

SYNTEC CONSTRUCTION PLC

No. 176/2018

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CORPORATES

Company Rating: BBB

Outlook: Stable

Last Review Date :

Date	Rating	Outlook/Alert
12/10/17	BBB	Stable

Company Rating History:

Date	Rating	Outlook/Alert
12/10/16	BBB	Stable
27/08/15	BBB-	Positive
06/03/09	BBB-	Stable

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RATIONALE

TRIS Rating affirms the company rating on Syntec Construction PLC (SYNTEC) at “BBB”. The rating reflects the company’s strong market position in the construction of high-rise buildings and its robust profitability. The rating also recognizes SYNTEC’s resilience to a market downturn, aided by its sizable backlog and ample liquidity. However, the rating is constrained by a high reliance on the end markets SYNTEC serves and the cyclical nature of the engineering and construction (E&C) industry. The rating also takes into consideration a potential rise in leverage as SYNTEC plans to grow its real estate for rent business.

KEY RATING CONSIDERATIONS

Solid competitive position

We believe that SYNTEC’s strong market position in high-rise construction will persist. The company is well-positioned to serve several large property developers, propelled by its long track record of completing construction works, reliable service, and cost competitiveness. These strengths will help SYNTEC keep acquiring new projects from repeat clients and get new clients as well. Total operating revenues have grown steadily over the past five years, reaching a record high of Bt9.1 billion in 2017.

SYNTEC’s profitability is robust. The company has exhibited its ability to earn relatively higher profit margins than most contractors listed on the Stock Exchange of Thailand (SET). During the past three years, the operating margins (operating income as a percentage of total operating revenues) of most SET-listed contractors rated by TRIS Rating were below 12%, while that of SYNTEC ranged from 12%-19%.

High reliance on end markets

SYNTEC’s strengths are weighed down by its high reliance on condominium projects from a small number of clients. Over the past three years, its major source of revenues (65%-75%) came from the construction of residential property buildings. Supalai PLC (SPALI) has been its biggest client, followed by AP (Thailand) PLC (AP) and Land and Houses PLC (LH). Projects for these three customers comprised about 40% of SYNTEC’s annual revenue. This concentration on a particular type of work and customer reflects the narrow end markets served. However, the concentration risk is alleviated by the acceptable payment risk. About half of its clients are listed top-tier property developers with satisfactory credit profiles.

We opine that SYNTEC is capable of constructing several types of high-rise buildings. The focus on building condominiums for top-tier property developers is the company’s strategy to enhance operating efficiency and reduce payment risk.

Exposure to cyclical nature of E&C industry

SYNTEC, like other E&C companies, is susceptible to the cyclicity of the E&C industry. The industry cycles, which are in large part derived from the property market, remain a rating constraint. A long dismal property market could undermine the sustainability of the company’s revenue streams.

The Bank of Thailand’s (BOT) recent measures to contain non-performing housing loans could make property developers postpone the launch of new condominium projects. However, we believe SYNTEC’s revenue will not drop

sharply. The company has recently taken on a wider range of construction projects such as hospital, school, and mix-used buildings. Moreover, its sizable backlog will help secure its revenue over the next three years.

Real estate for rent business will remain small despite expansion

SYNTEC is expanding its real estate for rent segment in the hope of diversifying its sources of revenue. However, we expect that revenue contributions from that segment will remain small over the next three years. In terms of revenue and EBITDA (earnings before interest, taxes, depreciation, and amortization), the real estate for rent segment represents about 5% of the total.

SYNTEC pledges to invest in two new hotels located in Phuket and Pattaya. The two greenfield projects will be operated by its new subsidiaries, JT Ten Co., Ltd. and PT Three Land Co., Ltd. Total investments are estimated at Bt1.2-Bt1.5 billion over the next three years. We expect these two hotels will be launched in 2021; together they will bring in about Bt300 million in revenues per year. With these two hotels in operation, revenue from the real estate for rent segment will rise to about Bt800 million per annum, from its current level below Bt400 million per annum.

