AAPICO HITECH PLC

No. 94/2017 | 3 August 2017

Company Rating: BBB+

Issue Rating:
Senior unsecured BBB+

Outlook: Stable

Company Rating History:

Date	Rating	Outlook/Alert
12/11/14	BBB+	Stable

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Rating Rationale

TRIS Rating affirms the company rating of AAPICO Hitech PLC (AH) and the rating of AH's senior unsecured debentures at "BBB+". The ratings reflect AH's solid business profile as a Tier-1 automotive part manufacturer in Thailand, the strong relationships it has with major automakers, high barriers to entry, improved profitability, and the strong fundamentals of the automotive industry in Thailand. These strengths are partially offset by the thin profit margins in two key segments: stamped products and car dealership, as well as high customer concentration, and the cyclical nature of the automotive industry. The ratings also take into considerations an expected rise in AH's leverage due to the recent huge investment.

Established in 1996, AH is a large Tier-1 manufacturer of automotive parts in Thailand. The company started business as a Ford distributor, before expanding to the manufacture of auto parts. It was listed on the Stock Exchange of Thailand (SET) in 2002. As of March 2017, the two major shareholders of AH were the Yeap family and Sojitz Corporation (Sojitz), holding 39.9% and 15.8% of the outstanding shares, respectively. However, in June 2017, Ms. Yeap Xin Rhu and Ms. Yeap Xin Yi separately signed a memorandum of understanding (MOU) with Sojitz to purchase all of the shares of AH held by Sojitz. Sojitz's divestment should not affect the core operations of AH as AH has a solid business foundation in Thailand.

AH has two core lines of business: the original equipment manufacturer (OEM) auto parts and the car dealership. The company's OEM products are stamped or pressed parts, forged and machined parts, plastic parts, and jigs and dies. Stamped or pressed parts, which include chassis frames, are the key OEM products. The car dealership segment sells Ford and Mitsubishi vehicles in Thailand and Honda vehicles in Malaysia. Revenue from the OEM auto part segment accounts for 60%-70% of total revenue annually, while the car dealership segment constitutes the rest. AH's operations in Thailand contribute 70%-80% of total revenue, followed by operations in Malaysia (15%-25%) and China (3%-5%).

The fundamentals of the Thai automotive industry are strong. In 2016, Thailand was the twelfth-largest automotive manufacturer in the world, building 1.9 million units in 2016 or about 2% of the global auto production. Thailand's strong position is attributed to the presence of a huge cluster of auto parts manufacturers and a large number of Tier 1, Tier 2, and Tier 3 suppliers. The government encourages auto makers to set up production in Thailand by providing several privileges and tax incentives. Furthermore, basic infrastructure, such as road networks, large seaports, and well-developed industrial estates, enhances the supply chain and productivity of the Thai automotive industry.

AH's business profile is solid. The revenue from the OEM auto part segment is rather stable and sizable, ranging between Bt9-Bt10 billion per annum. The size of the OEM segment reflects AH's strong market position. AH has continuously improved product quality and reduced costs of production. The company has grown stronger through cooperative agreements or joint ventures with international manufacturers. The partnerships enable AH to produce more advanced and higher value-added products. AH is able to supply its products to the automakers with factories in a number of locations. In Thailand, AH has 12 factories, located in several large industrial estates in many provinces.

AH has strong relationships with several leading automakers in Thailand. Its main customer is Isuzu. Sales to Isuzu comprise 25%-30% of total revenue. The other major customers include Auto Alliance (AAT; a Ford and Mazda joint venture) and Nissan, contributing about 10% and 5% of total revenue, respectively. Vehicle brands produced by Isuzu, Ford, Mazda, and Nissan account for about 30% of the vehicles produced in Thailand. The large market shares of AH's customers mean that AH can grow as demand for vehicles rises in Thailand and abroad. However, AH is exposed to concentration risk as the majority of its revenue relies on a few customers. Losing a customer or a drop in orders from one of its customers could significantly affect AH. The small number of major automakers in Thailand causes the high customer concentration. AH has no record of losing orders from its major customers. The recurring orders it receives reflect the reliability of AH's operations and the credibility it has earned. The company's position as a Tier-1 auto part manufacturer is well protected by the high barriers to entry, such as large and ongoing requirements for capital investments, a good track record of operation, and the ongoing efficiency improvement required by automakers.

AH has explored opportunities to expand to the global automotive market as a part of its growth strategy. In June 2017, AH invested US$100 million, or Bt3,522 million, in Sakthi Global Auto Holdings Ltd. (SGAH). The investment comprised the newly-issued shares of SGAH (US$50 million) and a synthetic convertible loan (US$50 million), due on 31 March 2020. AH was granted five-year loans, worth US$75 million, from two Thai banks. The rest of the investment or US$25 million was funded from AH's operating cash flow. The synthetic convertible loan offers a coupon rate of 20% per annum, with an option to convert the loan to ordinary shares of SGAH. The investment in SGAH should help strengthen AH's business profile as the cooperation will enable AH to enjoy the large scale of the global automotive market. AH's profits will also improve if the operating performance of SGAH goes well as expected. SGAH currently supplies markets and has product bases in many countries such as India, Portugal, the United States (US), and China. A successful market expansion will be a positive factor for AH's ratings.

