TRIS RATING
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PADAENG INDUSTRY PLC

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CORPORATES

Company Rating:	BBB-
Outlook:	Negative

Last Review Date: 08/02/19

Company Rating History:

Date	Rating	Outlook/Alert
08/02/19	BBB-	Stable

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RATIONALE

TRIS Rating affirms the company rating on PDI at "BBB-". At the same time, we revise the rating outlook to "negative" from "stable". The outlook revision reflects a potential deterioration of PDI's credit profile, following the company's new strategy to branch into the property business with substantial investments. In view of the large-scale investment plans, TRIS Rating expects PDI's capital structure and cash flow protection to weaken considerably in the years ahead. The revised outlook is also prompted by our concerns over the uncertainty of the company's investment strategy.

The rating continues to reflect PDI's stable earnings from its existing power portfolio and adequate liquidity. However, the rating is partly offset by the small size of its power portfolio, its short track record in the power business, and the likelihood of a steep rise in leverage from new investments.

KEY RATING CONSIDERATIONS

Small renewable energy portfolio

The rating reflects PDI's business status as an investment holding company, focusing on the renewable energy business. The company decided to shutter its former zinc business in 2014 and completely ceased all zinc-related operations in the first quarter of 2019. Over the same period, the company built up its power portfolio through acquisitions of operating solar farms in Thailand and Japan.

Currently, the solar power portfolio is a core revenue contributor of PDI. The company owns nine operating solar farms with total installed capacity of 49.3 megawatts (MW). The company's power portfolio is considered relatively small, compared with those of other companies rated by TRIS Rating.

Reliable earnings from solar power portfolio

PDI's rating strength is derived largely from the company's solar power portfolio. We expect PDI's solar power plants will continue to render steady earnings over a long term, supported by multi-year power purchase agreements (PPA) and financially strong off-takers. The PPAs are critical to revenue stability as they help mitigate demand risk and provide fixed-rate tariffs over the course of contracts. All PPAs are on a non-firm basis.

In addition, solar power entails low operation risk. The volume risk of power output is mitigated by the consistent operation of solar farms. Plant operations have remained smooth and in line with our forecast. Overall, the actual annual output from most of the company's solar power plants has reached P50 estimates (50% probability of energy production).

Short track record in the power business

The rating is constrained by PDI's short track record in the power business. So far, PDI's experience is limited to acquiring and operating solar power projects. The company has no track record in executing more complex types of power projects.

TRIS Rating also recognizes the disadvantages of PDI's late entry into the renewable power business. Due to limited opportunities and the low returns of renewable energy projects in Thailand, the company has had to acquire operating projects or seek new projects overseas. PDI has sought to further invest in new power projects but the company has not had much progress so far.

Uncertain scope of investment

We believe that the company is seeking for investment opportunities in a range of industries at the moment. The company is likely to lean toward more risky ventures after several highly anticipated projects have fallen through. Projects studied in the last year, including metal recycling, waste management, a biomass power plant, and a medium-sized Japan-based solar farm, have all been dropped. The company also incurred some investment write-downs. Given the diminishing attractiveness of investment in renewable energy projects in Thailand, the company has to seek higher risk investments such as solar power projects in neighboring countries or expand into other businesses.

In our view, PDI's business direction and investment strategy remains uncertain and likely to change according to the expertise and interests of the new management team. The sizable investments in new projects are likely to alter the asset mix of PDI's portfolio significantly, and thus reframing the company's business risk profile.

Strategic move to property business

TRIS Rating takes account of an abrupt change in PDI's investment strategy. Following a series of aborted investment plans, PDI is bent on branching into the property business with a plan to make hefty debt-financed acquisitions as a means to accelerate investment returns and growth. Currently, the company's only on-hand project is development of a newly built hotel in a prime location in Bangkok. PDI is also looking at overseas investment opportunities, with an eye on a group of hotels.

PDI's expansion into the property business will likely have an adverse impact on its credit profile due to the higher industry risk in comparison to the Thai power business. PDI's potential acquisitions to date are not yet concluded, leaving uncertainties in the size and profile of the investment assets. The company's tendency to enter into large-scale debt-funded investments in properties will materially change the company's business profile and concurrently lead to a more leveraged capital structure.

