SINO-THAI ENGINEERING & CONSTRUCTION PLC

No. 3/2018 4 January 2018

Company Rating: A-

Outlook: Stable

Company Rating History:

Date	Rating	Outlook/Alert
17/01/17	A-	Stable

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Rating Rationale

TRIS Rating affirms the company rating of Sino-Thai Engineering & Construction PLC (STEC) at "A-". The rating reflects STEC's strong business profile as a leading construction contractor with a longstanding track record of completing projects for private and public-sector clients. The rating also recognizes STEC's resilience to a drop-off in the engineering and construction (E&C) industry, due to the strength of its financial profile, as well as its large and fairly diversified backlog. However, the rating is weighed down by the cyclical nature of the E&C industry and stiff competition. The rating is also constrained by a potential rise in its financial leverage in the wake of forthcoming large-scale projects and investments in the power business.

STEC was established in 1962 by the Charnvirakul family and listed on the Stock Exchange of Thailand (SET) in 1992. STEC is a well-known construction contractor, providing E&C services to the public and private sectors.

During the last few years, about half of STEC's revenue was generated by public work projects, and the rest by projects for private sector clients. In view of the end-markets STEC serves, infrastructure projects contributed nearly half of total revenue, followed by power projects (24%), building projects (24%), and industrial plant projects (5%). The revenue mix, however, varies over time.

The rating reflects STEC's strong business profile, backed by its competence in undertaking various types of E&C work, as well as its strong market position. STEC is among the top four largest SET-listed contractors in terms of annual revenue. The company is categorized as a Class 1 licensed contractor for all government authorities and state enterprises. STEC is one of the few prequalified construction contractors eligible to bid for large public work projects. Given its established track record, the company is highly capable of bidding for several large infrastructure projects in the years ahead.

STEC has recently secured three large-scale mass transit construction projects, which will push revenue higher over the next few years. STEC, through BSR Joint Venture, won bids for the Metropolitan Rapid Transit (MRT) Pink Line and MRT Yellow Line projects, under the public-private partnership (PPP) scheme. The two projects have a combined contract value of about Bt100 billion. BSR Joint Venture comprises BTS Group Holding PLC (BTS) (75% ownership), STEC (15%), and Ratchaburi Electricity Generating Holding PLC (RATCH) (10%). STEC will be responsible for the civil work on both projects, worth approximately Bt40 billion in aggregate.

In addition, STEC, as one of the equity partners in BSR Joint Venture, will have to make sizable investments of about Bt4.3 billion over the course of these two projects. However, the profits generated from the construction work on both projects will comprise a large portion of the equity STEC must inject into BSR Joint Venture. As a result, gearing should not rise significantly.

Furthermore, STEC won three contracts for the construction of the MRT Orange Line project under the name of CKST Joint Venture. The three contracts were worth a total of about Bt47 billion. CKST Joint Venture is held 60% by CH. Karnchange PLC (CK) and 40% by STEC. Although the three mass-transit lines will boost STEC's revenue over the next few years, the simultaneous undertaking of the large-scale construction projects will be a challenge.

STEC has diversified into the power business, a move to ward off contractions in revenue during downturns in the E&C industry. In August 2016, STEC acquired a 2.78% stake in Absolute Clean Energy Co., Ltd. (ABCE), an operator of biomass power plants in Thailand. STEC paid Bt500 million for the stake. In November 2016, STEC acquired a 10% stake in Thai Solar Energy PLC (TSE), a developer of renewable power projects. The acquisition price was Bt880 million. In late 2017, STEC paid Bt1.8 billion for a 1.88% stake of Gulf Energy Development PLC (GULF), a leading power producer in Thailand. The series of investments did not raise gearing significantly as STEC had excess liquidity. Looking ahead, TRIS Rating expects STEC will invest more in the power business. However, the sizes of the investments should not materially hurt its financial profile.

TRIS Rating's base case forecasts revenue will grow steadily, reaching Bt30 billion by 2020. STEC has a large and fairly diversified backlog. As of September 2017, STEC's backlog stood at about Bt93 billion, a record high. The sizable backlog will secure almost 80% of the forecast revenue over the next three years.

