CHAROEN POKPHAND FOODS PLC

No. 21/2015

31 March 2015

Company Rating: A+

Issue Ratings:
Senior unsecured A+

Outlook: Stable

Company Rating History:

Date	Rating	Outlook/Alert
20/06/14	AA-	Negative
19/05/11	AA-	Stable
30/04/10	A+	Positive
22/06/06	A+	Stable
20/05/05	A	Positive
12/07/04	A	Stable
28/05/04	A	-
01/03/01	A+	-

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Rating Rationale

TRIS Rating lowers the company rating and existing issue ratings of Charoen Pokphand Foods PLC (CPF) to "A+" from "AA-". The downgrade reflects weakening cash flow protection following major acquisition and longer-than-expected recovery of shrimp operation in Thailand. At the same time, TRIS Rating assigns the rating of "A+" to CPF's proposed issue of up to Bt12,000 million in senior unsecured debentures. The proceeds from the new debentures will be used to repay CPF's existing debts and used for planned capital expenditures.

The "A+" ratings continue to reflect the company's leading position in the Thai agribusiness and food industry, its diverse range of products and markets, its efforts to create more branded food products, and its ample financial flexibility. The inherent volatility of the prices for farm products, the exposure to disease outbreaks, the strengthening of Thai baht, and changes in regulations imposed by importing countries remain rating concerns.

CPF is the largest agribusiness and food conglomerate in Thailand. As of 13 March 2015, Charoen Pokphand Group Co., Ltd. (CPG) and related companies held 44.3% of CPF's shares. CPF's business is divided into two major categories, livestock and aquaculture. Each of these categories comprises feed, farm, and food products. Fully-integrated operations help CPF's products meet safety and traceability standards, which qualify its products for export to major importing countries, including the countries of the European Union (EU), Asian nations, and the United States (US).

CPF's revenue is geographically diverse. The operations in Thailand accounted for 41% of total revenue in 2014. China operations contributed 27% of total revenue, followed by 15% from operations in Vietnam. The remaining revenue came from Turkey, Taiwan, India, and other countries, which accounted for 1%-4% each. Animal feed, which is a relatively stable source of revenue, is the largest product segment, contributing about 53% of total revenue in 2014. Sales of commodity-like farm products contributed 35% of the company's total sales in 2014 while revenue from the sales of food products accounted for 12%.

The company is striving to enlarge its portfolio of branded products and develop distribution channels for both the domestic and overseas markets. As of 31 December 2014, CPF's distribution channels included 5,220 kiosks of Five-Star chicken, 201 Chester's restaurants, 610 CP Fresh Mart shops, and about 15 stores under the CP Fresh Mart Plus, CP Kitchen, and CP Food World brands. CPF, through its subsidiary, C.P. Pokphand Co., Ltd. (CPP), operated in China and Vietnam, is building two food processing plants in China, one in Qinghuangdao and one in Qingdao.

In 2014, CPF's operations improved from the low level of profit in 2013, thanks to the favorable prices for livestock in Thailand. CPF's livestock price in overseas, especially Vietnam, was another factor underpinning the improved performance in 2014. However, the shrimp business in Thailand, one of the company's major profit contributors, posted a loss for the second consecutive year, as the industry still struggles to recover from the Early Mortality Syndrome (EMS) problem. Operations in China, accounting for 27% of CPF's revenues, had contended with an economic slowdown in China and higher operating expenses as the unit prepared for expansion. CPF's total operating margin before depreciation and amortization improved to 5.6% in 2014, from a record low of 2.6% in 2013.

Earnings before interest, tax, depreciation, and amortization (EBITDA) increased by 83.6% to Bt31,438 million in 2014, compared with Bt17,124 million in 2013.

Despite the improved operating results in 2014, ongoing capital expenditures and aggressive expansion plans weakened CPF's balance sheet. After CPF completed major acquisition in 2012, CPF spent Bt20,000-Bt25,000 million each year for capital expenditures, plus Bt10,000 million for series of acquisitions and investments in 2013 and 2014, plus annual dividend payments of Bt6,000-Bt7,000. Consequently, total debt continued to climb, rising to Bt195,929 million in 2014 from Bt69,449 million in 2011. CPF's EBITDA improved at a slower pace than an increase in debt. This resulted in weaker cash flow protection. The EBITDA interest coverage ratio was 2.3-3.8 times in 2012-2014, compared with 3.3-11.8 times in 2007-2011. The fund from operation (FFO) to total debt ratio was 4.3%-9.3% in 2012-2014, compared with 11%-37% during 2007-2011.

In September 2014, CPF divested its 25% stake in CPP. CPF sold its holding to ITOCHU Corporation, one of the leading trading companies in Japan, for HK$1.1 per share or Bt27,258 million in total. CPF's debt to capitalization ratio improved to 54.4% as of December 2014, from 59.0% in 2013 because the divestures boosted its equity base. CPP remains CPF's subsidiary, as CPF still holds 50.4% of total shares of CPP. Partnership with ITOCHU should help CPF further strengthen its distribution channels in many countries.

