

## **1. Overview of Business Operation and Policy**

### **1.1) Business Objectives**

Khon Kaen Sugar Industry Public Company Limited has the policy to operate its business ethically and responsibly towards , society, and the environment. It place emphasis on conducting transparent operations, respecting human rights standards, and safeguarding the interests of all stakeholders through the following vision, mission, and quality policy:

#### **Vision**

We are natural energy innovation for all.

#### **Mission**

1. Create income for farmers through efficient processes and high quality agricultural yields.
2. Continuous improvement on technology and R&D to efficiently increase agricultural yields.
3. Create an environment that mutually benefits our partners of success.
4. Develop down-stream businesses to maximize the usage of raw materials, byproducts, and other resources.

#### **Quality Policy**

To produce high quality sugar, achieve efficient operation, make on-time delivery, ensure customer's satisfaction and consumer's safety.

Long term goal of the company is to be one of the leaders in sugar, by-product, and value added productions which can be shown in company's sugar policy: "production of quality sugar with high efficiency, prompt delivery, winning customers' trust, consumption safety". This policy has encouraged company's 5 sugar factories to be widely accepted as one of the highest efficiency and highest quality sugar production groups in Thailand. In addition, with the goal of being one of leading companies in by-product and value added production and with the vision on the potential growth in related – sugar businesses, such as ethanol business, power business, and organic fertilizer business, the company has made continuous investments in these sectors which to date has been successful and highly satisfactory.

The company's short term goal is to be one of the leaders in the industry who excels in cost management and productivity. The goal can be achieved by applying modern technology to the corporate production and management systems. Furthermore, the company is aware that its primary risk is the amount of cane it is able to procure for crushing. The sugar factories and other integrated businesses cannot sustain without adequate cane crushed. The company, hence, aims to reduce the farmers' cane cultivation cost as well as to improve their productivity yields and efficiency. Its objective is to help the farmers sustain their living and receive higher return on their investment as well as to remain productive farmers to our businesses.

## 1.2) Important Changes and Developments During the Past 3 Years

In 2012, after performing feasibility study and other required assessments, the company decided to make further investment to expand its electricity power plant and sugar factory in Nampong district of Khon Kaen province. Electricity power plant production capacity will be 65 MW, up from 30 MW and sugar crushing capacity will increased by 8,000 tons of cane sugar/ day, totaling to 35,000 tons of sugarcane/ day. The expansion project was completed in 2014.

In 2016, the board of directors has approved to invest in Loei project at Wangsapung district, Loei province which consists of expansion of sugar mill from 18,000 to 34,000 tons of sugarcane/day and expansion of power plant from 40 to 75 MW plus boiler with 220 tons steam.

Moreover in 2016, the board of directors No.7/2015-2016 on September 30, 2016 has approved Initial Public Offering plan for the KSL Green Innovation Public Company Limited or previously named Khon Kaen Alcohol Co., Ltd. by offering newly share to public not more than 30% of total paid-up capital.

## 1.3) Company Overview

Khon Kaen Sugar Industry Public Company and its subsidiaries, under KSL, are Thailand 3<sup>rd</sup> largest sugar producer group. The company has 5 sugar factories in the group, located in three different regions, as follows:

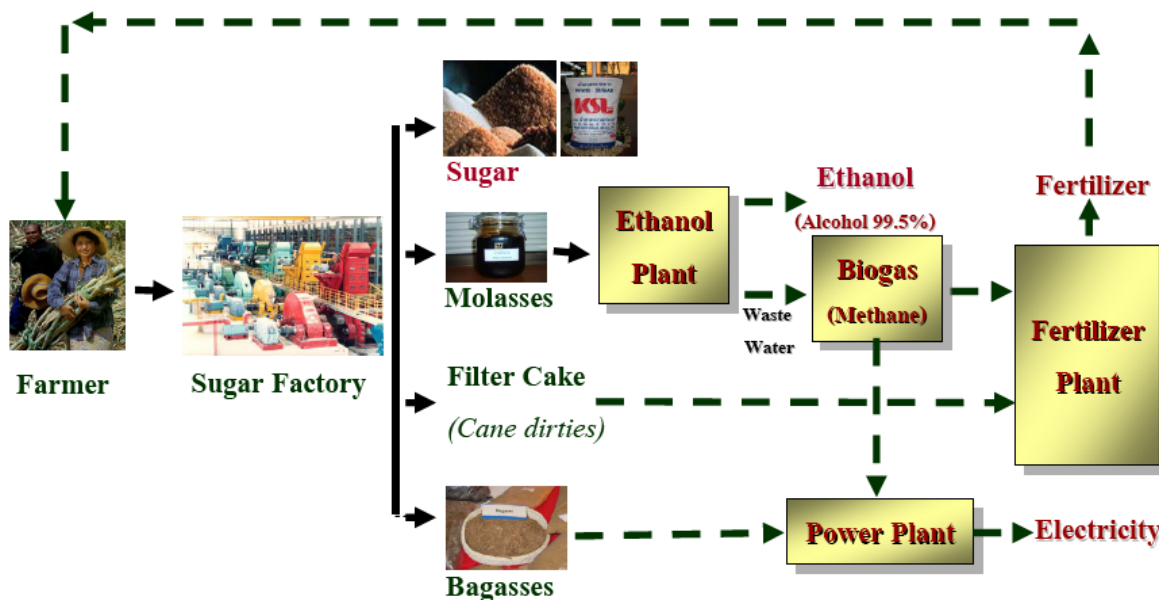
1. Northeastern Region: Khon Kaen Sugar Industry Public Company Limited; Nampong branch in Khon Kaen province and Wangsapung branch in Loei province.
2. Western Region: New Krung Thai Sugar Factory Co., Ltd and Tamaka Sugar Industry Co., Ltd in Kanchanaburi province
3. Eastern Region: New Kwang Soon Lee Sugar Factory Co., Ltd in Chonburi province

The core products which the company produces are sugar which can be categorized to be 4 types: (a) raw sugar (b) high pol sugar (c) white sugar and (d) refined sugar. The company also has other products related to sugar production process, such as molasses, bagasses and filter cake. According to these kinds of products, the company has a plan to invest in value added projects, as followings: (shown on Figure 1.1)

- (1) Ethanol plant: Ethanol is mixed with gasoline, and the mixture is used as fuel for vehicles. Raw materials used in the Group's ethanol production include molasses and sugarcane juice
- (2) The biogas plant uses waste water from ethanol production process as a raw material. Biogas produced through fermentation is used as a supplementary fuel for the corporate power plant.

- (3) The organic fertilizer plant uses waste from the sugar production process (filter cake) and waste water from biogas and ethanol production as raw materials.
- (4) The power plant uses waste from the sugar production process (bagasses) and biogas from the biogas plant as fuel sources for producing electricity and steam sold to plants in the Group and Grid.

**Figure 1.1 : The Relationship between KSL's Existing Sugar Production and KSL's Value Added Project**



As of October 31, 2016, Khon Kaen Sugar Industry Public Company Limited and its subsidiaries have the investment in subsidiaries and affiliates in total 14 companies as followings:

Business Unit/Company Name	Paid - Up Capital (THB Million)	Proportion Of Investment	Nature of Business
<b>Sugar Business</b>			
Tamaka Sugar Industry Co., Ltd.	600.00	90.21%	Produce and distribute sugar
New Krung Thai Sugar Factory Co., Ltd.	1000.00	95.78%	Produce and distribute sugar
New Kwang Soon Lee Sugar Factory Co., Ltd	500.00	98.61%	Produce and distribute sugar
Savannakhet Sugar Corporation	684.76	98.49%	Sugar cane Plantation and Sugar

			Factory in Laos
Koh Kong Plantation Co., Ltd*	936.98	80.00%	Sugar cane Plantation in Cambodia
Koh Kong Sugar Industry Co., Ltd	1,167.66	80.00%	Sugar Factory in Cambodia
<b>Supporting Business</b>			
Thai Sugar Terminal Public Company Limited**	145.20	23.82%	Terminal, Warehouses, Real estate, produce and distribute wheat flour and palm oil
KSL Export Trading Co.,Ltd.	20.00	79.55%	Sugar and Related products Exporting Activities
KSL Agro and Trading Co., Ltd.	300.00	100.00%	Trading domestic sugar and operating agricultural businesses
Wynn In Trading Co., Ltd	487.497	100.00%	International trading and consulting
<b>Energy and Chemical Business</b>			
KSL Green Innovation PCL***	610.00	100.00%	Producing and distributing ethanol or agri-fuel and organic fertilizer
Khon Kaen Sugar Power Plant Co., Ltd	800.00	100.00%	Power Plant (SPP)
KSL Material Supply Co., Ltd.	840.00	100.00%	Material Sourcing for sugarcane plantation
<b>Other Business</b>			
KSL Real Estate Co., Ltd	840.00	91.02%	Real Estate Development and Training Center
WSP Logistics Co., Ltd	0.25	100%	Provide transportation service

