

<b>PhilRatings</b> PHILIPPINE RATING SERVICES CORPORATION	<b>RENEWAL CREDIT RATING REPORT</b> <b>SL AGRITECH CORPORATION (SLAC)</b>
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#### ISSUER CREDIT RATING FOR:

<i>Instrument</i>	Commercial Papers (CPs)
<i>Issue Size</i>	Up to ₱2.0 billion
<i>Use of Proceeds</i>	Net proceeds of the issue shall be used to support working capital requirements
<i>Assigned Rating</i>	PRS Aa (corp.)
<i>Assigned Outlook</i>	Stable

#### RATIONALE

- **Competitive market position locally, supported by proprietary technology and vertically integrated operations**

SL Agritech Corporation (SLAC) is involved in the production of hybrid rice seeds and premium rice. It has established itself as one of the leading rice companies in the Philippines and exports high quality rice seeds and premium packaged rice. SLAC's fully integrated operations from hybrid rice seed research and development to the sale of premium rice products allow the company to maximize its resources.

SLAC is reportedly the largest hybrid rice seed company in the Philippines and in tropical Asia. Based on the company's estimates, its flagship product SL-8H accounts for 80% of the total market share of hybrid rice seeds in the country. Its seeds are reportedly more attuned to tropical climates compared to other hybrids. In an effort to capture a larger market share and increase the use of hybrid rice seeds, SLAC is currently developing additional varieties.

The company's premium rice products, on the other hand, are offered under two brands: Doña Maria and Willy Farms. Each brand targets a specific market segment. In 2017, it introduced the SL8-H rice to the market to offer more affordable rice to consumers and to increase awareness for its SL-8H seeds. These products are primarily distributed through supermarkets, groceries, and price clubs.

- **Potential growth given international business expansion**

SLAC continues to expand its network of customers abroad. Its hybrid seeds are exported to Vietnam, Myanmar, Indonesia and India. Its rice products, on the other hand, are sent to Saudi Arabia, Bahrain, Jordan, Kuwait, Singapore, Australia, United Arab Emirates (UAE) and United States of America (USA). One of its existing brands, Doña Maria, is reportedly dominating the premium rice market overseas and is starting to gain consumer preference there.

On September 21, 2017, management carried out an Investment Trust Agreement between SLAC and its Chairman, Mr. Henry Lim Bon Liong, to enable him to manage, supervise and administer Sterling SL Agritech Company Limited which was incorporated in the Union of Myanmar. Such has already started its seed and rice production after the issuance of a Certificate of Incorporation. It is currently in the process

of obtaining the Myanmar Investment Commission (MIC) permit, which allows businesses and foreign investors to get special privileges, tax incentives, among others. Myanmar is a strategic jump off point for exporting rice given the reportedly preferential zero tariff from Myanmar to European destinations. In addition, China may also be tapped from there.

In October 2017, SLAC signed a deal with an Indian government-owned firm, National Seeds Corp. Ltd. (NSC) for the production and marketing of SL-8H. NSC wants to plant such on 2.5 million to 5 million hectares (ha) of land in the next five years.

On October 6, 2017, PT Sterling Agritech Indonesia (SAI) was incorporated in Jakarta, Indonesia. SLAC directly owns 49% of SAI.

The above developments bode well for the international expansion of the company as Myanmar, India, Indonesia and Bangladesh are reportedly four of the world's largest rice producers.<sup>1</sup>

In the coming years, SLAC expects to have a larger growth in the international market. Although international sales only accounted for 1.9% of total revenues in 2018, it increased by 58.8% from ₱41.5 million in 2017 to ₱65.8 million in 2018.

- **Opportunities for growth for the local Hybrid Rice Industry given current rice supply situation**

The Philippines has roughly 29.8 million ha of land, of which 9.7 million ha are considered agricultural. Due to population growth, rapid urbanization and industrialization, the massive conversion of agricultural lands into other uses reduced the total rice plantation area in the country.

The country's population continues to grow, although at a declining pace, from 3.4% in 1961 to 1.5% in 2017. Currently, the Philippine population is 106.5 million. The Philippine Statistics Authority (PSA) projects this to reach 109.9 million by 2020.

Rice production, on the other hand, showed a decreasing trend from 12.4 million metric tons (MT) in 2014 to 11.5 million MT in 2016, an average rate of decline of 3.6% yearly. Likewise, total net food disposable recorded a continuous reduction from 11.4 million MT in 2014 to 11.1 million MT in 2016. Net food disposable is the volume of food available for human consumption.

With the continued growth in the population, the Philippine market for rice has grown. In the coming years, local rice production growth may be outpaced by demand. With this, there is a potential for expansion in the hybrid rice industry, which SLAC dominates, to cater to the increased requirements given the projected population base.

The Philippine government has been urging farmers to shift to hybrid rice seeds. With the proposed rice tariffication bill, it will prioritize the purchase of hybrid rice seeds with the revenues it will collect from the conversion of quantitative restrictions into tariffs. It recognizes that hybrid rice seeds will allow farmers to increase productivity and to produce more *palay* since such seeds have lower production costs, yet generate higher yields of up to 30% over the traditional rice varieties.

- **Declining margins and coverage ratios**

Growth in operating expenses and finance charges outpaced revenues for the last three fiscal years. Total expenses grew by an average of 24.3% against revenues' 20.1%. As a result, profitability margins and coverage ratios have been declining since fiscal year 2016.

For the period June to August 2018, SLAC almost doubled its total revenues. It grew by 85.6% to ₱738 million, from ₱398 million recorded in the same period last year. The growth in revenues is mainly attributable to the continued growth in sales of hybrid seeds and rice products in the domestic market, which stood at ₱720 million, up by 95.6%. Net income, however, posted a 12.1% decline mainly due to

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<sup>1</sup> Based on National Food Security Mission India's A Status Note on Rice in India



significant changes in cost of sales, fair value gain on agricultural produce and biological assets, foreign exchange gains, operating expenses and finance cost.

Cost of sales surged 49.9% to ₱474 million, mainly driven by the ₱146 million increase in the cost of fertilizers, seeds and agrichemicals as a result of higher production volume. From ₱1.29 million, foreign exchange gains registered a 90.7% decline to ₱120 thousand due to the depreciation of the Philippine peso against the US Dollar. The peso depreciated from ₱51.16 in August 31, 2017 to ₱53.41 in August 31, 2018. Total operating expenses rose by 30.1% during the period as a combined result of higher personnel expenses, freight, advertising and promotion, and transportation.

