TRIS RATING
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SAHAKOL EQUIPMENT PLC

No. 90/2023
22 May 2023

CORPORATES

Company Rating:	BBB-
Outlook:	Stable

Last Review Date: 30/05/22

Company Rating History:

Date	Rating	Outlook/Alert
11/06/21	BBB-	Stable
22/06/20	BBB-	Negative
08/06/18	BBB-	Stable

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RATIONALE

TRIS Rating affirms the company rating on Sahakol Equipment PLC (SQ) at "BBB-" with a "stable" rating outlook. The rating reflects SQ's competitive strengths in mining services and the predictable income streams from long-term service contracts with creditworthy clients. These strengths are somewhat weighed down by the company's narrow scope of business with dependency on a few large projects, depleting backlog, and high leverage. The rating also takes into consideration our concerns over rising construction materials and labor costs which could depress SQ's profit margins in the short to medium term.

KEY RATING CONSIDERATIONS

Strengths in mining services with predictable income streams from long-term contracts

SQ provides an extensive range of mining services. The company has a long track record in mining operations as it has served as the main contractor or a joint operator for several phases of the Mae Moh mining operations of the Electricity Generating Authority of Thailand (EGAT) over the past three decades. SQ's competitive strengths are founded on its wealth of experienced mining engineers and specialized mining equipment.

SQ has undertaken mining projects in the Lao People's Democratic Republic (Lao PDR) since 2015. The company currently holds a lignite mining service agreement with Hongsa Power Co., Ltd. (HPC), a leading power producer in the Lao PDR. The project is viewed as the start of SQ's overseas expansion. HPC continually feeds work related to the Hongsa mine to the company.

SQ's predictable income streams are backed by its long-term service contracts and the low credit risk of its contract counterparties who are the mining project sponsors, EGAT and HPC. Mining contracts typically span periods of 10 years for each phase.

High project concentration risk and depleting backlog continue to pressure business profile

SQ focuses only on the coal mining business which currently has very limited opportunities for growth. In addition, its backlog consists of projects from two major owners, EGAT and HPC. As of March 2023, SQ's backlog stood at THB17.7 billion, down from THB22.6 billion at the end of March 2022. The major projects in backlog comprised the Mae Moh Phase 8 (THB5.7 billion), the Hongsa Mine Phase D (THB5.2 billion), and projects related to the Hongsa mine including the build-lease-transfer (BLT) project, the operation and maintenance (O&M) services, and the North pit wall expansion project. Around 87% of its backlog is scheduled for completion in 2024-2027 and the rest in 2033.

Currently, the Mae Moh mine generates around 65%-70% of the company's revenue while the remainder comes from the Hongsa mine. Underperformance in any of these projects could significantly hurt the company's overall financial profile. Besides, as its backlog is depleting over time. The success of its bids for the Mae Moh Phase 10 and Hongsa Mine Phase G projects, to be tendered in 2024 and 2027 respectively, will be critical for the company's long-term business prospects.

Given the dearth of new viable mining projects in Thailand, SQ has sought opportunities to expand into other businesses, especially the renewable power business. However, its investment amount and timing remain uncertain.

Gross margins remain under pressure

SQ's operating performance in 2022 through the first quarter of 2023 was below our expectations. Its revenues in 2022 and the first quarter of 2023 were THB5.2 billion and THB1.3 billion, respectively. SQ reported gross margins of 16.2% in 2022 and 18.2% in the first quarter of 2023, decreasing from 20%-22% in 2020-2021. Its gross margins were hurt by rising explosives and fuel prices as well as higher repair and maintenance costs, in line with usage cycles.

Based on its existing backlog, we project SQ's revenue to peak at THB6.8 billion in 2023, then drop to THB4.6 billion in 2024 and THB3.6 billion in 2025 if no new contracts are added. We expect SQ's gross profit margin in 2023 to decline to around 13%-14% amid rising construction costs and a higher contribution of revenue from the BLT project which has a lower profit margin. Its gross profit margin is then expected to recover to 20%-21% in the following year. SQ's earnings before interest, taxes, depreciation, and amortization (EBITDA) are expected to be around THB1.5 billion per annum in 2023-2024 and THB0.9 billion in 2025. Its EBITDA margin will likely be in the range of 25%-30% over the forecast period.