Looking forward, the slow recovery from the EMS plague may cause CPF's aquaculture business in Thailand to remain weak. The performance of the operation in China hinges on an economic recovery in China. CPF's livestock operations in Thailand, which recorded solid performances in 2014, will face more challenges in 2015. The stronger Thai baht against EURO and yen will hold back demand for export even though more countries have removed import bans for frozen chicken meat from Thailand. Domestic poultry prices in Thailand started to fall again after a major producer resumed and other producers expanded their production capacities. Swine prices plunged by nearly 20% during the first two months of 2015. These factors will make the livestock business in Thailand more volatile while the aquaculture unit will remain crippled. CPF continues to pursue its growth strategy. CPF has laid out plans for sizeable capital expenditures of about Bt28,000 million for 2015, excluding acquisitions. CPF recently announced it would buy an additional 75% stake in C.P. Cambodia Co., Ltd. (CPC). The total consideration for the transaction is Bt2,850 million. CPF still opts for acquisitions if the investment is aligned with CPF's core business and the acquired business generates a reasonable profit. The room for deleverage is limited, given its growth-driven strategy. The EBITDA interest coverage ratio and FFO to total debt ratio will take time to return to normal levels, given the slow recovery from the EMS outbreak and challenging environment in major operations.

CPF's liquidity and financial flexibility remain strong. As of 31 December 2014, CPF's had Bt39,320 million in cash on hand and short-term securities. The company owns 33.27% interest in CP All PLC (CPALL), the leading convenience store operator in Thailand. The market capitalization of CPALL was approximately Bt343 billion, as of 23 March 2015.

Rating Outlook

The "stable" outlook reflects TRIS Rating's expectation that CPF will maintain its leading position in the dynamic agribusiness and food industry. The company's diverse range of operations, products, and markets is expected to provide CPF some insulation from the cyclical nature of commodity-like farm products and disease epidemics. The rating upside will rely on the company's ability to manage its debt to capitalization to be 50%, and demonstrate significant improvement in debt serviceability on sustainable basis. In contrast, the ratings would likely be downgraded should any debt-funded acquisition materially deteriorate the balance sheet and further weaken cash flow protection.

Charoen Pokphand Foods PLC (CPF)

Company Rating:	A+
Issue Ratings:	
CPF15NA: Bt3,000 million senior unsecured debentures due 2015	A+
CPF163A: Bt6,060 million senior unsecured debentures due 2016	A+
CPF17NA: Bt5,000 million senior unsecured debentures due 2017	A+
CPF178A: Bt2,000 million senior unsecured debentures due 2017	A+
CPF185A: Bt6,000 million senior unsecured debentures due 2018	A+
CPF188A: Bt3,000 million senior unsecured debentures due 2018	A+
CPF198A: Bt6,000 million senior unsecured debentures due 2019	A+
CPF198B: Bt2,500 million senior unsecured debentures due 2019	A+
CPF218A: Bt3,000 million senior unsecured debentures due 2021	A+
CPF218B: Bt5,500 million senior unsecured debentures due 2021	A+

CPF228A: Bt4,000 million senior unsecured debentures due 2022	A+
CPF328A: Bt5,000 million senior unsecured debentures due 2032	A+
CPF418A: Bt4,000 million senior unsecured debentures due 2041	A+
CPF41DA: Bt6,000 million senior unsecured debentures due 2041	A+
Up to Bt12,000 million senior unsecured debentures due within 2023	A+
Rating Outlook:	Stable

KEY RATING CONSIDERATIONS

Strengths/Opportunities

- Leading position in Thailand's agribusiness and food industry
- Diverse range of products and markets
- Fully vertically integration
- Focus on branded products
- Financial flexibility supported by valuable investments

Weaknesses/Threats

- Inherent volatility of commodity prices
- Exposure to climate changes and outbreaks of disease
- Changes in regulations imposed by importing countries
- Deteriorating balance sheet from continued large capital expenditures
- Strengthening Thai Baht

CORPORATE OVERVIEW

Founded in 1978, CPF is Thailand's largest agribusiness and food conglomerate. As of 13 March 2015, CPG and its related companies held 44.3% of CPF's shares. CPF's business is divided into two segments, livestock and aquaculture, with three types of operation in each segment: feed, farm, and food.

CPF has a market share of 45%-50% in the shrimp feed market and a 35%-40% share in the animal feed market in Thailand. Its fully-integrated operations help its products meet international standards, making its products qualified for export to the EU, Japan, and the US.

Table 1: CPF's Revenue Breakdown

Unit: %

By Country	2010	2011	2012	2013	2014
Thailand Operations					
- Domestic sales	60	61	36	34	35
- Export sales	14	14	9	8	6
Overseas Operations	26	25	55	58	59
Total	**100**	**100**	**100**	**100**	**100**
Sales (Bt mil.)	**189,049**	**206,099**	**357,175**	**389,251**	**426,039**

Source: CPF

CPF started to invest overseas in 2002. Currently, CPF's revenue base and operations have expanded to cover 13 countries. In 2014, overseas operations accounted for 59% of total sales. Domestic sales were 35% of total sales, and export sales from its Thailand operations were 6%.

Table 2: CPF's Revenue Breakdown

Unit: %

By Product	2010	2011	2012	2013	2014
Feed	39	38	56	56	53
Farm	43	43	32	32	35
Food	18	19	12	12	12
Total	100	100	100	100	100
Sales (Bt mil.)	**189,049**	**206,099**	**357,175**	**389,251**	**426,039**

Source: CPF

Revenue from feed products contributed more than half, or about 53%, of total sales in 2014. The contribution from farm products accounted for 35% of total sales in 2014, while food products accounted for 12%.

