

# SRI TRANG AGRO-INDUSTRY PLC

No. 176/2020  
26 October 2020

## CORPORATES

<b>Company Rating:</b>	A-
<b>Issue Ratings:</b>	
Senior unsecured	A-
<b>Outlook:</b>	Stable

Last Review Date: 25/10/19

### Company Rating History:

Date	Rating	Outlook/Alert
25/10/19	BBB+	Negative
27/10/17	BBB+	Stable
05/08/11	A-	Stable
20/11/10	BBB+	Positive
30/09/09	BBB+	Stable
14/09/07	BBB	Stable

### Contacts:

Jutatip Chitphromphan

jutatip@trisrating.com

Nauwarut Temwattanangkul

nauwarut@trisrating.com

Wajee Pitakpaibulkij

wajee@trisrating.com

Sasiporn Vajarodaya

sasiporn@trisrating.com



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## RATIONALE

TRIS Rating upgrades the company rating on Sri Trang Agro-Industry PLC (STA) and the rating on STA's senior unsecured debenture to "A-" from "BBB+" and revises the rating outlook to "stable" from "negative". The upgrade reflects STA's strengthened financial profile following the initial public offering (IPO) of Sri Trang Gloves (Thailand) (STGT) on the Stock Exchange of Thailand (SET) in July 2020, and our expectation of an improvement in the company's operating performance in the next few years.

The ratings continue to reflect STA's leading position in the natural rubber (NR) industry, its competitive edge in vertical integration, and the strong track record of the management team. However, STA's business profile is constrained by the cyclical and volatile nature of NR prices as well as the challenges the NR industry is facing amid a weak and highly uncertain global economy.

## KEY RATING CONSIDERATIONS

### Improved capital structure and key financial metrics

STA's capital structure strengthened significantly after STGT, which is a subsidiary of STA, successfully completed its IPO on the SET in July 2020 and received net proceeds of THB14.6 billion from the fund raising. The company aims to use the proceed of THB11.1 billion to expand its glove capacity and improve production efficiency in 2020-2026. Proceeds of THB2.3 billion will be used for loan repayment, and the remaining THB1.2 billion for working capital and for maintenance.

STA's total debt to capitalization ratio improved significantly to 11.3% as of June 2020 from 51.7% as of December 2019. Under our base-case scenario, STA's total debt to capitalization ratio is projected to be in the 20%-30% range during 2020-2022.

### Improvement in operating results

STA's operating results for 2019 were in line with our forecast. Total operating revenue was THB60.3 billion. Earnings before interest, taxes, depreciation, and amortization (EBITDA) stood at THB3.3 billion in 2019.

STA's total operating revenue grew by 9% year-on-year (y-o-y) to THB32.8 billion in the first half of 2020. The revenue contribution from the glove segment rose to 27% following strong demand induced by the Coronavirus Disease 2019 (COVID-19) pandemic, compared with 20% in 2019.

STA's gross margin (including gains or losses from derivatives instruments) improved to 15.3% during the first six months of 2020, up from 6.6% over the same period of the prior year. The improvement was the result of a more favorable product mix, lower raw material cost, and the depreciation of the Thai baht. STA reported a net profit of THB1.9 billion in the first six months of 2020, compared with a net loss of THB0.4 billion in the same period of the prior year.

We forecast that STA's total operating revenues will grow by 29% y-o-y in 2020, and will grow further, by 5% in 2021 and 1% in 2022. Its gross margin is expected to reach 22% in 2020 and will drop to 10%-12% per annum in 2021-2022. As a result, STA's EBITDA margin is forecast to improve to around 19% in 2020 and will decline to the 8%-9% range per annum in 2021-2022.

### Strong demand in the glove segment

We view that the glove business outlook will remain strong next year. According to STA and the Malaysian Rubber Glove Manufacturers Association (MARGMA), demand for gloves worldwide is forecast to increase to 360 billion pieces per annum in 2020 from 150 billion pieces per annum in 2010, a compound annual growth rate of 9%. Global glove demand is being driven by growth in healthcare industry in the United States (US), Europe, and the rest of the world.

During the first six months of 2020, the COVID-19 pandemic triggered a spike in global demand for rubber gloves. STA's sales volumes jumped by 45.6% y-o-y to 13.7 billion pieces in the first half of 2020. STA's backlogs for glove production have overflowed until mid-2022. STA plans to expand its glove capacity to 35.7 billion pieces in 2021, and 45.8 billion pieces in 2022, from 32.6 billion pieces in the first half of 2020.

### 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 nine months of 2020 fell by 12% y-o-y following softening demand in the auto industry during the COVID-19 lockdowns across countries.

The demand shock during the lockdowns resulted in an industry shakeout with some financially weak NR processors in Thailand ceasing operations. Nonetheless, some leading NR processors in Thailand have managed to weather the sharp decline in demand, while many tire producers in China are reopening their plants sooner than expected. It appears that the surviving NR processors stand to benefit from the revived demand. We expect the NR industry to gradually recover during 2021-2022.

