

EK-CHAI DISTRIBUTION SYSTEM CO., LTD.

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CORPORATES

Company Rating: A+
Outlook: Stable

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RATIONALE

TRIS Rating assigns a company rating of "A+" to Ek-Chai Distribution System Co., Ltd. (EKCHAI) with a "stable" rating outlook. The rating incorporates our view on the company's group status as a highly strategically important affiliate of CP All PLC (CPALL, rated "A+/Stable" by TRIS Rating), and our assessment on EKCHAI's stand-alone credit profile (SACP) of "a+". EKCHAI's group status under CPALL reflects our view of its strategic importance to the group in cementing the group's leading position in retail businesses and its significant earnings contribution to CPALL.

EKCHAI's SACP reflects the company's position as a leading operator of hypermarket in Thailand. Its competitive edge is strengthened by its leasable areas in prime locations as well as the cash generating nature of the grocery retailing business. However, the SACP is constrained by intense competition in the modern retail industry, secular changes in consumer behavior toward online shopping, as well as challenges from rising inflation and economic uncertainty.

KEY RATING CONSIDERATIONS

Leader in hypermarket segment with nationwide store network

EKCHAI's strong business profile is underpinned by its leading status and successful track record in the grocery retailer market, together with its nationwide store network and technical know-how in the retailing market.

EKCHAI operates a hypermarket chain under the "Lotus's" brand (formerly "Tesco Lotus") in Thailand. Lotus's is the largest modern trade retailer in the domestic hypermarket segment. The company owns 224 hypermarkets, or 43% of all hypermarkets in Thailand.

Besides hypermarkets, the company also operates medium-sized store network -- "Go Fresh" supermarket and small-sized store network -- "Go Fresh" mini-supermarket to penetrate the target markets. The large-store format provides an extensive range of food and non-food products, while the medium and small formats focus on fresh food products offering convenience to communities.

Competitive position in rental property market

EKCHAI has expertise and proven track record in rental property management. At the end of March 2022, EKCHAI had a total leasable area of 0.7 million square meters (sq.m.) with an occupancy rate (OR) above 90%.

Revenue from rental income has accounted for 5%-7% of EKCHAI's total revenue over the past three years. During the pre-COVID-19 period, the company's rental income grew steadily at the rate of about 4% per year on the back of store expansion and rental fee adjustments. However, rental income declined substantially in 2020-2021, following store closure and rental discount induced by the Coronavirus Disease 2019 (COVID-19) pandemic. Rental income was THB9.3 billion in 2021, down by 30% from THB13 billion during the pre-COVID-19 period.

However, we expect the rental income to gradually recover following the easing of impacts from COVID-19. Mall renovation and new store formats should revitalize rental space to attract traffic, as well as improve occupancy and rental rates. We forecast EKCHAI's rental income to bounce back to THB10-THB12 billion in 2022-2024.

Expanding revenue and margin from better product mix

The company's strategy to improve revenue and operating margins is focused on fast-growing fresh food products. With the "Go Fresh" rebranding, the company is shifting its focus more on the fresh food category in its all-store formats to serve the growing demand, as well as leveraging synergies from its parent company, Siam Makro PLC (MAKRO), and its affiliated company, Charoen Pokphand Foods PLC (CPF), Thailand's largest agribusiness and food conglomerate.

Apart from fresh products, EKCHAI will focus on private-label branded products. Presently, the proportion of revenue from its own brand accounts for about 12% of total revenue. The private-label brand lines cover several types of products from value-for-money products to premium products. EKCHAI strives to increase contributions from its own brands by improving the quality and product assortments to enhance its revenue and operating margins.

Operation expected to recover

EKCHAI's operating results deteriorated materially due to the COVID-19 pandemic. Its operating revenue plunged to THB170.2 billion in 2021, from the level of about THB190 billion per year before COVID-19. Its earnings before interest, taxes, depreciation and amortization (EBITDA) was THB20.2 billion in 2021, down from the level of THB21-THB26 billion before COVID-19.

