Credit Research Initiative
Risk Management Institute, National University of Singapore
NUS National University of Singapore | RMI Advancing Risk Management for Singapore and Beyond
transforming big data into smart data
Weekly Credit Brief Oct 03 - Oct 09

# World's largest fully integrated rubber company raises capital amidst low rubber prices

by Dexter Tan

*Corrections: Figure 1 was incorrectly published on Oct 10 and has been replaced by the 1-year Forward Probability of Default. The sections in italics below highlight changes made to the original article.*

Sri Trang Agro Industry Public Company Limited (Sri Trang), a listed company in Thailand, is planning to raise THB 2.56bn to repay debt and expand its production capacity through a common stock rights offering. The participation deadline for the subscription rights expired last Tuesday, October 3 and shareholders could purchase new shares at an offering price of THB 10 per share. Sri Trang has yet to announce the amount raised but the company's board has approved to increase the firm's registered capital to THB 1536mn from THB 1280mn.

Sri Trang is the world's largest fully integrated rubber company. The company's 2016 sales accounted for 12% of worldwide demand and the firm has announced plans to increase annual capacity by 20% this year. Besides selling rubber products and examination gloves, Sri Trang also operates 50,000 rai of rubber plantations and manages a supply chain of processed dried rubber wood. Their customers include the tire and gloves industries that are located in Asia, US and Europe.

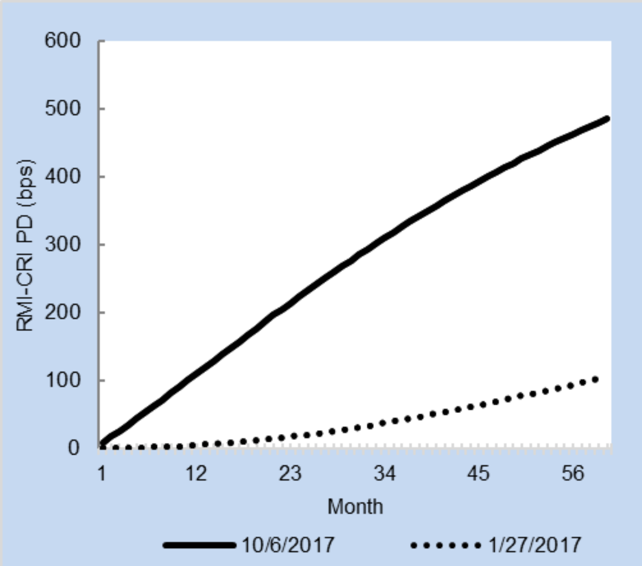
In Q2, the rubber producer reported a net loss of *THB 2.08bn*, bringing down their T12M EBITDA to THB -1.95bn. The company bought rubber contracts when prices were high during Q1, which resulted in losses as rubber prices subsequently declined due to poor demand and oversupply. Inventory write-downs resulted in poor earnings and the company expects a full year loss of *THB 1.94bn*.

As shown in Table 1, the company's financial performance has been declining with negative cash flows and high gearing ratios. The ratio of debt to total assets has increased to 63% from 44% in a year while *cash flows* plunged to THB -13.9bn in Q1 from THB -1.5bn in Q2 2016. Sales are forecast to fall 16% this year, as rubber prices remain volatile. The firm has reduced exposure to long-term rubber contracts but intense competition in the gloves industry could pressure its operating margin moving forward, as Sri Trang remains a new entrant in the market.

| | Q2 2016 | Q3 2016 | Q4 2016 | Q1 2017 | Q2 2017 |
|---|---|---|---|---|---|
| **T12M EBITDA (THB mn)** | 1083 | 682 | 473 | 799 | -1953 |
| **Total debt (THB mn)** | 19194 | 22125 | 31710 | 40946 | 36030 |
| **Total debt to T12M EBITDA (X)** | 17.72 | 32.40 | 66.99 | 51.24 | -18.44 |
| **T12M Retained cash flow (THB mn)** | -1577 | -3351 | -10725 | -13938 | -8795 |
| **Total debt / total assets (%)** | 43.68 | 47.56 | 56.67 | 60.96 | 63.06 |

