

TMT STEEL PLC

No. 167/2021
12 October 2021

CORPORATES

Company Rating: BBB
Outlook: Stable

Last Review Date: 26/10/20

Company Rating History:

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

RATIONALE

TRIS Rating affirms the company rating on TMT Steel PLC (TMT) at “BBB” with a “stable” rating outlook. The rating mirrors TMT’s solid market position in the downstream steel industry, supported by strong product offerings and a diverse customer base. The rating also recognizes TMT’s robust profitability and resilience to a market downturn. However, the rating is largely constrained by the steel industry’s cyclical nature, stiff price competition, and volatile profit margins.

KEY RATING CONSIDERATIONS

Solid market presence

The rating mirrors TMT’s solid market presence, supported by its relatively large scale of operation and its effective supply-chain management. With its competitive strengths, TMT is well positioned as an all-around steel solution provider in Thailand. The company has successfully differentiated itself from most steel traders by offering technical and consultation services that help customers improve their operational efficiency. By revenue and earnings, TMT is the largest company among listed peers in the downstream steel industry.

TMT has continued to expand its production capacity over the past several years, widening its customer base and diversifying its product mix. TMT recently expanded steel pipe production, slitting production, and steel sheet production called “STAY FLAT”, as well as enlarged its warehouse space. These should support TMT’s growth in sales volumes over the next few years.

Broad product offerings and diverse customer base

TMT has positioned itself as a one-stop steel supplier to capture demand in multiple market segments. TMT has a broad range of product offerings that cover flat and long steel products. Added to that, the company also provides several services, such as steel processing, distribution center, and tailor-made products.

TMT has a diverse customer base, comprising wholesalers, construction contractors, steel fabricators, and automotive and industrial-part manufacturers. However, TMT’s revenue tends to link increasingly with construction-related segments, as indicated by the rapid growth of structural steel tubes sales volume, and the company’s tube production plan. TMT’s production capacity of structural steel pipes has expanded over several years, suggesting more penetration in the construction sector.

We are of the view that TMT’s comprehensive coverage across diverse market segments will meaningfully mitigate the effect of volatility in steel demand.

Robust profitability and resilience to downturn

TMT has reported satisfactory operating results over the past several years, reflecting its strong resilience to a market downturn. The company has steadily arrived at satisfactory profit margins, which are well above most of its peers listed on The Stock Exchange of Thailand (SET). In contrast, some competitors have experienced losses and seen greater earnings volatility. TMT’s robust profitability mainly stemmed from its add-on consulting services and its ability to manage the effects of price fluctuations of hot-rolled

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coil (HRC), an essential raw material. TMT has placed efficient cost management and fast inventory turnover at the forefront of its business strategy.

Spike in steel prices

Across the industry, steel producers and traders have reaped great benefits from the spike in steel prices in 2021, after being hurt by the fallout from the Coronavirus Disease 2019 (COVID-19) pandemic last year. Global steel prices have surged from the prior year as the pent-up demand in manufacturing after the pandemic markedly outstripped supply.

The global economy has recovered strongly as many countries eased lockdown measures and implemented economic stimulus packages. China, the largest consumer of steel, was the first country that staged a strong rebound in economic activity. A surge in global economic activity with the broadly synchronous resumption of normal operations across major sectors such as automotive, construction and machinery, has brought about strong revival in steel demand.

On the supply side, China, the world's dominating steelmaker, has slashed its heavy-polluting steel production, as part of its policy to cut carbon emissions and move toward carbon neutrality over the long term. At the same time, the country has also heightened tariffs on steel-related exports to ensure sufficient supply for domestic use. In effect, China HRC price soared to above USD900 per ton since May 2021.

TMT's strong upswing in earnings

In the domestic market, the impact from the COVID-19 pandemic led to a significant drop in finished steel products consumption by 10.8% in 2020. TMT's sales volume dropped by 2.8% to 0.76 million tons in 2020, from 0.78 million tons in 2019. For the first half of 2021, TMT's sales volume totaled 0.38 tons, almost the same level year-on-year (y-o-y). That said, TMT reported a strong upswing in earnings, largely stemming from the prices rally. The average China HRC price in 2021 is 40% higher than that in 2020.

TMT arrived at THB1.46 billion in earnings before interest, taxes, depreciation, and amortization (EBITDA) for the first half of 2021, a steep rise of 254% y-o-y. EBITDA margin rose from 6% in 2020 to 14% in the first half of 2021. In our base-case forecast, we expect TMT's EBITDA will increase to a fresh record in 2021, reaching THB2 billion. However, we view that such EBITDA level is not sustainable as it is essentially caused by coincidental changes in demand and supply. In our forecast, we project steel prices to remain at high levels due to the current supply crunch but should decline with a gradual return to an equilibrium balance of supply and demand.