As a result, profitability margins were generally lower than the same period last year, with net profit margin declining to 11.2% from 23.6%. EBIT interest coverage ratio was lower than last year at 1.8x.

- **Uncertainties arising from government plans**

The Philippine government has been exerting efforts to promote hybrid rice seeds in the country. The Department of Agriculture (DA) launched the High Yielding Technology Adoption (HYTA) program that advocates the propagation of high-yield rice varieties such as hybrid rice. The HYTA is being implemented in areas with good irrigation to ensure the attainment of high yield and avoidance of crop failure.

But with the depletion of NFA inventories, commercial dealers were able to raise rice prices. The Department of Finance (DOF) said that the contribution of rice to inflation has risen by ten times, equivalent to one percentage point. This made the government implement different policies, such as rice importation, that may affect SLAC's business and pricing strategy.

Recently, Budget Secretary Benjamin E. Diokno said that the government is adopting an "almost unimpeded" policy in relation to rice importation to control the soaring inflation. Although entities still need to go through the National Food Authority (NFA) process of accreditation and licensing, the DA will approve their application as long as they have warehouses and the ability to import and raise money. Furthermore, Mr. Diokno stated that there will be no import quota for rice.

The DA has also come up with suggested retail prices (SRP) on rice for Metro Manila. These prices will range from ₱37 to ₱47 per kilogram (kg), while imported premium rice will be at ₱60 per kg. Special rice (e.g. dinorado, organic brown, sticky, etc.) and fancy rice variants (e.g. Jasmine and Japanese) will be exempted. Even though the company's products will not be regulated, this may still impose an indirect impact on their sales as cheaper substitutes will be more available in the market.

## **BUSINESS PROFILE**

SL Agritech Corporation (SLAC) is engaged in the research, development, and distribution of hybrid rice seeds and premium quality rice. Founded in September 2000 under the ownership and management of Sterling Paper Group of Companies, SLAC has established itself as one of the market leaders in hybrid rice seeds and premium quality rice in the country. SLAC is reportedly the first local company to export high quality rice seeds and premium packaged rice, and the only company in the Philippines with a fully-integrated "rice seed to rice bowl" system.

The company's fully integrated operations from hybrid rice seed research and development, to the sale of premium rice products allow SLAC to optimize the use of its technology as well as volume production. This is said to have an advantage over traditional rice producers, as the company can develop hybrid rice seed varieties to either sell them to farmers or to mass produce as premium rice.

## Operations

SLAC has two operating segments, namely the seeds division and the rice division. Each offers its own products and serves different markets as summarized below:

Table 1 Operating Segments of SLAC

Operating Segment	Description
Seeds Division	Cultivation, harvest and selling of hybrid rice seeds to farmers
Rice Division	Purchase of dried palay, milling and selling of finished good rice grains to consumers

The company has major operating facilities in Laguna, Davao del Sur, Davao Oriental, Nueva Ecija and Bulacan to cover production, storage and distribution. SLAC has also started the expansion, improvement and modernization of its facilities in these areas.

In addition, SLAC is reportedly building a ₱500 million rice mill on a seven-hectare property in San Victoria, Tarlac. Such is expected to double the company's production of rice and contract growing to 500,000 bags and 20,000 hectares (ha), respectively.<sup>2</sup>

SLAC's hybrid seeds are exported to Vietnam, Myanmar, Indonesia and India. Its rice products, on the other hand, are sent to Saudi Arabia, Bahrain, Jordan, Kuwait, Singapore, Australia, United Arab Emirates (UAE) and United States of America (USA). Domestic sales accounted for 98.1% of total revenues for the fiscal year ending May 31, 2018. Net sales from exports booked a 58.77% increase during the period from ₱41.5 million in 2017 to ₱65.8 million in 2018. It should be, however, noted that net sales from exports posted a 45.58% decline for the period 2016-2017.

## Products

### • Hybrid Rice Seeds

SLAC is reportedly the largest hybrid rice seed company in the Philippines and in tropical Asia. It began marketing its seed product in 2003 by introducing the SL-8H variety to the market. In an effort to capture a larger market share and increase the use of hybrid rice seeds, SLAC further introduced additional hybrid rice seed varieties. The company's existing hybrid rice seed varieties are seen in Table 2.

Table 2 Hybrid Rice Seed Varieties of SLAC

Variety	Description	Packaging	Country
SL-8H	Hybrid seed with high heterotic performance (i.e. the tendency of hybrids to perform better than each of its parents), good disease resistance, excellent adaptability to tropical conditions, good palate qualities, good milling qualities, and easy hybrid seed production.	18 kg	Philippines Bangladesh Indonesia Vietnam
SL-7H	Used for the company's premium rice products. For contract growing.	15 kg	Philippines
SL-9H	Used for the company's premium rice products. For contract growing.	15 kg	Philippines
SL-12H	Hybrid seed a potential yield ranging from 7 up to 12 metric tons or equivalent to 140 to 240 cavans per hectares and is suitable for wet and dry season. Used for commercial planting.	5 kg	Philippines
SL-18H	Hybrid seed with a potential yield ranging from 230 to 300 cavans per hectare and is suitable for wet and dry season. Used for commercial planting.	5 kg	Philippines

<sup>2</sup> <https://www.philstar.com/business/agriculture/2018/04/15/1805955/sl-agritech-build-p500-million-rice-mill>



SLAC is currently developing additional hybrid rice seeds which have been initially determined to be viable after several tests and experiments.

The company's hybrid rice seeds are made available through local dealers with which it has contracts, and through Municipal Agriculture Offices (MAOs). SLAC's products are strategically positioned in every MAO as local farmers visit these offices for agricultural needs and assistance.

As of report writing date, there are eight distributors nationwide, of which three are located in Davao. Moreover, there are seven and 782 dealers for rice and seeds, respectively. These are all strategically placed in different areas to cover the entire region.

Revenues from the sale of hybrid rice seeds contributed 59% of the company's 2018 fiscal year revenues.

- *Premium Rice*

SLAC's premium rice products are offered under two brands, namely Doña Maria and Willy Farms. Each brand targets a specific market segment as shown in the following table.

