GUNKUL ENGINEERING PLC

No. 47/2023
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CORPORATES

Company Rating:	BBB+
Outlook:	Stable

Last Review Date: 04/03/22

Company Rating History:

Date	Rating	Outlook/Alert
17/03/21	BBB+	Stable
09/03/20	BBB	Positive
11/04/17	BBB	Stable

Contacts:

Rapeepol Mahapant
rapeepol@trisrating.com

Narongchai Ponsirichusopol
narongchai@trisrating.com

Parat Mahuttano
parat@trisrating.com

Monthian Chantarklam
monthian@trisrating.com

WWW.TRISRATING.COM

RATIONALE

TRIS Rating affirms the company rating on Gunkul Engineering PLC (GUNKUL) at “BBB+” with a “stable” outlook. The rating continues to reflect the company’s reliable cash flows from the power business, its competitive strengths in the electrical equipment business, and advantages from vertical integration. However, the rating is held back by the increasingly challenging power business and associated risks of non-power businesses including the hemp and cannabis business. The rating also considers the company’s recent deleveraging, enlarging the financial headroom to accommodate potential investment opportunities.

KEY RATING CONSIDERATIONS

Power business renders reliable cash flow

The rating is chiefly predicated on the reliable cash flow from GUNKUL’s power business, the centerpiece of its earnings and investment. The company currently owns more than a hundred solar and wind power plants in diverse locations. As of December 2022, GUNKUL’s aggregate equity capacity (or contracted capacity in proportion to its ownership stakes in the power plants) totaled 600 megawatts (MWe).

Solar power makes up the majority of GUNKUL’s power-generating assets, representing about 85% of total equity capacity. Given its low operational risk, solar power has proven to generate highly predictable power outputs and cash flows. On the other hand, outputs from wind power are typically less predictable, due mainly to wind speed variation. However, low operating costs have kept the performance of GUNKUL’s wind power projects satisfactory.

Looking forward, we project the earnings before interest, taxes, depreciation, and amortization as a percentage of the revenue (EBITDA margin) of the solar power and wind power plants, on average, to stay at satisfactory levels of about 80%.

GUNKUL’s power business is subject to minimal payment risk. Most of its power plants have multi-year power purchase agreements (PPAs) with state-owned power utilities. The company has also attained growth in its solar rooftop electricity generation that sells electricity to creditworthy industrial customers under private PPAs. The capacity under this scheme made up about 20% of total equity capacity.

Overseas investment risks

Like other power developers, GUNKUL has expanded internationally in recent years. Apart from investments in Japan and Malaysia, the company owns and operates four solar farms in Vietnam, with an aggregate capacity of 160 MWe, accounting for 27% of total equity capacity.

Investments in Vietnam carry higher country and regulatory risks relative to Thailand based power generation assets despite the fast-growing demand for electricity. Power outputs from plants in Vietnam remain at risk of being curtailed due to insufficient grid capacity. Also, we hold the view that the credit profile of the state-run Vietnam Electricity (EVN) is not as strong as the state-owned power buyers in Thailand.

We view GUNKUL’s overseas investment risks to be at acceptable level. As of December 2022, investments in Vietnam represented about 13% of the company’s total assets.

Strategic partnership

GUNKUL has recently formed a strategic partnership with GULF Energy Development PLC (GULF), a leading power producer in Thailand. Both companies established Gulf Gunkul Corporation Co., Ltd. (GGC), a joint venture focusing on investments in potential renewable power projects and innovative energy businesses. Originally, GUNKUL fully owned GGC, but following restructuring, GUNKUL and GULF now have equal ownership. Currently, GGC owns a 100% stake in the three 170-MW wind power projects formerly fully owned by GUNKUL.

As GUNKUL's equity interest in the three wind projects has been reduced to 50%, the debts incurred by these projects have been deconsolidated from GUNKUL's balance sheet. TRIS Rating expects the strategic partnership to benefit GUNKUL in terms of both investment capability enhancement and business expansion opportunities.

