

TIRATHAI PLC

No. 137/2018

24 September 2018

CORPORATES

Company Rating: BBB-
Outlook: Negative

Company Rating History:

Date	Rating	Outlook/Alert
19/09/17	BBB-	Stable
29/02/16	BBB	Stable
25/01/11	BBB+	Stable

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RATIONALE

TRIS Rating affirms the company rating on Tirathai PLC (TRT) at “BBB-” but revises the outlook to “negative” from “stable”. The “negative” outlook reflects concerns over the company’s abated competitive and financial strengths, which result in a weak resilience.

The rating continues to take into account TRT’s long track record and its capability in producing both power and distribution transformers with wide range of capacities and system voltages. These strengths are considerably weighed down by high competitive pressure, a streak of eroded performance, and high leverage.

KEY RATING CONSIDERATIONS

Long track record with a broad product line

TRT is one of a few long-established transformer manufacturers in Thailand which can produce both power and distribution transformers with wide-ranging capacities and system voltages. The company has been making electrical transformers for 31 years.

TRT’s power transformers have capacities of up to 300 megavolt-amperes (MVA), at system voltages of up to 500 kilovolts (kV). The distribution transformers range in capacity from 1 kilovolt-amperes (KVA) to 10 MVA, at system voltages of up to 36 kV. In 2017, TRT’s production capacity rose to 9,000 MVA from 5,000 MVA.

The company is one of the few power transformer manufacturers that are qualified to sell to state enterprises. In addition, the license contract with Siemens Transformers Austria GmbH & Co KG (Siemens), (a well-known international brand) from Austria, helps TRT maintain its competitive advantage, especially in the new export markets.

Declining competitive strengths

Despite its competence in manufacturing transformers, TRT’s competitive strengths, particularly in the power transformer segment, were heavily dampened by Chinese manufacturers with licenses from internationally-known firms like ABB and Siemens. The import tariff reduction, according to the free trade area agreement (FTA), and the support from the Chinese government to its manufacturers have intensified competition in the power transformer segment.

TRT’s gross margin of transformer sales, which ranged from 20%-23% during 2012-2014, steadily declined to average about 18% over the past three years. The gross margin fell to a record low at 15% in 2017, suggesting TRT’s weakened competitive position.

In efforts to mitigate the drawback of transformers, TRT has diversified into the assembling of hydraulic crane trucks, customized metalwork, and O&M (operation and maintenance) services through its subsidiaries.

In TRIS Rating’s view, the company’s concerted diversification is not paying off as the net income from non-transformer segment does not amount to softened profit of its cornerstone products.

Ongoing tough competition

TRIS Rating has slashed the outlook for the domestic transformer market, though demand for electricity is rising. The domestic transformers producers have experienced delayed bidding and awarding by electricity authorities. In addition, private sector investment has remained weak, and demand has flagged.

In both the public and private sector segments, fierce competition has presaged aggressive bidding. As for power transformer segment, the market is dominated by a small number of transformer producers. Considering the distribution transformer market, competition is fairly intense, with a low barrier to entry.

Operating performance is likely to remain weak

After the considerable loss in 2017, TRT still could not recover its profitability as per previous forecast of TRIS Rating. The company arrived at weaker-than-expected sales and operating margin (operating income before depreciation and amortization as percentage of sales) in the first half of 2018. In TRIS Rating's view, the company's business remains mired, with significant susceptibility to the competitive threat of the Chinese manufacturers. Therefore, weak operating performance tends to linger in the next three years.

Under TRIS Rating's base case, we anticipate TRT's revenue will grow in a range of Bt2.7 billion to Bt3.1 billion per annum during 2018-2021, given the backlog of Bt2.0 billion as of June 2018. The forecast is also built on the expectation that the state enterprises resume a normal bidding schedule and private sector investment rebounds. However, we slashed estimated overall gross margin to around 22%, compared with 25%-26% under our previous forecast. Given a significant amount of selling and administrative expenses, TRT would achieve operating margin of around 6%-7%.