**Table 3 List of Premium Rice Products of SLAC**

<b>Variant</b>	<b>Description</b>	<b>Market</b>	<b>Packaging</b>
<b>Doña Maria Jasponica</b>	Combines the fragrant aroma of Jasmine rice and the excellent eating quality of Japanese rice. When cooked, the grains achieve a soft and chewy texture enhanced further by its aroma.	High to mid-income segment	0.3 kg 2.0 kg 5.0 kg 10.0 kg 25.0 kg
<b>Doña Maria Jasponica Brown</b>	Offers the healthy benefits of brown rice to the Jasmine-Japanese rice mix. High in fiber with no cholesterol and fully flavored by the natural nutty texture of brown rice, the variant is an alternative for health-conscious, rice-loving Filipino families.	High to mid-income segment	0.3 kg 2.0 kg 5.0 kg 10.0 kg
<b>Doña Maria Jasponica Plus</b>	Combination of Jasponica Brown rice and Jasponica rice. This product specifically targets customers who are still unfamiliar with brown rice but would like to make the change.	High to mid-income segment	2.0 kg 5.0 kg
<b>Doña Maria Jasponica Congee</b>	Can be an alternative to "malagkit" rice. It can be used in making risotto, sticky rice and maki.	High to mid-income segment	2.0 kg 5.0 kg
<b>Doña Maria Miponica</b>	Combination of the clear, translucent, long and slender grain quality of Milagrosa and the exceptional eating quality of Japanese rice. Fluffy and sticky with a pleasant aroma, Miponica rice is easy to cook and stays soft throughout.	High to mid-income segment	0.3 kg 2.0 kg 5.0 kg 10.0 kg 25.0 kg
<b>Doña Maria Miponica Brown</b>	The brown rice alternative of the Milagrosa and Japanese rice mix. It still maintains the long grain and sticky qualities of the Miponica rice.	High to mid-income segment	2.0 kg 5.0 kg 10.0 kg
<b>Willy Farms Premium Dinorado</b>	Caters all types of occasion rice. It is soft and delicious and can be enjoyed as plain rice or fried rice.	Mid-income segment	2.0 kg 5.0 kg 10.0 kg 25.0 kg

Willy Farms Sticky Jasmine	Contains the fragrance of Jasmine in sticky rice and is ideal for Paella, Arroz ala Valenciana	Mid-income segment	2.0 kg 5.0 kg 25.0 kg
Willy Farms Long Grain Japanese Textured	Has the quality and texture of Japanese rice but in long grains	Mid-income segment	2.0 kg 5.0 kg
Willy Farms Deliciously Healthy Brown	A good source of fiber, iron, protein and B+. It has a tasty, chewy and nutty flavor.	Mid-income segment	2.0 kg 5.0 kg 25.0 kg

In 2017, SLAC introduced the SL8-H rice to the market to offer more affordable rice to consumers. This variety is said to be appetizing because of its texture and delicious taste.

SLAC's rice products are primarily distributed through supermarkets, groceries, and price clubs. Major retail distributors include SM, Puregold, Robinsons, Shopwise, Rustans and Waltermart. They are also made commercially available through wholesalers and dealers. In addition, SLAC supplies premium rice products to hotels, restaurants, and cafes.

The company's premium rice products contributed 41% of the company's 2018 fiscal year revenues.

#### Market Competition

- *Hybrid Rice Seeds*

SLAC mainly competes with three other local companies for its hybrid rice seed products, as enumerated in the table below. Based on the company's estimates, SL-8H reportedly accounts for 80% of the total market share of hybrid rice seeds in the Philippines.

Table 4 Hybrid Rice Seed Competitors of SLAC

Company	Variety
Bayer Cropscience, Inc.	Arize Bigante Plus Arize Bigante (TEJ) Arize H 64
Pioneer Hi-Bred Philippines, Inc.	Phb 77 Phb 79 Phb 81
Syngenta Philippines, Inc.	Frontline Gold

- *Premium Rice*

For its rice products, SLAC considers companies producing premium rice varieties such as Jasmine rice, Japanese rice, Thai Jasmine rice, Brown rice, Long Grain rice and High-Fiber rice as its main competitors. Brands that produce these varieties include Sunnywood, LH Cereal Corp. (Vita Rice), Northern Luzon (Farmer's Choice), Worthgold, and Qualigrains, among others.



Table 5 Select Premium Rice Product Retail Price

Brand	Variety	Price per 5 kg bag (in PHP)		Price Change	% Change	Price per kg (PHP)* As of Oct 7, 2018
		As of Sep 20, 2017	As of Oct 7, 2018			
Doña Maria	Jasponica Brown	453.00	490.00	37.00	8.17	98.00
	Miponica Brown	453.00	490.00	37.00	8.17	98.00
	Jasponica	442.00	478.50	36.50	8.26	95.70
	Miponica	453.00	490.00	37.00	8.17	98.00
Sunnywood Harvester's	Gold Premium Sticky	403.00	445.00	42.00	10.42	89.00
	Fluffy Long Grain	329.00	384.00	55.00	16.72	76.80
	Whole Grain Red		450.00			90.00
	Black		502.00			100.40
	Thai Jasmine	424.00	536.00	112.00	26.42	107.20
	Rice Sinandomeng		369.50			73.90
	Special Dinorado		418.00			83.60
	Healthy Brown	294.00	384.00	90.00	30.61	76.80
Sunnywood Jordan Farms	Red Rice	452.00	504.00	52.00	11.50	100.80
Sunnywood Farmboy	Long Grain		339.00			67.80
	Thai Jasmine		514.00			102.80
	Sinandomeng		359.00			71.80
Vita Rice	Brown Healthy	328.00	361.00	33.00	10.06	72.20
	Whole Grain	329.00	362.00	33.00	10.03	72.40
	Classic Long Grain	296.00	326.00	30.00	10.14	65.20
	Fragrant Dinorado	332.00	366.00	34.00	10.24	73.20
	Premium Sinandomeng		338.00			67.60

\*Deduced

Source: SM Supermarket (SM Cubao) &amp; Savemore Market Cubao store checking by PhilRatings

SLAC implements a premium pricing strategy considering the qualities of its rice. As seen in Table 6, the per kilogram (kg) cost for SLAC's Doña Maria products ranges from ₱95 to ₱100. Willy Farms, on the other hand, ranges from ₱70 to ₱90 based on the submitted data of SLAC. Vita Rice continued to be the least expensive among all brands, while SLAC was generally among the most expensive. All rice products for the selected brands implemented a price increase ranging from 8% to 31% from 2017 to 2018.