Table 1: Financial Data for Sri Trang. Retained cash flow is defined as the difference between operating cash flow and paid dividends. Source: Bloomberg

The RMI-CRI Probability of Default (PD) term structure for Sri Trang has moved upwards since the start of the year, reflecting deteriorating credit conditions for the firm over horizons from an immediate term to 5 years. *The 12 month RMI-CRI PD was less than 5bps on Jan 27 but increased to 109bps on Oct 6. The RMI-CRI 1-year Forward Probability of Default accompanied the changes. Intuitively, the Forward PD computes the credit risk of the firm on a future period, which works like a forward interest rate. For instance, the 3-month Forward 1-year PD is the probability that the firm defaults during the period from 3 months onward to 1 year plus 3 months, on condition that the firm has survived next 3 months. The curve on October 6 shows the Forward 1-year PD gradually steepens with time to peak at around 12 months, and then decline afterward, suggesting that with the market information on October 6, the firm faces relatively higher default probabilities over the next two years vis-a-vis other times. The curve on October 6 also differs from the one on an earlier time, which is not only much lower in magnitude but also offers a different pattern on future default prospect.*



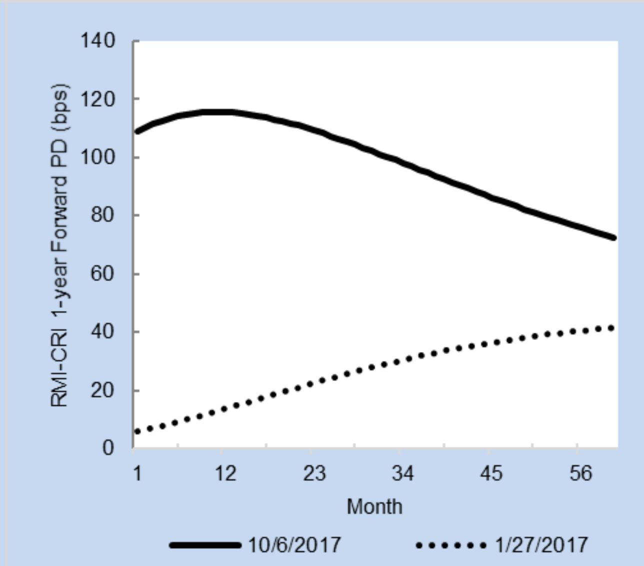




Figure 1: RMI-CRI PD term structure and *RMI-CRI Forward 1-year PD term structure for Sri Trang. Source: RMI-CRI*

Sri Trang's credit profile depends largely on rubber prices, which continue to remain at a low level. Since 2011, the global natural rubber market has been in a state of oversupply. Affected by the growing tapping area of natural rubber in main producing regions, the slowdown in the growth rate of the tire industry and other factors, the glut of natural rubber excess supply may continue until 2020. Due to slow global economic growth and the excess supply of natural rubber, the price of natural rubber has been hovering at a low level. There have been market interventions such as the Thai government's Thai Rubber Joint Venture but it is unclear if they are successful.

## Credit News

### Bankrupt US retailers begin to catch a break

**Oct 6.** Creditors, landlords and vendors that are affected by the retail rout are now seeing more value left as they minimize their losses. Bankrupt retailers argue that they can still generate enough cash to withstand the sector's woes if their debts could shrink and payment obligations could ease. Creditors are likely to forgive some of their debt in exchange of equity stakes since they understand liquidations would result in a limited recovery. Landlords who rent out store space are also willing to provide relief rather than looking for another tenant amid a glut of unused mall space. Vendors also offered longer payment terms relieving working capital required by retailers to operate. (Straits Times)

