TRIS RATING
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EAST COAST FURNITECH PLC

No. 110/2020
23 July 2020

CORPORATES

Company Rating: BB+

Outlook: Negative

Last Review Date: 14/08/19

Company Rating History:

Date	Rating	Outlook/Alert
25/07/18	BB+	Stable
19/06/17	BB	Stable

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RATIONALE

TRIS Rating affirms the company rating on East Coast Furnitech PLC (ECF) at "BB+" and at the same time, revises the rating outlook to "negative" from "stable". The "negative" outlook reflects the prospect of a significant increase in ECF's financial leverage as a result of a high level of furniture inventory and the planned expansion of its investment in the power generation business. ECF's potential new borrowings to fund the investment for the remaining phases of the Minbu project will be a negative factor that further weakens its financial status.

The "BB+" rating continues to reflect ECF's adequate competitive strength in the furniture market and established distribution channels. However, the rating is weighed down by the prospect of the company's rising financial leverage and tight liquidity, and the investment risks associated with the solar power project in Myanmar.

KEY RATING CONSIDERATIONS

Adequate competitive strength in furniture market

ECF's business profile is underpinned by its established position as a medium-sized furniture manufacturer in Thailand. The company can be considered an Original Equipment Manufacturer (OEM) since about 50%-60% of its furniture sales are made-to-order products for overseas customers. ECF's products are price-driven as the majority of the products are simple knockdown furniture targeted at the low- to medium-priced segments. Market competition in this segment is predominantly driven by operating efficiency and cost management.

TRIS Rating views that ECF's competitive strength in production cost management is maintained, supported by the large economies of scale, compared with majority of furniture manufacturers.

Established distribution channels

ECF's other important competitive strength is its established distribution channels through leading modern trade retailers. The company has two core distribution channels, comprising exports and domestic distribution through modern trade retailers. Most of ECF's overseas customers are furniture and modern trade retailers in Japan. The two distribution channels account for 80%-90% of its furniture sales.

The two distribution channels have been a key supporting factor for consistent sales growth for several years. We expect these sales channels will be even more crucial to ECF as the company has closed all its loss-making showrooms and reduced sales through the dealer channel. We expect the company to have less revenue concentration in the Japanese market taking into consideration its plan to broaden its export customer base.

Expected quick revenue revival post COVID-19

ECF's operating performance deteriorated materially in the first quarter of 2020, as a result of a slowdown demand in the Japanese market and the Coronavirus Disease 2019 (COVID-19)-containment lockdown in Thailand. Total revenue in the first quarter of 2020 fell by 17.9% year-over-year. The company's earnings before interest, taxes, depreciation, and amortization (EBITDA) was only THB17 million and its funds from operations (FFO) were negative in the first quarter of 2020. EBITDA margin dropped to 5.9% in the first quarter of 2020 from 18.2% in 2019.

However, TRIS Rating expects furniture demand to improve quickly in the second half of 2020 owing to the improving demand for furniture from the stay-at-home trend. The newly acquired overseas customers will be a factor to help bolster revenue recovery. The company received a new order from an online retailer in India in the first quarter of 2020. We expect the company's revenue to decline by 10% in 2020 before recovering at a similar rate in 2021. EBITDA is expected to recover gradually and stay over THB200 million from 2021 onwards.

Required funding for the Minbu project

TRIS Rating views that the execution risks associated with the Minbu project have decreased significantly after the first phase (50 megawatts -- MW) of the project commenced commercial operations in September 2019. The records of satisfactory operations of solar power plant and payments received from the off-taker have also alleviated concerns over the operation and counterparty. The company is also benefiting from a 15% reduction in total project cost after renegotiations with the main contractor. The construction of phases 2-4 (170 MW) is scheduled for completion in late 2021. However, the risk of project delays is still a concern due to the COVID-19-induced travel restrictions and the financial constraint from the upfront capital injection requirement imposed by bank lenders.

