

SAMART CORPORATION PLC

No. 26/2018
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CORPORATES

Company Rating: BBB+
Outlook: Negative

Company Rating History:

Date	Rating	Outlook/Alert
20/04/15	BBB+	Stable

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RATIONALE

TRIS Rating affirms the company rating of Smart Corporation PLC (SAMART) at “BBB+”. At the same time, TRIS Rating revises the rating outlook of SAMART to “negative” from “stable”. The “negative” outlook reflects a weaker equity base and the risk that a substantial amount of the remaining overdue account receivables would be deemed uncollectible, thereby further depleting its equity.

The rating continues to reflect SAMART’s diverse lines of business and sources of income, as well as a strong competitive position in the information technology (IT) segment. The rating also takes into consideration fluctuations in trading/turnkey projects in the IT and utility segments, plus a weaker financial risk profile.

KEY RATING CONSIDERATIONS

Substantial amount of overdue account receivables

As of December 2017, SAMART carried on its books of Bt5,536 million account receivables with more than 12 months past due. Most of the past due receivables were from the mobile handset distribution business operated by Smart Digital PLC (SDC) a few years ago. Of the amount past due, only about 30% has been set aside as a provision through an allowance for doubtful debts. A further write-down of up to Bt3,000 million in overdue receivables could be ahead in the coming years.

SAMART has a weak capital base and needs to strengthen it through improved profitability or capital injection. If the write-off comes before the equity base is re-built, SAMART might violate a financial covenant in its outstanding debentures. Under the terms of the debentures, SAMART is required to keep the ratio of net interest bearing debt to equity below 3 times.

Diverse business lines and sources of income

SAMART’s business portfolio covers five key segments including IT solutions, digital solutions, contact center services, technology-related businesses, and utility and transportation services. The broad product line, wide market coverage, and different types of customers mitigate some of the effects of economic downturns and provide diverse sources of income. This enhances SAMART’s business profile. In addition, the company has a strong competitive position in the IT solutions segment. The company has a proven record of undertaking a broad range of IT projects for a number of government agencies.

Base of recurring revenue

SAMART’s revenue base is secured by recurring service income from the IT solutions segment and steady cash flow from providing air traffic control service in Cambodia. In 2017, these two lines of business generated approximately Bt5,200 million in revenue or about 40% of total revenue. TRIS Rating forecasts revenue from these two segments to be Bt5,000-Bt5,500 million per annum over the next three years. These stable sources of revenue provide a cushion and reduce the volatility of SAMART’s operating performance.

In 2017, SAMART reported revenue of Bt13,023 million, down by 4.8% from 2016, due mainly to declines in mobile handset sales. Over the next three years, a sizable backlog will secure the revenue base. The backlog, mainly from

Samart Telcoms PLC (SAMTEL), TEDA Co., Ltd, and One To One Contacts PLC (OTO), will yield revenue of Bt5,000 million in 2018, Bt2,600 million in 2019, and Bt1,200 million in 2020. In addition, air traffic control service in Cambodia is expected to bring in at least Bt1,700 million in revenue per year.

During 2018-2020, TRIS Rating's base case assumes revenue will range from Bt14,600-Bt16,400 million per annum. The forecast takes into account the backlog, new projects at SAMTEL's, and a trunk radio and co-tower projects at SDC. Capital expenditures are estimated at Bt8,000-Bt10,000 million in total during 2018-2020.

Financial risk profile deteriorates

SAMART's financial profile materially weakened in 2017 due to poor operating results at SDC. Funds from operations (FFO) dropped from Bt1,891 million in 2016 to Bt36 million in 2017, due mainly to a Bt1,535 million provision for doubtful debts at SDC. FFO will remain under pressure in 2018, especially if SAMART must make another large provision. FFO is forecast to return to Bt2,800-Bt3,000 million per annum in 2019-2020.

SDC has transformed from a mobile handset distributor to a provider of digital services and solutions. However, the new business lines will take time to come to fruition. Thus, TRIS Rating holds the view that SAMART's financial risk will stay elevated during the next one to two years.