Financial leverage remains high

SQ's financial leverage is expected to remain high over the forecast period. SQ typically carries a heavy debt load at the commencement of each project, due to hefty capital expenditure for new heavy-duty machinery and equipment. Thus, we forecast SQ's debt to capitalization ratio to rise to 65%-66% in 2023, from around 62% at the end of 2022, in view of the front-end funding needed for the construction of the BLT project. The ratio is expected to then decline to around 61%-62% in the following years. SQ's debt to EBITDA ratio is projected to stay at 3.5-4.0 times while the funds from operations (FFO) to debt ratio should hold at above 20%.

The financial covenants on its bank loan obligations require the maintenance of a debt service coverage ratio above 1.2 times, an interest-bearing debt (IBD) to equity ratio below 2 times, and IBD to EBITDA ratio lower than 4 times. For the covenant in relation to SQ's outstanding debentures, the company is obliged to keep its IBD to equity ratio below 3.5 times. At the end of March 2023, barring the debt service coverage ratio, SQ was able to comply with the financial covenants. SQ's debt service coverage ratio at the end of March 2023 stood at 1.0 times, below the threshold of 1.2 times. However, the company is expected to receive a waiver from its creditors. The financial covenants are tested at the end of every quarter, while those for debentures are tested at the end of each year.

Most of SQ's debts are secured loans. At the end of March 2023, SQ's priority debt to total debt ratio was 66%, exceeding our 50% threshold. Thus, we consider SQ's unsecured creditors to be significantly disadvantaged to its priority debt holders with respect to the priority of claims against the company's assets.

Tight liquidity

SQ's liquidity is tight. As of March 2023, the company's liquidity sources comprised cash on hand of THB211 million plus undrawn credit lines of about THB858 million. We forecast SQ will generate FFO of around THB1.1-THB1.2 billion over the next 12 months. SQ's uses of funds over the next 12 months include maturing debts of about THB2.1 billion, capital expenditure of around THB0.7 billion, and dividend payments of around THB0.1 billion. Debts coming due over the next 12 months comprise THB1.8 billion of scheduled project loan repayments and THB0.3 billion of maturing debentures. The company will repay the project loans with the cash it receives from project progress payments. The company plans to refinance maturing debentures with new debenture issuances.

BASE-CASE ASSUMPTIONS

- SQ's revenue will peak at THB6.8 billion in 2023, then drop to THB4.6 billion in 2024 and THB3.6 billion in 2025.
- EBITDA margin to hold in the 25%-30% range.
- Capital expenditure of around THB0.9-THB1.0 billion in total over the next three years.

RATING OUTLOOK

The "stable" outlook reflects our expectation that SQ will maintain its competitive strengths in the mining business, and that the company will perform in accordance with the terms of the contracts and generate an acceptable level of cash flow over the course of the undertaken projects. We expect its FFO to debt ratio to stay above 20% over the next three years.

RATING SENSITIVITIES

The rating could be revised downward if SQ's operating performance falls significantly short of expectations. A negative rating pressure could develop if the FFO to debt ratio falls below 20% for a sustained period. The prospect of a rating upside is limited. However, the rating or outlook could be revised upward if the company successfully diversifies its sources of income and lowers its leverage materially.

COMPANY OVERVIEW

SQ was established in May 2001 by the Sirison and Areekul families, but its roots date back to 1983. In that year, mining operations at the Mae Moh Phase 1 project were undertaken by Sahakol Engineer Co., Ltd., a predecessor company. SQ is currently the largest mining contractor in Thailand, providing a complete range of mining engineering services, including mine planning, open-pit mining operations, mining consultancy, and heavy-duty mining equipment rental and maintenance.

The company is primarily engaged in overburden and lignite removal services for the Mae Moh mine in Lampang province. The mine supplies lignite to the Mae Moh coal-fired power plants owned and operated by EGAT. SQ has conducted mining operations for several phases of the Mae Moh mine over the past 35 years. Projects at the Mae Moh mine have accounted for 65%-70% of the company's total annual revenue over the past three years.

SQ went public in 2015 and was listed on the Stock Exchange of Thailand (SET) in October 2016. The Sirison family has been the company's major shareholder since its inception. As of March 2023, this founding family held a 23% stake in the company. SQ's revenue has grown continually over the past few years after winning contracts for the Hongsa mine and the Mae Moh Phase 8 project. The latter is currently the largest project in the company's backlog. Revenue has been in the THB4.8-THB5.2 billion per annum range during 2019-2022, up from THB3.6 billion in 2018. The EBITDA margin had been maintained in the 25%-35% range over the past five years.