Heightened leverage and limited headroom for covenants

The persistently high level of leverage heightens concerns over the company's ability to comply with respective financial covenants of loans and debentures. The company's debt to capitalization ratio has ranged from 50% to 60% since 2015. TRT's financial leverage is deemed high, given its current business risk. In our base case, the debt to capitalization ratio would still stay at nearly 60% during 2018-2021.

TRT's interest-bearing debt to equity ratio stood at 1.4 times as of June 2018, against the limit of 1.5 times under the covenant of debentures. Due to limited headroom, TRT remains at risk of breaching such financial covenant. The weak financial profile also heightens refinancing risk of debentures coming due in 2019.

Deteriorating cash flow protection

TRT's deteriorating cash flow protection considerably weighs down the rating for the next three years. In 2017, the ratio of funds from operations (FFO) to adjusted debt fell and the earnings before interest, tax, depreciation and amortization (EBITDA) interest coverage ratio significantly dropped from average levels during 2014-2016. Although the ratios seemingly recovered in the first half of 2018, both ratios were lower than our expectation.

Going forward, TRIS Rating expects TRT's FFO to be around Bt120 million per annum in 2018-2021, while EBITDA is forecast to be around Bt200 million per year. TRIS Rating cut down the estimated FFO to adjusted debt ratio to 8%-10%, from our previous expectation of 10%-15%. Meanwhile, the EBITDA interest coverage ratio could fall below 3 times.

RATING OUTLOOK

The "negative" outlook reflects the fact that TRT's business profile is weakened, in consideration of abated competitive position and fierce competition threatening to undercut recovery. As a result, the company's operating performance will likely to remain weak over the next three years. Leverage level is prone to stay elevated, leading to lowered financial resilience.

RATING SENSITIVITIES

TRT's rating could be downgraded if the company fails to restore its market position and operating performance remains weak. A downward rating pressure would also emerge if the company's financial leverage remains high and cash flow protection deteriorates for a sustained period. The breach of financial covenant could also trigger the rating action as well.

The outlook could be revised back to "stable" if TRT could considerably improve its profitability and the operating margin stays over 8% over a sustained period. Furthermore, the positive factors for the outlook raising are also the ratio of FFO to adjusted debt that exceeds 13% and the EBITDA interest coverage ratio of over 3 times.

COMPANY OVERVIEW

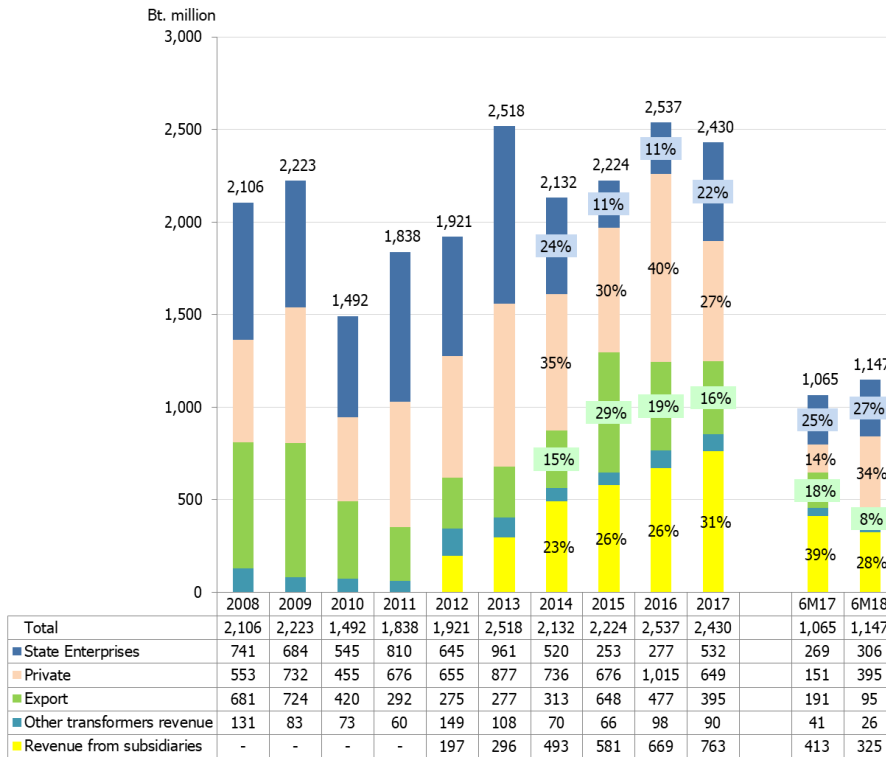
TRT was established in 1987 and listed on the Market for Alternative Investment (MAI) in May 2006. As of August 2018, TRT’s key directors and managers were major shareholders, with combined stake of 29%. TRT is a leading manufacturer of power and distribution transformers in Thailand. The company’s customer base comprises three groups: state enterprises, private companies, and export customers. State enterprises include the Metropolitan Electricity Authority (MEA), the Provincial Electricity Authority (PEA), and the Electricity Generating Authority of Thailand (EGAT). Private sector customers are mostly construction contractors, including factories and large buildings. The export markets are mainly Asian countries.