**Note:**

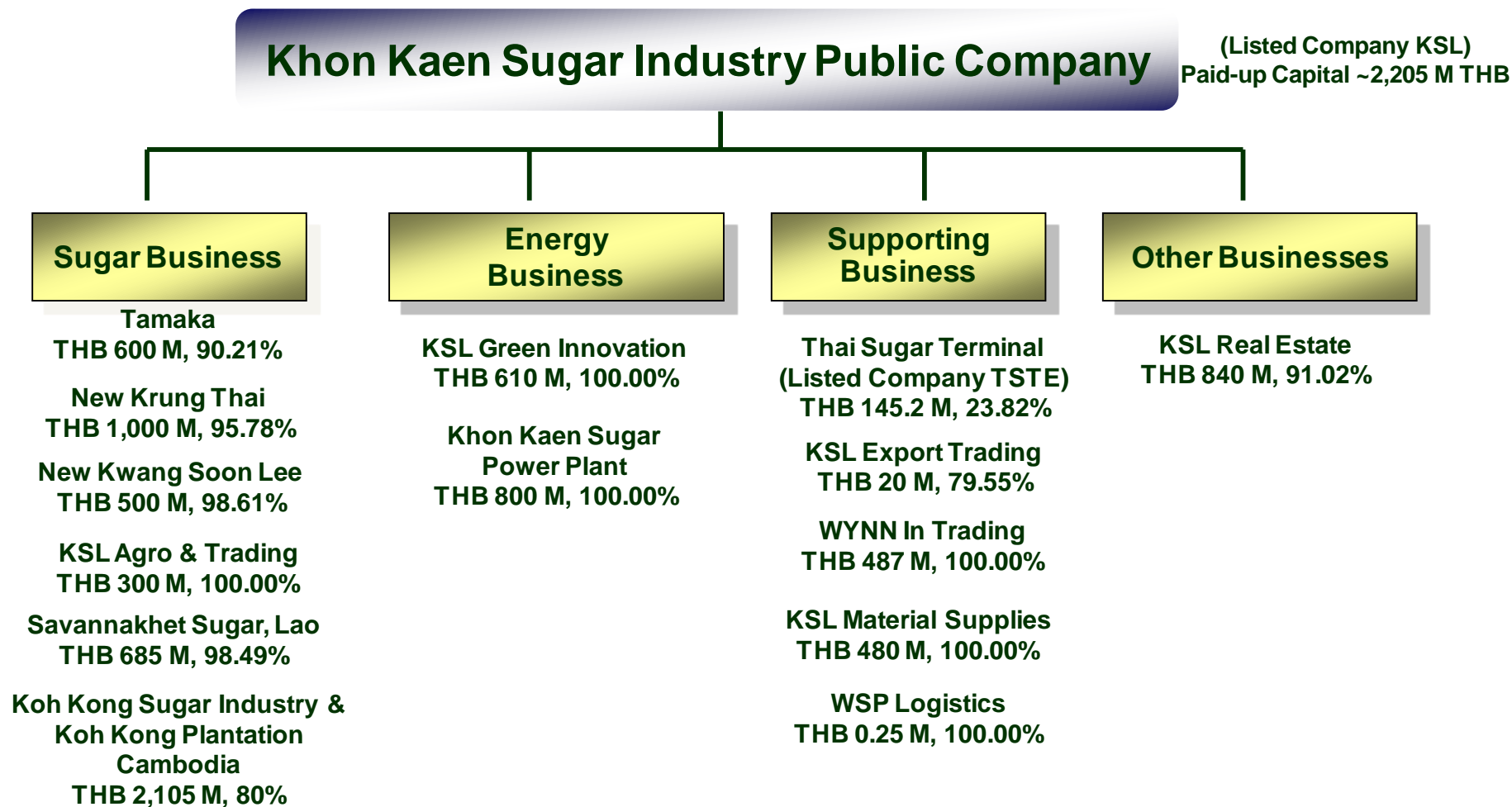
Proportion of investment shown above includes both direct and indirect shareholdings

\* indirect holding by Wynn in Trading Co., Ltd.

\*\* Associated company

\*\*\*Previously named Khon Kaen Alcohol Co., Ltd

Business structure of KSL Group on October 31, 2016 shown on the following chart:



The details of Khon Kaen Sugar Industry Public Company Limited, subsidiaries and affiliates are as follows:

**Sugar Business**

**Khon Kaen Sugar Industry Public Company Limited**

The nature of business is to produce and distribute sugar and other by-products. The first branch is located in Nampong district, Khon Kaen province. In 2014, improvements were made to increase its maximum crushing capacity to 35,000 ton cane per day. The second branch is located in Wangsapung district, Loei province with the maximum crushing capacity of 18,000 ton cane per day. Both branches have the capability to produce raw sugar, high pol sugar, white sugar and refined sugar.

**Tamaka Sugar Industry Co.,Ltd**

The nature of business is to produce and distribute sugar and other by-products. The factory is located in Tamaka district, Kanchanaburi province with the maximum crushing capacity of 22,000 ton cane per day and capable to produce raw sugar, white sugar and refined sugar.

**New Krung Thai Sugar Factory Co.,Ltd**

The company produces and distributes sugar and other by-products. The factory, which was originally located in Tamaka district, Kanchanaburi province, was relocated to Bo Ploy district, Kanchanaburi province. The production capacity was expanded to the maximum crushing capacity of 36,000 tons of cane per day. Construction has already completed, the factory is capable of producing raw sugar, white sugar, and refined sugar.

**New Kwang Soon Lee Sugar Factory Co.,Ltd**

The enterprise produces and distributes sugar and other by-products. The factory located in Panusnikom district, Chonburi province, has the maximum crushing capacity of 4,000 tons of cane per day. The cane crushing capacity decreased due to the fact that some of the machines had been moved to Laos and Cambodia. The factory is capable of producing raw sugar, high pol sugar, white sugar, and refined sugar.

**Savannakhet Sugar Corporation**

The company received sugarcane plantation concession that covers approximately 10,000 hectares (62,500 rai) from the Lao government. Sugarcane cultivation is undertaken by the company itself. The

sugar factory in Savannakhet has the maximum crushing capacity of 3,000 tons of cane per day. Its output includes raw sugar and other byproducts.

*Koh Kong Plantation and Koh Kong Sugar Industry*

The company received sugarcane plantation concession that covers approximately 19,100 hectares (119,375 rai) from the Cambodian government. Sugarcane cultivation is undertaken by the company itself. The sugar factory in Koh Kong has the maximum crushing capacity of 6,000 tons of cane per day. Its output includes raw sugar and other byproducts.

**Energy and Chemical Business**

*KSL Green Innovation Public Company Limited*

Established in early 2004, the company runs the business of producing alcohol (Ethanol) from molasses, sugarcane and others with the licenses to produce 350,000 liters per day (150,000 at Nampong, Khon Kaen and 200,000 at Boploy, Kanchanaburi) granted by Ministry of Industry for the purpose of producing alcohol for blending with gasoline, so-called “gasohol”, using as fuel in vehicles. In addition, the company produces fertilizers as a downstream project to the alcohol plant, which uses waste water from alcohol plant and filter cake, waste products from sugar processing.

*Khon Kaen Sugar Power Plant Co., Ltd.*

Established late in 2003, the company operates renewable power plants that can produce electricity and steam by using bagasses as raw material. The power produced at the plants can supply the factories within the group and any additional power generated are then sold to EGAT and PEA (Grid). Currently, the company operates 3 power plants all locating nearby its sugar factories. The first branch is closed to Khon Kaen Sugar Factory in Nampong district of Khon Kaen province. The second branch is closed to New Krung Thai Factory in Kanchanaburi province (part of the Boploy Renewable Energy Project). The third branch is located next to Khon Kaen Sugar Factory in Wangsapung district of Loei province (The Loei Project). Currently, the total capacity of all three branches can produce up to 195 MW of electricity.

*KSL Material Supply Co., Ltd*

KSL Material Supply Co., Ltd. now operate business relating to sourcing and selling raw materials and materials related to agriculture such as organic fertilizers and related services.

**Supporting Business**

*KSL Export Trading Co., Ltd*

Established in 1992, the company performs as a licensed exporting company, according to Cane and Sugar Act 1984, which provides services of exporting activities to the sugar companies in KSL Group and also other sugar factories.

*Thai Sugar Terminal Public Company Limited (TSTE)*

The company is a listed company in the Stock Exchange of Thailand. Its businesses involve warehouse leasing, loading and discharging sea freight, port operations, and freight forwarding. The terminal and warehouse are located in Prapadang, Samutprakarn, on the Chopraya River. Customers are primarily sugar companies in the KSL Group, other sugar factories owned by strategic partners, and general customers. In addition, Thai Sugar Terminal Public Company Limited (TSTE) is the mother company of 5 subsidiaries, which mainly deal with real estate trading and leasing, wheat flour production, plastic sack manufacturing, and palm oil refinery plant operations. (For details, refer to listed company profiles section: Thai Sugar Terminal Public Company Limited (TSTE) and TS Flour Mill Public Company Limited (TMILL)).

*KSL Agro and Trading Co., Ltd.*

Established in 2006, the company trade sugar and related products for domestic customers. It also grow sugar cane on the company's land.

*Wynn In Trading Co., Ltd*

The nature of business is international trading and international investment consulting. Khon Kaen Sugar Industry Public Company holds 100.00% share of Wynn In Trading Co., Ltd.

**Other Businesses**

*KSL Real Estate Co.,Ltd*

The company is involved in the business of property rental and resort ownership in Kanchanaburi, near the River Kwai, under the name of "River Kwai Park and Resort" This company provides the accommodation and facilities for holiday vacation and training center for employees of the KSL group and other general customers. Additionally, the company has acquired a commercial rental property, The Liberty Square Building that is located in the heart of Silom Road that is one of the busiest business area of Bangkok with approximately 19,151 sqm of rental space consisting of 22 floors and 6 levels of underground parking.

WSP Logistics Co., Ltd.

The nature of business is transporting sugar and other products.

Regarding the policy to regulate and monitor the operation of subsidiaries and affiliates, Khon Kaen Sugar Industry has categorized its subsidiaries and affiliates which have the similar nature of business to be a group together under the same team of management. Four sugar companies are under the same board of executive directors. For supporting business, energy and chemical business and other business, Khon Kaen Sugar Industry will assign its own representatives to join as a position of company directors for policy making or as a position of top management for operation directing, which will make consistency in policies from parent company, subsidiaries and affiliates.