KEY OPERATING PERFORMANCE

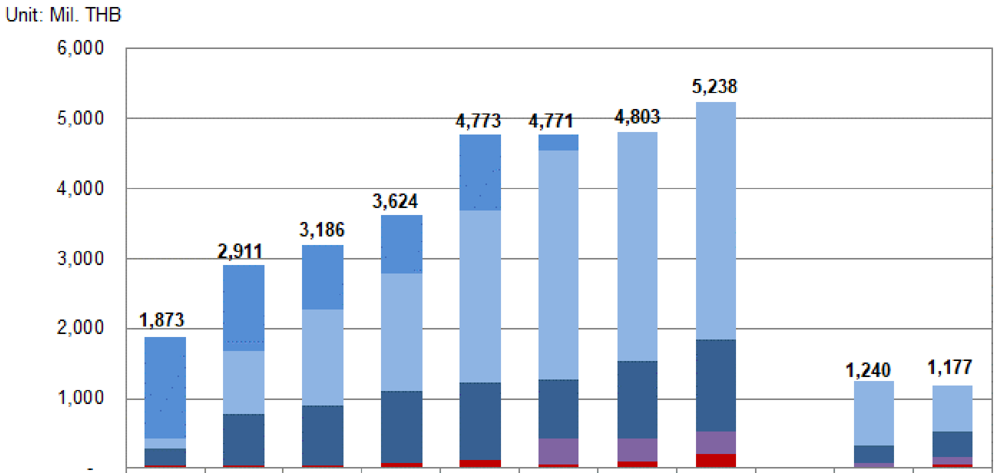
Table 1: SQ's Projects in the Backlog as of Mar 2023

Unit: Mil. THB

Projects	Duration	Project Value (Mil. THB)	Backlog Value (Mil. THB)	Total Backlog (%)
Mae Moh Phase 8	2016-2025	22,871	5,718	32
Hongsa Mine Phase D	2015-2026	12,779	5,186	29
O&M Hongsa	2020-2026	2,265	1,360	8
North pit wall expansion	2022-2027	837	837	5
Build lease & transfer (BLT)	2021-2024	2,245	2,245	13
O&M Hongsa expansion	2027-2033	2,342	2,342	13
Total		**43,339**	**17,688**	**100**

Source: SQ

Chart 1: Revenue Breakdown



	2015	2016	2017	2018	2019	2020	2021	2022		3M22	3M23
Mae Moh Phase 7	1,445	1,238	905	848	1,090	223				-	-
Mae Moh Phase 8	146	897	1,376	1,673	2,461	3,277	3,269	3,402		916	652
Hongsa	247	731	857	1,027	1,107	850	1,104	1,314		244	356
Hongsa O&M	-	-	-	-	-	353	340	317		67	102
Others	35	46	47	77	116	68	91	204		12	67

Source: SQ

FINANCIAL STATISTICS AND KEY FINANCIAL RATIOS*

Unit: Mil. THB

		-------------Year Ended 31 December ----------			
	Jan-Mar 2023	2022	2021	2020	2019
Total operating revenues	1,256	5,238	4,803	4,771	4,773
Earnings before interest and taxes (EBIT)	114	554	595	547	386
Earnings before interest, taxes, depreciation, and amortization (EBITDA)	334	1,495	1,605	1,650	1,564
Funds from operations (FFO)	273	1,257	1,343	1,333	1,163
Adjusted interest expense	61	238	265	317	391
Capital expenditures	11	511	152	310	463
Total assets	8,782	8,870	9,210	10,009	11,106
Adjusted debt	4,698	4,652	5,676	6,669	7,544
Adjusted equity	2,928	2,874	2,658	2,412	2,165
Adjusted Ratios					
EBITDA margin (%)	26.58	28.54	33.41	34.58	32.77
Pretax return on permanent capital (%)	4.86 **	6.80	6.67	5.67	3.82
EBITDA interest coverage (times)	5.48	6.28	6.07	5.21	4.00
Debt to EBITDA (times)	3.57 **	3.11	3.54	4.04	4.82
FFO to debt (%)	22.97 **	27.02	23.65	19.99	15.42
Debt to capitalization (%)	61.60	61.81	68.10	73.44	77.70

* *Consolidated financial statements*
** *Annualized 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

Sahakol Equipment PLC (SQ)

Company Rating:	BBB-
Rating Outlook:	Stable

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