Beginning 2018, the Tax Reform for Acceleration and Inclusion (TRAIN) Law was implemented. Such included the imposition of higher taxes on gasoline and petroleum. According to SLAC, this affected the costs of transportation and irrigation of their products. Thus the price increase was unavoidable.

### Ownership & Management

SLAC is 100% owned by the Lim family. As of May 2018, the beneficial owners of SLAC are presented in the table below.

Table 6 Ownership

Name	Designation	Percentage Ownership
Henry Lim Bon Liong	Chairman/President and Chief Executive Officer (CEO)	40.50%
Joseph Lim Bon Huan	Director	36.49%
Gerry Lim Bon Hiong	Director/Executive Vice President (EVP) and Chief Finance Officer (CFO)	16.00%
Ruben Lim Bon Siong	Director	7.00%
Evelyn Lim	Director	0.01%

\*Note: Mr. Henry Lim Bon Liong, Mr. Joseph Lim BonHuan, Mr. Gerry Lim Bon Hiong, Mr. Ruben Lim Bon Siong, and Ms. Evelyn Lim are siblings.



Mr. Henry Lim Bon Liong serves as company Chairman, President and CEO. He is concurrently the Chairman and CEO of the Sterling Paper Group. He likewise holds key positions in various businesses and civic organizations in the country. Mr. Lim graduated from the University of the Philippines with a Bachelor of Science degree in Mechanical Engineering.

There have been no major changes in SLAC's leadership team composition since the last credit rating review completed in October 2017.

Although SLAC remains to be a family business, it is supported by a team of experienced professionals with technical expertise and understanding in agriculture, primarily in the rice industry. This will promote sustainability of services required to keep business operations in place. The company is also composed of a group of select researchers and scientists trained by Dr. Yuan Longping. He developed the first hybrid rice varieties in the 1970s in China, which is reportedly the biggest producer of hybrid rice seed in the world. This will help SLAC ensure the continuous improvement and development of its products.

SLAC is likewise affiliated with the Sterling Paper Group of Companies which is a diversified conglomerate involved in the manufacture of paper products; importation and distribution of school and office supplies and furniture; retailing; real estate development; and agriculture.

### Strategy

SLAC continues to expand its network of customers in the Philippines and abroad. One of its existing brands, Doña Maria, is reportedly dominating the premium rice market overseas and is starting to gain consumer preference there.

- In June 2017, SLAC signed a collaboration agreement with EnP Solution Limited (ESL) for SL-18H seeds trial production, marketing and development in Bangladesh. It should be noted that ESL's partnership with SLAC is its first venture in agriculture as it mainly provides services for the oil and gas industry in Bangladesh. At present, ESL continues to be an export market for SL-18H rice seeds.
- On August 23, 2017, Sterling SL Agritech Company Limited was incorporated in the Union of Myanmar. It is involved in the production, promotion and transfer of hybrid seed technology, including SL-8H, to sell to the domestic and international export markets, and perform trading activities.

On September 21, 2017, the management carried out an Investment Trust Agreement between SLAC and its Chairman, Mr. Henry Lim Bon Liong, to enable him to manage, supervise and administer Sterling SL Agritech Company Limited on behalf of SLAC, making it its subsidiary. As of May 31, 2018, SLAC invested ₱12.40 million in Sterling SL Agritech Company Limited.

Such has already started its seed and rice production after the issuance of a Certificate of Incorporation. It is currently in the process of obtaining the Myanmar Investment Commission (MIC) permit, which allows businesses and foreign investors to get special privileges, tax incentives, among others.

According to SLAC's Chairman Mr. Henry Lim Bon Liong, they experienced difficulty in entering into the Chinese rice market. This, however, can be tapped through Myanmar.

- In October 2017, SLAC signed a deal with an Indian government-owned firm, National Seeds Corp. Ltd. (NSC) for the production and marketing of SL-8H. NSC wants to plant SL-8 hybrid rice variety on 2.5 million to 5 million ha of land in the next five years.<sup>3</sup>
- On October 6, 2017, PT Sterling Agritech Indonesia (SAI) was incorporated in Jakarta, Indonesia. Its operations is primarily focused on the seed production and marketing to serve Indonesia's hybrid rice seed market. SLAC directly owns 49% of SAI.

<sup>3</sup> <http://www.bworldonline.com/sl-agritech-supply-hybrid-rice-seeds-india/>



Management believes that international revenues will be a significant source of growth for the company in the coming years. It should be noted, however, that for fiscal year ending May 31, 2018, international sales only accounted for 1.9% of total revenues.

Locally, SLAC plans to further increase its position in the hybrid rice seeds industry and expand its market share of its premium rice products. The company has done several marketing strategies, such as seminars, demonstration activities and harvest festivals, to strengthen its brand and to attract a larger market throughout the Philippines.

Last year, the company appointed Coco Martin as their celebrity endorser in an effort to change the image of farmers and make farming appealing to the younger generation. Print and TV ads were rolled out to promote the SL-18H variant.

## FINANCIAL PROFILE

**Table 7 Balance Sheet Items**

	2016	2017	2018
Cash	346,006,634	241,765,185	593,935,603
Total Current Assets	5,055,937,154	5,796,730,254	8,103,047,346
Property and Equipment	643,201,577	1,089,420,608	1,201,999,085
Investment in / Advances in Associates	-	-	9,397,839
Total Assets	7,023,974,850	8,421,002,337	10,886,654,055
Current Portion of Long-Term Debt	-	-	100,000,000
Total Current Liabilities	5,058,672,265	5,943,706,141	7,481,746,962
Long-Term Debt - Net of Current Portion	-	-	396,297,916
Total Liabilities	5,070,709,655	5,963,957,028	7,895,282,589
Retained Earnings	1,143,604,399	677,830,059	1,187,908,623
Total Equity	1,953,265,195	2,457,045,309	2,991,371,466

**Table 8 Income Statement Items**

	2016	2017	2018
Total Revenues	2,552,208,495	3,336,750,855	3,498,791,361
Gross Profit	1,024,049,279	1,157,728,968	1,238,970,820
Fair Value Gain (Loss) on Agricultural Produce and Biological Assets	69,712,034	155,929,466	300,386,518
Operating Expenses	(458,075,254)	(527,965,593)	(712,240,634)
Net Income	458,990,823	509,225,660	508,661,851

**Table 9 Financial Ratios**

	2016	2017	2018
Net Profit Margin	17.98%	15.26%	14.54%
Return on Average Equity (ROAE)	26.65%	23.09%	18.67%
EBITDA Interest Coverage (x)	3.51	2.80	2.57
Current Ratio (x)	1.00	0.98	1.08
Debt to Equity (x)	2.15	2.07	2.27

### Profitability

#### • Fiscal Year 2018

The company's net sales for the period amounted to ₱3.5 billion, a 4.9% increase from last year's ₱3.3 billion. Fair value gain (loss) on agricultural produce and biological assets accelerated by ₱144 million to ₱300.4 million, or a 92.6% growth from last year. This, however, was outpaced by the increases in operating expenses and finance charges, and a decrease in foreign exchange gains.

