TRIS RATING
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GUNKUL ENGINEERING PLC

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CORPORATES

Company Rating: BBB+
Outlook: Stable

Last Review Date: 31/03/23

Company Rating History:

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

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RATIONALE

TRIS Rating affirms the company rating on Gunkul Engineering PLC (GUNKUL) at "BBB+" with a "stable" outlook. The rating considers the reliable cash flow from the company's power generating assets, its competitive strengths in the electrical equipment business, and advantages from vertical integration. Conversely, the rating is weighed down by the mounting challenges in the power business and risks associated with non-power businesses including the hemp and cannabis business.

KEY RATING CONSIDERATIONS

Reliable cash flow from power generating assets

The reliable cash generation from GUNKUL's power plants remains the key factor supporting the rating. The company owns more than a hundred solar and wind power plants in diverse locations. Currently, GUNKUL's aggregate equity capacity in operation (or contracted capacity in proportion to its ownership stakes in the operating power plants) totals 627 megawatts (MW).

Of the total, solar power represents about 86%. Solar power has been proven to generate highly predictable power outputs and cash flows, thanks to its low operational risk. Wind power makes up the remaining 14%. Outputs from wind power are typically less predictable, due mainly to wind speed variation. However, low operating costs have meant GUNKUL's wind power projects have performed satisfactorily.

TRIS Rating predicts both solar and wind power projects will continue to perform well, generating earnings before interest, taxes, depreciation, and amortization as a percentage of the revenue (EBITDA margin), on average, at above 80%. A pending legal issue concerning revocation of the land title deeds for the site of one of GUNKUL's wind power plants should not materially affect the company's operations, considering the relatively small investment exposure involved (3.2% of the total equity capacity in operation).

GUNKUL's power business carries minimal counterparty risk as most of its power plants have multi-year power purchase agreements (PPAs) with state-owned power utilities. The company has also pursued growth in solar rooftop electricity generation, selling electricity to creditworthy industrial customers under private PPAs. The capacity under this scheme makes up about 15% of the total operating equity capacity. Our base-case projection assumes the company will secure a total of 90 MW in new solar power generation under private PPAs during 2024-2026.

Acceptable overseas investment risks

GUNKUL has solar power projects in other countries, including Japan, Malaysia, and Vietnam, with a combined operating equity capacity of 246 MW. Of this, four solar farms in Vietnam represent the majority, with an aggregate operating equity capacity of 160 MW. We view the investments in Vietnam as entailing higher country and regulatory risks than other countries. Power output from plants in Vietnam is exposed to curtailment risk. More importantly, we view the credit profile of the state-run Vietnam Electricity (EVN) to not be as strong as the state-owned power buyers in Thailand. However, we assess GUNKUL's investment risks in Vietnam as acceptable, considering the past records of operations and payments from the power buyer.

Mounting challenges in 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 intensified, due to the increasing number of players and declining power tariffs for new power projects.

GUNKUL has recently secured 17 new power projects under the state 5.2-gigawatt renewable power scheme, with a combined contracted capacity of 832 MW. These include ground-mounted solar (569 MW), solar plus battery energy storage system (BESS) (84 MW), and wind power (180 MW). All projects are scheduled to be up and running during 2026-2030. Despite the challenges from low tariffs of THB2.17 per kilowatt-hour (kWh) for ground-mounted solar, THB2.83 per kWh for solar plus BESS, and THB3.1 per kWh for wind power, we expect these projects will be able to render satisfactory earnings, thanks mainly to economies of scale and improving technologies.

Competitive edges from business integration

We expect GUNKUL's advantages from business integration to continue. 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 can provide one-stop services to project owners, helping enhance sales of electrical equipment. It can also better control project construction costs.

As for the trading and manufacturing of electrical equipment businesses, GUNKUL's competitiveness has developed from its long market presence and extensive range of products covering all stages of the transmission and distribution of electricity. We forecast the electrical equipment business will bring in THB1.8-THB2 billion in revenue per annum over the next three years. Notwithstanding the tough competition, we expect GUNKUL to attain a gross margin of about 20%.

