

AAPICO HITECH PLC

No. 115/2019
22 July 2019

CORPORATES

Company Rating: BBB+

Outlook: Stable

Last Review Date: 24/08/18

Company Rating History:

Date	Rating	Outlook/Alert
24/08/18	BBB+	Positive
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 “stable” from “positive”. The change reflects a recent increase in financial leverage. AH provided additional financial support to Sakthi Global Auto Holdings Ltd. (SGAH), an affiliated company, late last year. AH injected US\$65 million, or about Bt2,100 million, with the intent of reviving SGAH that had been dormant. AH recognized large losses associated with the investment in SGAH in 2018 and in the first quarter of 2019.

The rating continues to reflect AH’s strong competitive position as a Tier-1 automotive parts manufacturer in Thailand, solid core operations, and careful control of costs. These strengths are partially offset by rather thin profit margins, customer concentration risk, and the cyclical nature of the automotive industry. New investments, under taken with offshore partners, represent both new opportunities and new challenges for the company.

KEY RATING CONSIDERATIONS

Strong competitive position in OEM auto parts segment

AH has a strong position in the original equipment manufacturer or OEM auto parts segment. The OEM auto parts segment accounts for the major portion of AH’s revenue, typically making up 60%-70% of total revenue in a year. As evidence of its strong competitive position, revenue has grown steadily since 2016. The growth came despite little growth in the domestic automotive industry. TRIS Rating believes AH will be able to maintain its competitive position in the OEM auto parts segment.

AH’s competitive position is attributable to its lengthy track record of producing auto parts for several automakers. The company has never lost 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. Isuzu is AH’s major customer, making up about one-fourth of AH’s revenue.

TRIS Rating expects AH will continue to receive orders from Isuzu, including parts for new car models which should be introduced in late 2019. The parts for the new car models will likely secure revenue over the next 5-10 years.

International expansion bring growth and challenges

AH has made two major investments abroad during the past five years: SGAH and a joint venture with VINFAST Trading & Production LLC (VINFAST). SGAH has operation bases in the United States (US), India, Portugal, and China, while VINFAST operates in Vietnam.

TRIS Rating believes AH’s strategy to expand outside of Thailand will help unlock growth opportunities. However, this effort will also bring challenges. If the expansion abroad is successful, it would be a plus for AH’s rating. On the contrary, the rating could be negatively affected if it makes AH’s overall performance suffer.

SGAH has struggled recently, the result of production problems in the US. SGAH reported significant losses of Bt821 million in 2018 and Bt320 million in the first

quarter of 2019. AH recognized a loss of Bt411 million in 2018, its share of the annual loss on an equity basis, and a loss of Bt160 million in the first quarter of 2019. The losses lowered AH's overall equity returns, and cut consolidated net income. TRIS Rating expects operations will return to normal at SGAH by the second half of 2020. SGAH's production capacity has already increased after AH provided additional financial support late last year.

AH has invested US\$165 million, or Bt5,544 million, in SGAH since 2017. The investment in SGAH has grown and now represents nearly 30% of AH's total assets. The sizable investment comprises an equity stake of 49.99% (US\$75 million), a synthetic convertible loan (US\$50 million), and a three-year loan (US\$40 million). AH may take a greater, more active role in SGAH, in TRIS Rating's opinion. SGAH should be unable to repay the synthetic convertible loan to AH in March 2020, considering its weak performance. As a result, AH may have to continue to provide financial support to SGAH.

The second large international investment AH made was a joint venture with VINFAST. The joint venture will supply Body in White parts for the first two vehicle models of VINFAST, expected to hit the market in the second half of 2019. TRIS Rating expects the joint venture will report a small loss in 2019 and a profit in 2020. The success of this venture remains to be seen because both AH and VINFAST are new to the automotive business in Vietnam. In addition to a profit/loss associated with the joint investment, AH got an order from VINFAST, worth about Bt1,700 million, to produce jigs and dies. This order will boost AH's revenue and earnings in 2019.

Core operations will continue to improve

TRIS Rating forecasts AH's revenues and profits from the core operations will rise over the next three years. Orders for chassis frames for the new Isuzu D-Max and orders to produce jigs and dies for VINFAST vehicles will drive growth in 2019 and 2020. Our forecast assumes total operating revenues will reach Bt19,500 million in the next three years, rising from Bt17,370 million in 2018.

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. Looking forward, operating profit should keep growing. However, the shared losses associated with the investment in SGAH may cut net income in the coming years.

Our forecast assumes the operating margin (operating income as percentage of total operating revenues) will range from 8%-11% over the next three years. A rise in production volume will keep the unit cost of production low. EBITDA (earnings before interest, tax, depreciation, and amortization) will range from Bt1,900-Bt2,800 million annually, while FFO (funds from operations) will range from Bt1,500-Bt2,200 million annually.