Operating expenses grew by ₱184 million, or 34.9%, primarily due to reassessment of receivables that resulted to an increased allowance for doubtful accounts. This was in relation to a new accounting standard being implemented by the company upon recommendation of its auditors. Such does not reflect an actual decrease in the quality of its receivables, according to SLAC.

In addition, finance charges rose by ₱41 million, or 14.3%, as a result of an increase in working capital requirements for the sales volume for fiscal year 2018. Foreign exchange gains decreased by 30% which was primarily attributable to the net effect of reevaluation of foreign currency bank accounts, and of receivables and payables from/to foreign parties. SLAC's equity share in net losses of an associate was ₱1.02 million. As a result, net income was relatively flat from ₱509.2 million to ₱508.7 million, with net profit margin declining to 14.5% from 15.3%.

During the period, the company's newly incorporated subsidiary in Myanmar started its operations, which recorded a net loss of ₱9.4 million.

- *Interim June – August 31, 2018*

SLAC almost doubled its total revenues for the first quarter of fiscal year 2019. It grew by 85.6% to ₱738 million, from ₱398 million recorded in the same period last year. The growth in revenues was mainly attributable to the continued growth in sales of hybrid seeds and rice products in the domestic market, which stood at ₱720 million, up by 95.6%. Net income, however, posted a 12.1% decline mainly due to significant changes in cost of sales, fair value gain on agricultural produce and biological assets, foreign exchange gains, operating expenses and finance cost.

Cost of sales surged 49.9% to ₱474 million, mainly driven by the ₱146 million increase in the cost of fertilizers, seeds and agrichemicals as a result of higher production volume. From ₱1.29 million, foreign exchange gains registered a 90.7% decline to ₱120 thousand due to the depreciation of the Philippine peso against the US Dollar. The peso depreciated from ₱51.16 in August 31, 2017 to ₱53.41 in August 31, 2018. Total operating expenses rose by 30.1% during the period as a combined result of higher personnel expenses, freight, advertising and promotion, and transportation.

As a result, profitability margins were generally lower than the same period last year with net profit margin declining to 11.2% from 23.6%.

- *Projections (2019-2020)*

For the next two years, SLAC expects growth to continue, supported by local operations and increasing contributions from the international market. Furthermore, margins are expected to stabilize and recover in the coming years. PhilRatings will continue to monitor the results of international operations as developments in relation to these markets progress.

## **Cash Flow and Liquidity**

- *Fiscal Year 2018*

Operating cash flows decreased by 270.7% for the period. The increases in receivables and inventories continued to pull down internal cash generation, which remained to be negative since 2014. Cash, however, recorded a 145.7% growth due to additional financing acquired.

Interest payments were adequately covered. Earnings before interest and taxes (EBIT) interest coverage ratio was kept acceptable at 2.6x. Current ratio improved to 1.1x.

As of May 31, 2018, total receivables amounted to ₱3.6 billion. Total past due but not impaired trade receivables were at ₱8.3 million or 0.2% of total trade receivables.

- *Interim June – August 31, 2018*

SLAC recorded a 348% increase in cash for the first three months of 2019, from last year's ₱159 million to ₱712 million. The net increase in cash was mainly due to the 892.4% growth posted by cash flows from operations driven by the substantial decrease of prepayments and other current assets.

Current ratio was stable at 1.09x. EBIT interest coverage ratio was lower than last year at 1.8x.

- *Projections (2019-2020)*

Liquidity and coverage ratios are expected to be stable supported by improving income generation.



## Capitalization

### • *Fiscal Year 2018*

SLAC recorded debt to equity (DE) and capitalization ratios of 2.3x and 69.4%, respectively. Short-term debt grew by 23.9%, from ₱5.1 billion to ₱6.3 billion, caused by loans from local banks and an additional ₱500 million in outstanding short-term commercial papers. The proceeds from the availment of short-term debt were used to finance the company's working capital requirements. On the other hand, solvency ratio remained stable at 1.4x. The company had minimal long-term debt.

### • *Interim June – August 31, 2018*

Total debt posted a minimal growth of 1.03% from fiscal year 2018. DE ratio stood at 2.2x, while capitalization ratio was at 71.9%. The company relies on short-term debt to finance working capital requirements considering the nature of its business.

Stockholders' equity stood at ₱3.07 billion which is a 2.8% increase from May 31, 2018. Such growth was due to higher retained earnings which recorded a 6.98% increase to ₱1.27 billion.

### • *Projections (2019-2020)*

For the projected period, SLAC intends to plow back earnings to equity to support its financial position. Moreover, SLAC reportedly postponed its plan to conduct an initial public offering (IPO) to 2021 from 2018 due to low interest from the market and the company also wants to focus on its expansion programs.<sup>4</sup>

## ECONOMY

### Gross Domestic Product (GDP)

The Philippine Gross Domestic Product (GDP) posted a growth of 6.6% in the fourth quarter of 2017, leading to a full-year growth of 6.7%. This is driven by the recovered agriculture sectors, strong government consumption, and better exports and imports which offset the decline in private construction spending, post-election impact, and a plateauing business process outsourcing (BPO) industry.<sup>5</sup>

Although slightly lower than the 6.9% rise recorded in 2016, Socioeconomic Planning Secretary, Ernesto M. Pernia, stated that a 0.2% difference in GDP growth was still respectable given the fact that a massive drop in GDP expansion is expected for post-election years.<sup>6</sup> In 2005 and 2011, both post-election years, the economy experienced a steeper drop to 4.8% and 3.7%, respectively, from 6.7% in 2004 and 7.6% in 2010.