## **2. Description of Each Business Operation**

### **2.1) Revenue Structure**

Company	% of Shareholding in 2016	2014		2015		2016	
		Revenue (Million THB)	%	Revenue (Million THB)	%	Revenue (Million THB)	%
<b>1. Khon Kaen Sugar Industry Public Company</b>	Mother Company	8,668.09	31%	8,335.09	31%	9,864.34	37%
<b>2. Tamaka Sugar Industry Co., Ltd</b>	90.21%	3,196.84	11%	2,946.99	11%	2,498.79	9%
<b>3. New Krung Thai Sugar Factory Co., Ltd</b>	95.78%	4,540.44	16%	4,645.78	17%	3,285.37	12%
<b>4. New Kwang Soon Lee Sugar Factory</b>	98.61%	744.15	3%	550.1254679	2%	534.0458602	2%
<b>5. Thai Sugar Terminal Public Company</b>	23.82%	1,538.84	6%	0.00	0%	0.00	0%
<b>6. KSL Export Trading Co., Ltd</b>	79.55%	13.15	0%	20.5991328	0%	15.48967457	0%
<b>7. KSL Green Innovation PCL</b>	100.00%	2,472.01	9%	2,600.92	10%	2,143.92	8%
<b>8. Khon Kaen Sugar Power Plant Co., Ltd</b>	100.00%	2,493.81	9%	2,994.70	11%	2,524.71	10%
<b>9. KSL Material Supplies Co., Ltd*</b>	100.00%	20.56	0%	11.61435613	0%	29.185405	0%
<b>10. KSL Real Estate Co.,Ltd</b>	91.02%	150.34	1%	154.9648645	1%	174.9911018	1%
<b>11. KSL Agro and Trading Co., Ltd.</b>	100.00%	3,605.85	13%	4,172.69	16%	4169.198022	16%
<b>12. Koh Kong Plantation Co., Ltd**</b>	80.00%	128.73	0%	116.7002359	0%	152.8091787	1%
<b>13. Koh Kong Sugar Co., Ltd</b>	80.00%	89.36	0%	136.9219072	1%	672.95243	3%
<b>14. Savannakhet Sugar Corporation</b>	98.49%	211.21	1%	219.5473385	1%	240.9437847	1%
<b>15. Wynn In Trading Co., Ltd</b>	100.00%	-	-	0	0%	0	0%
<b>Total</b>		27,873.38	100%	26,906.64	100%	26,306.75	100%
<b>Minus Interrelated items</b>		-8,688.53		-9,431.32		-9,395.58	
<b>Total Revenues</b>		19,184.84		17,475.33		16,911.17	

\* In 2015 and 2016 the Company recorded the revenue from Thai Sugar Terminal PCL and its group as associate but in 2014, the Company recorded the revenue as subsidiary.

\*\*Formerly name Khon Kaen Alcohol Co., Ltd

\*\*\* Indirect shareholding through Wynn In Trading Co., Ltd.

Unofficial Translation

(Explanation of change in revenue and earnings stated in Part 3 Financial Position and Operating Performance)

## **2.2) Description of each products**

### **Sugar: Production and Characteristics**

The company is a group of sugar manufacturers whose quality management system is certified by SQF 2000, ISO 9001: 2000, and Hazardous Analysis and Critical Control Point (HACCP) accreditations. Sugar produced by the KSL group can be divided into four categories according to their types and levels of purity as follows:

**Raw sugar** – Raw sugar has a color index higher than 1,500 ICUMSA. It is dark brown, and has a high dirt index and a low purity index. Transfer is done in bulk without the use of sacks. This type of sugar cannot be consumed until it is refined or purified, turning into white sugar or refined sugar.

**High pol sugar** - High pol sugar has a color index between 1,000 - 1,500 ICUMSA. It can be consumed without any further process needed. Generally, the sugar is put in sacks before being transported. It is priced lower than white sugar and refined sugar.

**White sugar** - White sugar has a color index between 46 – 200 ICUMSA with a degree of polarization not lower than 99.50. It is widely consumed among households and used as a raw material in food industries where moderate purity is required.

**Refined sugar** – Refined sugar has a color index that does not exceed 45 ICUMSA. It is especially high in purity. The sugar is used in certain industries where highly pure sugar is needed, such as pharmaceutical industry, carbonated beverage industry, and energy drink industry.

After sugar manufacturing there is a residue called “molasses” that its sugar content is so low that any further sugar extracting is uneconomical. Molasses is a valuable by-product obtained from sugar production. It contains 20% water, 30% sucrose, 32% invert sugar, 12% non-sugar organic substance, and 6% ash. From one ton of sugarcane, the corporate sugar factories have capacity to manufacture between 45-50 kilograms of molasses. An amount of molasses produced in a year depends on a quantity of sugarcane crushed in the year. Molasses can be widely used in such biochemistry industries as alcohol and distilling industry, yeast industry, monosodium glutamate industry, animal food industry (where molasses is mixed with cassavas and bagasse), vinegar industry, and soy sauce and seasoning sauce brewing industry.

Other residues from sugar manufacturing process that are also useful include bagasse and filter cake. Bagasse is the fibrous material remaining after the last extraction of juice from sugarcane. Now the company uses burned bagasse as a source of energy for electricity and steam generation used in sugar manufacturing process. Part of the electricity generated is sold to the Grid. Filter cake is a residue from vacuum filtration. It can be used as a raw material for general-purpose fertilizer. In the past, the company gives away filter cake to sugarcane farmers to promote sugarcane plantation in nearby areas.

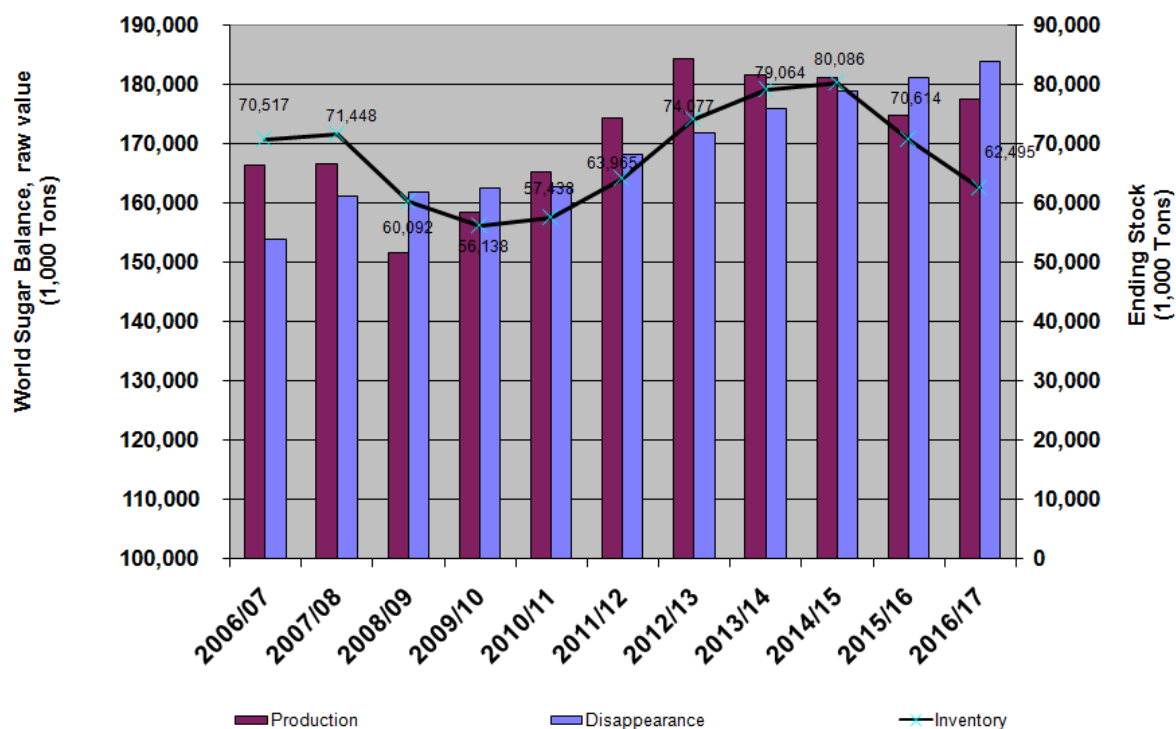
After the company's subsidiary has continuously operated alcohol and chemical production, wastewater from the factory can be mixed with filter cake and bio-decomposed to produce organic fertilizer that is suitable for sugarcane plantation. This completes the corporate value-added product ranges.

## Sugar: Market and Competition

### International Market and Industry Overview

The world sugar market: In 2014/15 approximately 182.3 million tons of raw sugar was produced worldwide, representing a increase of 1 million tons or 0.5% from the 2013/2014. The world's total consumption demand rose to 179.1 million tons, a 3 million tons increase or about 2% growth compared to that of 2013/14. However, the ending stock increases from 77.2 million tons in 2013/14 to 79.3 million tons in 2014/15. The stock represented 44% of the total demand, or an equivalent of 5 months sugar consumption.

Chart 2.1: World Sugar Balance (1000 Tons, centrifugal sugar, raw value, OCT/SEP)



Note: 2016/17 is forecasted number

Source: F.O.Lichit, updated 4-11-2016

According to F.O. Licht's forecast on November 14, 2016, the 2016/17 output will increase by 1.6%, from 174.6 million tons to 177.4 million tons. Consumption will increase by 1.46% from 181 million tons to 183.7 million tons. Consequently, the world sugar supply will be short, with ending stock for the year 2016/17 decreasing from 70.6 million tons to 62.5 million tons. In Asia, it is forecasted that in 2016/17 demand for sugar within the region will overtake supply, causing a shortage of 26 million tons. However, this figure is subject to changed in demand, supply, and many other external factors.

Moreover the uncontrollable changes in climates such as flooding, drought, or severe cold in countries where sugar is produced can have a significant impact on the availability of sugar in the market and consequently affect on the price of sugar sold.

For a trend in sugar price can also depends on output quantities from major producer countries, such as Brazil expect to have same volume of sugar compare to previous year and as long as sugar price parity is attractive, Brazilian sugar mills will produce more sugar/rthanol ratio than the previous year. However apart from sugar price, the other factor is oil price which may be the key to make them reconsider to produce more ethanol instead (currently, they produce 45% sugar 55% ethanol). For Thailand, due to a drought at the beginning of last year affected 2017/16 output, the production is expected to be close to the output in 2016. China and India expect to have less production and sugar deficit in 2017. Especially China has to import approximately 4 – 5 million tons every year. Consequently the sugar price keep rally since the end of 2016. The effect of global stock to consumption ratio at 34% which is considerably low level and global 2017/18 production might not compensate this deficit within a year.