RECENT DEVELOPMENTS

- ***Sold 25% stake in CPP to ITOCHU Corporation***

In September 2014, CPF, via its subsidiaries, sold 6,018 million ordinary shares of CPP, equivalent to a 25% stake, to ITOCHU, one of the leading trading companies in Japan. The selling price was HK$1.1 per share, compared with CPF's cost of HK$0.9 per share. CPF received Bt27,258 million from the divesture. After the transaction, CPF, via its subsidiaries, holds 50.43% of CPP. CPP remains a subsidiary of CPF and its operations are still consolidated on CPF's financial statements.

- ***CPP to spin off and separately list its biochemical business***

In June 2014, CPP announced via the Stock Exchange of Hong Kong Limited that it plans to spin off its biochemical business and the interests in industrial business to Chia Tai Enterprises International Limited (CTEI), a wholly-owned subsidiary. CPP will declare a special dividend by distributing all of CTEI's shares it owns to CPP's shareholders in proportion to their respective shareholdings in CPP. After the CTEI's shares distribution, CPP will list CTEI on the Stock Exchange of Hong Kong

Limited. In October 2014, CPP's board of directors has approved the spin off and listing. The plans are subject to the approval of CPP's shareholders, CTEI's shareholders, as well as related parties and authorities including the Listing Committee of the Stock Exchange of Hong Kong Limited.

- ***Acquired additional 75% stake in CPC***

In February 2015, CPF announced that it would increase its stake in C.P. Cambodia Company Limited (CPC) to 100% from the current level of 25%. CPF would acquire the 75% holding from a related party, Orient Success International Limited. CPF will pay at Bt2,850 million for the stake, equivalent to 1.5 times the book value of CPC. The transaction will be put to CPF's shareholders for approval in April 2015. CPC is the market leader in Cambodia, with the highest market shares in feed, swine farms and poultry farms. About 59% of CPC's revenues come from swine farms, followed by poultry farms (18%), and feed sales (18%). During 2012-2014, CPC's revenues ranged from Bt5,785 million to Bt8,309 million. EBITDA ranged from Bt149 million to Bt1,052 million in 2012-2014, and the EBITDA margin swung from 2.6%-12.7% during the last three years.

BUSINESS ANALYSIS

CPF's strong business profile reflects its leading position in Thailand's agribusiness and food industry, its fully-integrated production process, and its diverse markets. The volatile nature of farm products and disease outbreaks remain major challenges for the company. The aquaculture unit in Thailand, a major profit contributor, has not recovered from the EMS problem and has been a drag on CPF's overall performance. However, CPF's continued efforts to diversify its product lines and to increase its geographical diversity have gradually alleviated the impact.

- ***Fully-integrated operations in swine, chicken, and shrimp products***

Except for grandparent breeder stock, CPF's chicken production process is fully vertically integrated. CPF produces feed, breeds animals, uses in-house and contract farms to raise the animals, and processes the meat. CPF has a competitive advantage because it can control the quality and the costs throughout the production processes. CPF also has the flexibility to adjust the product mix.

Once it successfully developed its own white shrimp breeder, CPF's shrimp business became fully integrated. The traceability of shrimp products is a major competitive advantage in export markets, just as it is for chicken products.

- ***Market leader in agricultural products***

CPF is the market leader in many of its lines of business. In the feed segment, the company's share of the shrimp feed market, based on production volume, is 45%-50%. Its market share for animal feed is 35%-40%. In the Thai poultry and swine industry, CPF's market shares account for about one-fourth of domestic production. As one of the nation's largest producers, CPF benefits significantly from economies of scale.

- ***Diverse markets***

CPF has expanded its operations in many developing countries worldwide, because meat consumption in these nations is in the rising trend. Currently, CPF's operations cover 13 countries. In 2014, CPF's operations in Thailand accounted for 41% of its total revenue, while revenues from its international operations comprised 59%. The operations in China contributed the largest portion of international sales, or 27% of total revenue, followed by operations in Vietnam (15%). Operations in Turkey, Taiwan, India, and other countries each accounted for 1%-4% of total revenue.

In terms of market, Thailand contributed only 34.8% of total sales in 2014. The Asian region has become an important sales destination. The portion of revenue from the Asian region increased from 21.9% of total sales in 2010 to 55.2% in 2014. The EU and the US accounted for only 8.4% and 1.4% of total sales in 2014, respectively. By operating in many nations, CPF can partly offset the cyclical nature of the agribusiness industry in each country. If the import regulations change in any importing countries, CPF will be less affected than other exporters in the agribusiness industry because CPF can relocate some production to other countries to alleviate the impact of the regulatory changes.

Table 3: CPF's Revenue Breakdown by Country

Unit: %

Country	2010	2011	2012	2013	2014
Thailand	59.8	60.9	35.9	34.5	34.8
EU	16.5	14.5	9.1	8.0	8.4
Asia	21.9	22.7	53.8	55.5	55.2
USA	1.5	1.6	0.9	1.0	1.4
Others	0.3	0.3	0.3	1.0	0.2
Total	**100**	**100**	**100**	**100**	**100**

Source: CPF

- ***Diverse product lines***

The company's product portfolio includes animal feed, poultry, shrimp, swine, and food products.