With respect to the EPC business, we consider GUNKUL poised to benefit from the renewable projects recently awarded. We forecast revenue from its EPC business will range between THB2-THB2.6 billion annually during 2024-2026, aided by its sizable backlog and promising domestic power-related construction projects.

Risks associated with non-power businesses

GUNKUL's non-power businesses typically deal with relatively higher risks. GUNKUL's electrical equipment and EPC businesses are driven by projects with public and private sector clients. We view the growth of the EPC business as being chiefly subject to the government's efforts to push forward several power-related infrastructure projects. The EPC business typically provides inferior and volatile profit margins to the power business. This is due to the multiple risks involved, such as severe competition, delays in the bidding and awarding of contracts, and unforeseeable holdups and cost overruns. However, we believe GUNKUL's efficient cost controls will keep the EPC business gross margin at about 15% during 2024-2026.

Also, GUNKUL entered into new ventures in hemp and cannabis plantation and production in 2021. Nevertheless, unclear regulations over hemp and cannabis have raised execution risks, limiting growth opportunities. With the current scale of investment, we do not expect the new ventures to significantly affect the company's financial risk profile over the next three years. Revenue from the business should remain small, staying below THB100 million per annum during 2024-2026.

Financial leverage to remain under control

We expect GUNKUL to perform satisfactorily in each business segment. In all, we project GUNKUL's total operating revenue to remain at about THB8 billion per annum during 2024-2026. With an expected EBITDA margin of about 40%, its EBITDA should range between THB3.1-THB3.2 billon per annum over the forecast period.

Also, we expect GUNKUL to keep financial leverage at acceptable levels. Our base-case forecast assumes the company will properly structure its investments in the 832-MW committed power projects to avoid overleveraging. The debt to EBITDA ratio is projected to stay at about 4 times during 2024-2026, given capital expenditures and investments total about THB2 billion. The debt to capitalization ratio should stay below 50%. Looking further ahead, we expect GUNKUL to incur heavier investments of THB2-THB3 billion per annum during 2028-2029 to complete its new wind power projects. At this pace of investment, the debt to EBITDA ratio could reach 5 times.

Debt structure

As of December 2023, GUNKUL's consolidated debt, excluding lease liabilities, was about THB15.2 billion. Of this, THB10.7 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 70%, 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 remain manageable

We expect GUNKUL to continue to manage its liquidity sufficiently. Debts of about THB3.8 billion will mature in 2024. As of December 2023, GUNKUL's sources of liquidity totaled THB6.5 billion, including cash and marketable securities of THB1.6 billion and undrawn credit facilities of THB4.9 billion, enabling the company to comfortably meet the debt obligations coming due. GUNKUL plans to refinance debentures worth about THB1.8 billion that will mature this July with a new 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 2023, the ratio was about 1 time. We believe the company will remain compliant with the covenant over the forecast period.

BASE-CASE ASSUMPTIONS

Key assumptions in TRIS Rating's base-case forecast during 2024-2026 are as follows:

- GUNKUL to secure a total of 90 MW in new solar power generation under private PPAs.
- GUNKUL to secure new EPC contracts for THB2 billion per annum.
- Total operating revenues to stay at about THB8 billion per annum.
- EBITDA margin to hover around 40%.
- Capital expenditures and investments to total THB2 billion.

RATING OUTLOOK

The "stable" outlook reflects our expectation that GUNKUL will continue to deliver satisfactory results. Its power plants in operation will run smoothly and generate cash flows as planned, while the plants under development will commence operations as scheduled. The company's power portfolio expansion will not significantly weaken its financial profile. Also, the other lines of businesses will deliver decent results over the forecast period.