### Strong liquidity

We expect STA to have strong liquidity over the next 12-18 months. The company has scheduled debt repayments of THB1.3-THB3.7 billion per annum during 2020-2022. Our base-case forecast projects STA's EBITDA to be a range of THB6-THB15 billion per annum. At the end of June 2020, cash on hand and short-term investments stood at THB16.5 billion, plus unused credit facilities of more than THB25.5 billion.

Looking forward, STA's ratio of funds from operations (FFO) to total debt is projected to improve to 127% in 2020 and 25%-35% per annum in 2021-2022, while the EBITDA interest coverage ratio is forecast to improve to 19 times in 2020, and 7-9 times per annum in 2021-2022.

### BASE-CASE ASSUMPTIONS

- Total revenues to grow by 29% y-o-y in 2020, 5% in 2021, and 1% in 2022.
- Gross profit margin of 22% in 2020, declining to 10%-12% per annum in 2021-2022.
- EBITDA margin of around 19% in 2020, declining to 8%-9% per annum in 2021-2022.
- Total capital spending of around THB3.1 billion in 2020, and THB5.6-THB7.9 billion per annum during 2021-2022.

### RATING OUTLOOK

The "stable" outlook reflects the expectation of TRIS Rating that STA will maintain its competitive position in the NR industry with increasing revenue contribution from the glove business. We also expect the company to prudently manage NR price risk and foreign exchange risk as well as maintain sufficient liquidity to withstand the effects of volatile NR prices.

### RATING SENSITIVITIES

STA's credit upside is limited in the near term following this upgrade. A rating downgrade could occur if the company's performance weakens materially for an extended period, with its adjusted debt to EBITDA ratio staying above 4 times. Any aggressive debt-funded expansion which would potentially weaken its balance sheet and cash flow protection, could also lead to a downgrade scenario.

### COMPANY OVERVIEW

STA is a leading worldwide processor and merchandiser of NR. The company has 36 rubber processing plants for block rubber, ribbed smoked sheet, and concentrated latex, located in Thailand, Indonesia, and Myanmar, together with three glove processing plants, located in Thailand. The company's plants are located in Thailand, Indonesia, and Myanmar. As of 30 June 2020, the company's total installed NR processing capacity was 2,831,035 tonnes per year and glove production capacity was 32.6 billion pieces per year.

Approximately 91% of its NR products are sold directly to customers and dealers, which are mostly tyre manufacturers. Exports accounted for 86% of total sales volume. China was the largest export market, accounting for 64% of export

volume during the first half of 2020.

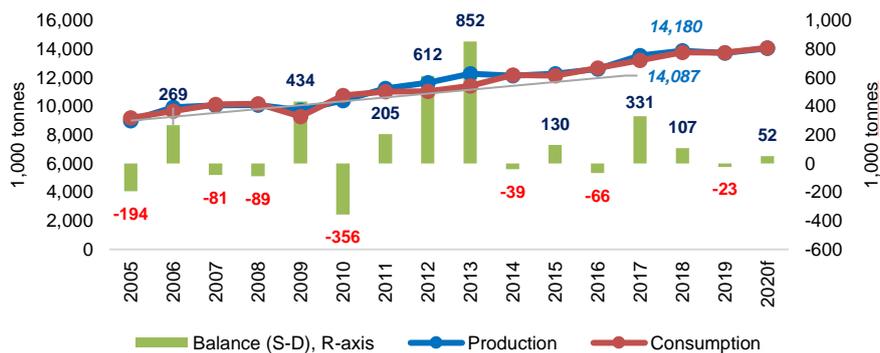
Currently, the major NR producing nations are Thailand, Indonesia, Vietnam, and Malaysia. In the first six months of 2020, these four countries accounted for 75% of the NR produced worldwide. Thailand was the largest producer, with a total production volume of 2.3 million tonnes, followed by Indonesia (1.4 million tonnes), Vietnam (0.4 million tonnes), and Malaysia (0.2 million tonnes). In terms of consumption, demand for NR worldwide has increased to 13.6 million tonnes in 2019 from 10.8 million tonnes in 2010, growing by 2.7% per annum on average. China consumes around 39% of the global NR output. However, worldwide NR consumption declined by 15% in the first six months of 2020 following impacts from the COVID-19 pandemic, the global economic slowdown, and a slump in the global automotive sector.

STGT, one of Sri Trang Group’s flagship companies, engages in the production and distribution of latex and nitrile examination as well as industrial gloves for customers in over 140 countries around the world. The main markets are Asia, US, and European Union (EU). With an annual installed production capacity of 33 billion pieces as of 30 June 2020, STGT is Thailand’s biggest glove producer and is ranked among the world’s leading producers. In 2019, STGT had a market share of 7% of global glove consumption.

STGT, which is a subsidiary of STA, successfully raised funds via an IPO on the SET on 2 July 2020. STGT’s net proceeds of THB14.6 billion will primarily be used toward a planned capacity expansion to serve the global demand for gloves. STGT intends to achieve an annual production capacity of 50 billion pieces by 2023, and 70 billion pieces by 2026, with new capacity first coming from the new Surat Thani plant (SR2) in the first quarter of 2021. The remainder of the IPO proceeds will be used for the SAP installation to improve efficiency and loan repayment, as well as working capital. Following the IPO, from the third quarter of 2020 onwards, STA has become a major shareholder of STGT with a 56.1% direct and indirect shareholding.

