THAI POLYCONS PLC

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CORPORATES

Company Rating:	BBB
Outlook:	Stable

Last Review Date: 09/10/18

Company Rating History:

Date	Rating	Outlook/Alert
09/10/18	BBB	Stable

Contacts:

Rapeepol Mahapant
rapeepol@trisrating.com

Narongchai Ponisirichusopol
narongchai@trisrating.com

Monthian Chantarklam
monthian@trisrating.com

RATIONALE

TRIS Rating affirms the company rating on Thai Polycons PLC (TPOLY) at "BBB" with a "stable" outlook. The rating reflects the solid operating performance and the predictable cash flows of the power business. These factors offset the impact from the cyclical nature of the construction business. However, the rating is weighed down by fluctuations in the supply and prices of biomass feedstock, the execution risks associated with several new power projects, and an impending rise in leverage. The rating also takes into consideration TPOLY's mediocre competitive position and stiff competition in the construction business.

KEY RATING CONSIDERATIONS

Predictable cash flows from power business

TPOLY's rating is chiefly predicated on the predictable cash flows of the power business. Looking ahead, we believe the power business will remain the centerpiece of TPOLY's earnings.

The power business is operated by its core and profit-making subsidiary, TPC Power Holding PLC (TPCH). TPCH currently owns and operates six biomass power plants, with a combined contracted capacity of 52.8 megawatts (MW). TPCH is adding more capacity to enlarge its power portfolio. The power business accounts for more than 90% of TPOLY's EBITDA (earnings before interest, taxes, depreciation, and amortization).

The power business brings in stable cash flows as TPCH's power plants have secured multi-year power purchase agreements (PPAs) with the state-owned producers and distributors of electricity. Each PPA contains contractually committed tariff rates.

Solid performance of power plants

The power plants which are currently operating have consistently rendered solid performance over the past three years. In all, the EBITDA margin (earnings before interest, taxes, depreciation, and amortization as a percentage of revenues) of the power plants has stayed at about 50%.

We are of the view that the reliable cash flows from the power-generating assets largely countervail the cyclicality of the construction business. In our base case, we expect the power plants will continue to deliver strong performance over the next three years.

Fluctuations in supply and prices of feedstock

Despite running at high efficiency, the power plants are highly susceptible to fluctuations in the supply and prices of biomass feedstock. TPCH mitigates the supply risk by locating its power plants near sources of biomass feedstock. Operation and maintenance (O&M) contractors are responsible for the supply of the biomass feedstock, in addition to running most of the plants. However, as a practical matter, TPCH cannot entirely pass the price risk to the O&M contractors.

TPCH plans to hire O&M contractors to operate its new power plants. However, the company will manage the supply of biomass feedstock itself, enlarging its exposure to the supply risk. The company has secured long-term supply agreements with local suppliers to ensure the availability of fuel. That said, contract enforcement remains a challenge. TPCH wards off this risk by taking in suppliers as partners in the company's projects. In addition, TPCH is developing its own bio-fuel plantation. Given these efforts, we believe TPCH could manage the supply risk prudently.

Execution risks associated with new power projects

TPOLY, through TPCH, faces execution risks associated with new power projects. TPCH currently has five sizable projects under way. The aggregate contracted capacity of these five projects is 53.7 MW, comprising four biomass power plants (45.7 MW) and a waste-to-energy power plant (8 MW). Once all of these new projects are fully on stream during 2020-2021, the aggregate contracted capacity of TPCH's power plants will double to 106.5 MW, from 52.8 MW.

The execution risks come from the project location choices, construction delays, environmental issues and local resistance, and feedstock procurement. The new biomass power projects heighten operational risks as all of them are located in Pattani, Yala, and Narathiwat provinces. The ongoing conflict centered in southern Thailand has caused construction delays on these new biomass power projects. However, the investment budgets remain under control.

The new biomass power projects also bring challenges as they are under a competitive bidding system, yielding much lower tariffs. The tariffs for most of the new biomass power plants range between Bt2.8 and Bt3.4 per kilowatt hour (kWh), versus above Bt4 per kWh for the current plants. Therefore, the company will need to double-down on production cost control.

Mediocre competitive position in construction business

The rating takes into account TPOLY's mediocre competitive position in the construction business. This business is rather small, compared with other contractors rated by TRIS Rating. Revenue in the construction business has averaged about Bt2 billion per annum during the past several years. In our view, TPOLY is unlikely to undertake large-scale projects as the main contractor over the coming years. A typical contract for construction work has been worth below Bt1 billion per contract during the past three years.

TPOLY has a limited scope of construction work. It focuses on the construction of buildings such as hospitals, universities, hotels, and shopping malls. It has constructed a few power plants. TPOLY aims at acquiring contracts for public infrastructure construction projects. However, TPOLY has no track record in this type of construction work, and it has to compete with a large number of contractors. We expect the company will continue to undertake construction work mainly for the private sector over the next three years.