ECF has an obligation to inject new capital of about THB300 million for the Minbu project before the construction of the remaining phases can begin. ECF plans to primarily fund the equity injection with proceeds from the divestment of SAFE Energy Holdings Co., Ltd. (SAFE), which is an operator of biomass and biogas power plants. Currently, ECF holds a 33.37% equity stake in SAFE. The investment in SAFE was worth THB223 million as of March 2020. The company also plans to recall the advance payment for share purchase in a wind power project worth THB95 million.

Weakening financial profile

We consider ECF's financial position to weaken at a faster pace than our previous assessment due to its higher-than-expected outstanding debts. Net adjusted debt rose to THB1.65 billion as of March 2020 from THB1.3 billion at the end of 2018. Interest payments rose significantly in tandem with the rising debt, eroding the company's cashflow generation. The FFO to net debt ratio deteriorated substantially, declining to 7.2% in 2019 from 9.9% in 2018. The impacts of the COVID-19 also exacerbated the company's financial position, pulling the ratio down to 3.8% in the first quarter of 2020.

The causes of the rising debt are due primarily to troublesome inventory management and overspending on new power projects. ECF's inventory rose continuously to a very high level of about THB1.4 billion as of March 2020, higher than its average furniture sales of THB1.2-THB1.3 billion per annum. The advance payment for share purchase in a wind power project and a deposit for a feasibility study on a Japanese biomass power project were other key borrowing needs.

We assign a "negative" outlook to the rating to reflect the prospect of ECF's cash flow to debt ratio to worsen further. Without asset divestments of SAFE, the company will need new bank loans to fund the Minbu project, resulting in an additional debt load of THB300 million. Based on a prospect of the lingering high inventory level coupled with potential debt-financing for the Minbu project, we expect the financial ratios of ECF are likely to stay at a very weak level. ECF's FFO to net debt ratio is likely to stay below 5% and net debt to EBITDA ratio to stay above 8 times for an extended period.

Tight liquidity

We expect ECF to experience tight liquidity over the next 12 months. The main uses of funds will consist of the equity investment of THB300 million in the Minbu project and bond repayments totaling THB380 million due in March and July 2021. Cash flow from operations will be insufficient to cover the uses of funds over the next 12 months. The company may need to refinance its maturing bonds and seek new bank loans to fund the Minbu project in case the divestment of SAFE Energy is not successful as planned.

We note that the refinancing risk of the THB605 million in debentures due in August 2020 is mitigated by the bond issuance in June 2020.

BASE-CASE ASSUMPTIONS

- Revenue to drop by about 10% in 2020 before rebounding at the same rate in 2021. Revenue growth in 2022 is estimated to be 3%-4%.
- EBITDA margin to remain low at 12% in 2020 and to improve to 15%-18% during 2021-2022.
- Shared profits from investments in the power business to be about THB30 million in 2020 before rising to THB70 million in 2022.
- Maintenance capital expenditure to be THB50-THB100 million per year.
- Dividend payout ratio to be 50%.

RATING OUTLOOK

The "negative" outlook reflects the prospect of a significant rise in ECF's financial leverage as a result of a high level of furniture inventory and the expansion of its investment in the power generation business. ECF's potential new borrowings to fund the investment for the remaining phases of the Minbu project will further weaken its financial position.

RATING SENSITIVITIES

The rating downgrade could occur if ECF's financial position further deteriorates following the large debt-funded equity injection in the Minbu project and/or the level of inventory kept rising. Any new investments that strain the company's already stretched financials will also have a negative effect on the rating.

The rating outlook could be revised back to "stable" if we believe that the company's outstanding debt will be kept at or reduced continuously from the 2019 level. Funding the Minbu project without taking on new loans will be viewed as a plus for the rating.