Leverage on the rise

TRIS Rating forecasts a slight rise in the level of leverage this year. The debt to capitalization ratio climbed to around 44% at the end of March 2019, up from below 40% in the recent past. The rise was due to the investment in SGAH. Our base case forecast assumes investments and capital expenditures will amount to about Bt1,700 million in 2019, and Bt500 million annually during 2020 and 2021. The sizable expenditure in 2019 reflects our expectations that AH will provide additional financial support to SGAH. As a consequence, the debt to capitalization ratio is likely to increase further. Despite a rise, the debt to capitalization ratio should stay below 50% over the next three years. The debt to EBITDA ratio will stay below 3 times, while the FFO to total debt ratio will stay above 20%.

Liquidity remains manageable

TRIS Rating believes AH will be able to manage its liquidity prudently. Debts of about Bt1,800 million will come due during the remaining nine months of 2019. Of this total, short-term loans for working capital comprise approximately Bt620 million, long-term bank loans comprise Bt900 million, and outstanding debentures amount to Bt300 million. At the end of March 2019, cash and marketable securities amounted to about Bt580 million. FFO during the remaining nine months of 2019 is expected at almost Bt1,700 million. The liquid assets and cash from operations would total Bt2,280 million as a result, sufficient to support the debts coming due. The company had undrawn credit facilities of almost Bt3,700 million as another source of cash. No large single (bullet) debt repayments are due over the next three years.

A key financial covenants in AH's debentures requires the net total liabilities to equity ratio to stay below 2 times. As of March 2019, the ratio was 1.2 times. TRIS Rating believes that AH will continue to comply with this covenant for the next 12-18 months.

BASE-CASE ASSUMPTIONS

- Total operating revenue will range between Bt18.0-Bt19.5 billion per annum.
- The operating margin will range from 8%-11%.
- Annual investments and capital expenditures will be Bt1,700 million in 2019, falling to Bt500 million in 2020 and 2021.

RATING OUTLOOK

The “stable” outlook reflects TRIS Rating’s expectation that AH will maintain its strong market position in its core lines of business. Profits from the core operations should keep rising. In addition, the operating performance of SGAH should recover gradually over the next three years.

RATING SENSITIVITIES

The rating upside is limited. However, the upside case could emerge if profitability improves significantly, or if the investments abroad are successful.

In contrast, the rating and/or outlook could be revised downward if the investments abroad drag down AH’s financial profile. The rating could also be lowered if the operating margin drops below 5% or if the 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 2019, the major shareholder of AH remained the Yeap family, holding about 39% of the outstanding shares.

AH has two core lines of business: 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 and Proton vehicles in Malaysia. 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%).

KEY OPERATING PERFORMANCE

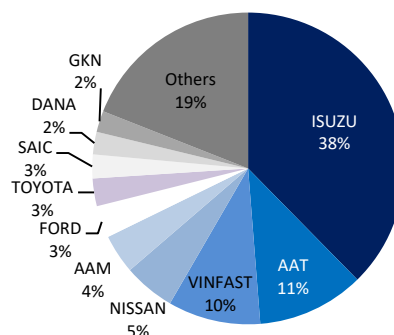
Table 1: Revenue Breakdown

Unit: %

	2015	2016	2017	2018	Jan-Mar 19
OEM auto parts	64	63	62	64	71
Car dealership	36	37	38	36	29
Total	100	100	100	100	100
Total revenue (Bt million)	14,534	14,731	15,776	16,738	4,230

Source: AH

Chart 1: AH’s Major OEM Customers in 1Q19



Source: AH

FINANCIAL STATISTICS AND KEY FINANCIAL RATIOS*

Unit: Bt million

	Jan-Mar 2019	----- Year Ended 31 December -----			
		2018	2017	2016	2015
Total operating revenues	4,364	17,370	16,288	15,137	14,994
Operating income	418	1,691	1,277	1,294	1,172
Earnings before interest and taxes (EBIT)	344	1,522	1,277	740	546
Earnings before interest, taxes, depreciation, and amortization (EBITDA)	616	2,475	1,588	1,393	1,306
Funds from operations (FFO)	487	2,293	1,394	1,222	1,098
Adjusted interest expense	68	212	162	144	181
Capital expenditures	134	915	173	167	273
Total assets	19,030	17,891	14,721	11,113	11,507
Adjusted debt	6,452	6,087	4,764	2,366	3,182
Adjusted equity	8,382	7,947	7,183	6,236	5,983
Adjusted Ratios					
Operating income as % of total operating revenues (%)	9.58	9.74	7.84	8.55	7.82
Pretax return on permanent capital (%)	10.09 **	11.25	11.90	7.98	5.68
EBITDA interest coverage (times)	9.11	11.67	9.78	9.67	7.20
Debt to EBITDA (times)	2.64 **	2.46	3.00	1.70	2.44
FFO to debt (%)	34.03 **	37.67	29.26	51.65	34.51
Debt to capitalization (%)	43.49	43.37	39.88	27.51	34.72

* Consolidated financial statements

** Adjusted with trailing 12 months

RELATED CRITERIA

- Key Financial Ratios and Adjustments, 5 September 2018
- Rating Methodology – Corporate, 31 October 2007

AAPICO Hitech PLC (AH)

Company Rating:	BBB+
Rating Outlook:	Stable

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