Increasingly challenging power business

We see growth opportunities for renewable power in Thailand, aided by the government's new quota for purchasing electricity from renewable energy sources. However, competition in the power market has mounted, with a number of players ranging from very small entrepreneurs to large conglomerates. Also, power tariffs for new power projects have tended to decline compared to the past. The Energy Regulatory Commission of Thailand (ERC) has recently opened bids to purchase up to 5,203 MW of renewable energy, including ground-mounted solar and wind power projects. These projects are slated to commence operation during 2024-2030. The ERC is currently scheduled to announce the bid results in April 2023.

As regards these opportunities, GUNKUL has submitted several proposals for solar and wind projects, with a combined capacity of more than 1,000 MW. In our base-case forecast, we expect GUNKUL to succeed in securing a significant number of new contracts in solar and wind power generation. However, the low tariffs of THB2.17 per kilowatt-hour (kWh) for solar power and THB3.1 per kWh for wind power will be major challenges to derive attractive earnings. Our base-case forecast assumes the company will add 50 MW-100 MW in new power capacity annually over the next three years.

Competitive strengths in electrical equipment business

We expect GUNKUL to remain competitive in the trading and manufacturing of electrical equipment, backed by its long market presence and extensive range of products covering all stages of the transmission and distribution of electricity. Despite intensified competition, we forecast the electrical equipment business will bring in about THB2 billion in revenue per annum over the next three years, with a gross margin of 20%.

We view that GUNKUL will continue to benefit from business integration as its three main businesses of electrical equipment, engineering, procurement, and construction (EPC), and power are complementary in nature. As an EPC contractor and supplier of electrical equipment, GUNKUL is well-positioned to offer one-stop services to project owners, helping increase sales of electrical equipment. It can also better control project construction costs. Also, if GUNKUL successfully secures new renewable power projects, it will not only boost the growth of the power business, but the electrical equipment and EPC businesses as well.

EPC business expected to grow

GUNKUL continues to build its record of construction works, alongside its plan to file for the listing of its subsidiary engaging in EPC. We forecast revenue from its EPC business will grow to THB2-THB2.4 billion annually during 2023-2025, from THB1.9 billion in 2022. With expertise in solar farm construction, GUNKUL is poised to benefit from new project development following the new renewable energy quota.

The EPC business typically provides inferior and volatile profit margins to the power business, due to the multiple risks involved, such as severe competition, delays in the bidding and awarding of contracts, as well as unforeseeable holdups and cost overruns. However, we believe GUNKUL's efficient cost controls will keep the EPC business' gross margin at 10%-15% during 2023-2025.

Risks associated with new ventures

GUNKUL has recently entered into new ventures in hemp and cannabis plantation and production. The company is currently planting hemp and cannabis to produce upstream and midstream products, such as dry flower, full spectrum cannabidiol (CBD), and CBD isolate, using vacant land in one of its wind power projects. GUNKUL also holds a 50% stake in THCG Group Co., Ltd. (THCG), a hemp and cannabis producer in Thailand.

Despite growth potential, the new business is subject to an array of execution risks, particularly unclear regulations. Stagnant domestic demand for hemp and cannabis has caused the company to look towards international markets. Given the initial stage of development, we expect the new ventures to add a small revenue of THB100-THB200 million per annum during

2023-2025. Also, we do not expect GUNKUL to invest aggressively in the hemp and cannabis business. With the current scale of investment, the new ventures should not significantly affect GUNKUL's financial profile over the next three years.

Operating performance to stay firm

We project GUNKUL to continue performing satisfactorily over the next three years, supported by the reliable earnings generation from its core power business. Our base-case projection assumes the company will secure a total of 250 MWe in new solar and wind power generation during 2023-2025, boosting the aggregate capacity of its power projects to about 850 MWe.

We expect most of GUNKUL's new power projects to be developed through its joint ventures. The investment scheme will generate a share of profit and dividend income instead of revenue. In our base case, we project GUNKUL's total operating revenue to range from THB7.2-THB8.2 billion per annum in 2023-2025, down from the record of THB9.4 billion in 2021, due mainly to the deconsolidation of its three wind power projects.

In all, we forecast GUNKUL's EBITDA to stay in the THB3.7-THB4 billion per annum range during 2023-2025, declining from the peak of THB4.7 billion in 2021. The fall in the company's EBITDA follows the recent reduction in its ownership in the three wind power projects. Furthermore, the new greenfield renewable power projects should take time to develop and generate income. GUNKUL's EBITDA margin should hover around 50% over the forecast period, given our expectations that its solar power and wind power plants will continue to perform well.