Other global economic factors affect world sugar price such as president election in US, Fed rate hike, slow economic growth in China, the economic problems in Brazil that cause the devaluation of its currency compared to USD, shifting investing strategies from investment funds, changes in oil prices, and falling commodity prices.

Chart 2.2: World Sugar Price (NYBOT#11) During Last 10 Years



Unofficial Translation

Furthermore, export channels of Thai sugar manufacturers are divided into:

1. Thai sugar manufacturers sell their sugar through major traders such as Cargill, Tate & Lyle, Kerry, etc. The traders then sell the sugar to other overseas buyers. Risk of failure to collect payments and complications in export management are minimized. Thai sugar manufacturers' only responsibility is to transport their sugar to ports of exports, such as FOB ports of Bangkok and Lamchabang.
2. Thai sugar manufacturers export their products to neighboring countries, such as Laos and Cambodia, through borders. A small amount of sugar is sold to vendors at borders.
3. Thai sugar manufacturers sell to manufacturers who use sugar in production of their exports. When domestic sugar prices are higher than those in international markets, the export manufacturers who use sugar as a production material lose their competitiveness in the world market. To promote investment in the food industry and competitiveness, the government allows those who manufacture exports to buy sugar at the world' market prices conditionally.

#### Domestic Marketing and Industry Overview

Domestic sugarcane and sugar industries are governed by Thai Sugarcane and Sugar Industry Act B.E. 2527. Office of the Cane and Sugar Board is in charge of ensuring adequacy of sugar for the domestic demand. Every year the board estimates the domestic sugar consumption amount and determines quotas for sugar factories according to their capacity. Domestic sugar prices are controlled by Goods and Services Act B.E. 2542. Current domestic sugar price are mandated that:

- (1) Prices of regular white sugar purchased at sugar factories do not exceed Baht 1,900 per 100-kilogram sack.
- (2) Prices of refined white sugar purchased at sugar factories do not exceed Baht 2,000 per 100-kilogram sack.
- (3) Wholesale prices of regular white sugar at all domestic wholesale businesses do not exceed Baht 1,965 per 100-kilogram sack, and those of refined white sugar do not exceed Baht 2,065 per 100-kilogram sack.
- (4) Retail prices of regular white sugar at retail businesses in Bangkok, Nonthaburi, Pahumthani, Samutprakarn, and Samutsakorn do not exceed Baht 21.50 per kilogram; and those of refined white sugar do not exceed Baht 22.50 per kilogram. (included VAT)

The price control does not apply to sugar cubes in boxes or packets that do not weigh over 10 grams.

#### Competition Situation and Competitors

In 2016, there are 52 operating sugar factories (exclude non-operating and new license sugar factories which is not yet constructed) in Thailand with sugarcane crushing capacity of 94 million tons/year and sugar manufacturing capacity of 9.8 million tons/year (depending on yearly sugarcane

amounts in the crushing process and sugarcane quality). The crushing process lasts about 4 - 6 months each year due to small amounts of sugarcanes entering the process. It begins in November and ends in April or May. The numbers of sugar factories are under government control. Licenses from Office of the Cane and Sugar Board and Department of Industrial Works, Ministry of Industry, are required for sugar factories in increasing capacity, moving factories, or operating new sugar factories.

In 2016, all 52 sugar factories are opened for operation. Most of these factories are part of the five major groups of sugar manufacturers and only a handful of small manufacturers operate independently. The KSL Group is the 3<sup>rd</sup> largest sugar producer in Thailand, with 8 % market share. It has 5 factories (In 2012, KSL operates 4 factories since the new one just finish construction) located in three regions: Northeast (2 factories), Western (2 factories), and Eastern (1 factory). Table 2.3 shows sales of different types of sugar in the past 3 years as well as ratios of sales in export markets to domestic markets.

Table 2.3: Sales of Different Types of Sugar and Ratio of Domestic Sugar to Total Sugar Sales in the Past 3 Years

Sale Volume & Price	Volume Unit	2016 Avg. Price THB / unit	Value M THB	Volume Unit	2015 Avg. Price THB / unit	Value M THB	Volume Unit	2014 Avg. Price THB / unit	Value M THB
Sugar	875,841	14,939	13,084	923,267	14,008	12,933	836,701	15,721	13,154
Domestic	219,304	19,532	4,284	209,571	19,592	4,106	177,057	19,887	3,521
Export	656,537	13,405	8,801	713,697	12,368	8,827	659,644	14,603	9,633
% Domestic Sale/Total Sale	25%			23%			21%		

## Sugar: Product and Service Provision

### Raw Material Provision Policy

Providing raw materials for manufacturing is a vital process for sugar producers. As the total capacity of the Thai sugar industry exceeds domestic sugarcane produce, all the sugar factories need to ensure that the maximum amount of cane is provided for their production in order to reduce their fixed cost per unit. The main solution employed by most sugar manufacturers is providing financial support to farmers, which is known as the “Geaw” system. Agreements of the sugar producers’ advance purchase of sugarcanes from the supported farmers are made, allowing the farmers to apply for loans from the sugar manufacturers. The loans are used for sugarcane cultivation. Harvested sugarcanes, then, are delivered to the factories and the sugarcane costs are deducted from the loans.

The company’s strategy is giving long-term benefits as incentives to the sugarcane farmers providing their crops to the corporate factories. This promotes both the growth of the farmers’ incomes and the company. The main policy “Prosperity of farmers is prosperity of the factory”, especially employed in the northeast, emphasizes creating and promoting a sustainable way to make a living for sugarcane farmers, as well as eliminating middlemen known as “Quota Heads”. This effort allows the company to learn about problems experienced by the farmers and provide them suitable assistance. Also, the company provides the farmers equipment, knowledge and production support, such as

providing loans for purchasing trucks; giving them filter cakes for making fertilizers free of charge; and providing experts in sugarcane cultivation, and prevention and elimination of crop pests. The support enhances good relationships between the farmers and the company, as well as systematic growth.

#### Production policy

The company focuses on maximizing the volume of white sugar and refined white sugar manufactured, as the two products have the highest selling prices with the highest profit. It also focuses on the improvement of production efficiency. Production efficiency that is higher than the average of the industry will help reduce unit cost. As a result, the company will be more competitive.

#### Marketing policy

Due to the fact that sugar prices in domestic consumer markets are controlled by the Government, the company emphasizes direct sale to industries with product quality and on-time delivery promises. Most of the customers are businesses in beverage and confectionary industries.

The company, moreover, emphasizes the sale of its sugar products to food product re-exporters, as it allows the sale of C quota sugar which yields better profit than regular exports while requires lower transport cost.

#### Environmental effects

The sugar manufacturing process causes wastewater and dust from ash in the steamer's burning process. The company is well aware of such effects and has employed appropriate measures to prevent environmental problems, in compliance with standards issued by Ministry of Industry.

#### **Sugar: Works Not Submitted**

- None -

### Ethanol : Product Characteristics

KSL Green Innovation PCL or previously named Khon Kaen Alcohol Co., Ltd., a subsidiary of Khon Kaen Sugar Industry Public Company Limited, produces and sells ethanol to oil companies. The ethanol is combined with gasoline at 10, 20 and 85 % to produce the final product commonly called gasohol.

### Ethanol : Marketing and Competition

#### Domestic Marketing and Industry Overview

Since the first quarter of 2013, ethanol consumption in Thailand significantly increased due to Thai government cancelled Gasoline 91 and mandate usage of Gasohol 91 (Mixing 10% ethanol). As shown in Table 2.4. The promotion of the usage of gasohol as an alternative energy source allowed continuous growth for the ethanol market. Currently, average 4 million liters of ethanol per day is mixed in gasoline. The amounts of ethanol used to mix with gasoline for gasohol production is shown in Table 2.5.

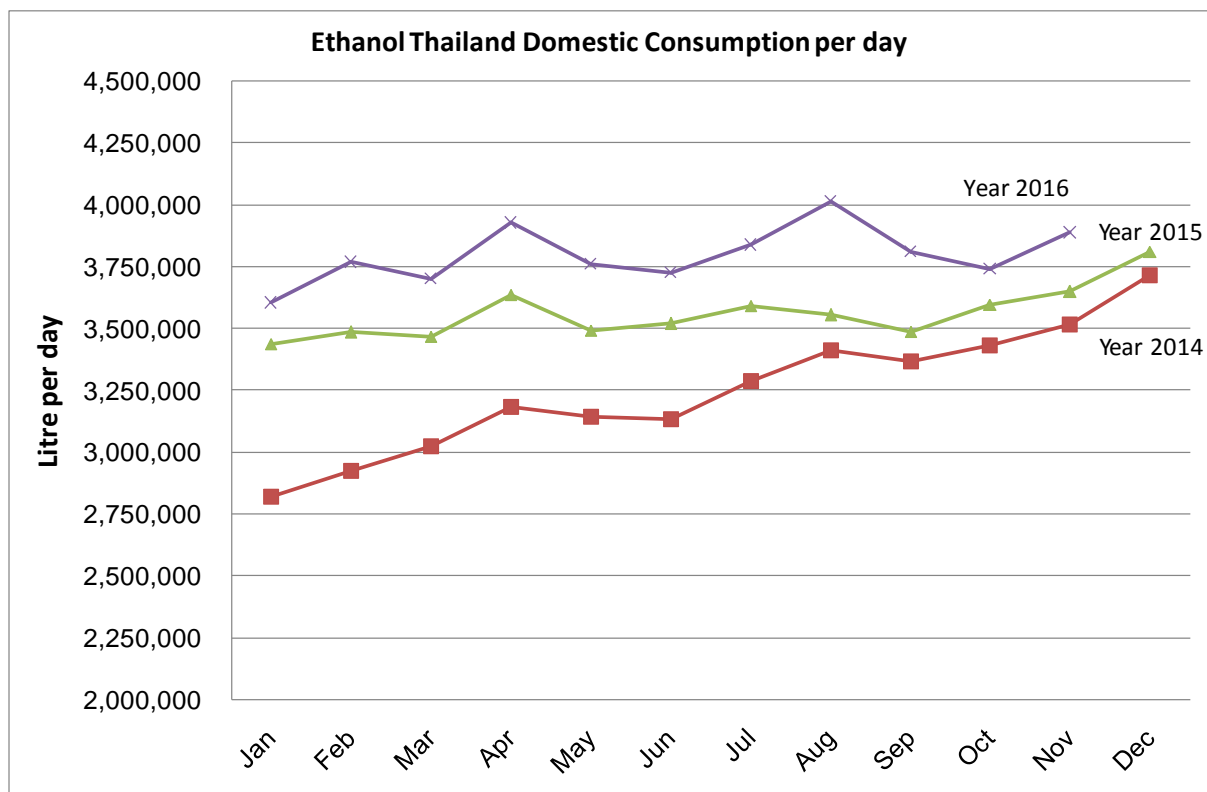
Table 2.4: Selling Price Structure of Gasohol