In the second quarter of 2018, GDP growth decelerated to 6% amidst a high inflation environment, bringing the country's GDP to increase by 6.3% for the first half of the year. This is slower than the revised Q1 GDP growth of 6.6% and the 6.5% posted in the same period last year.

The slowdown in GDP is caused by a slower agricultural output, a lower mining sector output, and the six-month closure of Boracay. Export of services posted a 9.6% growth in the second quarter from 16.4% in the first quarter of 2018. Mr. Pernia added that policy decisions undertaken by the government to promote sustainable development also affected GDP growth.<sup>7</sup> In addition, Philippine Statistics Authority (PSA) reported that agricultural output grew by a nearly flat 0.07%, compared to the 6.22% growth it recorded in the same period last year and 1.47% registered in the first quarter of 2018. This resulted in an only 0.58% first-half growth of farm output, outside the 2.5-3.5% annual target for the sector.<sup>8</sup> Household Final Consumption Expenditure (HFCE) grew by 5.6% in the second quarter, slower than the 6% growth in the same period last year.<sup>9</sup>

<sup>4</sup> <http://www.gmanetwork.com/news/money/companies/628261/sl-agritech-postpones-ipo-to-2021/story/>

<sup>5</sup> <https://www.rappler.com/business/194294-gross-domestic-product-philippines-q4-2017-economic-growth>

<sup>6</sup> <http://www.neda.gov.ph/2018/01/23/13833/>

<sup>7</sup> <http://cnnphilippines.com/business/2018/08/09/Philippine-economy-growth-2018-Q2-GDP.html>

<sup>8</sup> <http://www.bworldonline.com/no-gdp-boost-from-flat-second-quarter-agriculture-output/>

<sup>9</sup> <http://psa.gov.ph/nap-press-release/sector/Household%20Final%20Consumption>

Despite the slowdown, the Philippines is still among the fastest-growing economies in Asia behind Vietnam's 6.8% and China's 6.6%.

On October 17, 2018, the Development Budget Coordination Committee (DBCC) revised downwards its 2018 GDP growth target to 6.5-6.9% from 7-8% due to above-target inflation, rising crude prices, and monetary policy tightening.<sup>10</sup> Both Fitch Ratings and International Monetary Fund (IMF) project GDP to grow by 6.5% this year and 6.7% in 2019. Factors considered were continued rapid credit growth and external risks, such as higher oil prices, tighter credit conditions and worsening trade conflict between the US and China. Tighter monetary conditions in the US could trigger capital outflows, especially from Asia Pacific, which could lead to more depreciation pressure on the Philippine peso.

IMF said, however, that the medium-term economic outlook remains favorable. This is mainly supported by the government's infrastructure spending, stable foreign direct investment inflows and strong domestic demand.<sup>11</sup> World Bank, on the other hand, expects the Philippines' growth trajectory to be positive, although lower than expected.

The government is targeting GDP growth to range from 7% to 8% annually for much of President Duterte's term. The National Economic and Development Authority (NEDA) stated that the government's plan of sharply increasing public spending on infrastructure will boost the Philippine economy.

### **Inflation**

Year-to-date inflation averaged at 5.0%, higher than the 2-4% target of the Bangko Sentral ng Pilipinas (BSP) for the year and the 2.8% recorded in the same period last year.

Inflation continued to increase to 6.7% in September 2018, higher than the 6.4% recorded in August 2018 and the 3.0% registered in September 2017. This was also the fastest since February 2009 when it was at 7.2%.

PSA attributed the hike to food and non-alcoholic beverages which rose by 1.2 percentage points to 9.7% from 8.5% in August. Moreover, the farm damage brought by Typhoon Ompong last September 15 in portions of northern Luzon is one of the factors that may have pushed up commodity prices. The farm sector damage reportedly reached ₱27 billion.<sup>12</sup> According to PSA, rice was the top contributor to inflation which rose ten times, equivalent to one percentage point.<sup>13</sup>

IMF expects inflation to settle at 4.9% due to a weaker peso, higher excise taxes, and rising global oil prices as key drivers.

### **INDUSTRY**

#### **Rice Supply and Consumption<sup>14</sup>**

Rice is a staple food in the Philippines. Based on a survey conducted by the PSA in 2012, Filipino households spend, on average, 12% of their total family income for cereals and cereals preparations. In 2016, gross supply of rice posted a 4.23% reduction, lower than the 2.51% growth recorded in 2015. This was mainly due to the 59.07% drop in rice imports during the year, compared to the 35.97% increase in 2015.

<sup>10</sup> <https://business.inquirer.net/259068/govt-cuts-gdp-growth-target-2018>

<sup>11</sup> <https://www.bworldonline.com/imf-cuts-philippine-growth-forecast-for-2018-amid-new-challenges/>

<sup>12</sup> <https://businessmirror.com.ph/ompong-farm-damage-climbs-to-nearly-p27b/>

<sup>13</sup> <https://businessmirror.com.ph/rices-share-in-inflation-levels-rises-tenfold/>

<sup>14</sup> Supply Utilization Accounts (SUA) of Selected Agricultural Commodities by Philippine Statistics Authority (PSA)



Table 11 Supply Utilization Account of Rice (2014-2016)

	In '000 Metric Tons (MT)			% Change	
	2014	2015	2016	2014-2015	2015-2016
<b>SUPPLY</b>					
Beginning Stock	2,126	2,662	3,199	0.25	0.20
Production	12,405	11,870	11,528	(0.04)	(0.03)
Imports	1,087	1,478	605	0.36	(0.59)
Gross Supply	15,618	16,010	15,332	0.03	(0.04)
<b>UTILIZATION</b>					
Exports	1	<1	<1		
Total Net Food Disposable	11,421	11,336	11,134	(0.01)	(0.02)
Per Capita kg/yr	114.35	111.62	107.84	(0.02)	(0.03)

Rice production showed a decreasing trend from 12.4 million metric tons (MT) in 2014 to 11.5 million MT in 2016, giving an average rate of decline of 3.6% yearly. Likewise, total net food disposable recorded a continuous reduction from 11.4 million MT in 2014 to 11.1 million MT in 2016. Net food disposable is the volume of food available for human consumption.