Table 4: CPF's Revenue Breakdown by Product

Unit: %

Product	2010	2011	2012	2013	2014
Sales (Bt mil.)	**189,049**	**206,099**	**357,175**	**389,251**	**426,039**
Sales growth (y-o-y)	15	9	73	9	9
Thailand					
- Animal feed	25	26	16	13	12
- Poultry	13	13	7	8	8
- Shrimp	7	6	3	3	3
- Swine	12	12	7	7	8
- Food products	17	18	11	11	10
- Others	0	0	1	0	0
Overseas					
- Animal feed	14	13	40	42	41
-Poultry and swine	10	10	12	13	15
-Shrimp	1	1	1	1	1
- Food products	1	1	1	2	2
-Others	0	0	1	0	0
Total	100	100	100	100	100

Source: CPF

In 2014, feed comprised the largest portion of revenue for the Thailand operations, or about 12% of total sales. The second-largest sales contribution came from food products (10%), and then poultry (8%), swine (8%), and shrimp (3%). For CPF's international operations, feed is the largest revenue contributor, providing 41% of total sales, followed by swine and poultry (15%) and shrimp (1%). CPF's operational risk is partly mitigated because its sources of revenue are spread across diverse ranges of products and markets.

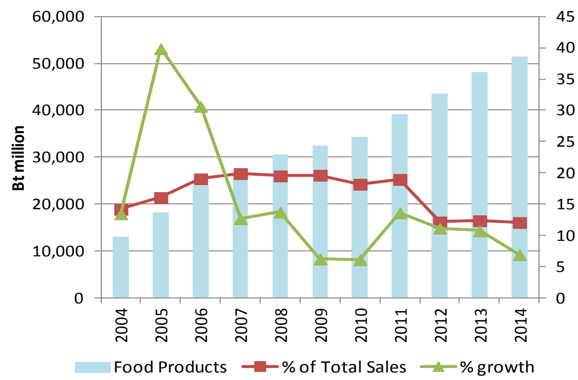
- ***Move towards value-added products under the "CP" brand***

CPF is pursuing a long-term strategy of focusing on value-added products. As a result, CPF has partially insulated itself from the price fluctuations inherent in commodity-type products. CPF has adopted a one brand policy, using the "CP" brand for most of its packaged products sold in Thailand and overseas.

CPF's strategy to focus on processed products is prudent, as it is a response to changing consumer preferences. This strategy also enables the company to avoid competition in the commodity-like markets of frozen and fresh products, and allows the company to charge a premium for its branded products.

In 2014, revenue from food products accounted for 12% of CPF's total sales. The proportion fell from 19% in 2011 because the CPP acquisition increased the proportion of revenue from the feed segment. Sales in the food segment continued to rise in 2014, climbing by 6.9% over the same period of the prior year (year-on-year or y-o-y) in 2014. CPF aims to increase revenue from food by 15%-20% per year onwards.

Chart 1: CPF's Sales of Food Products



Source: CPF

- ***Expands retail distribution network***

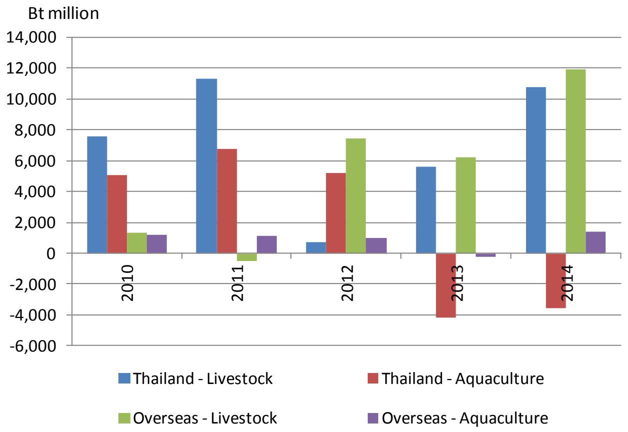
CPF created its own retail distribution channel, CP Fresh Mart, to support its strategy of focusing on branded food products. The company had 610 CP Fresh Mart stores by the end of December 2014. CPF also expanded the number of franchised Five-Star kiosks from 4,517 kiosks in 2011 to 5,220 kiosks by the end of December 2014. Five-Star franchises include Five-Star grilled/fried chicken, Five-Star chicken rice, wonton noodles, and ready meals kiosks. As of December 2014, CPF also had two CP Fresh Mart Plus shops, two CP Food World stores and 9 CP Kitchen shops. CPF operates 201 Chester's fast food restaurants via Chester's Food Co., Ltd. CPF's efforts to develop its own distribution network will drive the sales of its food products over the long term.

- ***Increasing contribution from international ventures***

Over the past seven years, CPF has focused its efforts to expand in overseas in order to pursue growth opportunities as well as to increase geographical diversification to mitigate in part the volatility of its revenue streams and margins. Sales from CPF's international operations have increased gradually via acquisitions and expansions. In 2014, more than half of CPF's revenues (59%) came from overseas.

