RIGHT TUNNELLING PLC

No. 232/2022
20 December 2022

CORPORATES

Company Rating:	BBB-
Outlook:	Negative

Last Review Date: 01/02/22

Company Rating History:

Date	Rating	Outlook/Alert
01/02/22	BBB-	Stable

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RATIONALE

TRIS Rating affirms the company rating on Right Tunnelling PLC (RT) at "BBB-". At the same time, we revise the rating outlook to "negative" from "stable". The revised outlook reflects a recent deterioration in RT's financial profile, due mainly to weakening earnings and increasing debt loads, with uncertain performance recovery.

The rating continues to reflect RT's competitive strengths and well-established track record in tunnel and shaft works. Conversely, the rating is constrained by RT's small scale of business and narrow scope of service offerings. The rating is also held back by the severe competition and cyclicality of the engineering and construction (E&C) industry.

KEY RATING CONSIDERATIONS

Weaker performance, gradual recovery expected

RT's recent operating performance has been significantly weaker than our expectation. The Coronavirus Disease 2019 (COVID-19) pandemic and the Ukraine-Russia war caused significant delays in several construction projects and rises in construction material costs. As a result, the company's total operating revenue dropped by 12.4% year-on-year (y-o-y) to THB1.7 billion in the first nine months of 2022, achieving only a half of our full-year revenue forecast. The surge in raw material prices, particularly steel, dampened its gross margin to the lowest level seen of 7.9% in the first nine months of 2022. We forecast RT's earnings before interest, taxes, depreciation, and amortization (EBITDA) to drop to below THB100 million and its funds from operation (FFO) to be lower than THB50 million in 2022.

However, the increasing value of new construction projects and the cool-down of raw material prices could help improve RT's operating performance in coming years. Our base-case expects the company's gross margin to bounce back to 10%-12% during 2023-2024. We assume the company will secure new construction contracts of about THB8 billion in 2022 and THB3 billion per annum during 2023-2024, bolstering its total operating revenue to around THB4 billion per annum. RT's EBITDA will likely improve to THB350-THB500 million per annum and its FFO should climb to THB230-THB330 million per annum during 2023-2024.

Despite the expected performance recovery, intense competition in the E&C industry and volatile raw material prices remain significant downside risks. Challenging excavation works could also cause unforeseen difficulties, posing risks of project delays and cost overruns. Further deterioration or slower-than-expected recovery in RT's operating performance could negatively affect the rating.

Rising debt loads

RT has shown deteriorating working capital management. A continued increase in the sum of outstanding unbilled receivables has kept working capital requirements high, pushing up the company's debt burden. Coupled with the compressed profit margins, its debt to EBITDA ratio shot up to 12.6 times during the first nine months of 2022, from 3.9 times in 2021. Its FFO to debt ratio slid to 2.6% during the first nine months of 2022, from 20% in 2021.

However, since most of RT's clients are government agencies and top-tier construction companies, the payment risk is considered minimal. We expect the company's debt outstanding to drop significantly once it receives payments from the project owners. Given that the problem-plagued projects are nearly completed and its earnings should gradually recover, we expect RT's debt to EBITDA ratio to improve to about 7 times in 2023 and below 4 times in 2024. The company's FFO to debt ratio should also improve, ranging between 10%-20% during 2023-2024.

As of September 2022, RT's consolidated debt, excluding financial lease, was THB1.5 billion. About THB0.9 billion of this was considered priority debt, comprising secured debt owed by RT. The priority debt to total debt ratio was 61%, suggesting that RT's unsecured creditors are significantly disadvantaged to its priority debt holders with respect to claims against the company's assets.

Well-established track record, competitive strength in excavation

RT is a leading geotechnical construction company in Thailand. The company specializes in open and underground rock excavation. Its strengths derive from its experienced management team, engineers, and geologists, as well as a wealth of machinery and equipment. The company focuses on tunnel and shaft works, dam construction, hydro power plants, pipe jacking, and horizontal directional drilling, mostly for public sector clients.

RT has been involved in several large-scale projects, including tunnelling the diversion and power waterways of Nam Ngum 2 hydropower and major civil works for the powerhouse of Xayaburi hydropower plant. Both are part of the large-scale hydropower plants in the Lao People's Democratic Republic (Lao PDR). The company is also working on the tunnelling works of the Dual-Track Rail Route Project for the Northeastern Line (Map Kabao-Thanon Chira Junction) and the Mae Taeng-Mae Ngat Project. These two projects should help enhance its track record, increasing its chances of successfully bidding for future construction contracts.

Small business scale, high business concentration

RT's competitiveness is offset by its small business scale, as measured by size of revenue and asset base. Also, its operating performance has been dominated by a few large projects. Revenue from the three largest projects made up almost two thirds of total revenue over the past three years. The three largest projects under construction accounted for nearly 70% of its backlog as of September 2022. Failure to complete one large project or any significant disruption to the project could result in material impact on its financial results. In addition, RT's revenue stream relies heavily on public constructions that are prone to project delays.

However, looking forward, the company will likely benefit from the government's efforts to improve the country's infrastructure. We expect several potential projects to involve excavation works in which the company has expertise. RT recently secured two large construction contracts for the Double-Track Denchai-Chiang Rai-Chiang Khong railway, worth THB4.3 billion in total, boosting its backlog to almost THB9 billion as of September 2022. The increasing backlog should boost RT's total operating revenue to reach our base-case target.

Liquidity to be manageable

We expect RT to manage its liquidity appropriately. As of September 2022, about half of the total debt comprised project finances from banks providing flexible debt repayment terms. RT had about THB269 million in long-term loans and financial leases coming due in the next 12 months. This should be sufficiently covered by cash and undrawn credit facilities of THB223 million in total, plus the expected FFO of THB180 million.