We expect a gradual recovery in the company's operational performance. Our base-case forecast projects EKCHAI's revenue to escalate by 7%-8% per annum in 2022-2024, driven by better product mix, new store opening, and rising contribution from rental income. However, the company's profitability will likely remain under pressure from rebranding and IT expenses over the next few years. We project its EBITDA margin to stay between 11%-12%, and EBITDA to hover at around THB20-THB26 billion in 2022-2024.

Leverage surged on the back of dividend payment

EKCHAI's leverage has risen substantially owing to the sizable dividend upstream to its shareholders, following the recapitalization under the group policy. In 2021, EKCHAI took out a new bank loan of approximately THB82 billion and paid dividend upstream to its parent company, C.P.Retail Development Co., Ltd. (CPRD). As a result, the adjusted debt stood at THB108.4 billion at the end of 2021 from THB18.7 billion as of February 2021. The debt to capitalization ratio rose to 73.3% at the end of 2021 from 13.7% as of February 2021, while the adjusted debt to EBITDA ratio increased to 5.4 times in 2021 compared with 0.9 times for the period of 12 months ended February 2021.

To pursue its growth strategy, the capital expenditures include store renovation and IT investments. The company also plans to launch 3-5 hypermarket stores, 8-10 medium-sized stores, and 150-250 mini stores per year. Nonetheless, we expect EKCHAI's leverage to gradually decline from the elevated level, with its debt to EBITDA ratio to drop and stay below 4 times, while the debt to capitalization ratio to fall below 70% in 2024.

Adequate liquidity

We assess EKCHAI's liquidity to be sufficient over the next 12 months considering its sources and uses of funds. Its primary sources of funds are cash on hand of THB17.5 billion at the end of 2021 and expected funds from operations (FFO) of about THB15 billion in 2022. Primary uses of fund are planned capital spendings of THB11 billion. There is no long-term debt due in the coming year.

BASE CASE ASSUMPTIONS

- EKCHAI's operating revenue to increase by 7%-8% annually in 2022-2024.
- The adjusted EBITDA margin to stay in the range of 11%-12% in 2022-2024.
- Total capital spending of around THB9-THB11 billion per year during the forecast period.

RATING OUTLOOK

The "stable" outlook reflects our expectation that EKCHAI will maintain its leading position in the retailing industry in Thailand despite the challenging business conditions and intense competition. We expect the company's leverage to remain at an acceptable level even as the company continues to grow.

RATING SENSITIVITIES

As a highly strategically important affiliate of CPALL, the rating on EKCHAI is subject to the cap of the company rating assigned to CPALL. However, in the scenario EKCHAI's SACP falls below CPALL's group credit profile, the rating on EKCHAI would be one-notch below the company rating assigned to CPALL. A rating change on CPALL could trigger a rating change on EKCHAI.

EKCHAI’s SACP could be revised downward if its operating performance falls significantly below the anticipated levels, or any debt-funded investments materially weaken the company’s balance sheet and cash flow protection, such that the adjusted debt to EBITDA ratio rises above 8 times for a sustained period.

COMPANY OVERVIEW

EKCHAI, a leading retailer in Thailand, operates a hypermarket chain under the name “Lotus’s”, formerly “Tesco Lotus”. EKCHAI was established in 1994 by Charoen Pokphand Group. During 1998 through 2003, Charoen Pokphand Group sold its entire stakes in EKCHAI to Tesco PLC., the UK’s largest grocery retailer and one of the world’s largest retailers.

In December 2020, Charoen Pokphand Group and its affiliates completed an acquisition of 100% of Lotus’s stores in Thailand and in Malaysia. Following this transaction, CPALL and Charoen Pokphand Holdings Co., Ltd. (CPH) held 40% each in CP Retail Holding Co., Ltd. (CPRH), an investment holding company, which holds 99.99% in EKCHAI and Lotus’s operation in Malaysia. The remainder (20%) was held by Charoen Pokphand Foods PLC (CPF).

In October 2021, MAKRO acquired 99.9% of the shares of Lotus’s stores in Thailand and in Malaysia through the entire business transfer (EBT) of CPRH by allocating MAKRO’s newly issued shares to the group of CPRH’s shareholder. As a result, MAKRO is a major shareholder, holding 99.99% EKCHAI’s stakes.

