48%), followed by Bumble Bee (24%).

Sizable one-off expense weakened profit margin

Despite satisfactory gross margin, operating profit margin has been squeezed by a sizable one-off expense from legal settlements in the US.

TU's gross margin hovered in the range of 13%-16%, depending on the cost of raw materials, market competition, and foreign exchange rates. The gross margin recorded low in early 2018 and improved gradually during late 2018 through the first half of 2019. The improved margin was mainly due to lower costs of tuna and shrimp, its main products, product price adjustment, and improved operational efficiency. As a result, TU posted a strong gross margin at 15.8% during the first half of 2019.

However, profits were affected by a one-time charge. Since 2018, TU's US subsidiary has reached settlements with major retailers and customers in the US in ongoing antitrust litigation. TU accrued provisions for the estimated total risk, amounting to US$44 million (or Bt1.4 billion), in 2018 and an additional US$60 million (or Bt1.9 billion) during the first half of 2019. As a result, the operating profit margin before depreciation and amortization dropped to 5.7% in 2018 through the first half of 2019, compared with 7%-9% in 2014-2017. EBITDA also declined, slipping to Bt9.8 billion in 2018 and Bt4.1 billion in the first half of 2019, compared with the level around Bt12.0 billion during 2014-2017.

However, TRIS Rating views the additional impact of extraordinary expenses should be minimal as the company has accrued a sizable amount of provisions for the antitrust litigation. The operating results should improve gradually from the company's strategy to focus on innovative products, cost controls, and production efficiency.

Under TRIS Rating's base case scenario, TU's operating revenue should grow to Bt151.2 billion in 2022 from Bt134.2 billion in 2018, excluding any sizable acquisitions. We expect the operating margin will stay around 7%-8% in 2019-2022. EBITDA is projected to increase gradually to Bt12.7 billion in 2022, from Bt9.8 billion in 2018. Adjusted net debt to EBITDA ratio is expected to decline gradually to 5.6 times over the next few years.

Adequate liquidity

We assess TU's liquidity to be adequate. Over the next 24 months, the company will have debt repayments of Bt3.5-Bt6.0 billion per year. Primary source of repayment shall be from the funds from operations (FFO) of Bt8.0-Bt9.0 billion per annum. Liquidity buffer is supported with Bt1.06 billion of cash at the end of June 2019, as well as several credit lines with financial institutions.

BASE CASE ASSUMPTIONS

- Operating revenue is expected to decline by 2% in 2019 and grow by 5% during 2020-2022.
- Gross profit margin is forecast at 15%-16%; adjusted operating margin will stay around 7%-8%.
- Total capital spending will be around Bt5 billion per annum during 2020-2022.

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 ratings could be revised upward if cash flow protection improves significantly. 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, lobster, sardines, salmon, pet food, and more. TU's major tuna production facilities are located in Thailand, the US, Ghana, and the Seychelles islands. TU also has production facilities in Vietnam, France, Germany, Norway, Poland, Portugal, 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 smoked salmon producer in 2014; King Oscar, a producer of premium canned sardines, in 2014; Rugen Fisch, a German ambient and chilled fish company, in 2016, Red Lobster, a chain of casual dining seafood restaurants in North America, in 2016; Thammachart Seafood, a seafood retailer in Thailand, in 2018 ; and TUMD Luxemburg S.a.r.l, a leading Russian canned tuna producer in 2018.

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 (Bt20.13 billion). 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 also focused on innovation as a key growth driver. The company continues to invest in innovation, and its new Global Innovation Center in Bangkok was recently opened by Her Royal Highness Princess Maha Chakri Sirindhorn. Expanded to over 5,000 square meters and housing more than 160 scientists and researchers from around the world, the state-of-art, world-class research and product development facility seeks to find new innovation seafood solutions that meet the needs of consumers.

During the second quarter of 2019, TU's subsidiary, Chicken of the Sea, reached a settlement with a majority of the plaintiffs in the ongoing antitrust litigation in the US. As a result, Chicken of the Sea recorded an additional US$ 60 million (Bt1.9 billion) in one-time accruals to reflect additional risks, up from the US$44 million (or Bt1.4 billion) in accruals in 2018.

KEY OPERATING PERFORMANCE

Table 1: TU's Sales Breakdown by Geographic Area

Unit: %

Market	2014	2015	2016	2017	2018	Jan-Jun 2019
USA	44	42	39	39	38	39
EU	29	29	33	31	31	29
Thailand	7	8	8	9	11	12
Japan	7	7	6	6	6	5
Others	13	14	14	15	14	15
Total	**100**	**100**	**100**	**100**	**100**	100
Total sales (Bt million)	**121,402**	**124,904**	**134,375**	**134,937**	**133,285**	**61,583**