RATING SENSITIVITIES

A rating upside could develop if GUNKUL's operating performance and cash flow against debt obligations are well above our forecast. Conversely, a downward revision of the rating could emerge if its financial profile deteriorates materially. This could arise from significant underperformances of the power generation assets or aggressive 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 2024, the Dhumrongpiyawut Family remained the major shareholder, holding about 54% of the company's interest.

The company was one of the first movers in the renewable power business, starting development of solar power projects in 2010. The power business accounted for the majority (30%) of its total revenue in 2023, followed by the EPC business (27%, excluding sales of asset under finance lease), and the electrical equipment business (23%). Currently, GUNKUL holds an aggregate equity capacity of 1,459 MW, comprising existing power projects (627 MW) and new power projects under the new quota (832 MW).

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.

GUNKUL unveiled its new ventures into the hemp and cannabis business in 2021. However, unclear regulations have meant the revenue remains negligible.

KEY OPERATING PERFORMANCE

Table 1: Revenue Breakdown

Unit: %

	2019	2020	2021	2022	2023
Electrical equipment	22	17	16	24	23
EPC	14	34	30	26	39
Power	63	47	51	46	30
Others	1	2	3	4	8
Total	**100**	**100**	**100**	**100**	**100**
Total revenue (million THB)	**7,099**	**8,649**	**9,318**	**7,506**	**7,605**

Source: GUNKUL

Table 2: Current Power Project Portfolio

Company/Country	Held by GUNKUL (%)	Gross Contracted Capacity (MW)	Equity Contracted Capacity (MW)	Tariff
Solar Projects				
GPS	40	26.0	10.4	Adder
GCPG	51	30.9	15.8	Adder
RNS	67	87.0	87.0	FiT
SES, GIG, GSP1	100	119.2	119.2	FiT/Agreed Prices
Japan	100	65.3	65.3	FiT
Malaysia	70	30.0	21.0	FiT
Vietnam	100	160.0	160.0	FiT
Others	25-100	68.2	63.3	Adder/FiT/ Agreed Prices
Sub total - Solar		**586.6**	**542.0**	
Wind Projects				
WED	50	60.0	30.0	Adder
GNP	50	60.0	30.0	Adder
KWE	50	50.0	25.0	Adder
Sub total - Wind		**170.0**	**85.0**	
Projects under New Quota				
Solar	100	568.8	568.8	FiT
Solar plus BESS	100	83.6	83.6	FiT
Wind	100	180.0	180.0	FiT
Sub total - New Quota		**832.4**	**832.4**	
Grand total		**1,589.0**	**1,459.4**	

Source: GUNKUL

FINANCIAL STATISTICS AND KEY FINANCIAL RATIOS*

Unit: Mil. THB

	---------------------Year Ended 31 December ----------------				
	2023	2022	2021	2020	2019
Total operating revenues	7,717	7,554	9,380	8,727	7,157
Earnings before interest and taxes (EBIT)	2,382	2,233	3,165	2,235	3,186
Earnings before interest, taxes, depreciation, and amortization (EBITDA)	3,215	3,639	4,706	3,714	4,252
Funds from operations (FFO)	2,350	2,493	3,577	2,734	3,286
Adjusted interest expense	690	872	973	915	923
Capital expenditures	2,590	857	3,017	3,505	776
Total assets	32,850	32,331	42,485	46,032	39,042
Adjusted debt	13,069	11,621	21,627	21,155	18,228
Adjusted equity	13,990	14,140	13,283	12,475	11,333
Adjusted Ratios					
EBITDA margin (%)	41.7	48.2	50.2	42.6	59.4
Pretax return on permanent capital (%)	8.0	6.5	8.0	6.0	9.4
EBITDA interest coverage (times)	4.7	4.2	4.8	4.1	4.6
Debt to EBITDA (times)	4.1	3.2	4.6	5.7	4.3
FFO to debt (%)	18.0	21.5	16.5	12.9	18.0
Debt to capitalization (%)	48.3	45.1	62.0	62.9	61.7

* *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

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