

THAI METAL TRADE PLC

No. 184/2018
22 November 2018

CORPORATES

Company Rating: BBB

Outlook: Stable

Last Review Date :

Date	Rating	Outlook/Alert
15/02/18	BBB	Stable

Company Rating History:

Date	Rating	Outlook/Alert
15/02/18	BBB	Stable

Contacts:

Pravit Chaichamnapai, CFA

pravit@trisrating.com

Auyporn Vachirakanjanaporn

auyporn@trisrating.com

Monthian Chantarklam

monthian@trisrating.com



WWW.TRISRATING.COM

RATIONALE

TRIS Rating affirms the company rating on Thai Metal Trade PLC (TMT) at “BBB”. The rating reflects TMT’s strong and well-established market position among downstream steel companies, broad product offerings, diverse customer base, and stronger profitability than peers. However, the rating is constrained by its exposure to the cyclical nature of the steel industry, volatile prices of raw materials, significant supplier concentration risk, and potential increases in operational and financial risk as the business grows.

KEY RATING CONSIDERATIONS

Well positioned as a steel solution provider

TMT’s business profile reflects its position as a leading steel solution provider in Thailand. TMT is currently the largest company, by revenue, among listed peers in the downstream steel producer industry. The company’s business advantages include value-added consultation services, efficient inventory management, supply stability, and competitive product cost. These strengths help TMT gain market shares despite the intensified market competition. The company’s marketing strategy, focusing on customer needs, builds lasting customer relationships which provide steady growth in sales.

Wide product offerings and diverse customer base

The rating also recognizes TMT’s diverse range of products, covering both flat and long steel products as well as tailor-made products. The broad product offerings enable the company to serve as a one-stop steel supplier, being able to capture demand in a variety of industries. TMT’s customers mainly include construction contractors, steel fabricators, and automotive manufacturers. The company also sells to wholesalers.

About 42% of TMT’s total revenue comes from wholesalers and dealers, while 30% is from construction-related industries and 9%-10% is from the automotive industry. The rating also takes into consideration the good quality of TMT’s accounts receivable.

Above-peer profitability

TMT’s profitability is higher and more stable than its peers. The stronger profitability reflects the added value TMT earns from consulting services and its ability to lessen the effect of price fluctuation of hot rolled coil (HRC), a key raw material.

To stabilize its profit margin, TMT’s strategy places a priority on efficient cost management and fast inventory turnover. Over the past 10 years, TMT’s gross margin has held at 8%-9%, with a peak of 13.7% and a low of 7.1%. Meanwhile, many of its peers listed on the stock market have experienced losses and have higher swings in profit.

Exposure to a highly cyclical industry and fluctuation of raw material prices

TMT’s rating is weighed down by industry cyclicality as steel demand is closely linked to the construction and manufacturing industries which are sensitive to changes in economic conditions. Although, TMT has proven less sensitive to HRC price risk than other companies, it remains susceptible to an abrupt falloff in steel prices. Affected by the price risk of steel, TMT’s earnings before interest, taxes, depreciation, and amortization (EBITDA) was volatile, ranging

between Bt0.65-Bt1.35 billion over the last five years. TMT also faces supplier risk as there are three main suppliers of HRC in Thailand. However, the company can partially mitigate the risk by importing the HRC from overseas suppliers.

New factories supporting growth of volume

During the first nine month of 2018, TMT's operating performance fell shy of our expectation. Despite a 24.6% year-over-year growth of sales, TMT's operating margin (operating income before depreciation and amortization as a percentage of sales) fell to a record of 4.5%. This was due to intensified competition, following a glut in the market and weaker-than-expected demand.

However, TRIS Rating forecasts that TMT's sales volume over the next three years will grow by 6%-10% per annum, driven by its new production capacity. The company is in an expansion phase with plans to raise production capacity to one million tonnes per annum. The capacity expansion is expected to be completed by 2019. Given its competitive edge and past record of growing sales volume, we believe TMT should be able to grow its sales volume among the intense industry competition.

Under our base-case scenario, we forecast that TMT's total sales volumes will reach 850,000-900,000 tonnes in 2021-2022. Overall profitability should be enhanced, backed by enlarging operating scale and a rising mix of processing products which produce higher margins than trading products. We expect the operating margin will stay in a range of 6%-7%. We estimate the average annual EBITDA should rise to around Bt1.0-Bt1.1 billion, from the Bt900 million earned on average over the past five years.

Expected recovery of financial status

TMT's financial profile was weakened by rising debt as a result of capacity expansion and an escalation in steel price which led to larger working capital needs. The company's outstanding debt rose significantly to approximately Bt5.1 billion as of September 2018 from around Bt3.6 billion in 2017. Meanwhile, the company continued to pay substantial dividend payments, thus suppressing equity growth. The debt to capitalization ratio rose to over 65% as of September 2018.

However, we assess the company's financial leverage should restore after the construction of new factories are completed in 2019. We expect the debt to capitalization will gradually decline to a normal level or below 60% over the next three years. The debt to EBITDA ratio should steadily decrease and stay below 4 times. The ratio of funds from operations (FFO) to total debt should increase to 20%.