SAMART's capital structure weakened due mainly to operating losses at SDC's and a deteriorated equity base. Although the company's outstanding debt declined from Bt13,241 million at the end of 2016 to Bt12,474 million at the end of 2017, the debt to capitalization ratio rose from 62.61% in 2016 to 66.98% in 2017 as the equity eroded.

Without a fresh capital injection, the debt to capitalization ratio is expected to stay above 70% during 2018-2020. This forecast takes into account the potential adverse effect of additional provisions for doubtful debts, new borrowing to fund the trunk radio and co-tower projects at SDC, as well as new service projects at SAMTEL. The high level of leverage is a negative factor.

RATING OUTLOOK

The "negative" outlook reflects SAMART's deteriorating financial profile and our concern over SAMART's weakening capital base which might potentially trigger the breach of a financial covenant.

RATING SENSITIVITIES

The rating downgrade pressure could be triggered if SAMART's financial profile deteriorates further and the company fails to manage its capital base so that the debt to capitalization ratio stays above 70% on sustained basis. The outlook could be revised to "stable" if the company strengthens its balance sheet or improves its operations, adding more financial flexibility.

COMPANY OVERVIEW

SAMART was founded by the Vilailuck family in 1950 and was listed on the Stock Exchange of Thailand (SET) in 1993. At the end of 2017, the Vilailuck family owned about 45% of SAMART's outstanding shares. The business profile of SAMART is underpinned by its diverse sources of revenue from five major lines of business: IT solutions, mobile multimedia, contact center services, technology-related businesses, and utility and transportation services.

The IT solutions segment is operated by SAMTEL. The mobile multimedia segment is operated by SDC. Contact center services are the responsibility of OTO. The remaining lines of business are operated by SAMART and SAMART's unlisted subsidiaries.

As of December 2017, SAMART held about 70% of SAMTEL, 71% of SDC, and 68% of OTO. The major revenue generator is the IT solutions segment, contributing 53% of total revenue, followed by utility and transportation services (27%), and the digital solutions segment (10%).

KEY OPERATING PERFORMANCE
Table 1: Revenue Contribution by Segment

Business Line	2015		2016		2017	
	Bt Mil.	%	Bt Mil.	%	Bt Mil.	%
IT solutions and services (SAMTEL)	5,716	31	5,721	42	6,949	53
Mobile multimedia/digital solutions (SDC)	7,730	42	3,366	25	1,334	10
Contact center services (OTO)	988	5	962	7	818	6
Technology-related	2,991	6	3,350	24	3,502	27
Utilities and transportation	1,546	8	684	5	888	7
Eliminations	(605)	(3)	(407)	(3)	(468)	(4)
Total	18,366	100	13,676	100	13,023	100

Source: SAMART

FINANCIAL STATISTICS AND KEY FINANCIAL RATIOS*

Unit: Bt million

	----- Year Ended 31 December -----				
	2017	2016	2015	2014	2013
Revenue	13,023	13,676	18,366	23,880	22,293
Gross interest expense	486	502	541	452	510
Net income from operations	(948)	71	808	1,433	1,491
Funds from operations (FFO)	36	1,891	2,507	3,158	3,277
Capital expenditures	1,072	2,090	2,304	1,168	893
Total assets	22,210	25,216	27,317	26,136	24,081
Total debts	12,474	13,241	14,555	13,350	9,604
Shareholders' equity	6,150	7,907	8,318	8,262	8,531
Operating income before depreciation and amortization as % of sales	3.64	15.21	16.44	16.57	17.97
Pretax return on permanent capital (%)	(6.60)	2.36	7.35	13.58	16.57
Earnings before interest, tax, depreciation, and amortization (EBITDA) interest coverage (times)	0.91	4.44	5.91	9.28	7.97
FFO/total debt (%)	0.29	14.28	17.23	23.66	34.13
Total debt/capitalization (%)	66.98	62.61	63.63	61.77	52.96

* Consolidated financial statements

Samart Corporation PLC (SAMART)

Company Rating:	BBB+
Rating Outlook:	Negative

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