#### **PRICE STRUCTURE OF PETROLEUM IN BANGKOK, January 9, 2017**

<b>THB / Litre</b>	<b>EX</b>	<b>TAX</b>	<b>OIL</b>	<b>CONSV.</b>	<b>WHOLE</b>	<b>MARKET</b>	<b>VAT</b>	<b>RETAIL</b>
	<b>REFIN</b>		<b>FUND(1)</b>	<b>FUND</b>	<b>SALE+VAT</b>	<b>MARGIN</b>		<b>PRICE</b>
<b>ULG 95 R</b>	<b>16.80</b>	<b>6.50</b>	<b>6.31</b>	<b>0.25</b>	<b>32.64</b>	<b>2.26</b>	<b>0.16</b>	<b>35.06</b>
<b>GASOHOL 95 E10</b>	<b>17.57</b>	<b>5.85</b>	<b>0.35</b>	<b>0.25</b>	<b>26.33</b>	<b>1.52</b>	<b>0.11</b>	<b>27.95</b>
<b>GASOHOL 95 E20</b>	<b>18.30</b>	<b>5.20</b>	<b>3.00</b>	<b>0.25</b>	<b>22.76</b>	<b>2.51</b>	<b>0.18</b>	<b>25.44</b>
<b>GASOHOL 91 E10</b>	<b>17.32</b>	<b>5.85</b>	<b>0.35</b>	<b>0.25</b>	<b>26.06</b>	<b>1.51</b>	<b>0.11</b>	<b>27.68</b>
<b>GASOHOL E85</b>	<b>21.50</b>	<b>0.98</b>	<b>9.35</b>	<b>0.25</b>	<b>14.42</b>	<b>5.49</b>	<b>0.38</b>	<b>20.29</b>

Source: Energy Policy and Planning Office, Ministry of Energy

Chart 2.5: Quantity of Ethanol Used to Mix with Gasoline as Gasohol



Source: Department of Energy Business, Ministry of Energy

#### International Marketing and Industry Overview

Brazil is the world's major ethanol producer and exporter. Primarily, ethanol is produced from sugarcane. It can be used as fuel for car by mixing with gasoline at the ratio of 20 – 25 % or purely 100 % with specially designed cars. The Brazilian government has a policy to promote the use and manufacture of cars that run with ethanol 100 %. There is a control over the production and demand for ethanol through changing the amount of ethanol content in gasoline.

#### Competition situation and competitors

In 2016, ethanol price decreased compare to previous year due to the competitiveness of cassava-based ethanol producer increased from lower price of cassava which increased a lot of supply for awhile in 2016 however ethanol demand continue to increase every year, therefore demand-supply of ethanol is quite tight and also ethanol stock is not enough. As a result, for 2017, the Company expects average selling price will be improve while sales volume may slightly improve.

Table 2.6: Sales Volume and Average Selling Price of Ethanol in the Past 3 Years

	2016	2015	2014
Sale Volume (Liters)	85,443,140	97,116,975	91,606,665
Avg. selling price (Baht/Liter)	23.56	25.71	25.92

### **Ethanol: Product and Service Provision**

#### Raw material provision policy

The company's ethanol plants purchase the raw material, molasses, from sugar factories of KSL (the holding company) at the market price. A one-year agreement is made in advance. If the KSL factories do not have enough molasses, the raw material is purchased from nearby sugar factories. For more flexible raw material management the company invested in facilities that allow the production of ethanol from cassava flour and other cassava-related products. This is to ensure that there is sufficient raw material and that production cost is manageable. If the world's sugar prices drop, sugarcane juice from the KSL group's sugar factories can be used as raw material in ethanol production.

#### Production policy

The company minimizes its costs by ensuring economy of scale, flexibility in using cheap raw materials and cost reduction. Expenses are minimized, such as using wastewater in producing organic fertilizer. Corporate resources are shared, such as personnel of sugar factory, or the Group purchasing energy from its own power plant. Leasing molasses storage tanks reduces the cost of investing them. Purchasing molasses at the factories helps save transport costs.

Being able to produce the raw material, molasses, within the group allows the consistency of the quality of the material and more production effectiveness. Contaminants are reduced. Molasses storage tanks are appropriately temperature controlled, allowing highly effective production.

#### Marketing policy

Ethanol is an industrial product. It is used as a material in producing gasohol. Consistency in quality, standard, and availability are very important. The company ensures that its production meets those requirements by exercising quality assurance. Part of the ethanol produced is stored in tanks for sale during the period when the operation is ceased for annual machinery repair and maintenance.

Environmental effects

The production of ethanol generates wastewater. The company uses the wastewater from ethanol production process to mix with filter cake from the group's sugar factories to make organic fertilizer. The fertilizer is then sold to farmers. Hence, the company is able to minimize its negative impact on the environment.

**Ethanol: Works Not Submitted**

- None -

**Electricity and Steam Product Characteristic**

The project has been undertaken by Khon Kaen Sugar Power Plant Co., Ltd who sells electricity and steam to factories within the group as well as selling any excess electricity produced to Electricity Generating Authority of Thailand (EGAT) and Provincial Electricity Authority (PEA). Currently, the group operates 3 power plants. The first power plant is located near to Khon Kaen Sugar Factory in Nampong district of Khon Kaen province. It can produce up to 65 MW, 20 MW of which is sold to EGAT. The second power plant is located near to New Krungthai Sugar Factory in BoPloy, Kanchanaburi. It can produce up to 90 MW, 30 MW of which is sold to EGAT. The third power plant is located near to Khon Kaen Sugar Factory in Wangsapung, Loei province. It has the capacity to produce 40 MW.

**Electricity and Steam Market and Competition**

The electricity and steam generated is first sold to the KSL Group's plants so that it can be used to produce sugar and ethanol. The excess electricity produced is then sold to Electricity Generating Authority of Thailand (EGAT) and Provincial Electricity Authority (PEA) through long-term contract and therefore has limited number of competitor and reliable customer. A 100% of electricity and steam produce is sold domestically.

Table 2.7 Sales Volume and Average Selling Price of Electricity in the Past 3 Years

	<b>2016</b>	<b>2015</b>	<b>2014</b>
Sale Volume (MW-hour)	275,456	300,292	324,099
Avg. selling price (THB/MW-hour)	2,935	3,368	3,520

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## **Electricity and Steam: Product and Service Provision**

### Raw material provision policy

Raw material procurement is crucial in operating the electricity generating business. The corporate power plant is mainly fueled by bagasse. Each year, the Group crushed sugarcane fluctuates. A limited amount of crushed sugarcane may affect the fuel amount available for the power plant's electricity generating. Thus, Khon Kaen Sugar Power Plant has prepared purchasing biomass fuel sources, such as bagasse from nearby plants.

### Production policy

#### (1) Cost Management

The Khon Kaen Sugar Power Plant committed to minimize its production cost. Costs of electricity generating and steam energy production include fuel and depreciation. Fuel efficiency is, hence, crucial. The company also ensures economy of scale to reduce its unit cost.

#### (2) Improving and Developing Production Effectiveness

The quality of fuel is effectively controlled, as the company uses its own bagasse. Fuel efficiency is ensured by controlling moisture in bagasse using such methods as bagasse dryer system and setting up roofs to protect the material from the rain.

### Marketing policy

The long-term agreement between the company and EGAT allows the electricity produced to be priced based on natural gas prices and exchange rates. The sale unit price increases at the time when EGAT's demand for electricity is high. Electricity sold to the companies in the KSL Group is priced at the same rate as that sold to EGAT.

### Environmental effects

Extensive Environmental Impact Assessment (EIA) has been carried out. The facilities in Khon Kaen has been registered with CDM Executive Board as a CDM project (under the Kyoto Protocol). The company has the right to sell its carbon credits if and when the UNFCCC officially count and certify the amount of carbon it help reduced.

**Electricity & Steam: Works Not Submitted**

- None -

### **3. RISK FACTORS**

Significant risk factors in the operation of the sugar business of the company, which may have affect on the return on investment by the shareholders, can be summarized as follows.

#### **3.1) Risk factors in Raw Material Sourcing – Sugarcane**

Khon Kaen Sugar Industry Public Company Limited produces sugar which use sugarcane as raw material. The company has also invested in other related projects, which use by products and wastes generated from the sugar manufacturing process, to create added value. Therefore, the quantity of sugarcane available for crushing is the most important factor affecting the operations of the company.

There are two main reasons that cause fluctuations in the quantity of sugarcane, viz. (1) changes in the acreage under sugarcane plantation which may depend on the price agreed for the cane and whether it is worthwhile for the farmers to grow sugarcane compared to other agricultural crops as well as the promotional policies of the Government and (2) changes in the yield of sugarcane (ton(s) of cane per rai) which may occur due to climate change conditions, such as drought and flood, caused by global warming.

When the quantity of sugarcane crushed reduces, the effect on the company is that the quantity of sugar produced goes down, the unit cost, especially the fixed cost per unit, goes up, the profit per unit reduces and the company's overall profit is reduced. In addition, in those years when the sugarcane crushed is low, there is increased competition among sugar factories to purchase the sugar cane locating in the neighborhood area. Therefore, in order to protect their crushing quantities, sugar factories have to vie by paying more than the price, established by revenue sharing system. This increases the overall raw material cost for the company.

