

NORTHEAST RUBBER PLC

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CORPORATES

Company Rating: BB+
Outlook: Stable

Contacts:

Jutatip Chitpromphan
jutatip@trisrating.com

Nauwarut Temwattanangkul
nauwarut@trisrating.com

Wajee Pitakpaibulkij
wajee@trisrating.com

Sasiporn Vajarodaya
sasiporn@trisrating.com



WWW.TRISRATING.COM

RATIONALE

TRIS Rating assigns the company rating on Northeast Rubber PLC (NER) at “BB+”, with a “stable” outlook. The rating reflects the company’s market position as a medium-sized processor in the Thai natural rubber (NR) industry, and its proven track record of producing and merchandising NR. The rating also reflects the company’s matching strategy to partially mitigate price risk.

The rating is constrained by a number of factors including fluctuations in the price of NR, a highly competitive market, government intervention, NER’s narrow product mix, market concentration, and single production site. The rating also takes into consideration NER’s high financial leverage resulting from investments for business expansion.

KEY RATING CONSIDERATIONS

NR industry facing challenges

According to the International Rubber Study Group (IRSG), a decline in NR supplies together with unchanging demand led to a slight rise in global NR prices in 2019. However, the average NR price during the first five months of 2020 fell by 11%-15% year-on-year (y-o-y) following softening demand in the auto industry during the Coronavirus Disease (COVID-19) lockdown. Nonetheless, some leading NR processors in Thailand have managed through and recovering from the period of sharp decline in demand, partly because many tire producers in China are reopening their tire manufacturing plants sooner than expected. The demand shock during the months of COVID-19 lockdowns had resulted in an industry shakeout with some financially weak NR processors in Thailand ceasing their operations. The survived NR processors stand to benefit from the revived demand.

TRIS Rating expects the NR industry to gradually recover post-COVID-19 during 2021-2022. NR production in Thailand is expected to decline by 1 million tonnes in 2020, and then will grow at a slow pace of 2% per year during 2021-2022. Growth is likely to be sluggish, due to a lack of incentive for new plantings, delays in replanting schedules, and the uprooting of rubber trees to make way for more profitable crops. NR consumption is forecast to remain low in 2020, leading to the forecast of persistently low NR prices throughout the year, and to gradually pick up following the recovery of the global economy.

Medium-sized NR processor

NER’s market share, in terms of sales volume of NR products, was 1%-2%. NER’s market share is on par with most other medium-sized NR producers, but is much lower than those of the leading NR producers. The market leader holds about 10% share of the market. NER’s revenue base was moderate at around THB10-THB13 billion per year during 2017-2019. Its revenue ranked 4th-5th among NR processors in Thailand. Sales are primarily to China, and subject to concentration risk. In 2019, approximately 61% of export sales were to the Chinese market, and 39% to Singapore. NER has long-established relationships with its customers, most of which are medium- to large-sized companies.

Volatile operating results

Although the NR processing industry is labor intensive, raw material costs

typically account for 95%-97% of total processing costs. Processors are highly exposed to volatility in the NR price. As a result, earnings and cash flow tend to fluctuate. In an attempt to mitigate price risk and stabilize earnings and cash flow, NER implements its back-to-back selling and buying approach. Nonetheless, some price risk is unavoidable when rubber prices are especially volatile.

NER's profit margin is very thin, and volatile, fluctuating in tandem with rubber prices and exchange rates. The company can partially mitigate some of the negative effects of the price risk by hedging. NER's earnings before interest, tax, depreciation, and amortization (EBITDA) margin declined to 6.7% in 2019, from 8.1% in 2018. The fall was caused by higher raw material costs, coupled with the appreciation of the Thai baht.

For the first six months of 2020, NER's EBITDA margin rose to 8%, compared with 6.5% over the same period of the prior year. The rise was mainly due to NR's lower average raw material cost. TRIS Rating believes NER's EBITDA margin will stay at around 5% during 2020-2022. We also expect NER's production volume to grow as the auto industry recovers and economic conditions improve around the globe.

High financial leverage

NER's financial leverage is considered high. NER's total debt to capitalization ratio rose to 58.9% in 2019 and 60% at the end of June 2020, up from 56.8% in 2018. This was due to NER's greater need for working capital and increased capital expenditure. In our forecast, NER's capital expenditure will rise, which will push up leverage and the financial risk metrics. Capital expenditures are forecast at THB523 million in 2020 and THB100-THB190 million in 2021-2022. Most of the spending is earmarked for expansion of a new block rubber processing plant. As a result, the company's debt to capitalization ratio is expected to remain high at 65% during 2020-2022.

Adequate cash flow protection

We expect NER to have adequate liquidity over the next 12 months. The company has outstanding debts of THB68 million due over the next 12 months. Our base-case forecast projects funds from operations (FFO) of around THB300 million over the same period. The company had cash and cash equivalents of THB168 million and unused credit facilities of THB310 million, as of June 2020.

Looking forward, NER's FFO to total debt ratio is projected to hover around 5% in 2020-2022 while the EBITDA interest coverage ratio is forecast to be 2 times over the same period.

