

THAILUXE ENTERPRISES PLC

No. 55/2017

31 May 2017

Company Rating: BB**Outlook:** Stable**Contacts:**Nauwarut Temwattanangkul
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rungrat@trisrating.com**WWW.TRISRATING.COM****Rating Rationale**

TRIS Rating assigns the company rating of Thailuxe Enterprises PLC (TLUXE) at “BB”. The “BB” rating reflects TLUXE’s market position as a small-scale feed producer and long track record in aquatic feed industry. The rating also incorporates its diversification efforts to the renewable energy sector. However, the rating is constrained by the competitive environment and possible exposure to the disease outbreak in the shrimp feed industry, TLUXE’s limited track record in geothermal and wind power projects, the execution risks of the power projects, aggressive treasury management, as well as rising leverage from sizable investments to fund its growth plans in the years ahead.

TLUXE was founded in 1987 as an aquatic feed producer. The company was listed on the Stock Exchange of Thailand (SET) in 1994. As of March 2017, the Jindasombatcharoen family held 12.9% of TLUXE while the Sereepakornkrai family, the founder of the company, owned 3.8%. TLUXE’s main products comprise shrimp feeds and fish feeds. In 2015, the company expanded its business scope and became a contract manufacturer of pet food products. In mid-2016, TLUXE diversified its business into renewable energy business by acquiring two companies, PPSN Co.,Ltd. (PPSN) and Sumo Power Co.,Ltd. (Sumo) in Japan with total investments of Bt255 million. These two companies is developing 12 geothermal power plants with a capacity of 125 kilowatts (kw) each in Beppu, Oita, Japan. Two of them have commenced the commercial operation date (COD) in July 2016. The two projects have agreements with Kyushu Electric Power Co. Inc, one of the leading power producers in Japan, to sell power at favorable feed-in tariffs set by the Japanese government for 15 years. The revenue from these two power plants was approximately Bt10 million in 2016. Presently, the fish feed sales are the company’s largest contributor, accounting for 68% of TLUXE’s total revenue in 2016, followed by shrimp feed (23%), pet food (8%), and power business (1%).

TLUXE’s financial performance was hard hit by an early mortality syndrome (EMS) rocking the shrimp business in Thailand. TLUXE’s shrimp feed sales declined significantly, plunging from Bt1,688 million in 2012 to Bt352 million in 2016 while the fish feed sales ranged between Bt900-Bt1,300 million during 2012-2016. The revenue from the frozen food business, which the company divested in 2016, contributed Bt220-Bt330 million in 2012-2015. As a result, TLUXE’s revenue was Bt1,511 million in 2016, only a half of Bt3,146 million the company achieved in 2012. The disease outbreak also cut TLUXE’s operating profit margin before depreciation and amortization from 7.7% in 2012 to a record low of 3.1% in 2014. However, the profit margin recovered in 2016. TLUXE’s operating margin rose from 3.1% in 2014 to 7.2% in 2016. The increase was due mainly to the fine-tuning in raw material sourcing and inventory management. The company also attempted to develop more premium products to reclaim its market share. TLUXE’s earnings before interest, tax, depreciation, and amortization (EBITDA) dropped, slipping from Bt281 million in 2012, to Bt85 million in 2014, and gradually improved to Bt109 million in 2015 and Bt142 million in 2016 following the gradual recovery of profitability .

TLUXE’s operating performance remains flat during the first quarter of 2017. Revenue was Bt401 million, a 18% up from Bt340 million the first quarter of 2016.

The increase was mainly driven by more orders for shrimp feed. The operating margin was 7.2% during the first quarter of 2017, down from 9.1% during the same period of 2016. As a result, EBITDA was flat at Bt41 million in the first quarter of 2017.

TLUXE's balance sheet deteriorated. Its total debt was Bt1,480 million in 2016, surging from the debt-free position in 2014. The total debt to capitalization ratio jumped to 44.9% in 2016, from 0.9% in 2014. The rise in leverage came after the company decided to invest in the power plant projects in Japan. TLUXE issued new debentures worth Bt1,486 million in 2016. Nevertheless, the scheduled investment in the power plant projects has been delayed. TLUXE invested the funds from new debentures in several non-rated bills of exchange (B/E) and in common stocks. As leverage surged and profit dropped, TLUXE's cash flow protection was weak. The ratio of the funds from operations (FFO) to total debt was 6.1% in 2016 and 6.2% (annualized, from the trailing 12 months) at the end of March 2017. The EBITDA interest coverage was 1.9 times in 2016 and the first quarter of 2017, compared with 16.6 times in 2014.