High industry risk

The rating is largely held back by the highly cyclical nature of steel industry. Steel demand can swing sharply in either direction as it is closely linked to the construction and manufacturing industries, which are in turn sensitive to changes in economic conditions. During 2016-2020, the growth rate of domestic steel consumption demonstrated wide swings, in the range of -11% to 15% per year. The average growth was 0.3% a year. TMT's profitability is influenced by the commodity nature of steel products and intense price competition.

Volatile margins

TMT remains susceptible to the volatility of raw material costs, which impacts its earnings stability. During 2016-2020, TMT's annual EBITDA ranged from THB0.6 billion to THB1.35 billion. Its EBITDA margins for the past five years also swung widely in the range of 3.6%-10.9%. However, its operational record has evidenced that the company is more resilient to fluctuations of HRC price than other companies.

Satisfactory financial position

We see sustainable demand for steel in Thailand over the next few years, driven by growing demand from public infrastructure investment projects and automotive production. We expect TMT will benefit from the ongoing investment. At the current running rate, we project the company's sales volume to drop by only about 2% in 2021. Given TMT's expansion in production capacity and potential rebound of domestic consumption, we forecast sales volume will improve each year starting from 2022. In our base-case forecast, we project TMT will arrive at about THB21 billion in revenue for 2021 before increasing to THB22-THB24 billion per year in 2022-2023.

We expect steel price to remain in the higher band as it will take some time for supply to catch up with the surge in demand globally. Notwithstanding the remarkable upsurge in earnings in 2021, we expect the market will eventually return to normal and profit margins will likely decrease to normal level with the demand-supply balancing. In our base case, we forecast EBITDA to reduce to THB1.2-THB1.3 billion a year during 2022-2023. Funds from operations (FFO) should come in at about THB1.0 billion per year over the same period.

On one hand, the hike in steel prices has significantly benefited the company with widening profit margins. On the other, the high steel prices have escalated the level of working capital needs. As of June 2021, TMT's adjusted net debt rose to THB5 billion, up from THB4.1 billion as of 2020. We forecast the adjusted net debt will rise to THB5.7 billion towards the end of 2021 and will remain at about THB5.3-5.5 billion in 2022-2023. In effect, we forecast the ratio of net debt to EBITDA will climb to 4-4.5 times in 2022-2023, up from 3 times in 2021. The debt to capitalization ratio should stay at 58%-60%, and the ratio of FFO to debt to range 18%-20% over the forecast period.

Adequate liquidity

We assess TMT to have adequate liquidity. As of June 2021, TMT had long-term debt coming due in the next 12 months of about THB350 million and short-term loans totaling THB3.7 billion. The company's sources of funds, including estimated FFO of THB1 billion, cash of THB0.27 billion as of June 2021, and available banking facilities of THB6.4 billion, should be sufficient to meet near-term debt obligations.

Capital Structure

At the end of June 2021, TMT had THB5.1 billion in debt without any priority debt. TMT's debt included THB3.7 billion of short-term loans and THB1.5 billion of long-term loans. The loans are extended by several commercial banks, all of which are on clean basis.

BASE-CASE ASSUMPTIONS

- Volume drops by 2% in 2021, before restoring by around 6-8% per year in 2022-2023
- EBITDA margin 10% in 2021 then return to the average of 6% during 2022-2023
- Capital expenditures of about THB300 - THB700 million per year during 2021-2023
- Dividend payout ratio of 80%

RATING OUTLOOK

The "stable" outlook embeds our expectation that TMT will maintain its market position and stronger-than-peer profitability. The company's cash flow generation and leverage will be in line with our forecast. We also expect TMT will maintain its prudent working capital management and continue its disciplined approach in pricing its products.

RATING SENSITIVITIES

The uplift of rating or outlook could emerge if TMT's business scale improves, and the company could meaningfully enlarge its cash flow generation against debt obligations. For instance, TMT could keep the ratio of net debt to EBITDA below 3.5 times or its FFO to debt ratio stay at 20% or above on sustained basis.

Conversely, downward revision to the rating or outlook could develop if TMT's operating performance falls short of estimates that materially heightens the ratio of net debt to EBITDA. Also, downward rating pressure could be triggered by the persistently sluggish domestic demand over a long period.