AH's revenue was flat in 2016 at Bt15.1 billion, a consequence of the stagnant automotive market in Thailand. Revenue in the first quarter of 2017 was up slightly, rising by about 1% year-on-year (y-o-y) to Bt3.9 billion. Revenue from the OEM auto part segment fell by 5.7% y-o-y. The slowing automotive market caused a drop in the sales of stamped or pressed parts. In contrast, revenue from the car dealership segment increased by 13.4% y-o-y. Sales of Honda vehicles in Malaysia were the main driver of growth. TRIS Rating forecasts AH's revenue will be stagnant in 2017, before rising to Bt16-Bt17 billion in 2019. The company should receive more orders as Ford is expected to increase production of the Ranger pickup truck. In addition, the entry into new markets, a result of the cooperation with SGAH, may boost AH's revenue in the next few years.

AH's business strengths are partially offset by the low profit margins from the stamped part segment and the car dealership segment. Despite being low, the profit margins are stable. The company can pass through nearly all of the production costs in the OEM auto part segment to the automakers. AH's profitability improved recently due to its cost-cutting efforts and efficiency improvements. The forging business unit also turned profitable. The operating profit margin before depreciation and amortization (operating margin) was 9.7% in the first quarter of 2017, rising from a three-year average of 7.9%. TRIS Rating forecasts the operating margin will stay above 8% over the next three years. In addition, if the investment in SGAH performs well as expected, the share of the profits and interest income from the investment in SGAH will help bolster earnings before interest, taxes, depreciation, and amortization (EBITDA) and funds from operations (FFO) in the long term.

In the near term, financial leverage will rise as AH used new borrowings to fund the investment in SGAH. However, the company is expected to keep the debt to capitalization ratio below 50%. Under the assumptions in TRIS Rating's base case forecast, the debt to capitalization ratio will rise to about 44% in 2017, and decline gradually to below 40% in 2019. The FFO to total debt ratio will drop, and range between 25%-29% during the next three years, from 52.4% in the first quarter of 2017. The FFO to total debt ratio above 20% is an acceptable level, in TRIS Rating's assessment. The FFO, forecast at Bt1.4-Bt1.5 billion per annum, will be sufficient to cover the debts coming due in each fiscal year plus cover the maintenance capital expenditures for the year. Debt repayments plus capital expenditures will total Bt1-Bt1.5 billion per annum. As of March 2017, AH had cash and marketable securities of about Bt470 million and unused revolving credit facilities of about Bt2.7 billion as additional sources of funds. All of AH's short-term debts are working capital loans from the banks.

Rating Outlook

The "stable" outlook reflects TRIS Rating's expectation that AH will maintain its strong market position in its core lines of business and keep the debt to capitalization ratio below 50%.

The ratings and/or outlook could be lowered if the operating margin drops below 5% or the debt to capitalization ratio exceeds 50% for an extended period.

The ratings and/or outlook could be revised upward if AH's profitability improves significantly, or if the company is successful in diversifying into new markets or new products with higher margins.

AAPICO Hitech PLC (AH)

Company Rating:	BBB+
Issue Rating:	
AH184A: Bt800 million senior unsecured debentures due 2018	BBB+
Rating Outlook:	Stable

Financial Statistics and Key Financial Ratios *

Unit: Bt million

	Jan-Mar 2017	------------- Year Ended 31 December ------------ 2016	2015	2014	2013
Sales	3,946	15,139	14,994	15,196	16,096
Gross interest expense	28	131	170	208	273
Net income from operations	286	543	313	367	1,463
Funds from operations (FFO)	428	1,240	1,079	1,034	2,218
Capital expenditures	39	167	273	460	734
Total assets	11,396	11,113	11,507	12,083	12,579
Total debt	2,364	2,543	3,308	3,825	4,674
Shareholders' equity	6,514	6,236	5,983	5,681	5,471
Operating income before depreciation and amortization as % of sales	9.7	8.1	7.6	8.0	9.0
Pretax return on permanent capital (%)	9.7**	8.1	5.7	6.3	17.9
Earnings before interest, tax, depreciation, and amortization (EBITDA) interest coverage (times)	17.8	11.1	7.5	6.4	9.5
FFO/Total debt (%)	52.4 **	48.7	32.6	27.0	47.4
Total debt/capitalization (%)	26.6	29.0	35.6	40.2	46.1

* *Consolidated financial statements*
** *Annualized with trailing 12 months*

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