The rating also recognizes STEC's resilience to a drop-off in the E&C industry. STEC's healthy financial profile results from its strong profitability. Although the operating margin (operating profit before depreciation and amortization as a percentage of revenue) slid to about 8% in the first nine months of 2017, from a peak of 9.7% in 2015, the level of profitability was considered high for a contractor undertaking large-scale public work projects. TRIS Rating expects the operating margin will fall slightly further in the coming years as revenue contribution from the public work projects has been increasing. Over the next three years, the operating margin is assumed to stay above 7.5%, which means funds from operations (FFO) will range from Bt1.5-Bt2 billion per annum.

STEC's resilience is also built on its low level of financial leverage and robust liquidity position. At the end of September 2017, the total debt to capitalization ratio stood at merely 6.9%, a very low level. The funding needs for the equity investments in the MRT Pink Line and the MRT Yellow Line projects will be met in part by the profits from construction work for the two mass transit projects. As a result, looking forward, gearing will not rise substantially. TRIS Rating forecasts the debt to capitalization ratio will stay below 40% over the next three years.

Liquidity position is solid. STEC puts aside sizable amounts of liquid assets to fend off the liquidity risk. Cash and marketable securities stood at about Bt5.6 billion as of September 2017. Furthermore, the company had property investments, most of which were raw land, valued at about Bt4.1 billion in total. The large amount of STEC's current cash and marketable securities gives the company financial flexibility. The abundant liquidity results from the company's efficient working capital management. Its working capital needs are supported in large part by advance payments from project owners and the credit extended by suppliers and sub-contractors. The efficient working capital management keeps its external funding requirements low. Over the next three years, cash flow protection is likely to deteriorate, as financial leverage rises. However, STEC's liquidity profile is expected to remain consistent with the current rating.

The cyclicality of the E&C industry and intense competition keep a lid on the rating. Each of these two factors takes a toll on the sustainability of STEC's revenue streams and profitability. However, STEC is expected to maintain a healthy financial profile.

Rating Outlook

The "stable" outlook reflects TRIS Rating's expectation that STEC will maintain its strong market position and its competence in securing and completing projects. STEC is expected to remain highly profitable and manage its liquidity well over the course of the large-scale construction projects. The capital structure will remain solid despite a potential rise in gearing.

A credit upside case would emerge if revenue and operating cash flow are significantly higher than expected. A downside risk could arise if STEC's financial profile drops significantly, possibly due to project delays and cost overruns.

Sino-Thai Engineering & Construction PLC (STEC)

Company Rating:	A-
Rating Outlook:	Stable

Financial Statistics and Key Financial Ratios*

Unit: Bt million

		------------Year Ended 31 December ----------			
	Jan-Sep 2017	2016	2015	2014	2013
Revenue	14,067	17,953	18,331	21,652	22,294
Finance cost	16	13	13	18	29
Net income from operations	709	785	1,079	1,521	1,439
Funds from operations (FFO)	704	1,177	1,810	1,908	1,928
Capital expenditures	400	149	458	884	789
Total assets	29,852	25,000	22,661	25,004	25,010
Total debt	805	748	234	261	298
Total liabilities	19,062	14,415	13,153	16,454	17,233
Shareholders' equity	10,790	10,585	9,508	8,549	7,777
Depreciation & amortization	353	520	494	427	368
Dividends	336	503	610	763	38
Operating income before depreciation and amortization as % of sales	7.98	8.75	9.70	9.52	8.77
Pretax return on permanent capital (%)	10.07 **	10.92	15.44	22.95	26.37
Earnings before interest, tax, depreciation, and amortization (EBITDA) interest coverage (times)	75.53	123.94	143.11	129.74	78.53
FFO/total debt (%)	124.62 **	157.35	773.03	730.22	646.24
Total debt/capitalization (%)	6.94	6.60	2.40	2.97	3.69

* *Consolidated financial statements*
** *Annualized, based on the trailing 12 months*

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