Thailand is one of the world's leading sugar exporters and is the leading sugar supplier to the Asian region. Decreased amounts of cane crushed in Thailand result in lower sugar quantities available for exportation. Export prices, consequently, increase. Such increase relieves the impact of decreased quantities of cane crushed and burden of increased costs. The company, furthermore, values stability of sugarcane supplies. To ensure the sustained supplies, the company offers assistance to sugarcane farmers, such as loans for planting sugarcane crop, support in procuring inputs for farming, providing irrigation systems, introducing technology to increase yields and efficiency in cultivation, and reducing the influence of middle men in sugarcane sales and purchase deals. All the assistance is provided for the farmers in an attempt to help them improve their lives.

#### **3.2) Risk from Sugar Price Fluctuation in the World Market**

While considering sugar trade in the world markets, it can be said that sugar has high price fluctuations when compared with other agricultural products. The world sugar prices depend on several factors, such as demand and supply of countries that are producers, consumers, exporters and importers. Traders' speculations are in relation to climatic conditions facilitating cultivation in each of

the respective countries. Government policies on promoting, interfering, exporting and importing sugar, particularly in developed countries also determine pricing in the industry. At present, sugar prices are also interrelated to oil prices. Both sugarcane and molasses can be used to produce a type of alcohol called ethanol. Ethanol can be blended with gasoline to produce fuel. All the above factors cause high fluctuations in the world sugar prices.

Generally, sugar companies in Thailand are bound to meet the domestic demand first. The balance sugar can be exported. Every year, the Office of the Cane and Sugar Board estimates the quantity of domestic demand for sugar, called Quota A, and allocates this Quota to all the sugar factories based on their respective sugar production. The ratio of domestic sales to exports of all sugar factories is therefore quite similar, usually in the range of 20:80 to 30:70 depending on the sugarcane available for crushing all over the country. The sales of the sugar industry fluctuate according to world sugar prices in the 70 – 80% range. However, regarding on the cost of production, the cane price is the major cost, calculated by the formula based on the revenue sharing system 70:30. This means that when the sugar price has decreased 100 THB, the farmer should get the 70% impact in term of lower sugar cane price and the sugar factory should get 30% impact.

During the past 3-4 years, the world sugar price was very volatile. It can be seen from the average future price around 15 cents/lb surged to be around 32 cents/lb and it used to be trade at 25, 20, and 15 cent/lb. Sugar price has fallen to its lowest at 10-11 cent/lb in the second half of 2015. From the beginning of 2016 sugar price rebounded to 21 – 23 cent/lb. With severe price fluctuations, if the company were not able to establish a selling price that was higher than the price level for setting cane prices, the corporate operating results would have been severely affected. To prevent the risk posed by sugar price volatility in the world market, the company entered into a sugar futures contract with a financial institution. The risk hedging procedure would allow the company to minimize the dependency of its profitability on the risk posed by sugar price volatility. However, this could affect profit and loss account recording, and there was a risk that the amount hedged through the sugar futures contract could exceed the actual volume of sugar exported. This oversold condition could result in a loss.

Previously, the fluctuations in the world sugar price had a strong influence in the company's operations and profitability as it focused its businesses mainly on sugar and molasses. Since the company invested in other related industries such as ethanol, organic-fertilizer, and power plant, the risks it faced from sugar price fluctuations is drastically reduced and allow the company to operate in businesses that are more profitable and less dependent on world market price.

### **3.3) Risk from Government Policy**

The sugarcane and sugar industry in Thailand is under the supervision and control of the Office of the Cane and Sugar Board under the Cane and Sugar Act 1984. The Board regulates the amount of sugar produced by a quota system (Quota A for domestic sales, Quota B and C for sugar exports), controls the domestic price, regulates on the ratio of distribution of revenue from the sugar business between the farmers and sugar factories, with the revenues sharing in the ratio of 70:30, controls on the entry of new players in the sugar business etc. It is evident that the rules and regulations enacted by the

Cane and Sugar Board have an impact on the production costs and the operations of the company. For example, the revenues sharing system 70:30 ratio determines the sugar cane price which the sugar factories must pay to the farmers. In case, changes in the domestic sugar prices or changes in regulation of entire sugar industry, it will have a definite impact on the operations of the company.

Other overall Government policies also have an impact on the company's business. For example, the decision to promote the renewable energy, such as ethanol, has secured the domestic sale volume. The policy to promote the planting of oil palm trees or price guarantees for cassava have negative impact on the company since the area under sugar cane plantation will reduce and farmers will switch to growing alternative crops with better returns.

The Company realizes the importance of government policies in shaping directions of cane and sugar industry. Hence, it has collaborated with three sugar factories associations and associations of sugarcane farmers to enhance the government understanding of cane and sugar industry and its significance. The industry is a precursor of the food and processed food industries. Ethanol derived from sugar production can be used as fuel energy. Ethanol is a pure alcohol that can also be used as a starting point for production of other chemicals. Exporting sugar brings in foreign income and almost does not require import costs and expenses. This differentiates the sugar industry from other industries.

Sugarcane is Thailand's important economic crop in which every part of it can be utilized. Communication, explanation and understanding between the government and the sugar industry can reduce the risk potentially posed by government policies affecting directions of sugarcane and sugar industries.

During May 2016, Brazilian government has filed to with the World Trade Organization (WTO) by accusing Thai government on subsidy policy for sugar which adversely affects sugar industry in Brazil. Thai government currently negotiates with Brazilian government to compromise this issue by presenting sugar industry reformation plan.

The Company realized that the regulatory risk might affect industry outlook therefore company incorporate with Thai sugar association and also farmer association to explain to regulator and government to solve this problem together for national benefit.

### **3.4) Risk of Bad Debts Arising from Credit Given to Farmers (Advanced Credit)**

In the operation of a sugar factory, the factories provide loans or other kinds of financial support to sugarcane farmers as working capital to plant sugarcane crop, or what is called "advanced credit", thereby reserving the sugarcane for crushing. After the sugarcane crop is ready for harvesting and the sugar factories are ready to start crushing the cane, the farmers harvest the cane and send it to the sugar factories and receive payment for the value of the cane supplied after the loans and other financial support given is deducted. The risks that are generated from such credit can come from reduced volume of sugarcane in any year due to drought conditions, losses from crop disease and pestilence, farmers refusing to send the cane to the sugar factories etc. Such liabilities, arising from

sugarcane credit, can adversely affect the company's operations requiring higher amounts of provisioning for bad debts.

However, by track record, level of bad debt is low because the company not only concerns the above risk factors but also improves in the sugarcane credit system. The company has bought a satellite monitoring system (Global Positioning System – GPS) to survey the sugarcane plantation areas, which helps in reducing the problems of ownership of sugarcane fields. The system is also used to plan for sourcing more sugarcane. The company also encourages farmers to deposit assets as collateral for the loans advanced. All this has resulted in the company having a low bad debt situation at present and the major debts are adequately covered with the pledged assets.

### **3.5) Exchange Rate Risk**

The volatility of exchange rate poses a significant risk to the company's operation. The company exports about 70-80% of its total sugar sales. The company also imports tools and machinery, and conduct operations in neighboring country. The company tries to reduce its exchange rate risks by making currency forward contracts. The company has natural hedging mechanism under the 70:30 revenue sharing scheme that links the sugar price (revenue) and cane price (cost) together, thus making both prices move in the same direction and exposing both to the same exchange rate fluctuation. Moreover, the company closely monitors exchange rate fluctuation to be able to react to changes in a timely manner.

### **3.6) Risk of having major shareholders controlling the votes of at the Shareholders' meeting**

The Chinthammit and his company hold more than 60% of total paid up share capital of the company. Therefore, the Chinthammit Group and his company can control all the proceedings of the shareholders meetings whether it is the appointment of Directors or whether it is to seek approvals on other matters that require majority votes, except for special agendas which, by law or by the articles of association of the company, require 75% vote in shareholders' meetings. Therefore, it is difficult for other shareholders to collect enough votes to investigate or counterbalance the issues raised by the majority shareholders.

However, for the company's transparency and power balancing, the company has appointed 4 independent committee members for checking the operations of the company. Thus, power balancing for operation in the company is reasonable. In addition, the company also has also set up an independent internal control team which reports directly to the audit committee.

### **3.7) Risk from the World's Economic and Financial Situations**

The EU financial crises and oil price collapse caused a lot of problems for oil producers and negatively affected economies worldwide. Natural disasters and terrorist attacks also add more pressure to the world's economy. There is no guarantee that these issues and similar circumstances in the future

will not affect our businesses, the world's sugar prices and/or ethanol price. The lack of liquidity among financial institutions may also affect the Group's sources of loans and financing costs.

KSL has implemented its financial policies well. Its D/E has been at an appropriate level. The company has maintained good relationships with all the banks that are long-term corporate business partners. All the corporate businesses will be handled carefully in order to minimize the future probable effect of the world's financial and economic conditions on the company.

### **3.8) Risk from Laos & Cambodia Projects**

The projects in both countries are part of the first offshore sugar business in which the company is granted the concession area for cane plantation from the government and permitted to construct sugar factories. But land condition in concession area has low quality, lack of technology for large plantation, lack of infrastructure and human resources therefore the projects take longer time for develop than the first plan. Consequently the productions still not reach break-even point and in 2016 both projects had loss. However the company has witnessed and solved various problems throughout the years. The company hired consultants to develop not only planting technology but also management system to control budget. Moreover the company provides loan to local farmers and suppliers to expand more plantation. After continuously developing infrastructures and land condition in the past, the projects show improvement and potential for good return on investment in the future.

Additionally, there are risks associated with doing projects abroad which extend beyond agricultural risks relating to cane growing and sugar production and include risks from political turmoil and instability, local community dispute, and different law and regulations that often changes and are somewhat ambiguous. The company is aware of these risks and is trying to manage it efficiently and appropriately.

