

KHON KAEN SUGAR INDUSTRY PLC

No. 145/2020
28 September 2020

CORPORATES

Company Rating:	BBB+
Issue Rating:	
Senior unsecured	BBB+
Outlook:	Stable

Last Review Date: 04/06/20

Company Rating History:

Date	Rating	Outlook/Alert
04/06/20	A-	Negative
04/09/19	A-	Stable
13/11/13	A	Stable
24/11/06	A-	Stable

Contacts:

Jutatip Chitphromphan

jutatip@trisrating.com

Suchana Chantadisai

suchana@trisrating.com

Wajee Pitakpaibulkij

wajee@trisrating.com

Sasiporn Vajarodaya

sasiporn@trisrating.com



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RATIONALE

TRIS Rating downgrades the company rating on Khon Kaen Sugar Industry PLC (KSL) and the rating on KSL's senior unsecured debenture to "BBB+" from "A-" and revises the rating outlook to "stable" from "negative". The downgrades reflect our expectation of the company's materially weakening operating performances in fiscal year (FY) 2020 and FY2021 as a result of two consecutive years of severe drought in Thailand, leading to poor harvest seasons and persistently low world sugar prices.

The ratings have been taken into consideration KSL's long track record in the sugar industry, diversification into other sugar-related businesses, and benefits from a favorable regulatory environment. The ratings are constrained by the volatility of sugarcane supplies, and the company's operational risk of running sugar plants in neighboring countries.

KEY RATING CONSIDERATIONS

Deteriorating financial results

KSL's operating results for FY2019 were in line with TRIS Rating's forecast. Total operating revenue remained flat at THB18.6 billion. KSL's earnings before interest, tax, depreciation, and amortization (EBITDA) margin was 15.5% in FY2019, compared with 15.4% in FY2018, following a decline in raw material costs from high sugarcane supplies. EBITDA stood at THB2.9 billion in FY2019, in line with our forecast of THB2.8 billion.

However, KSL's operating performance deteriorated sharply in the first nine months of FY2020. EBITDA margin was reported at 8.2%, compared with 20.9% in the same period of the prior year. The sharp decline was due to losses from derivatives and contract cancellations of THB499 million, and high raw material costs from lower-than-expected sugarcane supply. In addition, the company realized a one-time transaction of a contribution to the Cane and Sugar Fund of THB337 million. As a result, KSL reported a net loss of THB179 million in the first nine months of FY2020 (or a net profit of THB84 million, excluding the one-time transaction), compared with a net profit of THB725 million in the same period of the prior year.

The plunge in sugar prices, together with the severe drought in the 2019/2020 crop year, is likely to squeeze the margins of sugar producers in Thailand over the next 12-18 months. We expect the company's total operating revenue to drop by 20%-32% to THB10.7-THB12.7 billion in FY2020-FY2021 and recover gradually to THB14.1 billion in FY2022. Our base-case forecast assumes the world sugar price will be around 14 cents per pound in FY2020 and will rise to 14.5 cents per pound in FY2021-FY2022. Thus, we expect a decline in KSL's EBITDA margin to around 8% in FY2020 and then a gradual improvement to 16%-18% in FY2021-FY2022.

Operations in neighboring countries continue to face challenges

KSL has operated sugar plants in the Lao PDR and Cambodia since FY2010. The total investment cost in both countries amounted to approximately THB1.6 billion as of October 2019 with impairment on investments totaling THB1.5 billion. Thus, the book value of both subsidiaries was reduced to THB100 million. The combined revenue contribution from the Lao PDR and Cambodia amounted to less than 5% of total revenues.

Currently, KSL's sugar operation in Cambodia is in the process of divestment.

However, sugar production in the Lao PDR improved during the first nine months of FY2020. The company reported a net profit of THB59 million in the Lao PDR, compared with a net profit of THB13 million over the same period of the prior year. The improvement was driven by an increase in sugarcane supplies and higher selling prices of sugar and molasses. The two subsidiaries reported a combined profit of THB37 million in the first nine months of 2020, compared with a combined loss of THB55 million over the same period of FY2019.

We expect that sugar operations in both countries will continue to face challenges, induced by volatility of sugarcane supplies and sugar prices, intensified competition among sugar operators, and regulatory risks.

Lower working capital requirements and limited capital expenditure pushed down leverage

KSL's inventory days fell to 73 days at the end of October 2019, from an average of 90 days at the end of FY2016-FY2018, following a decline in the amount of inventory held. KSL also reduced its capital expenditure to THB741 million in FY2019, down from an average of THB2 billion per year during FY2016-FY2018. As a result, KSL's total debt to capitalization ratio dropped to 51.3% at the end of October 2019, compared with 55.9% in FY2018, and 54.7% in FY2017.