Although the international subsidiaries have pushed CPF's revenue higher, the profit contributions made by most foreign operations remain negligible, except CPF's operations in China and Vietnam which are run by CPP. In 2014, CPP's net profit improved significantly. Swine prices in Vietnam rebounded from the low level in 2013, boosting CPP's margin. The operations in China remained weak due to the fragile economic conditions and higher operating expenses as CPP prepared to expand. CPP reported a net profit of US$251.4 million in 2014, a 35.0% y-o-y rise. In addition, many countries reported better earnings in 2014 due to the spike in meat prices. The good earnings from higher meat prices in CPF's overseas operations helped in part restore CPF's performance while the aquaculture segment in Thailand still reported loss from the EMS problem. EBITDA rose by 83.6% over the same period of the prior year, to Bt31,438 million in 2014.

Chart 2: CPF's Operating Profit by Business Unit



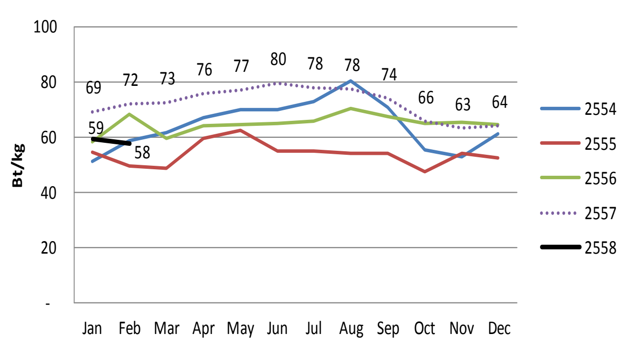
Source: CPF

CPF's future expansion efforts will focus on its existing overseas operations in China, Vietnam, India, Russia, and the Philippines. CPF also aims to penetrate the food industry in other countries. CPF, through its subsidiary, CPP, is building two food processing plants in China. One plant is in Qinghuangdao, the other is in Qingdao. The company is promoting the Five Star brand in the India and Vietnam markets. As it diversifies, CPF's earnings should be less volatile.

- ***Weaker poultry and swine prices in Thailand***

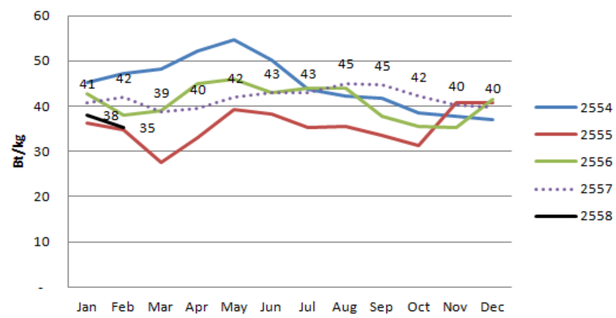
The livestock segment in Thailand enjoyed a cyclical upturn in the second half of 2013 through 2014. The upturn in the broiler segment accelerated partly because one major broiler producer, Saha Farm Co., Ltd. suffered financial problems and cut production. At the same time, swine prices surged as a result of a supply shortage caused by an outbreak of swine disease nationwide.

Chart 3: Swine Prices at Farms



Source: Thai Feed Mill Association

Chart 4: Broiler Prices at Farms



Source: Thai Feed Mill Association

According to the Thai Feed Mill Association, the average domestic price of broilers was healthy at Bt41/kg in 2014, close to the average price in 2013. The average price of domestic swine in 2014 rose 11.5% to Bt72/kg, compared with the 2013 average of Bt65/kg. Rising meat prices and lower grain costs widened the gross margin for domestic livestock producers. CPF's gross margin for the livestock segment in Thailand was 16%, improving from 12% in 2013. The gross margin was at a healthy level, compared with 9%-18% during 2008-2012.

However, meat prices became volatile in 2015. In the poultry industry, a major producer resumed operation after it cut production due to financial problems. Higher meat prices have induced more supply into the market. The price of broilers averaged Bt37kg. in the first two months of 2015, a decline of 12.2% from the average price of 2014. The price of swine also slipped, averaging Bt59/kg. in the first two months of 2015, a drop of 19.1% compared with the average price in 2014. More supply would come to market in the near future. Demand for exports is expected to fall due to the rapid increase in the value of the Thai baht against the euro and the Japanese yen, the major destinations for chicken exports. The increased supply will depress domestic broiler prices and negatively affect swine prices, since pork is a substitute for chicken.

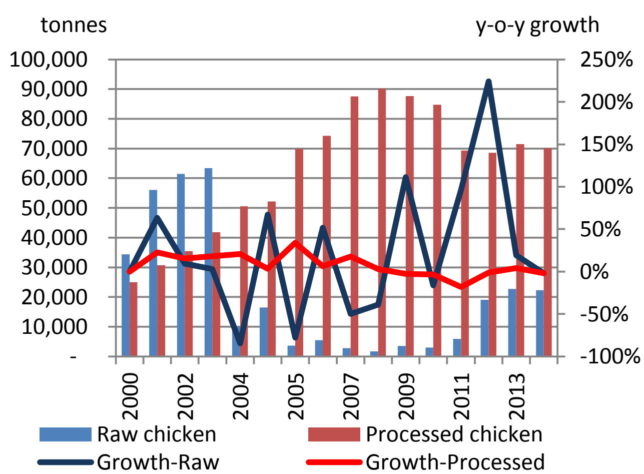
However, there is a positive development in poultry industry in Thailand. Recently, the Thai authorities have imposed import restrictions on the parent stock of poultry from the United States and European countries due to a bird flu outbreak. The import ban of parent stock is expected to reduce the supply of poultry in Thailand over the next 12 months and subsequently raise poultry prices.