### Rice Inventory<sup>15</sup>

Total rice stock inventory as of August 1, 2018 was 1.52 million MT. This was lower by 23.61% from the previous month's level of 1.99 million MT and 25% below the 2.03 million MT recorded in the same period last year. Rice held by households accounted 49.08% of the total, while commercial warehouses held 44.27% and the NFA 6.65%. The PSA reported that the NFA's rice stockpile almost doubled from its inventory last month due to importation.

Table 12 Rice Stock Inventory as of August 1, 2018

Sector	Stocks in '000 MT			% Change	
	August 1, 2016	August 1, 2017	August 1, 2018	August 2016-2017	August 2017-2018
Household	693.59	748.34	746.38	7.89	(0.26)
Commercial	621.59	1,170.97	673.23	88.38	(42.51)
NFA	787.97	108.69	101.15	(86.21)	(6.94)
<b>TOTAL</b>	<b>2,103.15</b>	<b>2,028.00</b>	<b>1,520.76</b>	<b>(3.57)</b>	<b>(25.01)</b>

Sector	Stocks in '000 MT		% Change
	July 1, 2018	August 1, 2018	
Household	992.42	746.38	(24.79)
Commercial	945.10	673.23	(28.77)
NFA	53.30	101.15	89.77
<b>TOTAL</b>	<b>1,990.82</b>	<b>1,520.76</b>	<b>(23.61)</b>

The rice inventory level for August 2018 is sufficient for 48 days based on average daily consumption of Filipinos of 32,000 MT. The National Food Authority (NFA), however, has limited inventory of only 3 days from the mandated 30 days. The law requires NFA to maintain reserve good enough to last for at least 15 days at any given time and for 30 days at the onset of lean months.

Last July, President Rodrigo Duterte ordered the NFA to maintain a 60-day buffer stock. The government admitted that it is improbable and may require the involvement of the private sector.<sup>16</sup>

The order was given in response to the NFA running out of rice in April 2018. Their buffer stock went down to only 200,000 bags which were good for less than half a day.<sup>17</sup> President Duterte then allowed the

<sup>15</sup> <https://psa.gov.ph/content/monthly-rice-and-corn-stock-inventory-july-2016-0>

<sup>16</sup> <https://business.mb.com.ph/2018/07/24/govt-wants-shared-responsibility-on-prrds-60-day-rice-buffer-stock-order/>



government-to-government importation of 250,000 MT of rice from Vietnam and Thailand to replenish NFA's inventory. It was followed by another set of bidding of 250,000 MT of rice through a government-to-private scheme.

Last August, Samahang Industriya ng Agrikultura (Sinag) filed graft charges against the NFA administrator for using the ₱5.1-billion fund allotted for buffer stocking to pay off the agency's debt in 2017.

Note that in 2016, rice self-sufficiency ratio (SSR) increased to 95.01% from 88.93% in 2015.<sup>18</sup> This meant that local production accounted for 95% of the total rice supply in the local market.

#### *National Food Authority (NFA)*

Aside from purchasing *palay* from farmers, the NFA also imports rice to increase its buffer stock. The agency is mandated to stabilize the market price of rice in the country, while providing a floor price for rice procured from domestic farmers. As of the second week of September 2018, however, both wholesale and retail prices of well milled and regular milled rice continued to climb to as much as 21% year on year. Lack of cheap rice and insufficient supply were said to have triggered price hikes.

According to Agriculture Secretary Emmanuel F. Piñol, high prices of commercial rice were caused by the depletion of NFA inventories which allowed commercial dealers to raise prices. Importation of rice was delayed due to late approval from government, as well as the onset of typhoons. Furthermore, the NFA's *palay* procurement goal of 100,000 MT for the year may not be reached because the agency's prices are not competitive against that of traders.<sup>19</sup>

Last August, Zamboanga City was placed under state of calamity due to a rice shortage that pushed up commercial rice prices to as much as ₱70 per kilo. In addition, the NFA's imported rice from Thailand and Vietnam was infested with weevil ("bukbok") due to delayed unloading of the shipment caused by heavy rains.

Last September, President Duterte issued Executive Order No. 62 (EO 62) which placed the NFA, Philippine Coconut Authority (PCA), and the Fertilizer and Pesticides Authority under the Department of Agriculture (DA).<sup>20</sup> This will improve NFA and DA's coordination regarding rice procurement and importation. Moreover, the DTI and NFA entered into a deal with the Philippine Amalgamated Supermarket Association Inc. (Pagasa) which allows supermarkets to sell NFA rice. This is intended to increase access to affordable rice sold by the NFA.<sup>21</sup>

#### **Suggested Retail Price (SRP) on Rice<sup>22</sup>**

The DA has come up with suggested retail prices (SRP) on rice for Metro Manila. Rice will only be labeled as local or imported regular-milled and well-milled rice, and special rice. Names such as "Sinandomeng," "Super Angelica" and "Yummy" rice will be prohibited. According to Mr. Piñol, prices of rice sold in the market will range from ₱37 to ₱47 per kg, while imported premium rice will be at ₱60 per kg. This, however, has an exemption. Special rice (e.g. dinorado, organic brown, sticky, etc.) and fancy rice variants (e.g. Jasmine and Japanese) will not be regulated, and these include SLAC products.

#### **Rice Tariffication Bill**

Last August, the House of Representatives passed on third and final reading the House Bill (HB) 7735, or the "Revised Agricultural Tariffication Act." Under the House version of the bill, quantitative restrictions (QR) on imports will be replaced by tariffs guided by the "bound rate" commitments of the Philippines

<sup>17</sup> <http://cnnphilippines.com/news/2018/04/04/NFA-rice-buffer-stock-left.html>

<sup>18</sup> Food Sufficiency and Security by Philippine Statistics Authority (PSA)

<sup>19</sup> <https://businessmirror.com.ph/with-low-price-nfa-could-miss-palay-procurement-goal/>

<sup>20</sup> <https://www.bworldonline.com/nfa-other-agencies-placed-under-da/>

<sup>21</sup> <https://businessmirror.com.ph/dti-to-nfa-support-government-effort-to-beef-up-rice-supply/>

<sup>22</sup> <https://businessmirror.com.ph/s-r-p-set-for-metro-markets/>



under the World Trade Organization (WTO). The bound rate refers to the maximum tariff on products committed to by a country to the WTO.