In our view, there are notable risks arising from SYNTEC's foray into the real estate for rent business. The company faces competitive threats and a glut in property projects. Contributions from income-generating assets will be a plus for SYNTEC's rating if such assets generate stable cash flows and offer superior margins to the construction segment. However, the performance of the real estate for rent segment remains weaker than our forecast. The EBITDA margin of the segment has stayed below 20% during the past three years. We expect the performance of the segment will improve gradually after the renovation of "Eight Thonglor Residences" is completed in late 2018.

Strong operating performance buoyed by sizable backlog

We expect SYNTEC's total operating revenues will fall to about Bt7.1 billion in 2018. Revenue growth was held back by intensified competition, as many property developers launched fewer condominium projects last year. SYNTEC generally does not aggressively outbid other contractors and foregoes bids on some construction works. A decline in new construction works signed in 2017 will dent its total operating revenue in 2018. However, SYNTEC's sizable backlog worth, about Bt13.8 billion as of June 2018, will support revenue growth in the coming years. We forecast the company's total operating revenues will climb to about Bt8.0 billion during 2019-2021. The backlog will secure nearly half of our forecast revenue.

We believe that SYNTEC will maintain its high operating efficiency, thanks to its efficient control of costs and its strategy to focus on high-margin construction works. However, the company's profitability could be softened in the coming years due to intensified competition in the construction segment and impending higher-priced major raw materials such as steel. Our forecast assumes the operating margin will stay above 12% over the next three years, compared with 12%-19% during the past three years.

Leverage will rise, but remain at a low level

TRIS Rating expects SYNTEC will maintain a conservative financial policy, as evidenced by its low gearing and sizable cash and marketable securities on hand. We forecast the debt to capitalization ratio will stay below 25%, although its strategy to grow in the real estate for rent segment will raise debts. The debt to capitalization ratio rose to about 10% as of June 2018, from a low in 2015, because SYNTEC has built up its real estate for rent portfolio. However, such a leverage level is considered low.

SYNTEC's core construction segment requires a small amount of debt. The strategy to tap clients with satisfactory credit profiles helps reduce the need for working capital. The need for external funding declines as a consequence. The funds SYNTEC borrowed are almost entirely used to fund its investments in real estate for rent. We do not expect the company to immerse in excessive investments, funded with a deluge of new debt, considering its prudent financial policy.

The ratio of funds from operations (FFO) to debt fell to about 163% in the first half of 2018, from about 293% in 2017. The EBITDA interest ratio decreased to 12.3 times in the first half of 2018, from 20.9 times in 2017. Cash flow in relation to debt is likely to drop further in the coming years due to a decrease in profitability and a rise in leverage. Our forecast assumes the ratio of FFO to debt will stay above 25% and the EBITDA interest coverage ratio will stay above 4 times over the next three years. Despite the drops, both of the ratios remain commensurate with the rating.

Ample liquidity

TRIS Rating believes SYNTEC will manage liquidity prudently over the next three years, thanks to its conservative financial policy. SYNTEC has a large amount of liquid assets and backup facilities. As of June 2018, cash and marketable securities, plus undrawn project loans, were worth about Bt2.6 billion. The company has debts of Bt100-Bt200 million coming due annually over the next three years. The high level of liquid assets and backup facilities not only increase SYNTEC's

financial flexibility, but also give the company an edge in the sourcing of raw materials. The company can use its high cash balance to source raw materials before prices start to rise.

SYNTEC has no financial covenants in its bank loans. However, its subsidiaries engaging in the real estate for rent segment are required to keep the debt to equity ratio below 2 times and maintain a debt service coverage ratio above 1.1 times. One of its subsidiaries is likely to breach the debt service coverage ratio requirement. However, TRIS Rating expects the subsidiary to get a waiver for this year, considering SYNTEC's strong financial profile. SYNTEC's board of directors recently approved granting up to Bt100 million in short-term loans to support its subsidiaries.

RATING OUTLOOK

The "stable" outlook reflects TRIS Rating's expectation that SYNTEC will maintain its strong market position in the construction segment, its core business. The company is also expected to keep its profitability and financial profile in line with expectations. More investments in the real estate for rent segment should not substantially weaken liquidity and heighten leverage.

