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THE UNION MOSAIC INDUSTRY PLC

No. 91/2017

31 July 2017

Company Rating: BB+

Outlook: Stable

Company Rating History:

Date	Rating	Outlook/Alert
27/05/14	BBB-	Stable
08/07/16	BB+	Stable

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Rating Rationale

TRIS Rating affirms the company rating of The Union Mosaic Industry PLC (UMI) at “BB+”. The rating reflects UMI’s satisfactory business profile, characterized by modest market share, well-accepted brand names, and long track record. Conversely, the rating is weighed down by waning demand in the domestic market for tile and rising competitive pressure from imported tiles. The rating also takes into account the company’s high susceptibility to volatile energy, as rising energy prices have a significant negative effect on profitability.

UMI is a medium-sized manufacturer and distributor of ceramic tiles in Thailand. The company was established in 1973 and was listed on the Stock Exchange of Thailand (SET) in 1989. As of 16 May 2017, major shareholders comprised the Penchart family (a 21.17% stake), and the Laowiwatwong family (a 20.86% stake). UMI offers ceramic floors and wall tiles. In efforts to boost its competitiveness and broaden its products line, UMI acquired The Royal Ceramic Industry PLC (RCI) and T.T Ceramic PLC (TTC) in 2012. RCI is a manufacturer of ceramic floor and wall tiles while TTC offers porcelain tiles. Market conditions changed significantly after the two acquisitions. In the wake of a continued decline in demand, UMI later opted to divest its entire stakes in RCI but maintain its stake in TTC. TTC produces and sells porcelain tiles under its own Cergres brand. In addition, TTC produces porcelain tiles for UMI to sell under Duragres brand. UMI currently holds 66.6% of TTC’s outstanding share.

The rating incorporates UMI’s satisfactory business profile. UMI’s product brands include Duragres and Cergres, which are well-accepted brands. UMI’s products have been distributed in Thailand for over 30 years. UMI targets its products at the middle- to high-end market segment. UMI’s sales are almost entirely derived from the domestic market. The company distributes its products mainly through several leading home improvement retailers. In response to sluggish domestic demand, UMI is forging ahead with plans to expand abroad, especially in neighboring countries.

UMI is the third largest tile manufacturer in Thailand, based on production capacity, behind the Siam Cement Group (SCG) and Dynasty Ceramic PLC (DCC). SCG is the market leader, with well-known brands in the high-end market, the same target market as UMI. DCC is strong in the low-end segment. UMI sold approximately 18.1 million square meters (sq.m.) of tiles in 2016. Among the three major tile producers, UMI had a modest market share of about 10% in 2016, behind SCG (48%) and DCC (25%).

In 2016, UMI reported total sales of Bt2.79 billion, a whopping 25.5% decline from a year ago. One main reason is that in 2016 the sales excluded RCI’s sales since UMI started divesting RCI in June 2015 and sold its entire stake in June 2016. UMI’s sales volume in 2016 slipped to 18.1 million sq.m., a 7.3% year-over-year (y-o-y) decline, larger than the 6.4% drop in sales volume for the tile industry. The drop in demand was due primarily to a slowdown in construction activity, particularly in the residential and commercial property sectors. Capacity utilization of UMI remained low at 67% in 2016. However, UMI reported a higher-than-expected gross margin of 24%, compared with gross margins of 17%-19% in the previous years. The gross margin improved in 2016 as a result of a significant drop in the price of natural gas.

The rating also takes into account waning demand in the domestic tile market. Demand for tiles in the Thai market generally moves in parallel with gross domestic product (GDP) but with a higher degree of volatility. Demand for tiles is more volatile because a portion of demand is linked to the new construction segment (primarily residential property), which is more volatile than the home improvement segment. Demand for tile has decreased for four consecutive years since 2012. Sales of tile in Thailand, on a volume basis, contracted by 6.4% y-o-y to 157 million sq.m. in 2016. In 2017, tile sales in the first three months of the year, which is usually the high season, continued to fall. Sales slumped by approximately 6.9% y-o-y to 41 million sq.m.