Weaker-than-expected performance

PDI's recent operating performance was weaker than our expectations, despite the satisfactory operations of solar farms. For the first nine months of 2019, earnings before interest, taxes, depreciation, and amortization (EBITDA) was about Bt222 million, much lower than our previous EBITDA forecast of about Bt500 million per annum. The lower-than-forecast profits were due to the absence of earnings from the aborted biomass power project, plus one-off expenses from impairment of project feasibility, costs of reforestation, and losses from business discontinuation. We expect PDI's EBITDA could improve over time, underpinned by continued cost-cutting measures. At the same time, PDI's financial leverage as of September 2019 was still lower than expected as none of the planned investments materialized.

Potential surge in leverage

Looking ahead, TRIS Rating expects PDI's capital structure and cash flow protection to weaken considerably in the near-to-intermediate term. Our base-case forecast takes into consideration the high likelihood of PDI exceeding our previous expectations for capital spending. During 2020-2022, we expect PDI to defray about Bt13.7 billion, including a newly built hotel in Bangkok (Bt1.6 billion), a large operating solar farm in neighboring countries (Bt2.1 billion), and prospective investments in other hotels (Bt10 billion).

Based on these investments, the ratio of debt to EBITDA could surge to an aggressive level of above 8 times. At the same time, funds from operations (FFO) to debt could fall below 10% during 2020-2022. The ratio of debt to capitalization would stay elevated at above 70%, in contrast to around 60%-62% in our previous forecast. The potentially larger-than-expected debt loads have triggered the negative revision on outlook.

Adequate liquidity

We assess PDI's liquidity as adequate, as all debt repayment risks are mitigated by the typical project financing structure in which net cash flows from the solar projects are used to service interest and principal as the first priority. As of September 2019, PDI had high levels of cash, deposits, and short-term investments, totaling about Bt3.9 billion, which far exceeds the debts coming due over the next 12 months. However, PDI's aggressive investment budgets could quickly deplete its cash reserves and liquid assets.

PDI has issued a secured debenture totaling Bt1.15 billion. The debenture will come due in December 2021. Under the bond conditions, PDI is obliged to maintain a debt to equity ratio below 3.5 times. The company has plenty of headroom as the ratio stood at merely 0.49 times as of September 2019.

BASE-CASE ASSUMPTIONS

- Total revenues to rise from Bt530 million in 2019 to Bt800 million in 2020 and Bt3.5 billion a year in 2021-2022. We assume the company will acquire a large solar farm in neighboring countries in 2020 and a group of hotels in 2021.
- EBITDA to surge from Bt285 million in 2019 to Bt520 million in 2020 and Bt1.3 billion a year in 2021-2022.
- EBITDA margin to drop from above 50% in 2020 to 38% thereafter due to the increasing proportion of lower earnings from the hotel business.
- Total capital expenditure of about Bt13.9 billion during 2020-2022.
- No new equity injections.
- No dividend paid in 2020. Dividend payout ratio of 50% for 2021-2022.

RATING OUTLOOK

The "negative" outlook embeds our expectation that PDI's capital structure and cash flow protection will weaken considerably in the near-to-intermediate term as the company forges ahead with aggressive investment plans. As for existing business, we expect PDI's solar farms will continue to perform satisfactorily and deliver stable cash flows over the long term.

RATING SENSITIVITIES

A rating downgrade would occur if PDI moves ahead with some of its planned investments, causing a material deterioration of its financial profile as expected.

Given the negative outlook, a rating upgrade is unlikely in the near and medium term. At the same time, the outlook could be revised to "stable" if the company is able to maintain its capital structure or financial leverage at levels significantly below our forecasts. This could occur if PDI injects new equity or cuts the size of its new investments.

COMPANY OVERVIEW

PDI was founded in 1981 to engage in zinc mining and production of high-grade zinc metal and value-added zinc alloys. PDI's zinc mine was located in Mae Sod district, Tak province. PDI also owned a smelter located in Muang district of Tak province, and a roaster plant in Rayong province.