Power business remains the key growth driver

TRIS Rating forecasts TPOLY's total operating revenues to increase steadily to Bt6.2 billion in 2022, from Bt3.8 billion in 2019. The power business will drive the growth. Revenue from the sale of electricity should grow steadily to Bt3.9 billion in 2022, from Bt1.8 billion in 2019.

We expect revenue from the construction business to range between Bt2.0-Bt3.0 billion per annum over the next three years, compared with an average of Bt1.9 billion per annum for the past three years. The strengths of the power business ease pressure to outbid for construction contracts. Our base-case forecast assumes TPOLY will acquire contracts for construction projects worth about Bt2.0 billion annually. As of June 2019, TPOLY had a backlog worth about Bt2.5 billion. The backlog will help partly secure revenue during 2019-2021.

We also assume sales in the residential property business will stay below Bt200 million a year over the next three years. TPOLY had less than Bt100 million in unsold units as of June 2019. We do not expect the residential property business will grow tremendously in the coming years, considering a slowdown in the residential property market.

Operating performance on solid course

We expect TPOLY's operating performance will stay strong over the next three years, aided by the growing contribution from the power business. Our base-case forecast predicts the company's operating margin (operating income before depreciation and amortization as a percentage of total operating revenues) will stay above 20% during 2019-2022.

The large earnings contribution from the power business helps offset the low profitability of the construction business. More intense competition among contractors and a recent expansion in the workforce has recently slashed profits of the construction business. As a result, the gross margin of this business dropped to 6.5% in the first half of 2019, from 9.6% in 2018. Over the next three years, we expect earnings of the construction business will remain low.

Leverage on the rise

TPCH guarantees the debts of the incorporated joint ventures (JVs) in proportion to its stakes in the JVs. In assessing the financial profile and performance of TPOLY, we include the assets, liabilities, and respective financial performances of the

JVs in TPOLY's consolidated accounts, in proportion to the ownership stake of TPCH in each venture.

TPOLY's gearing is on an upward trend as the power business is expanding. We forecast annual capital expenditures will range between Bt1.6-Bt1.8 billion. The debt to capitalization ratio will reach and stay at about 50% over the next three years, rising from 39.4% as of June 2019.

TPOLY's cash flow protection will soften as debt rises. The ratio of funds from operations (FFO) to debt is forecast to fall to about 17% in 2020, before rising to 22% in 2022. The ratio averaged 30.7% during the past three years. The debt to EBITDA ratio should also increase to 4.5 times in 2020, before gradually declining in the following years.

Liquidity stays manageable

TRIS Rating believes TPOLY will manage its liquidity prudently. The company has a fairly low debt level and has no funding mismatch. Debts of about Bt400 million will come due during the second half of 2019. About Bt200 million are short-term debts TPOLY uses to fund working capital. The remainders are long-term project loans TPCH uses to fund power projects.

As of June 2019, TPOLY had undrawn credit facilities, plus cash and marketable securities, of almost Bt700 million. This should be sufficient to repay all the debts coming due. Over the next three years, we forecast FFO to range between Bt0.8-Bt1.3 billion annually. In the meantime, TPOLY is obliged to repay long-term debts of Bt500-Bt800 million per annum.

There are no financial covenants imposed on TPOLY's banks loans. However, TPCH's subsidiaries and JVs are required to maintain a debt service coverage ratio at above 1.1 times or 1.2 times and keep the debt to equity ratio below 2.5 times. All the subsidiaries and JVs have complied with their respective financial covenants. TRIS Rating believes they will remain compliant for the next 12-18 months.

BASE-CASE ASSUMPTIONS

- Aggregate contracted capacity of TPCH's operating power plants to increase to 146.5 MW in the next three years, from 52.8 MW at present.
- New contracts for construction works will be worth about Bt2.0 billion per annum.
- Gross margin of the construction business to stay at 7.5%.
- Operating margin to stay above 20%.
- Total capital spending to range between Bt1.6-Bt1.8 billion per annum.

RATING OUTLOOK

The "stable" outlook reflects TRIS Rating's expectation that the power business will continue to be the core earner and generate sizable cash flows as planned. We expect the new power projects to earn satisfactory returns. In addition, the construction business will remain profitable while working capital will be prudently managed.

RATING SENSITIVITIES

A rating upgrade could occur if TPOLY's operating performance and capital structure are significantly stronger than expectations. For example, if EBITDA improves significantly and the leverage level is prudently managed. On the contrary, downward rating pressure would emerge if the performance of the construction business and/or the power business fall significantly short of our estimates, or if the capital structure deteriorates materially due to aggressive debt-funded investments.