BASE-CASE ASSUMPTIONS

- NER's revenues to decline by 8% in 2020, and to grow by 3%-5% in 2021-2022.
- Projected gross profit margin to be around 8% in 2020-2022.

RATING OUTLOOK

The "stable" outlook reflects our expectation that NER will maintain its competitive position in the NR industry, an adequate liquidity position, and a balance sheet strong enough to withstand the effects of volatile rubber prices.

RATING SENSITIVITIES

The credit upside case may materialize if the company could stabilize earnings and cash flow generation on a sustained basis. The downside case could occur if profitability deteriorates or if NER's performance weakens for an extended period. Any debt funded expansion, which could weaken the company's balance sheet and cash-flow protection, is a negative factor for the rating on NER.

COMPANY OVERVIEW

NER was established in 2006 by Mr. Chuwit Jungtanasomboon, to process and distribute rubber products. The company was certified by "Bridgestone" in 2009 as a producer of standard quality ribbed smoked sheet. The company added a new product, standard Thai rubber, by establishing its own block rubber plant in 2013.

NER owns and operates two rubber plants located in Buriram province, Thailand. Total capacity comprises 60,000 tonnes per annum of ribbed smoked sheet, plus 172,800 tonnes per annum of standard Thai rubber and compound rubber.

As of March 2020, the Jungtanasomboon family collectively held 62.4% of the company's shares. The company was listed on the Stock Exchange of Thailand (SET) in November 2018. The initial public offering (IPO) brought in new equity capital worth THB1.5 billion.

KEY OPERATING PERFORMANCE

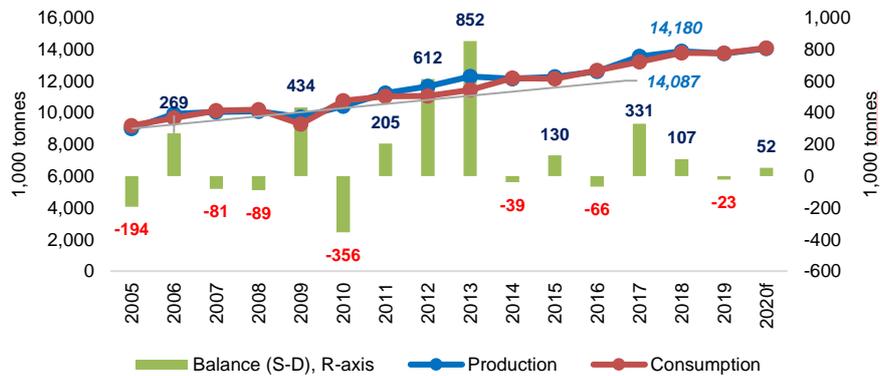
Table 1: NER's Revenue Breakdown by Business

Unit: %

Product	2015	2016	2017	2018	2019	Jan-Jun 2020
Ribbed smoked sheet	25	36	37	35	35	22
Standard Thai rubber	39	37	32	32	31	26
Compound rubber	36	26	31	34	34	52
Total sales	100	100	100	100	100	100
Total sales (Mil. THB)	4,441	6,145	9,805	10,056	13,006	5,647

Source: NER

Chart 1: World Production and Consumption of Natural Rubber



Source: International Rubber Study Group (IRSG)

FINANCIAL STATISTICS AND KEY FINANCIAL RATIOS*
Unit: Mil. THB

	Jan-Jun 2020	-----Year Ended 31 December -----			
		2019	2018	2017	2016
Total operating revenues	5,657	13,021	10,074	9,820	6,171
Earnings before interest and taxes (EBIT)	408	786	736	483	213
Earnings before interest, taxes, depreciation, and amortization (EBITDA)	454	869	816	558	275
Funds from operations (FFO)	329	611	552	282	60
Adjusted interest expense	115	234	252	267	207
Capital expenditures	352	241	83	45	196
Total assets	8,417	7,989	6,693	5,101	4,545
Adjusted debt	4,614	4,323	3,516	3,870	3,663
Adjusted equity	3,079	3,011	2,672	717	611
Adjusted Ratios					
EBITDA margin (%)	8.03	6.67	8.10	5.68	4.46
Pretax return on permanent capital (%) **	11.11	11.31	13.47	10.81	5.67
EBITDA interest coverage (times)	3.94	3.71	3.24	2.09	1.33
Debt to EBITDA (times)	5.07	4.98	4.31	6.94	13.31
FFO to debt (%) **	13.83	14.13	15.71	7.28	1.63
Debt to capitalization (%)	59.98	58.94	56.82	84.37	85.71

Note: All ratios have been adjusted by operating leases.

** Consolidated financial statements*

*** Annualized with trailing 12 months*

RELATED CRITERIA

- Rating Methodology – Corporate, 26 July 2019
- Key Financial Ratios and Adjustments, 5 September 2018
- Group Rating Methodology, 10 July 2015

Northeast Rubber PLC (NER)

Company Rating:	BB+
Rating Outlook:	Stable

TRIS Rating Co., Ltd.

Silom Complex Building, 24th Floor, 191 Silom Road, Bangkok 10500, Thailand Tel: 0-2098-3000

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