- ***More countries lift ban on frozen chicken, but stronger Thai baht would cut demand for export***

Since mid-2012, more countries, such as EU nations, Japan, the Philippines and Korea, lifted restrictions on importing frozen chicken from Thailand. The removal of the import ban increased raw chicken exports from Thailand significantly. Thailand exported about 154,416 tonnes of raw chicken in 2014, a rise of 73.3%, while the volume of processed chicken was flat at 424,470 tonnes. In total, Thailand exported about 578,886 tonnes of chicken in 2014, a 10.1% y-o-y increase. The export value rose by 11.2% y-o-y to Bt78,912 million in the same period. However, CPF's chicken export volume was relatively flat at 92,421 tonnes in 2014, due to the low margins in the export segment on the back of stiff competition. The export volumes of frozen chicken and processed meat declined slightly in 2014, slipping by about 2% each. About 65% of CPF's exports went to EU, and 35% to countries in Asia, especially Japan. In 2015, CPF set a target to increase chicken exports volume by 10%-15%.

Chicken export has faced increasing challenge. The stronger Thai baht will negatively affect chicken exports. During the first three months of 2015, the Thai baht has appreciated by 10.9% against Japanese yen, compared with the average exchange rate in 2014. The Thai baht also appreciated rapidly against the euro. The value of euro against the Thai baht fell by 14.9%, compared with the average exchange rate in the first quarter of 2015. The prices of Thai products will become more expensive for importing countries, especially compared with products from other countries. Chicken exports from Thailand may slow down or the margins on export would narrow in the short term.

Chart 5: CPF's Broiler Exports

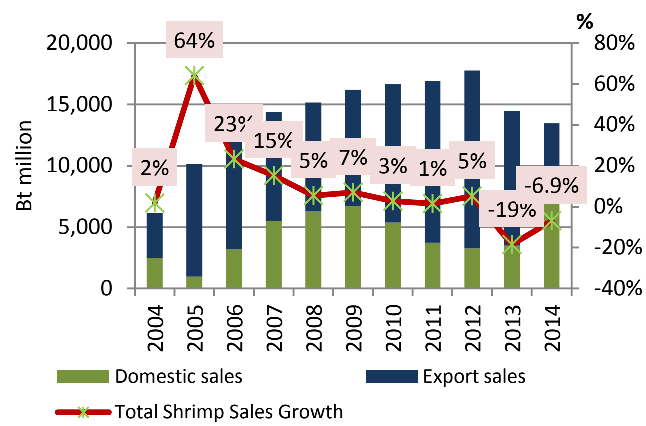


Sources: CPF

- ***Thai shrimp industry still reels from EMS outbreak***

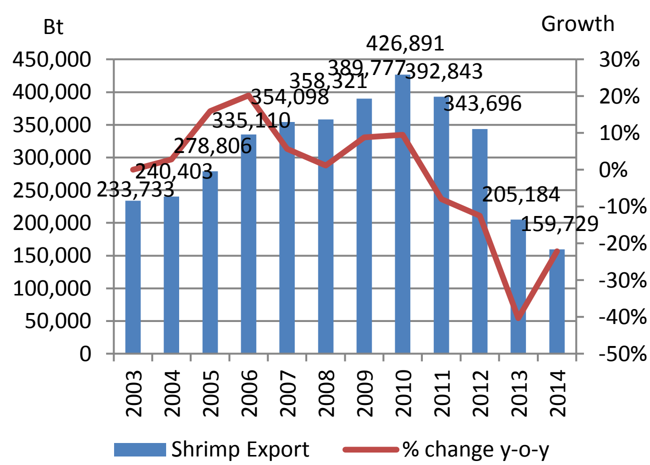
The shrimp industry in Thailand has been battling an EMS outbreak since the second half of 2012. The outbreak took a severe toll on the shrimp industry, causing supply shortages and slashing Thailand's shrimp exports. According to the Thai Frozen Foods Association, Thailand's supply of shrimp continued to contract by about 8% to 230,000 tonnes in 2014, from 250,000 tonnes in 2013 and 540,000 tonnes in 2012. Shrimp exports from Thailand declined by 22.2% in volume, and 7.3% in baht terms in 2014, the fourth-yearly decline in a row. CPF's shrimp segment tracked the industry trend. In 2014, CPF's shrimp exports plunged by 45.6% compared with 2013. However, CPF's domestic shrimp sales grew by 102.5% in 2014 because the supply shortage caused a sharp increase in the price of domestic shrimp. CPF's total sales of shrimp were Bt13,460 million, a decline of 6.9% in 2014. The EMS outbreak cut the supply of shrimp causing shrimp segment to report its second consecutive yearly loss in 2014.

