TRIS RATING
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CreditNews ข่าวเครดิต

AAPICO HITECH PLC

No. 123/2018
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CORPORATES

Company Rating:	BBB+
Outlook:	Positive

Company Rating History:

Date	Rating	Outlook/Alert
12/11/14	BBB+	Stable

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RATIONALE

TRIS Rating affirms the company rating on AAPICO Hitech PLC (AH) at "BBB+". At the same time, we revise the outlook to "positive" from "stable". The change reflects improved prospects on the company's business and earnings performance. We expect profitability will rise while the total debt to capitalization ratio will stay below 40%.

The rating continues to reflect AH's strong competitive position as a Tier-1 automotive parts manufacturer in Thailand, higher income contribution from investments in affiliates, and well controlled costs. These strengths are partially offset by rather thin profit margins and the cyclical nature of the automotive industry. The rating also takes into consideration a rise in leverage due to overseas expansion; the investment in Sakthi Global Auto Holdings Ltd. (SGAH) and the potential investment in a joint venture with VINFAST Trading & Production LLC (VINFAST). We expect the total debt to capitalization ratio will peak at about 40% and then decline gradually. AH has no major capital expenditures in the pipeline over the next few years. The investments with offshore partners are both challenges and opportunities for the company.

KEY RATING CONSIDERATIONS

Strong competitive position in the OEM auto part segment

TRIS Rating expects AH will be able to maintain its strong competitiveness in the OEM auto part segment. Revenue contribution from the OEM auto part segment accounted for 60%-70% of AH's total revenue. Despite stagnant growth in the domestic automotive industry during the last three years, revenue could grow steadily.

AH's competitiveness is attributed to its long track record in producing auto parts for several automakers. The company has no record of losing orders from its major customers. The reliability of its operations and the credibility has resulted in its strong relationships with major customers such as Isuzu, Auto Alliance (AAT; a Ford and Mazda joint venture), and Nissan. Automakers are also reluctant to change their major suppliers due to high switching costs. AH is the sole chassis frame supplier for ISUZU in Thailand. TRIS Rating expects the company will continue to receive orders from Isuzu, including new car models expected in 2020. The new car models will likely secure revenue over the next 5-10 years.

Steps toward global auto industry creates growth opportunities, but raises execution risks

TRIS Rating believes AH's strategy to expand globally will help unlock growth opportunities. Despite the solid fundamentals of the Thai automotive industry due to the strong supply chain and government supports, the growth rate has been moderate. It is difficult for AH to grow at a significantly faster pace than the domestic automotive industry because automakers rarely change suppliers.

The significant steps toward the global automotive industry are the investment in SGAH and the potential investment with VINFAST. In addition to provide investment returns, these initiatives expose AH to the global automotive industry. SGAH has several market bases such as the United States (US), India, Portugal, and China. Cooperation in the future is possible as each specializes in different types of auto parts.

The cooperation with an offshore partner is signified after AH signed a joint venture Memorandum of Understanding (MOU) with VINFAST around mid-2018. The joint venture will supply Body in White parts for the first two models of VINFAST vehicles. The joint venture's operations should be consolidated to AH, in our view, as AH will manage all the production for the joint venture. We expect the joint venture's operations will noticeably influence AH's financial statements after 2019. There could be pre-operating expenses for the joint venture next year, but the amounts should not affect AH's operating performance significantly. Before the joint venture's operations start, AH will produce and provide jigs and dies valued at about Bt1,700 million for VINFAST. This will boost AH's revenue in 2019.

The investment in SGAH and a joint venture with VINFAST are the two largest investments over the past five years. The investment in SGAH has already produced returns in the forms of shared profits and interest income. The joint venture with VINFAST is both a challenge and an opportunity for AH because both AH and VINFAST are new to the automotive business in Vietnam. A successful expansion into the global automotive market will be a plus for the rating.

Operating performance will continue improving

TRIS Rating forecasts AH's revenue and earnings will rise over the next three years. A positive momentum in the domestic automotive market, plus the recent offshore expansions, will drive growth. Our forecast assumes revenue will increase to Bt17,000-Bt19,000 million over the next three years, from about Bt16,000 million in 2017. Orders from its customers in Thailand and orders to produce jigs and dies for VINFAST vehicles will bolster revenue. Our base-case forecast does not include revenue from supplying Body in White parts under the joint venture with VINFAST.