Adequate liquidity

TMT's liquidity is adequate since all liquidity needs over the next 12 months stem from short-term debts of about Bt4 billion, which can be fully covered by its accounts receivable and inventory. The company also has unused credit facility of about Bt5.2 billion to support its liquidity reserve.

TRIS Rating notes that TMT currently has a non-rated debenture of Bt1 billion maturing in 2021. Under the financial covenant of the bond, TMT undertakes to maintain the net interest-bearing debt (IBD) to equity ratio not to exceed 2 times. We view, for the commodity trading business; the imposed covenant leaves TMT with small headroom, particularly during the expansion period. In recognition of this, we expect TMT to be more prudent in paying out dividends to properly sustain its equity base.

RATING OUTLOOK

The "stable" outlook reflects TRIS Rating's expectation that TMT can maintain its market position and stronger-than peer profitability. TRIS rating also believes TMT will maintain its prudent management of working capital and continue its disciplined approach to pricing the company's products.

RATING SENSITIVITIES

The rating or outlook may be revised upward if the company's operating performance beats estimates on a sustained basis. This may occur if the company can deliver stronger-than-expected profitability or if the company's market position improves significantly following the capacity expansion. The rating or outlook could be revised downward if operating performance falls short of estimates and materially affects the FFO to debt ratio. Downward pressure on the rating could occur from heavy debt-funded investments or slack domestic demand over a long period.

COMPANY OVERVIEW

TMT is a steel solution provider in Thailand. The company's business engages in steel trading, processing, and consulting services. The company was established in 1992 and listed on the Stock Exchange of Thailand (SET) in 2005. The

Tarasansombat family, the founding shareholder, owned a majority stake of 74.3% as of March 2018. The main factory and warehouse are located in Ayudhya province and the company also has a distribution center in Bangkok. TMT primarily offers flat steel products processed from HRC, such as hot rolled sheets, round tubes, and rectangular tubes. The company also sources long steel products such as I-Beams, H-Beams, and steel bars for customers.

Sales volume was 679,000 tonnes in 2017. The proportion of steel processing to steel trading was about 72:28. TMT’s annual revenue hovered between Bt11-Bt14 billion over the past five years, after the company implemented customer-centric strategies which have been resonating with customers.

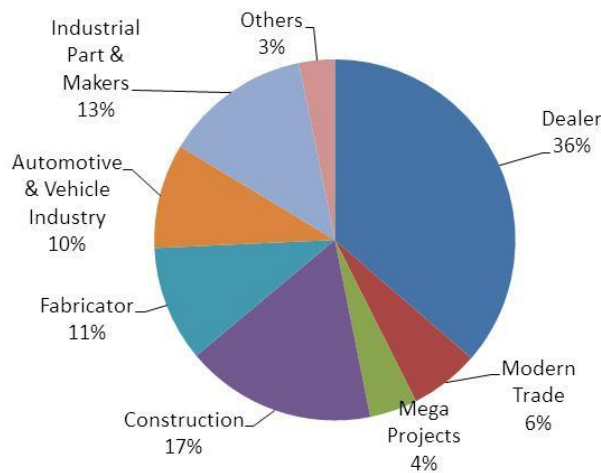
KEY OPERATING PERFORMANCE

Chart 1: TMT’s Sale Volumes



Source: TMT

Chart 2: Sale Volumes Breakdown by Customers*



Source: TMT

* For the first nine months of 2018

FINANCIAL STATISTICS AND KEY FINANCIAL RATIOS*

Unit: Bt million

	Jan-Sep 2018	----- Year Ended 31 December -----			
		2017	2016	2015	2014
Total operating revenues	13,279	14,374	12,519	11,627	12,295
Operating income	600	1,032	1,355	623	653
Earnings before interest and taxes (EBIT)	455	862	1,187	463	501
Earnings before interest, taxes, depreciation, and amortization (EBITDA)	600	1,040	1,358	629	654
Funds from operations (FFO)	487	818	1,083	484	488
Adjusted interest expense	74	67	51	61	81
Capital expenditures	539	473	584	206	173
Total assets	8,462	7,065	6,079	4,620	5,245
Adjusted debt	5,106	3,612	2,740	1,799	2,530
Adjusted equity	2,640	2,821	2,833	2,207	2,169
Adjusted Ratios					
Operating income as % of total operating revenues (%)	4.5	7.2	10.8	5.4	5.3
Pretax return on permanent capital (%)	9.0 **	14.0	23.4	9.9	9.6
EBITDA interest coverage (times)	8.1	15.6	26.7	10.3	8.0
Debt to EBITDA (times)	6.0 **	3.5	2.0	2.9	3.9
FFO to debt (%)	13.2 **	22.7	39.5	26.9	19.3
Debt to capitalization (%)	65.9	56.1	49.2	44.9	53.8

* Consolidated financial statements

** Annualized from trailing 12 months

RELATED CRITERIA

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

Thai Metal Trade PLC (TMT)

Company Rating:	BBB
Rating Outlook:	Stable

TRIS Rating Co., Ltd.

Silom Complex Building, 24th Floor, 191 Silom Road, Bangkok 10500, Thailand Tel: 0-2098-3000

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