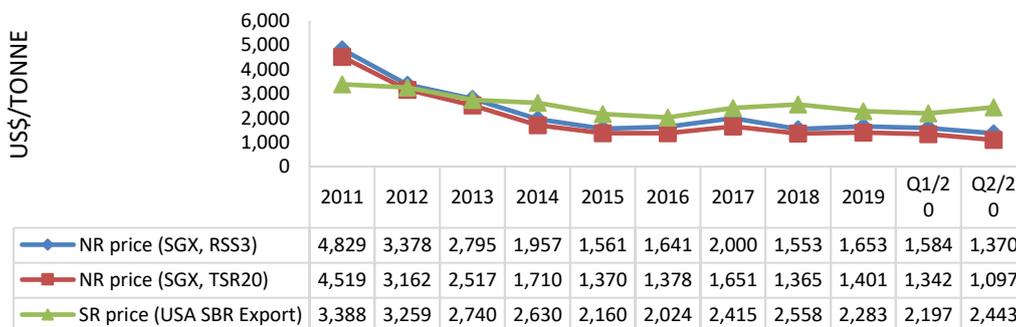
**KEY OPERATING PERFORMANCE**

**Chart 1: World Production and Consumption of Natural Rubber**

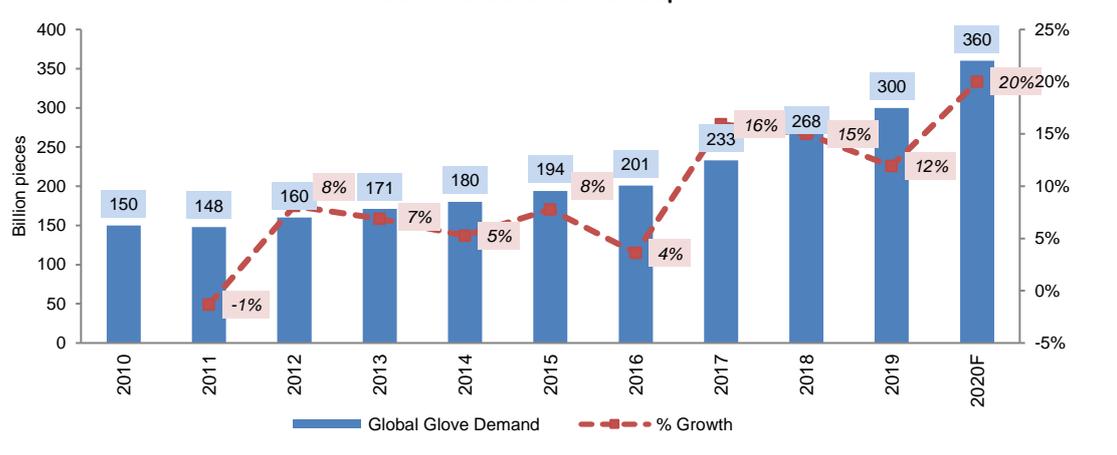


Source: International Rubber Study Group (IRSG)

**Chart 2: Natural Rubber Prices**



Source: IRSG

**Chart 3: Global Glove Consumption**


Source: STA and Malaysia Rubber Glove Manufacturers Association (MARGMA)

**FINANCIAL STATISTICS AND KEY FINANCIAL RATIOS\***

Unit: Mil. THB

	Jan-Jun 2020	-----Year Ended 31 December -----			
		2019	2018	2017	2016
Total operating revenues	32,806	60,465	73,298	89,565	77,410
Earnings before interest and taxes (EBIT)	2,774	783	3,297	(1,076)	(306)
Earnings before interest, taxes, depreciation, and amortization (EBITDA)	4,201	3,306	5,783	3,070	579
Funds from operations (FFO)	3,649	2,399	4,576	1,818	130
Adjusted interest expense	385	923	962	1,231	732
Capital expenditures	882	4,004	2,964	3,167	2,295
Total assets	67,773	58,331	58,414	59,708	55,959
Adjusted debt	5,330	27,259	24,099	30,600	30,469
Adjusted equity	41,949	25,488	26,411	23,277	19,912
<b>Adjusted Ratios</b>					
EBITDA margin (%)	12.80	5.47	7.89	3.43	0.75
Pretax return on permanent capital (%)**	5.76	1.43	5.94	(1.99)	(0.66)
EBITDA interest coverage (times)	10.90	3.58	6.01	2.49	0.79
Debt to EBITDA (times)	0.88	8.24	4.17	9.97	52.66
FFO to debt (%)**	95.77	8.80	18.99	5.94	0.43
Debt to capitalization (%)	11.27	51.68	47.71	56.80	60.48

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

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**Sri Trang Agro-Industry PLC (STA)**

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<b>Company Rating:</b>	A-
<b>Issue Rating:</b>	
STA215A: THB1,455 million senior unsecured debentures due 2021	A-
<b>Rating Outlook:</b>	Stable

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**TRIS Rating Co., Ltd.**

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

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