If passed into law, the bound rate for rice for non-members of the Association of Southeast Asian Nations (ASEAN) will be at about 40% under a minimum access volume (MAV) of 350,000 MT. Importation beyond the MAV limit are slapped a higher tariff of 180%. For ASEAN members, on the other hand, 35% will be implemented regardless of volume.<sup>23</sup>

Removing quantitative restrictions in favor of tariffs could reportedly reduce the price of rice by as much as ₱7 per kilo, according to the DOF and NEDA.<sup>24</sup> BSP expects the tariffication bill to lower the inflation rate by 0.4%.

HB 7735 is expected to pull down rice prices while stabilizing supply, and help local farmers to become more competitive through the establishment of the Rice Competitiveness Enhancement Fund (RCEF). The taxes collected on rice imports will be directed to the RCEF, which will then provide the farmers cheap loans, training, scholarships, and modern facilities, among others. It may reportedly take a long time, however, before farmers could benefit from the fund. Hence, a subsidy is still being pushed.

#### **Farmers Subsidy<sup>25</sup>**

The inclusion of a ₱10-billion subsidy for local rice farmers, along with the rice tariffication bill, is being pushed in the Senate to help the farmers compete with the cheap rice from abroad. This subsidy is proposed to be included in the government's annual national budget until funds from the RCEF would be adequate to support the rice sector.

It should be noted that the House version of the bill plans to subsidize farmers for only five years.

#### **Hybrid Rice Production in the Philippines**

The Philippines has roughly 29.8 million ha of land, of which 9.7 million ha are considered agricultural.<sup>26</sup> Due to population growth, rapid urbanization and industrialization, massive conversion of agricultural lands into other uses reduced the total rice plantation area in the country. With the continued growth in the population, the Philippine market for rice has grown. In the coming years, local rice production growth may be outpaced by demand given its current rate.

The government has been urging farmers to shift to hybrid rice seeds as this would contribute in achieving the 100% rice self-sufficiency level of the country. During the dry season of crop year 2014-2015, the DA launched High Yielding Technology Adoption (HYTA) program that promotes the propagation of high-yield rice varieties such as hybrid rice.

The HYTA is implemented in areas with good irrigation to ensure the attainment of high yield and avoidance of crop failure. The DA Regional Field Offices (RFOs) shall procure and grant hybrid seeds of appropriate varieties, registered under National Seed Industry Council, depending on the preference of farmers. This subsidy program of the government under HYTA shall continue until dry season 2022-2023.

In addition, with the rice tariffication bill, the government will prioritize the purchase of hybrid rice seeds with the revenues it will collect from the conversion of QR into tariffs.<sup>27</sup> It recognizes that such will allow farmers to increase their productivity and to produce more *palay*. They also have lower production costs, yet generate higher yields of up to 20% against the traditional or "inbred" rice varieties.<sup>28</sup>

<sup>23</sup> <http://www.bworldonline.com/rice-tariff-bill-hurdles-house-on-third-reading/>

<sup>24</sup> <https://businessmirror.com.ph/house-okays-rice-tariff-bill-on-second-reading/>

<sup>25</sup> <http://business.inquirer.net/255645/p10-b-farmers-subsidy-pushed>

<sup>26</sup> <http://www.dar.gov.ph/dar-in-the-news/2463-land-conversion-freeze-not-seen-affecting-economy-dar>

<sup>27</sup> <https://businessmirror.com.ph/palace-wants-farmers-to-plant-hybrid-rice/>

<sup>28</sup> <http://www.fao.org/rice2004/en/f-sheet/factsheet6.pdf>

### Free Irrigation Law

President Duterte has signed into law the Free Irrigation Service Act (R.A. 10969) that exempts farmers, who own at most 8 ha of land, from paying irrigation service fees. The National Irrigation Administration (NIA) will continue to develop, operate and maintain the national irrigation system.

Even so, NIA admitted that it would take 40 years to supply water to all 3.128 million ha of irrigable lands in the Philippines.<sup>29</sup> NIA was already able to irrigate 1.887 million ha as of last year, or 60.35% of the total irrigable lands. For 2018, NIA has only irrigated 2,193 ha out of the 47,707 target ha.

### Rice Integrative Genomics Workbench in Galaxy (RIGby)<sup>30</sup>

The Philippine Rice Research Institute (PhilRice), an attached agency of the DA, will be releasing a database software called the Rice Integrative Genomics Workbench in Galaxy (RIGby) soon.

This software, specifically designed for rice research, could hasten breeding of new stress-tolerant rice varieties which can help farmers deal with climate change. RIGby, also referred as a “swiss knife” of bioinformatics, can also generate necessary information in developing new rice varieties that are resistant to pests and diseases.

### WEATHER

Increasing temperatures, coupled with rainfall changes brought about by climate change, are likely to have a negative effect on the yield of crops. The 2015-2016 El Niño episode, the third strongest in recorded history, reportedly caused ₱12.8 billion worth of damages in different regions of the country. Such resulted in agricultural production declining by 4.5%.

In 2017, the agriculture industry grew by 4% due to a favorable climate and strong government intervention, as well as the base effect from the decline experienced in 2016.

A weak La Niña phenomenon persisted early in 2018, followed by a neutral phase – where there is neither La Niña nor El Niño. While El Niño-Southern Oscillation (ENSO)-neutral conditions are prevailing and are expected to remain until the third quarter of 2018, the Philippine Atmospheric, Geophysical and Astronomical Services Administration (PAGASA) projects an El Niño to develop by the end of the year, with up to 68% probability.<sup>31</sup> Drier condition in some parts of the country is expected in the first quarter of 2019.

According to World Meteorological Organization (WMO), most models showed a gradual warming of the tropical Pacific which may possibly result to a weak level of El Niño by the fourth quarter of 2018.

SLAC's management said that the impact of weather disturbances to its business has been minimal. Weather disturbances are being managed through its locational strategies.

It should be noted that SLAC's pricing structure is affected by weather conditions, seasonality of the planting process, and natural calamities.

<sup>29</sup> <https://businessmirror.com.ph/irrigating-all-phl-farms-would-take-40-years-nia/>

<sup>30</sup> <https://businessmirror.com.ph/government-to-roll-out-rice-research-software/>

<sup>31</sup> Climate Outlook: August 2018 – January 2019 by PAGASA-DOST, Climatology & Agrometeorology Division (CAD), and Climate Monitoring and Prediction Section (CLIMPS)