#### **4. Operating Assets**

##### **4.1) Core Operating Assets of the company and its subsidiaries**

As of 31 October 2016, the company and its subsidiaries have core operating assets, as followings:

Items	Area (estimated number)	Ownership	Net Book Value (THB Million)	Encumbrance
1. Land & Land Development (Rai) Land for factory location.				
- Khon Kaen Sugar Industry	1,362.32	Owner	926.86	
- Tamaka Sugar Industry	239.19	Owner	611.34	
- New Krung Thai Sugar Factory	1,547.34	Owner	539.02	
- New Kwang Soon Lee Sugar	219.86	Owner	80.18	
- KSL Green Innovation PCL	276.88	Owner	83.54	
- Khon Kaen Sugar Power Plant Co., Ltd.	420.15	Owner	141.30	
- KSL Material Supply Co., Ltd.	673.45	Owner	219.51	
Cane Plantation Area	10,297.65	Owner	407.68	
Office Lands		Owner		
Other Lands	98,981.35	Owner	1,513.33	Some in Loan Collateral
Total	114,018.20	Owner	4,303.25	
2. Factory Building and Construction		Owner	4,984.69	Some in Loan Collateral
3. Machinery and Equipment		Owner	14,271.44	Some in Loan Collateral
4. Motor Vehicle and Labors saving device		Owner	746.32	
5. Furniture and Office Equipment		Owner	55.70	
6. Assets in Construction		Owner	1,668.08	
Total			26,029.48	

## 4.2) Intangible Assets

### Trademarks

Key trademarks of Khon Kaen Sugar Industry Public Company and subsidiaries are registered at The Department of Intellectual Property, as followings:



### BOI Certificates

On 31 October 2016, Three domestic subsidiary companies received 5 investment promotion certificates from the Board of Investment of Thailand (BOI) under the Investment Promotion Act B.E. 2520. The benefits includes the exception of income tax for profit for the year derived from operation of promoted businesses for the period of 8 years commencing from the first date of income received from the promoted business. The details are as follows:-

<u>Certificate No.</u>	<u>Sections Privilege</u>	<u>Date</u>	<u>Promoted activity types</u>	<u>Commenced date</u>	<u>Expire date</u>
				<u>of revenues generated</u>	
1062(2)/2552	25, 26, 28, 31, 34, 35(3), 36(1), and 36(2)	January 30, 2009	- Production of pure alcohol or fuel from agricultural products, including scraps, garbage or waste	Income not yet derived	
			- Production of biological fertilizers or organic fertilizers	Income not yet derived	
1063(2)/2552	25, 26, 28, 31, 34, 35(3), 36(1), and 36(2)	January 30, 2009	- Production of pure alcohol or fuel from agricultural products, including scraps, garbage or waste	December 6, 2011	December 31, 2019
			- Production of biological fertilizers or organic fertilizers	December 30, 2011	December 31, 2019
			- Production of biological	February 29, 2012	December 31, 2019
2364(1)/2554	25, 26, 28, 31, 34, 35(1), 35(2), and 35(3)	September 20, 2011	- Production of biological	February 28, 2013	February 28, 2021
1432(2)/2552	25, 26, 28, 31(1), 31(2), 31(3), 31(4), 34, 35(1), 35(2) and 35(3)	June 24, 2009	- Production of electricity, power steams and water for manufacture	November 30, 2010	November 29, 2018
1349(2)/2556	25 26 28 31(1) 31(2) 31(3) 31(4) 34 35(1) 35(2) and 35(3)	Mach 15, 2013	- Production of electricity, power steams and water for manufacture	January 21, 2014	January 20, 2022

Furthermore, in accordance with the Promotion Certificate No.2364(1)/2554, 1432(2)/2552, and 1349(2)2556, the subsidiary receives the privilege in 50% income tax reduction of the regular rate for the period of 5 years commencing from the expiration date of income tax exemption.

Three foreign subsidiaries are granted by foreign investment certificate and tax privilege from Lao People's Democratic Republic (the 1<sup>st</sup> Certificate) and from Kingdom of Cambodia (the 2<sup>nd</sup>-4<sup>th</sup> Certificates) which the details are as follows:

- 1) Foreign Investment Certificate No. 017-06/ Khor Lor Tor includes tax privilege for exemption from income tax for 5 years from the date of first receiving revenue from sales of sugar, thereafter, the subsidiary shall pay income tax at the rate of 20%. The revenue is first derived on July 21, 2010 and will expire on July 20, 2015.
- 2) Foreign Investment Certificate No. 4420/06 Ghor. Wor. Ghor. dated December 15, 2006 and No. 4342/07 Ghor. Wor. Ghor. dated November 20, 2007 issued by the Council for the Development of Cambodia, the subsidiary is granted by tax privilege for exemption from import the duties for machinery for manufacturing and construction materials.
- 3) Foreign Investment Certificate No. 1641/09 Ghor. Wor. Ghor. and No. 1642/09 Ghor. Wor. Ghor. dated July 28, 2009 issued by the Council for the Development of Cambodia, the subsidiary is granted tax privilege for exemption from income tax for the period of 8 years, including priority period commencing from the period when subsidiary is operated (year 2006).
- 4) Tax Exemption Certificate for agriculture-industrial (sugar cane) No. 2299 dated April 12, 2013 issued by the Ministry of Economy and Finance, Cambodia, grants the privilege to charge value-added tax at 0% for sales of sugar cane to manufacture sugar for export. This certificate is valid for the period of 1 year from August 1, 2015 to July 31, 2016.

#### **4.3) Investment and Management Policy for subsidiaries and affiliates**

As of October 31, 2016, the company invests in both direct and indirect 19 subsidiaries and 1 affiliate, as followings:

##### **Subsidiaries (The company holds the shares directly)**

- 1) Tamaka Sugar Industry Co.,Ltd
- 2) New Krung Thai Sugar Factory Co.,Ltd
- 3) New Kwang Soon Lee Sugar Factory co.,Ltd
- 4) KSL Real Estate Co.,Ltd

- 5) KSL Export Trading Co.,Ltd
- 6) Khon Kaen Sugar Power Plant Co.,Ltd
- 7) KSL Green Innovation PCL (or previously named Khon Kaen Alcohol Co.,Ltd)
- 8) KSL Material Supplies Co., Ltd.
- 9) KSL Agro and Trading Co., Ltd.
- 10) Savannakhet Sugar Co.,Ltd
- 11) Koh Kong Sugar Industry Co.,Ltd
- 12) Wynn In Trading Co.,Ltd
- 13) WSP Logistics Co., Ltd.

**Subsidiaries (The company holds the shares indirectly through Wynn In Trading Co., Ltd.)**

- 14) Koh Kong Plantation Co., Ltd.

**Affiliate**

- 1) Thai Sugar Terminal PCL

For the subsidiaries that the company holds its shares directly, the company has controlling power through holding more than 50 % of shares.

The company has the policy to invest in the business related to sugar business, sweetener business or other business that gives the benefit and reasonable return to core business. The criteria for the investment will be based on competitive advantage, reasonable return, the amount of money to invest. In addition, considering the proportionate of investment will be depended on many factors, such as, how significant the expertise of business is. If the business needs special experiences significantly and the company has no or less experience, the company will let other strategic partners holding the share in higher proportion. However; if the company has the investment in high proportion, the company will assign its own representatives to participate in a position of company directors or a position of top management. In addition all of company investment must be approved by the board of director and there should not be the conflict of interest with the parent company in the future.

The company also have Non-financial KPIs such as Market share, Customer satisfaction

KSL has been certified ISO9001:2000, therefore the company have to survey Customer satisfaction both domestic and international survey which cover areas of Quality, Services and others to assess and

improve satisfaction. The company have target to get score at least 94 out of 100. The result in the lasr 3 years as follow;

Satisfaction Survey	2014	2015	2016
Domestic	95.10	94.60	96.51
International	96.67	95.60	95.21

For Market share in Sugar production ,in Thailand

	2014	2015	2016
Production	882,404 Ton	903,046 Ton	774,046 Ton
% Market Share	8%	8%	8%

## **5 Legal Dispute**

As of 31 October 2016, the Company had no dispute which might have a potential negative impact in excess of 5% of the shareholders' equity per its consolidated financial statements.

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## **6. General Information and Other Information**

### **6.1) General Information**

Company Name : Khon Kaen Sugar Industry Public Company Limited

Type of business : Manufacturer of Sugar & Sugar-related products

Registered & Head Office : 503 KSL TOWER 9<sup>th</sup> Floor, Sriayudhya Road, Rajathevi,  
Bangkok, 10400 Thailand.

Company Registration Number : 0107547000214

Registration Phone number

Tel. : +662-642-6230

Fax : +662-642-6228

Website : <http://www.kslsugar.com>

## 6.2) Risk Hedging Procedure Against Sugar Price Volatility in the World Market

Thailand has the capability to produce sugar more than domestic consumptions, some of remaining sugar were exported. Ratios of domestic consumption to exportation vary each year by year - approximately from 20:80 to 40:60--depending on yearly amounts of sugar cane crushed. Then, Thailand becomes the second largest sugar exporter after Brazil. Revenue of sugar producers in Thailand is partially based on the world market sugar prices and fixed domestic sugar prices, regulated by government.

In terms of world sugar price, the policies supporting and protecting benefits of farmers, and food security policies regulate importing countries to issue measures for regulating and restricting sugar importation. These policies, issued by international government sectors, affect sugar demand in the world market. Factors related to climate uncertainty such as flooding, droughts, or severe cold in countries where sugar is produced and consumed, limited number of exporting countries, and any other events affecting the world market sugar supply also affect the world sugar prices. Furthermore, in the past 2 – 3 years, significant increase in investment by foreign funds has heightened fluctuation of sugar prices in the world market; prices are much higher or lower than fundamental factors. Sugar prices are especially volatile in years when consumption demand is close to or greater than the amount of sugar produced. Chart 6.1: World Sugar Prices in the Past 10 Years demonstrates volatility of sugar prices.