Although AH's profit margins are rather thin, its ability to improve production efficiency and pass through raw material costs to automakers will keep profit margins stable and predictable. The operating margin has increased steadily during the last three years as AH has implemented efforts to improve its production efficiency. We expect profits will increase in the coming years, boosted by a rise in revenue and investment returns.

Our forecast assumes the operating margin (operating income before depreciation and amortization as a percentage of sales) will reach 9%-10% over the next three years, rising from 7%-9% during the past three years. A rise in production volume should lower the unit cost of production. On top of that, shared profits and interest income will increase, mostly attributed to the returns associated with the investment in SGAH. EBITDA (earnings before interest, tax, depreciation, and amortization) will likely climb to Bt2,000-Bt2,500 million during 2018-2020, from Bt1,300-Bt2,000 million during the past three years. FFO (funds from operations) will likely grow to Bt1,600-Bt1,900 million, from Bt1,000-Bt1,400 million.

Total debt to capitalization ratio will stay below 40%

TRIS Rating expects the investment in the joint venture with VINFAST will raise leverage slightly. AH expects the joint venture will invest about Bt1,800 million, spreading over 2018 and 2019, in setting up a press shop and assembly operations in Vietnam. The joint venture will fund its investment 50% with debts and 50% with equity. Thus, debt of about Bt900 million will be added to AH's balance sheet, under our assumption that the joint venture's operations will be fully consolidated. AH has no other major capital expenditures in the pipeline. Thus, the total debt to capitalization ratio should not rise above 40% over the next three years, from 36.3% as of June 2018. A rise in earnings will keep the debt to EBITDA ratio at 2-3 times. The FFO to total debt ratio will stay in a range of 30%-40% during 2018-2020.

Liquidity should be manageable

TRIS Rating believes AH will be able to manage its liquidity for the next twelve months. Debts of about Bt940 million will come due during the remaining six months of 2018. Approximately Bt540 million were short-term loans for working capital and Bt400 million were long-term loans. At the end of June 2018, AH had undrawn credit facilities plus cash and marketable securities of about Bt3,600 million. The sources of cash should be sufficient to support the debts coming due.

The key financial covenants in AH's debentures require the net total liabilities to equity ratio to stay below 2.0 times. As of June 2018, the ratio was 0.9 times. TRIS Rating believes that AH will stay compliant with the covenants for the next 12 to 18 months.

RATING OUTLOOK

The "positive" outlook reflects improved prospects on AH's business and earnings performance. Profitability should continue to increase thanks to further improvement in its operating performance and higher income contribution from its investments in affiliates. We view the recent investments with offshore partners as opportunities and potential risks. The success of its investments will be a plus for the rating.

RATING SENSITIVITIES

A rating upgrade could occur if profitability continues to improve and/or if the company is successful in diversifying into new markets. In contrast, the rating and/or outlook could be lowered if the operating margin drops below 5% or the total debt to capitalization ratio exceeds 50% for an extended period.

COMPANY OVERVIEW

Established in 1996, AH is a large Tier-1 manufacturer of automotive parts in Thailand. The company started as a Ford distributor, before expanding to the manufacture of auto parts. It was listed on the Stock Exchange of Thailand (SET) in 2002. As of March 2018, the major shareholder of AH remained the Yeap family, holding 45.5% of the outstanding shares. Sojitz previously had held a 15.8% stake in AH before selling its stake to the Yeap family in 2017.

AH has two core lines of business: original equipment manufacturer (OEM) auto parts and car dealerships. The company's OEM products are stamped or pressed parts, forged and machined parts, plastic parts, and jigs and dies. Stamped or pressed parts, which include chassis frames, are the key OEM products. The car dealership segment sells Ford and Mitsubishi vehicles in Thailand and Honda vehicles in Malaysia. Revenue from the OEM auto parts segment accounts for 60%-70% of total revenue annually, while the car dealership segment constitutes the rest. AH's operations in Thailand contribute 70%-80% of total revenue, followed by operations in Malaysia (15%-25%) and China (3%-5%).