Chart 6: CPF's Shrimp Sales (Thailand Operations)



Source: CPF

Chart 7: Thailand's Shrimp Exports



Source: Customs Department

To deal with the EMS outbreak effectively, shrimp farmers have to improve hatchery sanitary, the water treatment and nurseries, plus improve the management of their shrimp farm. The Fishery Department is encouraging shrimp farmers to adjust their farming procedures. However, most farmers remain reluctant to employ new technique and farm more shrimp as it costs more than the regular farming process.

- ***Increasing challenges in the shrimp industry***

In addition to the persistent EMS disease problems, the shrimp industry encountered a number of new challenges. Beginning in 2014, the EU disqualified Thailand for privileges under the generalized system of preferences (GSP) for the frozen shrimp in 2014 and processed shrimp products in 2015. Under GSP regime, imports of Thai frozen shrimp face a 4.2% import tariff and the tariff for processed shrimp imports is levied at 7.0%. The tariff was revised up to 12% for frozen shrimp in 2014 and 20% for processed shrimp in 2015. In June 2014, The US Department of State released its Trafficking in Persons report. Thailand was downgraded to the Tier 3 list, the lowest rank. The US considers that Thailand is responding too slowly to the human trafficking issue. The loss of GSP and the Tier 3 status would negatively affect the customers in the US and the EU. The loss of orders would be another blow for the Thai shrimp industry, which is currently crippled by the EMS outbreak.

In October 2014, the Directorate-General for Maritime Affairs and Fisheries (DG MARE) of the European Union issued a warning letter to the Thai government and ponted out that the Thai fishery industry has failed to tackle the problems in the fishery industry, such as human trafficking, overfishing, and unregistered boats, and more. Consequently, Thailand did not meet the conditions for IUU Fishing, an EU framework which is aimed at preventing illegal, unreported and unregulated fishing. Thailand will be given some time to work with the working team of the EU to address the problems. If Thailand does not make significant progress, the EU will ban all fishery products from Thailand. The Thai government is working to resolve the problems. Shrimp in Thailand is farmed shrimp, but farmers use fishmeal from fishing vessels as one of feed component. If the EU bans fishery products and shrimp imports from Thailand, shrimp exports to the EU would plunge. According to the Thai Frozen Foods Association, exports to the EU accounted for about 11% of total shrimp export in 2014, or about 18,000 tonnes in 2014.

The appreciation of the Thai baht against Japanese yen and the euro heaped more pressure on the suffering shrimp industry. Price competition from other countries, such as India and Vietnam, also cut demand for shrimp from Thailand. The decline in exports cut the domestic price of shrimp as more supply enters the domestic market. The falling shrimp prices will discourage shrimp farmers to farm more.

Due to CPF's diverse markets, wide geographic coverage, diverse product lines, the regulatory issues are expected to have limited direct effect on CPF. Only a small number of CPF's customers halted orders due to concerns over the human trafficking problem in supply chain of fishmeal in Thailand. The suspended orders constituted less than 0.1% of CPF's total sales. Regarding the IUU issue, CPF's shrimp export from Thailand to EU accounted for only 0.2% of total revenue in 2014. In addition, CPF could refer some orders to operating companies in other countries, such as Vietnam. However, the regulatory issues will affect CPF indirectly because it will take more time for the shrimp industry in Thailand to recover. The prolonged difficulty in the shrimp industry in Thailand means limited recovery in CPF's aquatic feed and breeding business in Thailand.

FINANCIAL ANALYSIS

After being hard hit in 2013, CPF's financial performance improved in 2014. The livestock segment in Thailand performed well and overseas operations improved. However, the EMS problem in Thailand was still a drag on CPF's performance, and would impede further significant improvement in operating profit. Ongoing investments and aggressive capital spending pushed the debt level higher. As a result, CPF's cash flow protection remained weak in 2014 despite a rise in profit. CPF has maintained its sizeable capital expenditure plans to pursue its growth strategy. The cash flow protection is then expected to take long time to improve to its previous level.

- ***Profit rebounded from the low level in 2013***

CPF's sales continued rising to Bt426,039 million in 2014, up 9.5% from 2013. Profitability improved, as the livestock segment in Thailand and some overseas operations performed well. The favorable prices for poultry and swine in Thailand boosted gross profit margin of the livestock segment up to 15.9% in 2014 from 12.0% in 2013. The higher swine prices in Taiwan and Vietnam as well as rising poultry prices in Turkey pushed gross profit margin of CPF's international operations in livestock segment rose to 14.7% in 2014, from 11.6% in 2013. However, the aquaculture segment in Thailand posted an operating loss as the gross margin slipped to a loss of 3.3%. The loss was the result of the ongoing EMS problem. The solid performance in the livestock segment lifted overall CPF's gross profit margin to 13.4% in 2014 from a record low of 10.0% in 2013. The ratio of operating income before depreciation and amortization to sales improved to 5.6% in 2014, from 2.6% in 2013. CPF's performance was supported by the equity income it earned from its investments in associated firms and the gains from divestments. CPF recorded healthy equity income of Bt4,869 million and a gain from divestment worth Bt4,662 million in 2014. Net profit totaled Bt10,562 million in 2014.

EBITDA rose to Bt31,438 million in 2014, an increase of 83.6% from Bt17,124 million in 2013.