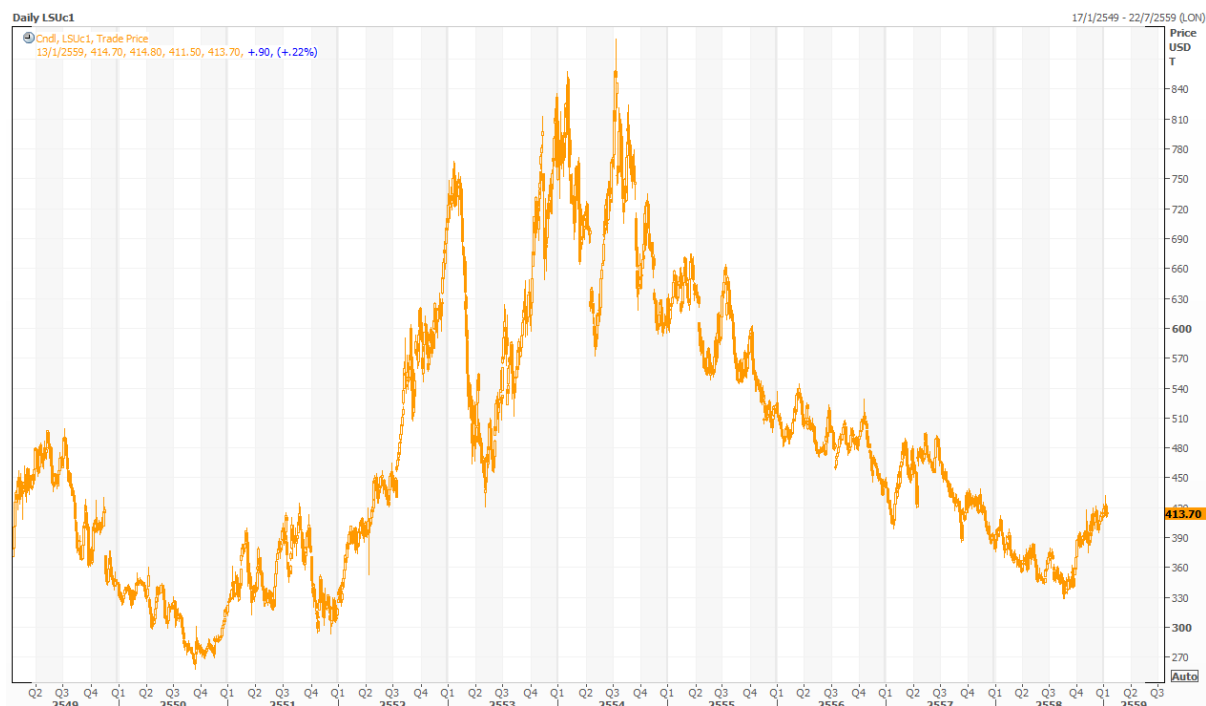
*Chart 6.1: World Sugar Prices in the Past 10 Years*

New York (NYBOT#11 – Raw Sugar)



Unofficial Translation

London (LD#5 – Refined Sugar)



Due to the fact that revenue of sugar producers in Thailand is partially based on the world sugar prices, which fluctuate significantly, the company's operating results will be affected when sugar prices in the world market drop drastically. To prevent the risk posed by sugar price volatility in the world market, the risk hedging procedure has been established with the use of risk management mechanisms and tools in the forms of futures contracts. Prices are based on those at futures markets in New York (NYBOT#11 – Raw Sugar) and London (LD#5 – Refined Sugar). Details are as follows:

#### Case 1: Normal business transactions in trading export sugar (without risk hedging)

A buyer and seller agree on a sugar price based on the market price. Once reaching an agreement, the changed world market price does not affect the agreed price and accounting recorded value. The seller records the price as agreed with the buyer, for instance:

##### In case of sugar price increase in futures market

Day 1: Sugar futures price is at 600 USD / ton :

The buyer and seller agree on a transaction of sugar at the market price of 600 USD + premium 100 USD

Day 2: Sugar futures price increases to 800 USD / ton :

The seller delivers the sugar. The buyer pays 600 USD + 100 USD premium = 700 USD  
Accounting Record: The company income generated from sugar sale is 700 USD.

Note: Premiums of sugar are based on types of sugar, delivery sites, delivery time, delivery terms, etc.

*In case of sugar price decrease in futures market*

Day 1: Sugar futures price is at 600 USD / ton :

The buyer and seller agree on a transaction of sugar at the market price of 600 USD + premium 100 USD.

Day 2: Sugar futures price decreases to 400 USD / ton :

The seller delivers the sugar. The buyer pays 600 USD + 100 USD premium = 700 USD.

Accounting Record: The company's income generated from sugar sale is 700 USD.

It can be seen that prices that buyers receive depend on the time that buyers and sellers agree to make transactions. This becomes problematic when the world sugar prices are high. Sellers are interested in selling, while buyers are not willing to buy due to high prices. When the world sugar prices are low, buyers are willing to buy. Sellers, however, consider the prices too low and are not so willing to sell. Sellers and buyers are unable to agree on prices. This method would only work if sugar prices in the world market were not volatile. High volatility of sugar price causes the sellers and/or buyers losing the opportunities to trade at their own satisfied prices.

**Case 2: Adopting risk hedging procedure for sugar price in form of sugar future contracts**

During a period when the world sugar prices are highly volatile, to prevent losing opportunities to sell at satisfied prices, sugar producers adopt risk hedging procedure in form of "sugar futures contracts" which their price are based on world sugar price. With this futures contracts, contracts are not settled by sugar delivery, but by cash settlement which paying the difference between the sugar price fixed on the day the contracts are made and the sugar price on the day the contracts are settled (unwinded). The risk hedging procedure may be carried out directly at sugar futures market through a broker or alternatively, through a financial institution as a counterparty. Examples are as follows:

*In case of sugar price decrease in futures market*

Day 1: Sugar futures price is at 600 USD / ton :

The seller is satisfied with the price at this level, but no interest from any buyer. Buyers expect the price to decrease. The seller entered into a contract with a financial institution fixing the sugar futures price at 600 USD.

Day 2: Sugar futures price decreases to 400 USD / ton :

A buyer is interested in buying. The seller sells sugar at the agreed market price of 400 USD + 100 USD premium = 500 USD. At the same time, the seller closes or unwinds the futures contract by buying back the contract at the market price of 400 USD/ton (sold at 600 USD while bought back at 400 USD), resulting in 200 USD gain.

From this example, the seller's actual income from the sugar sale is 500 USD + 200 USD gain from entering into the sugar futures contract = 700 USD. The amount equals the guaranteed price of 600 USD + 100 USD premium = 700 USD.

Accounting Record: The company generates income from sugar sale at 500 USD (which is lower than the guaranteed price of 700 USD). The 200 USD gain from entering into the sugar futures contract is recorded as other income.

*In case of sugar price increase in futures market*

Day 1: Sugar futures price is at 600 USD/ton :

The seller is satisfied with the price at this level, but receives no interest from any buyer. Buyers expect the price to decrease. The seller enters into a contract with a financial institution fixing the sugar futures price at 600 USD.

Day 2: Sugar futures price increases to 800 USD/ton :

A buyer needs sugar for use, resulting in buying at a high price. The seller sells sugar at the agreed market price of 800 USD + 100 USD premium = 900 USD. At the same time, the seller closes or unwinds the futures contract by buying back the contract at the market price of 800 USD/ton, resulting in 200 USD loss (sold at 600 USD while bought back at 800 USD).

In this example, the seller's actual income from the sugar sale is 900 USD + -200 USD loss from entering into the sugar futures contract = 700 USD. The amount equals the guaranteed price of 600 USD + 100 USD premium = 700 USD.

Accounting Record: The company generates income from sugar sale at 900 USD (which is higher than the guaranteed price of 700 USD). The -200 USD from entering into the sugar futures contract is recorded as a loss.

In all the cases, the company has the net income of 700 USD (excluding a commission paid to the financial institution). Methods of producing accounting records are, however, different. For the regular transaction, (no risk management involved), the company records 700 USD as income from sale. The concerns with this type of transaction is that at the time there may not be any buyer willing to buy, or the seller may not be willing to sell. Adopting a risk hedging tool of sugar futures contracts, if the market is in a downturn, the company will record income from the sugar sale at 500 USD, and 200 USD gain from entering into the sugar futures contract will be recorded as other income. However, during an

upturn in the market, the company will record 900 USD as income from sale and -200 USD loss from entering into the sugar futures contract.

In conclusion, entering into sugar futures contracts enable (1) buyers and sellers to trade at prices considered satisfactory by both parties without the need to wait for prices to reach the levels that buyers and sellers can agree on; and (2) the net revenue will be equal to fixed prices. If the market is experiencing a down turn, actual income from sugar sales will be low, but will be offset by gain from entering into sugar futures contracts. During an upturn, however, actual income from sugar sale will be high, while there is loss from entering into sugar futures contracts.

### **Important Concerns**

1. The times of recording actual sales may be different from those of recording gain/loss from entering into sugar futures contracts. Accounting policies of some companies, for example, record income from actual sales when sugar is delivered to customers. Gain/loss from entering into sugar futures contracts is recorded upon contract closure or unwinded. It is possible that companies will realize gain/loss from entering into sugar futures contracts before recording sales, resulting in a discrepancy between the two records produced at different periods. This outcome will be experienced significantly by companies that report their operating results in quarterly basis.

2. Adopting a risk hedging procedure for sugar price volatility in form of sugar futures contracts can insure the company against the sugar price risk on existing sugar volume and also sugar volume estimated to be produced in the future. Amounts hedged under sugar future contracts vary according to sugar production estimated to be produced in the future. However, amounts of sugar produced depend on quantities of cane crushed largely affected by climate, vast cultivation areas, and a lot of farmers. As a result, inaccuracy of estimation of sugar cane crops may be rather high.

When estimation of sugar cane crops are too high, sugar futures contracts have been made according to the estimates and later the actual outputs do not match up with the estimates, the contracts become oversold. If the sugar future price is in an upturn, there will be actual loss from sugar futures contracts made. This is due to the fact that there is no actual sale at a high price to offset. In contrast, when the sugar market price is experiencing a downturn, there will be actual gain from sugar futures contracts.