Competition from importers, mostly in the unglazed porcelain tile segment, is higher now, exacerbating the falloff in demand. Competition is expected to intensify further once Chinese producers improve the quality of their products and improve production standards to comply with the product requirements dictated by the Thai industrial standard specifications. Although imported tiles carry the additional cost of freight, their selling prices are more competitive than locally-produced tiles. In 2016, the volume of imported tile slipped to 52 million sq.m., declining by 3.8%, whereas the market demand, on the whole, dropped by 6.4%. As competition has intensified, as shown by higher price-based competition and rising imports of porcelain tiles produced in China, UMI started importing more tiles from abroad in order to fulfill the product ranges.

UMI's operating margin (operating profit before depreciation and amortization divided by total revenue) increased considerably to 11% in 2016, compared with 4.9% in 2015. However, the lingering effects from the investment in TCC dragged down UMI's net profit. The company recorded an asset impairment charge of Bt31 million for TTC's assets in 2016, after a substantial write-down of about Bt110 million a year ago. TTC's utilization rate remained below 70% in 2016. However, its sales declined by only 2.3%, a drop which was lower than the drop in the overall market. UMI reported net profit of Bt108 million in 2016, compared with a devastating loss of Bt190 million in the previous year.

In the first three months of 2017, UMI's revenue was Bt675 million, a 10% y-o-y drop. However, the ongoing slide in the price of natural gas lifted UMI's operating margin to 9.8%, higher than the average of 7% achieved during 2014-2016. TRIS Rating is of the view that UMI's susceptibility to volatile energy prices remains a drag on the rating. There is downside risk to UMI's profitability because the price of natural gas will increase as oil prices rise.

Financial leverage is on the mend. As of March 2017, total debt stood at Bt1.45 billion, mainly comprising an outstanding bond issue of Bt589 million and TTC's restructured debt of Bt797 million. The debt to capitalization ratio decreased to 45% in March 2017 from a peak of 52.6% in 2013. Leverage is expected to decrease, in the absence of any sizable investment in new production capacity.

Looking ahead, TRIS Rating is of the view that the outlook of the tile market remains bleak, due in large part to the slack demand. Supply will continue to outstrip demand over the next two to three years. Upsurges in prices are unlikely as oversupply and competitive threats from imported tiles linger on. Under TRIS Rating's base-case forecast, UMI's revenue would range from Bt2.7-Bt2.8 billion during 2017-2019. UMI's profitability is highly dependent on energy costs. Sharp rises in energy cost could hurt cash flow markedly. The total debt to capitalization ratio is expected to stay below 40%, underpinned by the ongoing bond repurchases and minimal capital expenditures. The FFO to total debt ratio is expected to range between 15%-21% over the next few years.

Rating Outlook

The "stable" outlook reflects the expectation that UMI's sales and operating profit margin will be in line with TRIS Rating's base-case scenario. UMI's rating or outlook could be revised upward if profitability shows a sustained improvement, which could arise from a strengthened market position and careful management of manufacturing costs and expenses. In contrast, the rating or outlook could be revised downward if there is a further deterioration in operating performance.

The Union Mosaic Industry PLC (UMI)

Company Rating:	BB+
Rating Outlook:	Stable

Financial Statistics and Key Financial Ratios*

Unit: Bt million

	Jan-Mar 2017	------------------- Year Ended 31 December ------------------- 2016	2015	2014	2013	2012
Sales	675	2,793	3,739	4,213	3,736	3,288
Gross interest expense	9	41	69	93	67	60
Net income from operations	23	136	(77)	(70)	28	71
Funds from operations (FFO)	65	267	180	154	176	296
Capital expenditures	7	52	58	176	118	83
Total assets	3,807	3,755	3,917	5,509	4,756	4,598
Total debt	1,446	1,480	1,545	2,198	2,077	2,010
Shareholders' equity	1,766	1,746	1,814	2,424	1,875	1,911
Operating income before depreciation and amortization as % of sales	9.8	10.0	4.9	5.4	5.6	11.7
Pretax return on permanent capital (%)	4.5 **	5.0	(2.4)	(1.1)	3.2	9.0
Earnings before interest, tax, depreciation, and amortization (EBITDA) interest coverage(times)	9.4	9.5	3.9	3.1	5.0	6.9
FFO/Total debt (%)	13.6**	18.0	11.7	7.0	8.5	14.7
Total debt/capitalization (%)	45.0	45.9	46.0	47.6	52.6	51.3

* *Consolidated financial statements*
** *Annualized with trailing 12 months*

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