Financial leverage to remain under control

The recent reduction of GUNKUL's ownership in the three wind power projects not only brought in cash proceeds of THB5 billion, but also allowed the company to deconsolidate the debts of the projects, amounting to about THB6.3 billion. The debt unloading, plus its strategy to make new investments mostly through joint ventures, should preclude GUNKUL from overleveraging and enable GUNKUL to vigorously expand its power portfolio.

We assume GUNKUL will spend THB2.5-3 billion per year for capital expenditures and investments during 2023-2025. As a result, the debt to EBITDA ratio will likely stay at about 4 times while the debt to capitalization ratio should hover around 50% over the forecast period.

Operation unaffected by wind project legal issue

Currently, there is a pending legal issue concerning the revocation of the land title deeds on which one of GUNKUL's wind power plants is located. The management views the worst scenario to be GUNKUL writing off the land plot it owns. In such a scenario, the wind power plant will still be able to continue operation through land lease agreements. As the legal issue remains uncertain and could take time to reach conclusion, it should not materially affect GUNKUL's operations in the near term.

Debt structure

As of December 2022, GUNKUL's consolidated debt, excluding lease liabilities, was about THB14.7 billion, of which THB10.1 billion was priority debt, comprising secured debt owed by GUNKUL and all borrowings incurred by its operating subsidiaries. The priority debt to total debt ratio was 69%, suggesting that GUNKUL's unsecured creditors are significantly disadvantaged to its priority debt holders with respect to claims against the company's assets.

Liquidity to be manageable

We expect GUNKUL to continue to manage its liquidity properly. Debts of about THB2.3 billion will mature in 2023. As of December 2022, the company had undrawn credit facilities, plus cash and marketable securities, of about THB5.6 billion. This should be sufficient to cover the repayments coming due. GUNKUL plans to refinance debentures worth about THB0.9 billion that will mature this April with the issuance of debentures.

A key financial covenant on GUNKUL's debentures requires the company's net interest-bearing debt to equity ratio to stay below 3 times. As of December 2022, the ratio was 0.9 times. We believe the company will stay compliant with the covenant over the forecast period.

BASE-CASE ASSUMPTIONS

Key assumptions in TRIS Rating's base-case forecast during 2023-2025 are as follows:

- Contracted capacity of power plants to reach 850 MWe in the next three years.
- GUNKUL to secure new EPC contracts for THB2 billion per year.
- Total operating revenues to range between THB7.2-THB8.2 billion per annum.
- EBITDA margin to remain at about 50%.
- Total investment spending to range between THB2.5-THB3 billion per year.

RATING OUTLOOK

The "stable" outlook reflects our expectation that GUNKUL's power plants will continue to deliver sound performance and render sizable and stable cash flows as planned. At the same time, GUNKUL's other lines of businesses will also deliver decent results over the forecast period. We expect its earnings and debt serviceability metrics will be in line with our estimates.

RATING SENSITIVITIES

A positive rating revision could emerge if GUNKUL's operating performance is well above our expectation or its level of cash flow generation against debt obligations further improves. Conversely, a downward revision to the rating could develop if GUNKUL's financial profile severely deteriorates. This could arise from a significant underperformance of the power generation assets or a deluge of debt-financed investments.

COMPANY OVERVIEW

GUNKUL was founded in 1982 by Mr. Gunkul Dhumrongpiyawut as a provider of electrical equipment. In 2010, the company expanded into the EPC business and the power business and was also listed on the Stock Exchange of Thailand (SET). As of January 2023, the Dhumrongpiyawut family remained the major shareholder, holding 52.4% of the company's interest.

The company was one of the first movers in the renewable power business, as it started to develop solar power projects of 57 MWe in 2010. The power business accounted for the majority (46%) of GUNKUL's total revenue in 2022, followed by the EPC business (26%), and the electrical equipment business (24%).

In the power business, GUNKUL currently holds an aggregate equity capacity of 600 MWe, comprising 154 solar power projects (515 MWe) and three wind power projects (85 MWe).