In 2014, PDI announced plans to shut down its zinc business after 33 years of operations. This crucial decision took into account a number of issues, including the exhaustion of zinc resources at its Mae Sod mine, the remote likelihood of the government granting new concessions, and strong opposition by environmentalists. PDI also wanted to move away from the volatility inherent in global zinc prices and shrinking domestic demand. The company's zinc business ceased operations completely in the first quarter of 2019.

PDI is currently an investment holding company, focusing on renewable energy. CGH has been the major shareholder since 2016 with a 25% stake. CGH has played a number of key roles in PDI's business transformation from zinc mining and trading to more sustainable businesses. CGH has recruited a new management team, carried out cost-cutting measures, and also revisited potential projects in which PDI planned to invest.

The company entered the renewable energy business by acquiring two Japanese solar farms and the 6.3-MW Mae Ramat solar farm in 2016. In 2017, the company acquired six operating solar projects with total installed capacity of 30 MW from Symbior Element Pte. Ltd. As of September 2019, the company owns nine operating solar farms with total installed capacity of 49.3 MW.

KEY OPERATING PERFORMANCE

Table 1: Power Project Portfolio as of September 2019

Project/Country	Held by PDI (%)	Status	Installed Capacity (MW)	Contracted Capacity (MW)	Tariff
Thailand					
Solar					
PDI Mae Ramat	100	Operating	6.3	6.3	Adder Bt6.5
ATCE1 (Prachinburi)	100	Operating	8.0	8.0	FIT Bt5.66
ATCE2 (Prachinburi)	100	Operating	8.0	8.0	FIT Bt5.66
ATCE3 (Prachinburi)	100	Operating	3.0	3.0	FIT Bt5.66
ATCE4 (Samutsakhon)	100	Operating	6.0	6.0	FIT Bt5.66
ATCE5 (Samutsakhon)	100	Operating	4.0	4.0	FIT Bt5.66
PPS (Khon Kaen)	100	Operating	1.0	0.99	Adder Bt8
			36.3	**36.3**	
Overseas (Japan)					
Solar					
Nanao	TK-GK	Operating	2.27	2.27	FIT JPY32
Nagota	TK-GK	Operating	10.73	10.73	FIT JPY36
			13.0	**13.0**	
Grand total			**49.3**	**49.3**	

Source: PDI

FINANCIAL STATISTICS AND KEY FINANCIAL RATIOS*

Unit: Bt million

	Jan-Sep 2019		--------------Year Ended 31 December 2018	2017	2016	2015 -----------
Total operating revenues	424		5,126	6,315	5,283	4,882
Earnings before interest and taxes (EBIT)	86		138	960	486	82
Earnings before interest, taxes, depreciation, and amortization (EBITDA)	222		329	1,127	1,224	590
Funds from operations (FFO)	137		221	991	1,142	306
Adjusted interest expense	87		103	35	11	42
Capital Expenditure	84		8	30	15	102
Total assets	9,128		8,550	7,596	5,794	5,105
Adjusted debt	0		666	276	0	0
Adjusted equity	4,683		4,703	5,084	4,017	3,581
Adjusted Ratios						
EBITDA margin (%)	52.5		6.4	17.8	23.2	12.1
Pretax return on permanent capital (%)	2.5	**	2.0	16.4	10.3	1.7
EBITDA interest coverage (times)	2.6		3.2	32.3	111.0	14.1
Debt to EBITDA (times)	0.0	**	2.0	0.2	0.0	0.0
FFO to debt (%)	n.m.	**	33.2	359.2	n.m.	n.m.
Debt to capitalization (%)	0.0		12.4	5.1	0.0	0.0

* *Consolidated financial statements*
** *Annualized with 12 months trailing*
Note: *The figures and financial ratios since 2016 are adjusted by including financial performance of Green Brilliant GK (13-MW solar farm projects in Japan) on consolidation basis, instead of initial recognition as long-term investments.*
n.m *Not meaningful*

RELATED CRITERIA

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

Company Rating:	BBB-
Rating Outlook:	Negative

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