COMPANY OVERVIEW

ECF engages in the manufacture and distribution of home furniture in Thailand. The company owns two factories in Rayong province, focusing on producing knockdown furniture and rubber wood furniture. Revenue from selling furniture contributes over 90% of its total revenue; the remainder is derived from selling decorative foil paper and dried rubber wood. ECF has been listed on the Market for Alternative Investment (MAI) since 2013. The Suksawad family is the main shareholder, holding approximately 50% of the outstanding shares as of 30 June 2020.

ECF distributes its furniture products through two main channels, including made-to-order and Thai modern trade. Almost all made-to-order furniture is exported to leading furnishing distributors and large modern trade retailers in Japan. In Thailand, the company distributes furniture under its own brands through well-known modern trade retailers, such as Home Pro, Big C, Mega Home, Thai Wasadu, Tesco Lotus, and Global House. The loss-making showroom channel ceased operations completely in 2019. Revenues from the export and Thai markets accounted for 56% and 44% of the total, respectively, in 2019. The Japanese market takes the largest portion, accounting for about 51% of total sales.

Apart from the furniture manufacturing business, the company, through ECF Power Co., Ltd., has also invested in three power projects, comprising a 7.5-MW biomass power plant in Narathiwas province, a 2-MW biogas project in Phrae province, and a 220-MW solar farm project, located in Myanmar. The company plans to divest all of its stakes in the biomass and biogas projects, and will use the proceeds to finance the remaining phases of the Minbu project.

KEY OPERATING PERFORMANCE

Table 1: ECF's Power Project Portfolio as of 30 Jun 2020

Project/Country	Type	Hold by ECF (%)	Installed Capacity (MW)	Contracted Capacity (MW)	COD	ECF's Investment Cost (Mil. THB)
Thailand						
PWGE	Biomass	33.37	7.5	7.0	Jun 2017	175.2
Bina Puri	Biomass	16.3	1	0.92	Aug 2018	35
			8.5	7.92		210.2
Myanmar						
Minbu project						
- Phase 1	Solar	20	50	40	Sep 2019	139
- Phase 2	Solar	20	50	40	Q2 2021	270-300 for Phase 2-4
- Phase 3	Solar	20	50	40	Q4 2021	
- Phase 4	Solar	20	70	50	Q1 2022	
			220	170		409-439
Total			**228.5**	**177.92**		

Note: The investment cost in Minbu project excludes share acquisition of about USD9 million
Source: ECF

FINANCIAL STATISTICS AND KEY FINANCIAL RATIOS*

Unit: Mil. THB

	Jan-Mar 2020		-------------- Year Ended 31 December ------------ 2019	2018	2017	2016
Total operating revenues	292		1,291	1,442	1,479	1,392
Earnings before interest and taxes (EBIT)	23		158	145	157	134
Earnings before interest, taxes, depreciation, and amortization (EBITDA)	17		235	246	253	216
Funds from operations (FFO)	(16)		115	129	160	147
Adjusted interest expense	30		118	104	81	58
Capital expenditures	9		57	136	33	37
Inventory	1,397		1,379	1,172	999	757
Total assets	3,326		3,591	3,396	2,780	2,357
Adjusted debt	1,650		1,608	1,299	1,176	901
Adjusted equity	1,254		1,454	1,447	1,027	659
Adjusted Ratios						
EBITDA margin (%)	5.9		18.2	17.0	17.1	15.5
Pretax return on permanent capital (%)	4.4	**	5.1	5.4	7.1	8.1
EBITDA interest coverage (times)	0.6		2.0	2.4	3.1	3.7
Debt to EBITDA (times)	8.8	**	6.8	5.3	4.6	4.2
FFO to debt (%)	3.8	**	7.2	9.9	13.6	16.3
Debt to capitalization (%)	56.8		52.5	47.3	53.4	57.7

* *Consolidated financial statements*
** *Trailing with the last 12 months*

RELATED CRITERIA

- Rating Methodology – Corporate, 26 July 2019
- Key Financial Ratios and Adjustments, 5 September 2018

East Coast Furnitech PLC (ECF)

Company Rating:	BB+
Rating Outlook:	Negative

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