RATING SENSITIVITIES

A rating upgrade could arise if cash flow from operations rises substantially and the financial profile remains strong. Downward rating pressure would emerge if the financial profile deteriorates significantly, which could arise from a slip in competitive position, cost overruns, or excessive investments.

COMPANY OVERVIEW

SYNTEC was established in 1988 and listed on the SET in 1993. The company is a general contractor, but it is best known for the construction of high-rise residential and commercial buildings for private sector clients. As of August 2018, the Phahusutr family remained the company's major shareholder, owning about 29% of the total number of shares outstanding.

SYNTEC, through its majority-owned subsidiaries, expanded into the real estate for rent business in 2013. The company acquired the lease rights of "Duchess Hotel and Residence" (previously known as "Natural Ville Residence"), a hotel located on Langsuan Road in Bangkok, in late 2013. SYNTEC then developed three hotels on greenfield sites in Chonburi and Prachinburi provinces. The first project, "Citadines Grand Central Sri Racha", was launched in the first quarter of 2015. The second project, "Somerset Central Sri Racha", will be launched by the end of 2018. The third project is under development. In addition to these greenfield projects, SYNTEC, through a subsidiary, acquired the assets of "Eight Thonglor Residences", a mixed-use development project, located at Soi Thonglor, in April 2016.

KEY OPERATING PERFORMANCE

Table 1: Revenue Breakdown

Unit: %

Business	2014	2015	2016	2017	6M18
Construction	99	98	96	96	94
Real estate for rent	1	2	4	4	6
Total	100	100	100	100	100
Total revenue (Bt million)	6,994	7,190	7,843	9,065	3,142

Source: SYNTEC

Table 2: Construction Backlog as of Jun 2018

Project	Project Owner	Backlog (Bt Mil.)	Total (%)
Unicorn	KamKung	1,650	12
Noble Recole & BE 19	NOBLE	1,602	12
The Politan Aqua	BRD	1,485	11
Supalai Riva Grande	SPALI	1,022	7
ORB International School	KamKung	878	6
Others	-	7,176	52
Total		13,812	100

Source: SYNTEC

Note: KamKung = KamKung Property Co., Ltd.
 NOBLE = Noble Development PLC
 BRD = Bangkok Riva Development Co., Ltd.
 SPALI = Supalai PLC

FINANCIAL STATISTICS AND KEY FINANCIAL RATIOS*

Unit: Bt million

	Jan-Jun 2018	Year Ended 31 December			
		2017	2016	2015	2014
Total operating revenues	3,174	9,114	7,894	7,210	7,001
Operating income	515	1,698	1,295	853	674
Earnings before interest and taxes (EBIT)	342	1,342	1,015	654	518
Earnings before interest, taxes, depreciation, and amortization (EBITDA)	514	1,704	1,311	864	696
Funds from operations (FFO)	383	1,346	1,086	791	573
Adjusted interest expense	42	82	74	54	55
Capital expenditures	255	358	2,760	262	590
Total assets	9,676	9,931	9,523	6,722	6,106
Adjusted debt	636	460	666	0	0
Adjusted equity	5,748	5,564	4,802	3,612	3,006
Adjusted Ratios					
Operating income as % of total operating revenues (%)	16.23	18.63	16.40	11.83	9.62
Pretax return on permanent capital (%)	13.28 **	18.14	17.53	15.13	13.16
EBITDA interest coverage (times)	12.27	20.88	17.71	16.03	12.69
Debt to EBITDA (times)	0.47 **	0.27	0.51	0.00	0.00
FFO to debt (%)	162.98 **	292.73	162.95	n.m.	n.m.
Debt to capitalization (%)	9.96	7.63	12.18	0.00	0.00

* Consolidated financial statements

** Adjusted with trailing 12 months

n.m. Not meaningful

RELATED CRITERIA

- Key Financial Ratios and Adjustments, 5 September 2018
- Rating Methodology – Corporate, 31 October 2007

Syntec Construction PLC (SYNTEC)

Company Rating:	BBB
Rating Outlook:	Stable

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