KSL's total adjusted debt rose to THB20.6 billion as of July 2020 due to seasonal working capital needs. Nevertheless, the company plans to cut capital expenditure, to around THB400 million per year during FY2020-FY2022. Most of the spending is earmarked for capacity expansions and maintenance. Thus, we expect the company's debt to capitalization ratio to gradually decline to 47%-49% during FY2020-FY2022, compared with 52.5% during the first nine months of FY2020. Cash flow protection is forecast to drop to 2.8% in FY2020, from 6.6%-10% during FY2017-FY2019, then improve to 7%-11% in FY2021-FY2022.

Strong market position

KSL's competitive strength is reflected by its track record in the sugar industry. KSL has the fourth-largest market share in terms of sugar production, equivalent to 7%-8%, and over 70 years of experience in the sugar industry. The company's major customers are large-scale food and beverage manufacturers. These industrial users value service reliability and product quality due to their product-specific requirements. As a result, the company is able to earn some price premium on its quality products.

Integration of downstream businesses

KSL's related businesses mostly stem from the utilization of by-products from the sugar production process. The major by-products are bagasse, filter cake, and molasses. Bagasse is mainly used as fuel in its power plants. Filter cake is processed to make fertilizer for sugarcane cultivation. Molasses is utilized to produce ethanol. KSL's downstream businesses consist of power generation, ethanol, and fertilizer production. The company started its sugar-related businesses more than a decade ago.

The energy and fertilizer businesses contribute around 7%-10% of KSL's total revenue. Its involvement in ethanol production is represented by a 40% equity stake in BBGI PLC (BBGI). In our base case forecast, we project the company will receive around THB220-THB280 million per annum during FY2020-FY2022 as its share of the profit from its investment in BBGI.

Sound liquidity

We assess KSL should have adequate liquidity for the next 12 months. Debts coming due in FY2020 include long-term loans of around THB831 million. KSL also has scheduled debt repayments of THB3-THB4.4 billion per year over the period of FY2021-FY2022. Funds from operations (FFO) are projected to fall below THB1 billion in FY2020, then improve to THB1.2 - THB1.9 billion during FY2021-FY2022 following a gradual recovery in sugar prices. Nevertheless, KSL's cash and cash equivalents of THB99 million, plus unused credit facilities of more than THB17.6 billion at the end of July 2020 should be sufficient to cover the loan repayments during FY2020-FY2022.

BASE-CASE ASSUMPTIONS

- Total revenue to drop by 16%-32% per annum during FY2020-FY2021 following the prolonged drought in Thailand, then rise by 32% in FY2022.
- Gross profit margin to be 10% in FY2020, and to improve to 15%-19% per annum during FY2021-FY2022. EBITDA margin to be 8% during FY2020, and to improve to 16%-18% per annum during FY2021-FY2022.
- Total capital spending of around THB400 million per annum during FY2020-FY2022.

RATING OUTLOOK

The “stable” outlook reflects TRIS Rating’s expectation that KSL will maintain its competitive position in the Thai sugar industry. Thailand’s sugar and sugarcane revenue sharing system as well as the revenue contribution from KSL’s power business should alleviate the effects of volatility in the sugar production business.

RATING SENSITIVITIES

An upgrade scenario could occur if KSL’s operating performance and profitability recover consistently on a sustained basis, while KSL is able to attain its deleveraging target by bringing down its net debt to EBITDA ratio below 7 times on sustained basis. A rating downgrade could occur if the company’s performance weakens for an extended period of time. Any aggressive debt-funded expansion, which would deteriorate the balance sheet and weaken cash flow protection, would also lead to a downgrade scenario.