A key financial covenant on RT's debentures requires maintenance of an interest-bearing debt to equity ratio below 2.5 times. The company was able to comply with this key financial covenant, with the ratio of about 1.4 times as of September 2022. Nevertheless, RT was unable to comply with the debt service coverage ratio covenant on its bank loans. This ratio was 0.8 times in 2021, lower than the required level of above 1.1 times. However, given the company's record of delivering construction projects as planned and the earnings recovery prospect, we expect RT to receive covenant waivers from its lenders.

BASE-CASE ASSUMPTIONS

- RT to secure new construction contracts for about THB8 billion in 2022 and THB3 billion per year during 2023-2024.
- Total operating revenue to reach THB2.5 billion in 2022 and THB4 billion per year during 2023-2024.
- Gross margin to stay about 7% in 2022 and improve to 10%-12% during 2023-2024.
- Total capital spending to be THB250-THB550 million per year during 2022-2024.

RATING OUTLOOK

The "negative" outlook reflects RT's significantly weaker-than-expected operating performance. Though we forecast the company's performance to improve in the following years, the pace of recovery remains uncertain, given future headwinds.

RATING SENSITIVITIES

A rating downgrade could occur if RT's financial results continue to come in below our expectations. This could be due to project delays, cost overruns, or inefficient working capital management, such as the scenario in which debt to EBITDA ratio stays above 4 times with no signs of recovery. In contrast, the rating outlook will be revised to "stable" if profitability and working capital management are in line with expectations and if revenue increases as targeted.

COMPANY OVERVIEW

RT was founded in 2000 by Mr. Chawalit Tanomtin and listed on the Stock Exchange of Thailand (SET) in 2020. Mr. Chawalit Tanomtin, the founder, remains the major shareholder, holding approximately 16% of the company's shares as of September 2022. The company is a contractor specializing in geotechnical works, covering tunnel and shaft construction, dam construction, hydro power plants, pipe jacking, and horizontal directional drilling. RT is also engaged with slope protection and stabilization, earth and rock excavation, and geological exploratory drilling services. Revenue from tunnel and shaft construction has accounted for 50%-60% of total revenue over the last three years.

KEY OPERATING PERFORMANCE

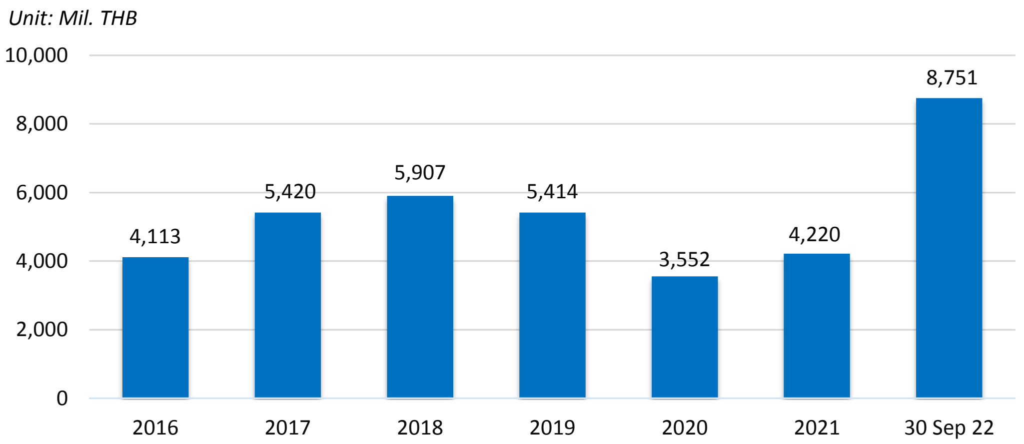
Table 1: Construction Revenue Breakdown by Type of Project

Unit: %

Type of Project	2017	2018	2019	2020	2021	Jan-Sep 2022
Tunnel & Shaft	33	65	61	59	52	37
Dam	7	1	2	8	20	31
Hydro Power	41	16	4	1	-	-
Pipe Jacking & Horizontal Directional Drilling	13	11	11	12	15	15
Others	6	7	22	20	13	17
Total	**100**	**100**	**100**	**100**	**100**	**100**

Source: RT

Chart 1: Backlog Movement



Source: RT

FINANCIAL STATISTICS AND KEY FINANCIAL RATIOS*

Unit: Mil. THB

	Jan-Sep 2022		-------------Year Ended 31 December ------------ 2021	2020	2019	2018
Total operating revenues	1,691		2,488	2,860	2,351	1,882
Earnings before interest and taxes (EBIT)	(39)		100	364	230	(38)
Earnings before interest, taxes, depreciation, and amortization (EBITDA)	74		255	550	500	203
Funds from operations (FFO)	18		198	428	382	151
Adjusted interest expense	53		54	68	75	47
Capital expenditures	36		32	28	135	238
Total assets	4,489		3,915	4,050	3,731	2,999
Adjusted debt	1,337		990	525	1,155	797
Adjusted equity	1,250		1,337	1,389	587	457
Adjusted Ratios						
EBITDA margin (%)	4.40		10.25	19.24	21.26	10.76
Pretax return on permanent capital (%)	(1.56)	**	3.83	15.66	12.67	(2.87)
EBITDA interest coverage (times)	1.40		4.72	8.09	6.68	4.30
Debt to EBITDA (times)	12.59	**	3.88	0.95	2.31	3.93
FFO to debt (%)	2.63	**	19.99	81.52	33.04	18.96
Debt to capitalization (%)	51.67		42.55	27.44	66.29	63.56

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

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

Company Rating:	BBB-
Rating Outlook:	Negative

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