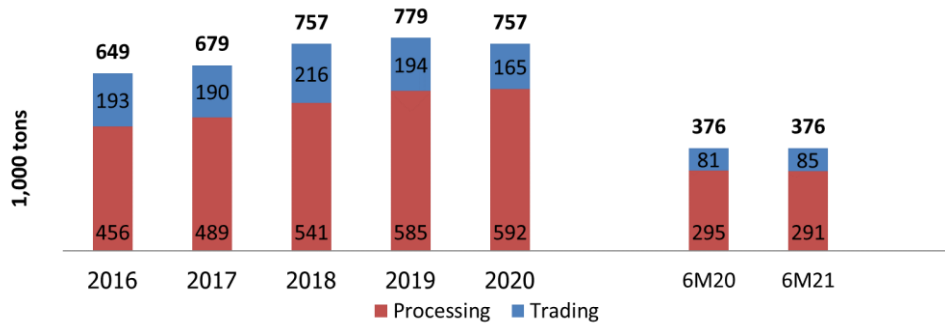
COMPANY OVERVIEW

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 SET in 2005. The Tarasansombat family, the founding shareholder, owned a majority of TMT's stake of about 68.6% as of April 2021. The main factory and warehouse are in Ayutthaya province and the company also has a distribution center in Bangkok. TMT's production capacity has expanded continuously to 782,400 tons per annum as of June 2021 from 390,000 tons per annum in 2013. TMT plans to expand its capacity to one million tons per annum in 2022. The company 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.

TMT's annual revenue has hovered between THB12-THB17 billion over the past five years, after the company implemented customer-centric strategies, which have resonated with customers. Sales volume was 757,000 tons in 2020. The proportion of steel processing to steel trading was about 78:22.

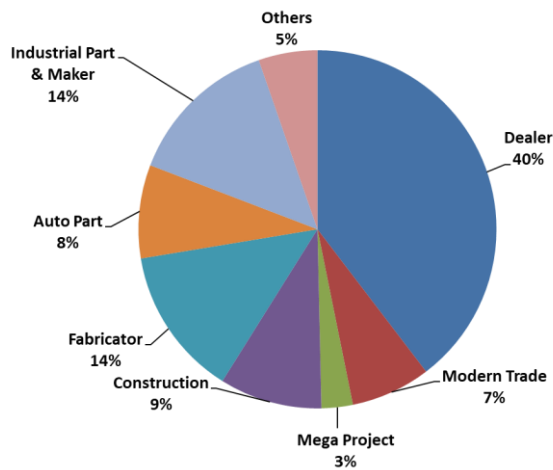
KEY OPERATING PERFORMANCE

Chart 1: TMT's Sale Volumes



Source: TMT

Chart 2: Sale Volumes Breakdown by Customers*



Source: TMT

* For the first six months of 2021

FINANCIAL STATISTICS AND KEY FINANCIAL RATIOS

Unit: Mil. THB

	Jan-Jun 2021	-----Year Ended 31 December -----			
		2020	2019	2018	2017
Total operating revenues	10,347	14,626	16,527	17,418	14,374
Earnings before interest and taxes (EBIT)	1,328	736	392	562	862
Earnings before interest, taxes, depreciation, and amortization (EBITDA)	1,460	994	603	757	1,040
Funds from operations (FFO)	1,159	795	441	601	818
Adjusted interest expense	49	83	119	105	67
Capital expenditures	227	193	350	701	473
Total assets	9,828	8,841	7,149	7,706	7,065
Adjusted debt	4,977	4,124	3,813	4,398	3,612
Adjusted equity	3,774	3,182	2,905	2,704	2,821
Adjusted Ratios					
EBITDA margin (%)	14.1	6.8	3.6	4.3	7.2
Pretax return on permanent capital (%)	22.9 **	9.6	5.5	8.1	14.0
EBITDA interest coverage (times)	29.7	11.9	5.1	7.2	15.6
Debt to EBITDA (times)	2.4 **	4.2	6.3	5.8	3.5
FFO to debt (%)	32.5 **	19.3	11.6	13.7	22.7
Debt to capitalization (%)	56.9	56.5	56.8	61.9	56.1

* Consolidated financial statements

** Annualized from trailing 12 months

RELATED CRITERIA

- Rating Methodology – Corporate, 26 July 2019
- Key Financial Ratios and Adjustments, 5 September 2018

TMT Steel PLC (TMT)

Company Rating:	BBB
Rating Outlook:	Stable

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