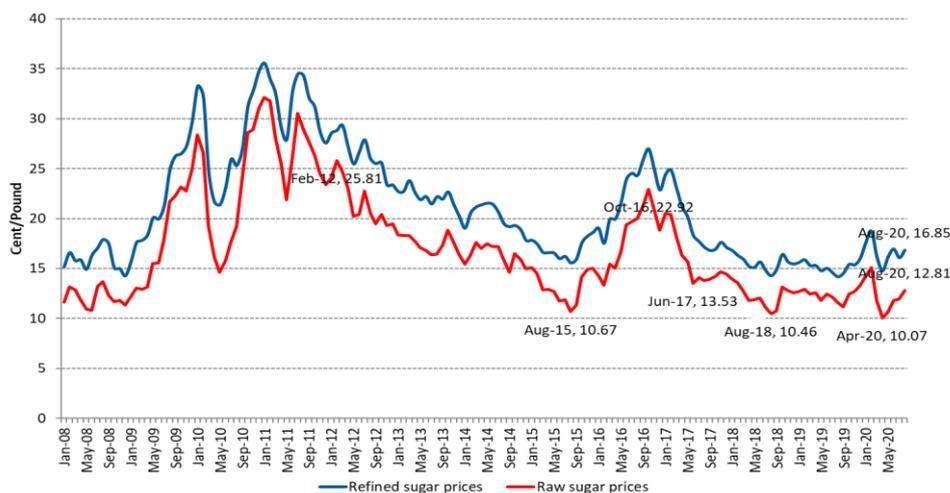
COMPANY OVERVIEW

KSL is one of the leading sugar producers in Thailand, established in 1945 by the Chinthammit family and associates. As of April 2020, the Chinthammit family collectively held 70% of the company’s shares. The company owns and operates five sugar plants in Thailand, with a combined cane crushing capacity of 131,500 cane tonnes per day as of April 2020. KSL procured 5.38 million tonnes of sugarcane in the 2019/2020 crop year and produced 0.58 million tonnes of sugar. The company’s sugar production in the 2019/2020 growing season ranked fourth in the industry, with a market share of 7%. KSL trailed Mitr Phol Group (19.4%), Thai Roong Ruang Group (16.1%), and Thai Ekkalak Group (7.3%).

KGI, a subsidiary of KSL, merged with BBP Holding Co., Ltd. (BBH), a subsidiary of Bangchak Corporation PLC (BCP). The merged operation under BBGI represents a business alliance for the production of bio-based products. BCP holds 60% of BBGI; the remaining 40% is held by KSL. The total investment in BBGI was THB3.24 billion. BBGI was established in October 2017 and became Thailand’s largest producer of bio-fuel with a total production capacity of 1,710,000 litres per day, consisting of 900,000 litres per day of ethanol and 810,000 litres per day of biodiesel. BBGI has planned for an initial public offering (IPO) in FY2022 to secure the funds it needs for business expansion.

KEY OPERATING PERFORMANCE

Chart 1: Raw Sugar Prices Worldwide



Note: Monthly prices of Futures Contract No. 11

Source: New York Board of Trade, United States Department of Agriculture (USDA)

Table 1: Sugar Production in Thailand

Unit: Mil. tonnes

Sugar Producer	Growing Season				
	2015/ 2016	2016/ 2017	2017/ 2018	2018/ 2019	2019/ 2020
Mitr Phol	1.96	1.98	2.73	2.92	1.61
Thai Roong Ruang	1.37	1.42	2.13	2.42	1.34
Thai Ekkalak	0.72	0.94	1.19	1.03	0.60
KSL Group	0.77	0.72	1.20	1.14	0.58
Banpong	0.44	0.44	0.52	0.58	0.38
Eastern Sugar	0.35	0.38	0.51	0.49	0.34
Kumpawapee	0.30	0.28	0.41	0.39	0.24
Wangkanai	0.51	0.39	0.79	0.69	0.22
Khonburi	0.29	0.27	0.44	0.37	0.19
Others	3.07	3.21	4.79	4.55	2.79
Total	9.78	10.03	14.71	14.58	8.29

Source: Office of the Cane and Sugar Board (OCSB)

Table 2: KSL's Revenue Breakdown by Business

Unit: %

Product	2016	2017	2018	2019	Nov 19- Apr 20
Sugar sales					
- Thailand	74.9	73.2	83.7	84.7	78.1
- Laos PDR & Cambodia	5.3	3.9	2.5	1.6	5.5
Ethanol and fertilizer sales	11.9	13.4	-	-	-
Electricity sales	4.8	4.8	6.8	7.4	10.3
Service and others	3.1	4.7	7.0	6.3	6.1
Total sales	100	100	100	100	100

Source: KSL

FINANCIAL STATISTICS AND KEY FINANCIAL RATIOS*

Unit: Mil. THB

	-----Year Ended 31 October -----				
	Nov 2019- Jul 2020	2019	2018	2017	2016
Total operating revenues	9,721	18,605	18,705	16,186	17,186
Earnings before interest and taxes (EBIT)	87	1,761	1,751	1,028	2,585
Earnings before interest, tax, depreciation, and amortization (EBITDA)	793	2,883	2,890	2,114	3,785
Funds from operations (FFO)	510	2,013	2,009	1,438	2,695
Adjusted interest expense	391	721	737	675	720
Capital expenditures	405	741	1,177	3,123	1,963
Total assets	42,226	44,121	45,542	42,991	38,375
Adjusted debt	20,572	20,018	23,597	21,811	19,016
Adjusted equity	18,593	19,021	18,639	18,092	16,650
Adjusted Ratios					
EBITDA margin (%)	8.16	15.49	15.45	13.06	22.02
Pretax return on permanent capital (%)**	1.09	4.20	4.25	2.71	7.22
EBITDA interest coverage (times)	2.03	4.00	3.92	3.13	5.26
Debt to EBITDA (times)	15.98	6.94	8.17	10.32	5.02
FFO to debt (%)**	3.81	10.06	8.51	6.59	14.17
Debt to capitalization (%)	52.53	51.28	55.87	54.66	53.32

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

Khon Kaen Sugar Industry PLC (KSL)

Company Rating:	BBB+
Issue Rating:	
KSL27DA: THB2,000 million senior unsecured debentures due 2027	BBB+
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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