### Energy debt sells like it's 2014 even with crude oil at USD 50

**Oct 6.** Energy companies return to the credit market at a rapid pace similar to 2014, when oil prices hit a high of USD 100 and companies were issuing mountains of debt to fund growth strategies. Now, oil prices have stabilized at around USD 50, but high-yield US energy debt reached USD 7bn in September and accounted for 31% of total issuance. The momentum has carried over into October, in which the most debts have been issued since 2012. With USD 71bn of debt maturing in 2019, oil and gas companies have issued a record amount of debt following a sharp drop of bankruptcy filings in the sector. Despite the positive sign, the skepticism over the fundamental recovery remains. (Bloomberg)

### Private credit booms as new hedge funds pile in

**Oct 4.** Private credit, which managed about USD 600bn at the end of last year, is growing at a highest rate since the hedge fund industry boom in the 1990s. According to a report released on October 4 by the Alternative Credit Council, the Alternative Investment Management Association, and the law firm Dechert, the private credit funds could grow to USD 1tn by 2020. The expanding opportunity set has attracted more entrants to the industry and resulted in pricing pressures, which is forcing funds to look outside United States for more opportunities. It is said about one-third of the money being managed is currently not invested and investors are piling into private credit as interest rates stay low. (FT)

**Offshore rig firms see end to worst downturn in history**

**Oct 4.** While the 2014-2016 oil price crash caused firms to cut exploration budgets, bankrupting many owners, energy companies are now seeking to replenish their hydrocarbon reserves. According to companies and analysts, the nascent demand for harsh-environment rigs, particularly for North Sea drilling, could lead to increased rates for these units as soon as 2018, and other categories may follow in 2019 or 2020. Historically, the percentage of the global fleet utilized had to rise to 85% or more for day rates to increase significantly. Today the percentage has arrived at around 60-70%. (Reuters)

**Cash flow woes for construction firms worsen in Q3 as slow payments rise across all sectors**

**Oct 3.** Slow payments rose across all sectors in Q3 this year according to the latest quarterly survey by the Singapore Commercial Credit Bureau. Slow payments rose marginally to 40.75% in Q3 2017 as compared to Q2 but this figure improved moderately as compared on a year on year basis. Slow payments worsened in five industries but the construction sector is the hardest hit. The slow payments in construction sector has worsened for the seventh straight quarter and has recorded the highest proportion of payment delays since Q1 2016. (Straits Times)

**S&P puts Syngenta at risk of downgrade after China funding questioned** (FT)

**South Korea web-only banks thrive as traditional lenders struggle** (FT)

**Noble sells US gas and power unit for less than expected** (FT)

**Regulatory Updates**

**US Treasury plan calls for easing dozen of Wall Street rules**

**Oct 6.** The US Treasury department has released a series of recommendations to roll back regulations affecting big banks, hedge funds and exchanges. The overhaul includes the adjustments to the Sarbanes-Oxley Act of 2002 and the Dodd-Frank Act of 2010, tweaking the IPO rules, and easing the regulations for swaps and securitized bonds, two products that fueled the financial crisis in 2008. Some of these recommendations are expected to receive opposition from investor advocates and lawmakers. (Bloomberg)

**ECB pushes to deter banks from holding sour loans**

**Oct 5.** The European Central Bank (ECB) will put up a rule change, which will force banks to tackle losses from loans that have gone sour, an effort to stamp out one of the biggest problems in the financial system. Banks will have to put up collateral against any loan that becomes non-performing which makes it more expensive for lenders to hold a stock of bad debt. Higher collateral requirements will also raise the cost of funding for lenders and lenders will lose a potential source of revenue. The rules would only apply to non-performing loans after January 2018 and not to the large stock of non-performing loans that are part of the legacy troubles during the crisis years. The ECB, however, signaled that it could issue tougher rulers to solve the sour loans problem from the past by end of March. (FT)

**US consumer watchdog moves ahead with payday loans curbs** (FT)

**Yellen says Fed is working on tailoring regulations to bank size** (Bloomberg)

Published weekly by Risk Management Institute, NUS | Disclaimer
Contributing Editor: Victor Liu