In the EPC business, GUNKUL's construction works mainly comprise electrical substations, solar rooftops, and underground cables. Through the trading and manufacture of its electrical equipment business, GUNKUL provides both public and private sector clients with an extensive range of products covering all stages of the transmission and distribution of electricity.

In 2021, GUNKUL unveiled its new ventures into the hemp and cannabis business, aiming to produce upstream and midstream hemp products, such as dry flower, full spectrum CBD, and CBD isolate. The company has also acquired a 50% stake in THCG, which has expertise in hemp and cannabis production and has sales contracts for dry flower with the Government Pharmaceutical Organization (GPO). THCG has been developing a wide range of CBD-based products.

KEY OPERATING PERFORMANCE

Table 1: Revenue Breakdown

Unit: %

	2018	2019	2020	2021	2022
Electrical equipment	22	22	17	16	24
EPC	30	14	34	30	26
Power	47	63	47	51	46
Others	1	1	2	3	4
Total	**100**	**100**	**100**	**100**	**100**
Total revenue (million THB)	**6,230**	**7,099**	**8,649**	**9,318**	**7,506**

Source: GUNKUL

Table 2: Power Project Portfolio (as of Dec 2022)

Company/Country	Held by GUNKUL (%)	No. of Project	Gross Contracted Capacity (MW)	Equity Contracted Capacity (MWe)	Tariff
Solar Projects					
GPS	40	4	26.0	10.4	Adder
GCPG	51	6	30.9	15.8	Adder
RNS	67	11	87.0	87.0	FiT
SES and GIG	100	114	141.0	141.0	FiT/Agreed Prices
Japan	100	2	65.3	65.3	FiT
Malaysia	70	1	30.0	21.0	FiT
Vietnam	100	4	160.0	160.0	FiT
Others	25-100	12	19.5	14.6	Adder/FiT
Sub total - Solar		**154**	**559.6**	**515.0**	
Wind Projects					
WED	50	1	60.0	30.0	Adder
GNP	50	1	60.0	30.0	Adder
KWE	50	1	50.0	25.0	Adder
Sub total - Wind		**3**	**170.0**	**85.0**	
Grand total		**157**	**729.6**	**600.0**	

Source: GUNKUL

FINANCIAL STATISTICS AND KEY FINANCIAL RATIOS*

Unit: Mil. THB

	--------------------Year Ended 31 December --------------------				
	2022	**2021**	**2020**	**2019**	**2018**
Total operating revenues	7,554	9,380	8,727	7,157	6,447
Earnings before interest and taxes (EBIT)	2,233	3,165	2,235	3,186	2,682
Earnings before interest, taxes, depreciation, and amortization (EBITDA)	3,639	4,706	3,714	4,252	3,382
Funds from operations (FFO)	2,493	3,577	2,734	3,286	2,320
Adjusted interest expense	872	973	915	923	905
Capital expenditures	857	3,017	3,505	776	6,303
Total assets	32,331	42,485	46,032	39,042	35,625
Adjusted debt	11,621	21,627	21,155	18,228	20,585
Adjusted equity	14,140	13,283	12,475	11,333	9,500
Adjusted Ratios					
EBITDA margin (%)	48.17	50.17	42.55	59.41	52.47
Pretax return on permanent capital (%)	6.51	7.98	6.01	9.42	8.85
EBITDA interest coverage (times)	4.17	4.84	4.06	4.61	3.74
Debt to EBITDA (times)	3.19	4.60	5.70	4.29	6.09
FFO to debt (%)	21.45	16.54	12.93	18.03	11.27
Debt to capitalization (%)	45.11	61.95	62.90	61.66	68.42

* *Consolidated financial statements*

RELATED CRITERIA

- Corporate Rating Methodology, 15 July 2022
- Key Financial Ratios and Adjustments for Corporate Issuers, 11 January 2022
- Issue Rating Criteria, 15 June 2021

Gunkul Engineering PLC (GUNKUL)

Company Rating:	BBB+
Rating Outlook:	Stable

TRIS Rating Co., Ltd.
Silom Complex Building, 24th Floor, 191 Silom Road, Bangkok 10500, Thailand Tel: +66 2 098 3000