TLUXE is striving to diversify from the feed manufacturing industry toward a renewable energy business. Apart from developing 12 units of geothermal power plants, during late-2016 through 2017, TLUXE's board of directors approved a plan to set up two joint ventures (JVs) with two Japanese partners to invest in land developments for new geothermal power projects and invest in wind power projects in Aomori, Japan. The company also plans to acquire eight more geothermal power units and develop 30 units in the developed JV land. All power projects are targeted to sell power under long-term contracts with leading power producers in Japan and apply for the favorable feed-in tariffs as announced by the Japanese government. TLUXE plans to spend about Bt3,500-Bt4,000 million over the next three years for the power plant projects and investment in the JVs. The expansion into the power business would enhance growth potentials and earnings stability in the long term. If the projects are successfully executed and operated as the company planned, the company expects that the 12 geothermal power projects and wind projects under development will increase EBITDA by Bt180 million per year, while the additional 38 geothermal power projects will raise its annual EBITDA by approximately Bt400 million.

However, the new business carries execution risks as the company has a short track record in the geothermal and wind energy operations. Additionally, those risks also associate with the projects abroad. Moreover, the sizable investment needed in order to develop several power projects will put pressure on TLUXE's financial profile in the near term. Nevertheless, TLUXE partially mitigated operating risks by contracting Setouchi Natural Energy Co.,Ltd. (Setouchi), TLUXE's Japanese partner, to operate all the geothermal projects. Setouchi is an onsen villa developer in Beppu and currently operates several units of geothermal power plants in the same area.

Under TRIS Rating's base case scenario, TLUXE's revenues will be approximately Bt1,700-Bt2,400 million per annum during 2017-2019. The operating margin is expected to improve gradually to 20% in 2019 on the back of a higher margin of power sales. The operating income is expected to grow as a result of the recovery in the shrimp feed business in Thailand, increased orders of pet food, and more income from the power segment. Funds from operations (FFO) are expected to increase gradually to around Bt340 million in 2019. However, TLUXE's considerable investment plan for the power projects will weaken cash flow protection during the investment period and the situation will recover along with the gradual commercial operations of the power projects. The total debt to capitalization ratio is expected to stay in a range of 60%-65% over the next three years. The FFO to total debt ratio is expected to stay around 2%-9% in 2017-2019, while the EBITDA interest coverage ratio will remain at 1.5-3 times during the same period.

Rating Outlook

The "stable" outlook reflects TRIS Rating's expectation that TLUXE will maintain its market position and the sales from aquatic feed will gradually improve along with the recovery in the shrimp business in Thailand. TLUXE is expected to successfully execute the upcoming power projects in Japan, and earn satisfactory returns.

A rating upgrade could occur if the geothermal and wind power projects are successfully executed and generate cash flow as planned while the debt to capitalization ratio is well managed and stays below 65%. On the contrary, the ratings could be lowered if the performances of the power projects significantly fall short of the estimates, or respective guidances. A worse-than-expected capital structure due to the below-target operating performances or aggressively debt-funded investments are also the negative factors for the ratings.

Thailuxe Enterprises PLC (TLUXE)

Company Rating:

BB

Rating Outlook:

Stable

Financial Statistics and Key Financial Ratios*

Unit: Bt million

	----- Year Ended 31 December -----					
	Jan-Mar 2017	2016	2015	2014	2013	2012
Revenues	401	1,511	1,675	2,134	2,523	3,146
Gross interest expense	22	74	11	5	8	7
Net income from operations	(9)	(146)	9	(12)	61	127
Funds from operations (FFO)	17	91	89	103	156	293
Earnings before interest, tax, depreciation, and amortization (EBITDA)	41	142	109	85	165	281
Capital expenditures	14	83	65	175	184	180
Total assets	3,717	3,569	2,309	1,666	1,762	1,857
Total debts	1,481	1,480	435	12	31	53
Shareholders' equity	1,893	1,819	1,582	1,328	1,341	1,334
Operating income before depreciation and amortization as % of sales	7.15	7.24	5.19	3.12	5.44	7.70
Pretax return on permanent capital (%)	1.42 **	1.49	0.34	(0.44)	6.42	16.89
EBITDA interest coverage(times)	1.89	1.93	9.55	16.63	20.26	37.52
FFO/total debt (%)	6.21 **	6.13	20.36	837.65	495.87	548.42
Total debt/capitalization (%)	43.89	44.85	21.44	0.92	2.29	3.84

* Consolidated financial statements

** Annualized with trailing 12 months

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