Source: TU

Table 2: TU's Sales Growth by Product

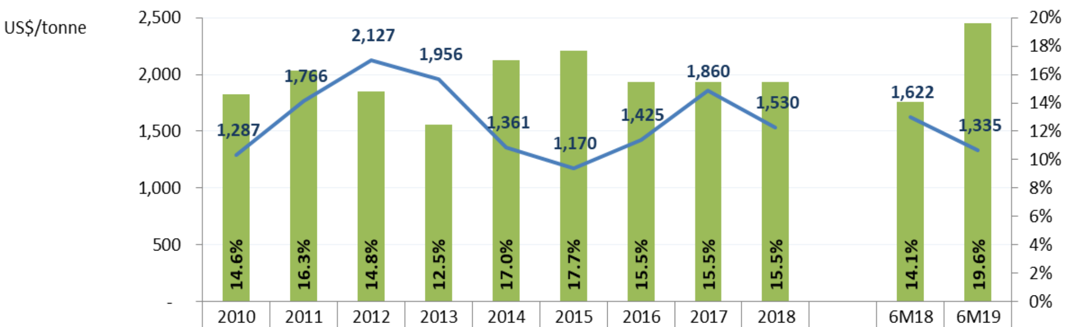
Unit: Bt million

Product (year-on-year)	2014	2015	2016	2017	2018	Jan-Jun 2019
Tuna	53,827	46,396	46,522	47,645	48,472	21,160
% change	1	-14	0	2	2	-11
Shrimp and related products	32,209	36,229	37,868	37,578	36,739	17,528
% change	14	12	5	-1	-2	9
Pet food	8,894	8,159	9,377	10,176	10,721	5,390
% change, y-o-y	11	-8	15	9	5	11
Sardines & mackerel	6,525	7,411	11,321	10,662	9,510	4,555
% change	1	14	53	-6	-11	-3
Salmon	6,180	11,346	12,789	11,255	10,702	4,624
% change, y-o-y	36	84	13	-12	-5	-7
Value-added and other products	13,767	15,643	16,499	17,621	17,141	8,325
% change	12	14	5	7	-3	-5
Total sales	**121,402**	**124,904**	**134,375**	**134,937**	**133,285**	**61,583**
% change	**8**	**3**	**8**	**0**	**-1**	**-2**

Source: TU

Note: Percentage is based in terms of Thai baht.

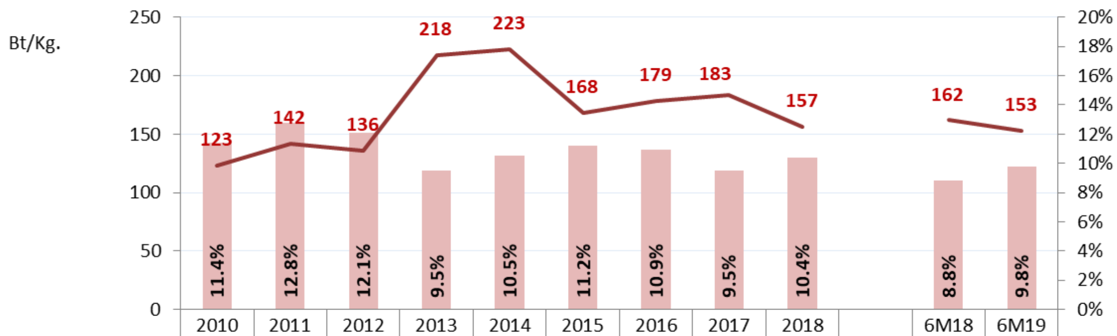
Chart 1: Global Price of Skipjack Tuna and Gross Margin of TU's Tuna Segment



	2010	2011	2012	2013	2014	2015	2016	2017	2018		6M18	6M19
Gross margin-Tuna	14.6%	16.3%	14.8%	12.5%	17.0%	17.7%	15.5%	15.5%	15.5%		14.1%	19.6%
Tuna price	1,287	1,766	2,127	1,956	1,361	1,170	1,425	1,860	1,530		1,622	1,335
%Chg. Tuna pice	12.8%	37.3%	20.4%	-8.0%	-30.4%	-14.0%	21.8%	30.5%	-17.8%		-4.5%	-17.7%

Source: TU

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



	2010	2011	2012	2013	2014	2015	2016	2017	2018		6M18	6M19
Gross margin-Shrimp	11.4%	12.8%	12.1%	9.5%	10.5%	11.2%	10.9%	9.5%	10.4%		8.8%	9.8%
Shrimp price	123	142	136	218	223	168	179	183	157		162	153
%Chg. Shrimp pice	9.3%	15.5%	-4.3%	60.1%	2.3%	-24.3%	6.0%	2.6%	-14.6%		-15.0%	-5.4%

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

Source: TU

FINANCIAL STATISTICS AND KEY FINANCIAL RATIOS

Unit: Bt million

	Jan-Jun 2019	---------------Year Ended 31 December 2018	2017	2016	2015 ------------
Total operating revenues	61,924	134,245	136,037	135,263	125,543
Operating income	3,510	7,587	9,310	11,139	11,636
Earnings before interest and taxes (EBIT)	2,388	6,492	8,976	8,448	10,121
Earnings before interest, taxes, depreciation, and amortization (EBITDA)	4,074	9,809	11,790	11,718	12,964
Funds from operations (FFO)	3,205	7,502	9,560	9,402	9,847
Adjusted interest expense	1,102	2,185	2,294	1,733	1,767
Capital expenditures	2,220	4,963	5,671	4,121	3,192
Total assets	140,116	141,916	146,092	142,365	110,911
Adjusted debt	65,902	66,766	70,028	68,003	39,371
Adjusted equity	46,013	46,494	48,051	47,436	47,970
Adjusted Ratios					
Operating income as % of total operating revenues (%)	5.67	5.65	6.84	8.24	9.27
Pretax return on permanent capital (%)	6.00	5.55	7.63	8.18	10.79
EBITDA interest coverage (times)	3.70	4.49	5.14	6.76	7.34
Debt to EBITDA (times)	6.33	6.81	5.94	5.80	3.04
FFO to debt (%)	12.56	11.24	13.65	13.83	25.01
Debt to capitalization (%)	58.89	58.95	59.31	58.91	45.08

RELATED CRITERIA

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

Thai Union Group PLC (TU)

Company Rating:	A+
Issue Ratings:	
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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