AH has explored opportunities to enter the global automotive market. In June 2017, AH invested US$100 million, or Bt3,522 million, in SGAH. The investment comprised newly-issued shares of SGAH (US$50 million) and a synthetic convertible loan (US$50 million), due on 31 March 2020. The synthetic convertible loan offers a coupon rate of 20% per annum, with an option to convert the loan to ordinary shares of SGAH. SGAH currently supplies markets and has product bases in many countries such as India, Portugal, the US, and China.

In addition to the investment in SGAH, in June 2018, AH announced a joint venture MOU with VINFAST to set up a press shop and assembly operations in Vietnam. The total investment for this project will be about US$60 million, or Bt1,800 million. AH will hold a 51% stake in the joint venture and VINFAST will hold the rest. The joint venture will supply Body in White parts for the first two models of VINFAST vehicles. AH will also produce and provide jigs and dies valued at about Bt1,700 million for VINFAST. VINFAST is a subsidiary of Vingroup, a Vietnamese conglomerate focusing on real estate development.

KEY OPERATING PERFORMANCE

Table 1: Revenue Breakdown

Unit: %

	2014	2015	2016	2017
OEM auto parts	62	64	63	62
Car dealership	38	36	37	38
Total	**100**	**100**	**100**	**100**
Total revenue (Bt million)	**14,572**	**14,534**	**14,731**	**15,776**

Source: AH

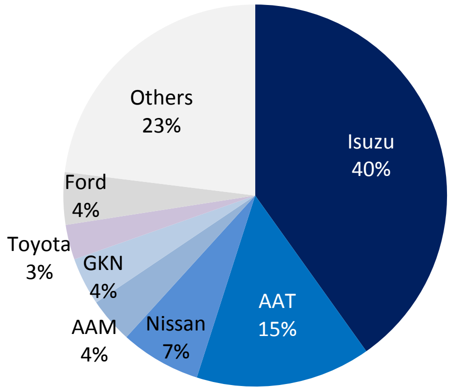
Table 2: EBITDA Breakdown

Unit: %

	2014	2015	2016	2017
OEM auto parts	88	88	88	91
Car dealership	12	12	12	9
Total	**100**	**100**	**100**	**100**
EBITDA from core operations (Bt million)	**1,213**	**1,133**	**1,226**	**1,336**
Shared profits and interest income (Bt million)	130	148	225	682
Total EBITDA (Bt million)	**1,343**	**1,281**	**1,451**	**2,018**

Source: AH

Chart 1: AH's Major OEM Customers in 2017



Source: AH

FINANCIAL STATISTICS AND KEY FINANCIAL RATIOS*

Unit: Bt million

		------------------- Year Ended 31 December -------------			
	Jan-Jun 2018	**2017**	**2016**	**2015**	**2014**
Revenue	8,581	16,288	15,137	14,994	15,196
Gross interest expense	97	149	131	170	208
Net income from operations	702	1,060	543	313	367
Funds from operations (FFO)	985	1,336	1,245	1,073	1,031
Capital expenditures	283	173	167	273	460
Total assets	15,220	14,721	11,113	11,507	12,083
Total debts	4,366	4,978	2,543	3,308	3,825
Shareholders' equity	7,675	7,183	6,236	5,983	5,681
Operating income before depreciation and amortization as % of sales	9.44	7.46	8.09	7.55	7.98
Pretax return on permanent capital (%)	12.96 **	12.07	8.05	5.69	6.29
Earnings before interest, tax, depreciation, and amortization (EBITDA) interest coverage (times)	12.12	12.74	11.07	7.52	6.45
FFO/total debt (%)	36.12 **	26.84	48.96	32.44	26.94
Total debt/capitalization (%)	36.26	40.93	28.97	35.60	40.24

Note: *All ratios are operating lease adjusted.*

* *Consolidated financial statements*

** *Adjusted with trailing 12 months*

Company Rating:	BBB+
Rating Outlook:	Positive

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