Table 5: Highlights of CPF's Financial Performance

Unit: Bt million

Performance	2010	2011	2012	2013	2014
Sales	189,049	206,099	357,175	389,251	426,039
Gross profit	32,698	33,612	41,337	38,857	57,280
Gross margin (%)	17.3	16.3	11.6	10.0	13.4
Selling & admin.	20,683	18,919	33,354	37,332	43,476
EBIT	16,049	19,916	15,117	8,580	21,472
EBITDA	20,847	24,655	22,493	17,124	31,438
Interest	1,773	2,422	6,283	7,568	8,241
Gains from investment	962	1,358	14,682	8,219	4,662
Net profit	13,563	16,117	18,790	7,065	10,562

Source: CPF

Looking forward, CPF's earning recovery seems vulnerable in 2015. The livestock segment in Thailand, which generated 40% of CPF's gross profit in 2014, has encountered several challenges in 2015. As the Thai baht strengths against the euro and the yen, exports may fall, even though more countries have removed import bans for frozen chicken meat from Thailand. Domestic poultry prices in Thailand started to fall again after a major producer resumed production and other producers expanded their production capacities. Swine prices plunged by nearly 20% during the first two months of 2015. These factors may cause the performance of the livestock segment to wobble. CPF's China operations, which accounted for 35% of gross profit in 2014, is expected to remain modest on the back of weak economic growth in China. The challenges in CPF's major operations may curb its earnings growth in 2015, especially since a meaningful recovery in the shrimp business in Thailand remains uncertain.

- ***Leverage to remain high***

After major acquisition in 2012, CPF spent Bt20,000-Bt25,000 million per year for capital spending, plus Bt10,000 million for series of acquisitions and investments in 2013 and 2014, plus annual dividend payments of Bt6,000-Bt7,000 million. Consequently, total debt continued to climb, rising to Bt195,929 million in 2014 from Bt69,449 million in 2011. However, CPF's capital base was enlarged by the partial divesture of CPP worth Bt27,258 million in 2014. CPF's total debt to capitalization ratio improved to 54.4% as of December 2014, from 59.0% in 2013 and 50.9% in 2011.

CPF has laid out plans for sizeable capital expenditures of about Bt28,000 million for 2015, excluding acquisitions. CPF recently announced it would buy an additional 75% stake in C.P. Cambodia Co., Ltd. (CPC). The total consideration for the transaction is Bt2,850 million. CPF still looks for acquisitions if the investment is aligned with CPF's core business and the acquired business generates a reasonable profit. On the back of the slow recovery in the domestic shrimp industry, CPF's EBITDA is expected to be about Bt30,000-Bt35,000 million per year. More debt is needed to fund the planned capital expenditures plus CPF's interest expenses, and a normal dividend payout. Total debt to capitalization is expected to hover around 55%-60% given the planned expansions.

- ***Cash flow protection was at low level in 2014 despite improving profit***

Even though EBITDA improved in 2014, the funds from operations (FFO) to total debt ratio remained weak. The ratio was 9.3% in 2014, up from 6.5% in 2012 and 4.3% in 2013. Despite the recent rise, the level is considered weak compared with the levels of 11%-25% CPF attained during 2007-2011. The EBITDA interest coverage ratio remained soft at 3.8 times in 2014, compared with 3-12 times during 2007-2011. Looking forward, CPF's cash flow protection is expected to improve gradually supported by the overseas expansion. However, the slow recovery of aquaculture unit in Thailand would keep cash flow protection lower than average level in 2007-2011.

- ***Liquidity and financial flexibility remain strong***

As of 31 December 2014, CPF had Bt39,320 million in cash on hand and short-term securities. The company had a 33.27% interest in CPALL, the leading convenience store operator in Thailand. The market capitalization of CPALL was approximately Bt343 billion, as of 23 March 2015. In addition to CPALL, CPF's subsidiary also owns 354.82 million shares of CPF worth Bt7,593 million, based on the market price of Bt21.40 per share. These investments provide CPF with financial flexibility. Its financial flexibility would be enhanced if CPP successfully spins off the biochemical business and the interests in its industrial businesses to CTEI and lists CTEI on the Stock Exchange of Hong Kong.

Financial Statistics and Key Financial Ratios*

Unit: Bt million

	Year Ended 31 December				
	2014	**2013**	**20 12**	**2011**	**2010**
Sales and service revenues	426,039	389,251	357,175	206,099	189,049
Gross interest expense	8,241	7,568	6,283	2,422	1,773
Net income from operations	5,914	(1,458)	3,930	14,476	11,592
Funds from operations (FFO)	18,269	8,027	9,486	17,480	17,455
Total capital expenditures	25,727	23,252	20,182	10,288	6,460
Total assets	416,764	365,003	310,544	160,506	126,092
Total debt	195,929	186,405	146,203	69,449	46,649
Shareholders' equity	163,966	129,573	120,781	67,077	60,944
Operating income before depreciation and amortization as % of sales	5.58	2.59	4.30	9.43	8.89
Pretax return on permanent capital (%)	6.35	2.94	7.49	16.32	15.63
Earnings before interest, tax, depreciation, and amortization (EBITDA) interest coverage (times)	3.81	2.26	3.58	10.18	11.76
FFO/total debt (%)	9.32	4.31	6.49	25.17	37.42
Total debt/capitalization (%)	54.44	58.99	54.76	50.87	43.36

* *Consolidated financial statements*

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