Apart from selling and providing service to transformers, TRT via its subsidiaries, offers other products and services such as aerial cranes, digger derricks, steel fabrication, engineering procurement and construction (EPC), and operation and maintenance (O&M).

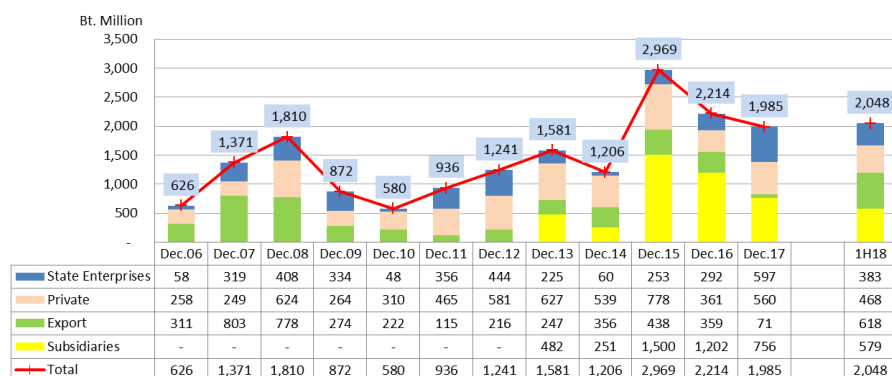
TRT has three plants at Bangpu Industrial Estate, Samutprakarn. The company utilized 41% of its total production capacity in 2017. In 2017, transformer sales and services contributed 69% of TRT’s total revenue, while the rest was from subsidiaries’ sales and services.

KEY OPERATING PERFORMANCE

Chart 1: Revenue by Customers



Source: TRT

Chart 2: Backlog by Customers


Source: TRT

FINANCIAL STATISTICS AND KEY FINANCIAL RATIOS*

Unit: Bt million

	Jan-Jun 2018	-----Year Ended 31 December -----			
		2017	2016	2015	2014
Total operating revenues	1,153	2,448	2,551	2,258	2,152
Operating income	81	74	197	62	177
Earnings before interest and taxes (EBIT)	28	(27)	131	(12)	116
Earnings before interest, taxes, depreciation, and amortization (EBITDA)	80	70	210	62	188
Funds from operations (FFO)	47	26	139	16	120
Adjusted interest expense	34	65	47	58	50
Capital expenditures	23	96	304	259	192
Total assets	3,193	3,147	3,304	3,025	2,653
Adjusted debt	1,404	1,275	1,464	1,104	495
Adjusted equity	1,034	1,035	1,127	1,077	1,174
Adjusted Ratios					
Operating income as % of total operating revenues (%)	7.01	3.02	7.72	2.73	8.22
Pretax return on permanent capital (%)	2.80 **	(0.98)	4.78	(0.50)	5.30
EBITDA interest coverage (times)	2.38	1.08	4.46	1.07	3.78
Debt to EBITDA (times)	7.90 **	18.31	6.96	17.71	2.64
FFO to debt (%)	7.96 **	2.00	9.47	1.46	24.23
Debt to capitalization (%)	57.60	55.20	56.51	50.61	29.67

* Consolidated financial statements

** Annualized with trailing 12 months

Tirathai PLC (TRT)

Company Rating:	BBB-
Rating Outlook:	Negative

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