As of March 2022, EKCHAI owned 2,600 stores in Thailand, comprising 224 large stores (Hypermarkets), 201 supermarket stores (“Go Fresh” supermarket), and 2,175 small stores (“Lotus’s Go Fresh” mini supermarket). Apart from retail sales, the company has rental space enclosed in its stores nationwide with total permanent leasable area of 722,693 sq.m. EKCHAI also holds 25% stakes in Lotus’s Retail Growth Freehold and Leasehold Property Fund (LPF), which operates 23 malls in Thailand with a net leasable area of approximately 337,000 sq.m.

KEY OPERATING PERFORMANCE

Chart 1: Group Shareholding Structure

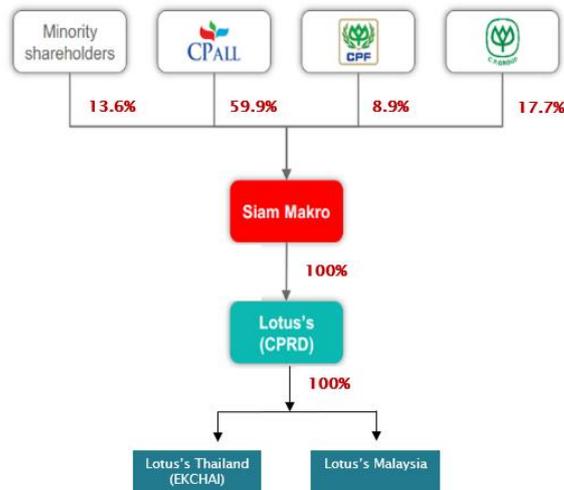


Table 1: EKCHAI’s Revenue Breakdown

Unit: %

By Business	Year Ended Feb 2020	Year Ended Feb 2021	Year Ended Dec 2021	3M22 (Jan-Mar 2022)
Retail sale	93	94	94	94
Rental income	7	6	6	6
Total	100	100	100	100
Sales (mil. THB)	184,061	172,629	168,616	42,804

Source: EKCHAI

FINANCIAL STATISTICS AND KEY FINANCIAL RATIOS

Unit: Mil. THB

	Mar - Dec 2021	-----Year Ended 28 February -----			
		2021	2020	2019	2018
Total operating revenues	143,396	174,236	186,633	187,529	195,632
Earnings before interest and taxes (EBIT)	7,329	9,418	15,707	10,467	13,028
Earnings before interest, taxes, depreciation, and amortization (EBITDA)	16,868	21,509	26,337	21,004	23,572
Funds from operations (FFO)	14,139	18,145	22,663	18,269	20,396
Adjusted interest expense	1,927	1,601	805	861	865
Capital expenditures	11,695	6,301	4,845	8,533	9,763
Total assets	200,039	184,938	144,898	139,780	137,552
Adjusted debt	108,424	18,687	211	3,273	5,281
Adjusted equity	39,462	117,938	103,686	97,579	94,159
Adjusted Ratios					
EBITDA margin (%)	11.76	12.34	14.11	11.20	12.05
Pretax return on permanent capital (%)	4.53 *	6.84	13.62	9.40	12.46
EBITDA interest coverage (times)	8.75	13.44	32.73	24.38	27.24
Debt to EBITDA (times)	6.43 *	0.87	0.01	0.16	0.22
FFO to debt (%)	13.04 *	97.10	10,742.15	558.25	386.21
Debt to capitalization (%)	73.32	13.68	0.20	3.24	5.31

* Based on consolidated financial statements for 10 months period ended December 2021

RELATED CRITERIA

- Key Financial Ratio and Adjustments for Corporate Issuers, 11 January 2022
- Issue Rating Criteria, 15 June 2021
- Group Rating Methodology, 13 January 2021
- Rating Methodology – Corporate, 26 July 2019

Ek-Chai Distribution System Co., Ltd. (EKCHAI)

Company Rating:	A+
Rating Outlook:	Stable

TRIS Rating Co., Ltd.

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