COMPANY OVERVIEW

Established in 1988, TPOLY is a construction contractor, providing engineering and construction (E&C) services to the public and private sectors. The company focuses on constructing buildings and civil works. The company was listed on the Market for Alternative Investment (MAI) in 2009 and moved to trade on the Stock Exchange of Thailand (SET) in 2010. TPOLY expanded into the residential property business and the power business in 2010. It spun off the power business to TPCH, its subsidiary, in 2012. The Chanpalangsri family remained the major shareholder, holding an approximately 44% interest in TPOLY, as of June 2019.

The power business currently accounts for the majority of TPOLY's revenue and earnings. In the first half of 2019, the business made up half of total revenue, followed by the construction business (48%), and the residential property business (2%). EBITDA of the power business make up more than 90% of TPOLY's EBITDA.

KEY OPERATING PERFORMANCE

Table 1: Revenue Breakdown

Unit: %

Segment	2015	2016	2017	2018	6M19
Construction	85	71	60	49	48
Property	4	4	8	3	2
Power	11	25	32	46	49
Trading	-	-	1	1	0
Total	**100**	**100**	**100**	**100**	**100**
Total revenue (Bt million)	**2,654**	**2,708**	**3,432**	**3,367**	**1,645**

Source: TPOLY

Table 2: Power Project Portfolio

Company/Country	Held by TPCH (%)	Status	Installed Capacity (MW)	Contracted Capacity (MW)	Tariff
Biomass Projects					
CRB	73	Operating	9.5	9.2	Fit
MWE	85	Operating	9.0	8.0	Fit
MGP	46	Operating	9.5	8.0	Fit
TSG	65	Operating	9.5	9.2	Fit
PGP	60	Operating	9.9	9.2	Fit
SGP	51	Operating	9.9	9.2	Fit
PTG	65	Developing	23.0	21.0	Adder
TPCH1	84	Developing	9.9	9.2	Fit
TPCH2	84	Developing	9.9	9.2	Fit
TPCH5	89	Developing	6.3	6.3	Fit
Sub total - Biomass			**106.4**	**98.5**	
Waste Projects					
SP	50	Developing	9.5	8.0	-
Sub total - Waste			**9.5**	**8.0**	
Grand total			**115.9**	**106.5**	

Source: TPCH

CRB = Chang Raek Bio Power
MWE = Maewong Energy
MGP = Mahachai Green Power
TSG = Thungsung Green
PGP = Phathalung Green Power
SGP = Satun Green Power
PTG = Pattani Green
TPCH1 = TPCH Power 1
TPCH2 = TPCH Power 2
TPCH5 = TPCH Power 5
SP = Siam Power

FINANCIAL STATISTICS AND KEY FINANCIAL RATIOS*

Unit: Bt million

		-------------- Year Ended 31 December ---------			
	Jan-Jun 2019	2018	2017	2016	2015
Total operating revenues	1,746	3,558	3,594	2,843	2,690
Operating income	414	880	716	424	(3)
Earnings before interest and taxes (EBIT)	322	685	573	335	(69)
Earnings before interest, taxes, depreciation, and amortization (EBITDA)	422	880	712	424	(3)
Funds from operations (FFO)	378	768	604	365	(164)
Adjusted interest expense	48	107	90	71	88
Capital expenditures	669	725	808	1,028	603
Total assets	8,622	7,494	6,936	6,570	5,429
Adjusted debt	2,607	2,104	1,989	1,446	717
Adjusted equity	4,011	3,785	3,262	2,854	2,514
Adjusted Ratios					
Operating income as % of total operating revenues (%)	23.71	24.74	19.93	14.92	(0.11)
Pretax return on permanent capital (%)	10.09 **	11.37	10.53	7.23	(1.77)
EBITDA interest coverage (times)	8.85	8.26	7.94	5.95	(0.03)
Debt to EBITDA (times)	2.99 **	2.39	2.79	3.41	(240.54)
FFO to debt (%)	29.66 **	36.50	30.35	25.25	(22.88)
Debt to capitalization (%)	39.39	35.73	37.88	33.63	22.20

Note: The figures include assets, liabilities, and the respective financial performances of MGP, in proportion to the ownership stake in this JV. The debts of SP, the other JV, did not reflect in TPOLY's consolidated accounts as SP had no bank debts.

* *Consolidated financial statements*

** *Adjusted with trailing 12 months*

RELATED CRITERIA

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

Thai Polycons PLC (TPOLY)

Company Rating:	BBB
Rating Outlook:	Stable

TRIS Rating Co., Ltd.
Silom Complex Building, 24th Floor, 191 Silom Road, Bangkok 10500, Thailand Tel: 02-098-3000