TRIS RATING
A Strategic Partner of S&P Global

CreditNews ข่าวเครดิต

CH. KARNCHANG PLC

No. 64/2020
30 April 2020

CORPORATES

Company Rating:	A
Issue Ratings:	
Senior unsecured	A
Outlook:	Stable

Last Review Date: 21/06/19

Company Rating History:

Date	Rating	Outlook/Alert
04/04/19	A	Stable
30/01/15	A-	Stable
24/01/14	BBB+	Positive
26/02/13	BBB+	Stable
21/01/11	BBB	Stable
09/06/09	BBB+	Negative
23/07/07	BBB+	Stable
16/02/07	A-	Alert Negative
07/09/04	A-	Stable

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RATIONALE

TRIS Rating affirms the company rating on CH. Karnchang PLC (CK) and the ratings on CK's outstanding senior unsecured debentures at "A" with a "stable" outlook. The ratings reflect CK's solid business profile as a top-tier construction contractor with strong capabilities of undertaking large and sophisticated construction projects. The ratings also mirror CK's strategic investments, which bring in business synergy and make CK resilient to a drop-off in construction. Conversely, the ratings are weighed down by earnings contraction and subdued backlog. The ratings also recognize the severe competition in the engineering and construction (E&C) industry and potential delays in public construction project bidding.

KEY RATING CONSIDERATIONS

A leading construction contractor

The ratings are reflective of CK's robust competitive position in the domestic E&C industry. CK's construction competence blankets a broad array of construction activities, ranging from general civil works, such as roads, expressways, buildings, and bridges, to highly sophisticated mega projects, such as underground mass transit and hydropower plants.

Across the construction industry, CK is the second largest contractor, as measured by revenue and asset size. Given its long-established track record and large capital base, CK is among a few top-tier contractors capable of bidding and undertaking massive-scale public infrastructure projects.

Strategic investments are paying off

CK has strategically built a strong foundation of recurring income by investing and holding meaningful stakes in Bangkok Expressway and Metro PLC (BEM), TTW PLC (TTW), and CK Power PLC (CKP). These three companies, all of which are listed on the Stock Exchange of Thailand (SET), provide products that serve the country's essential infrastructure needs (i.e., transportation, power, and water supply) under concession contracts or multi-year utility purchase contracts.

We view that CK has successfully carried through its business strategy, which makes the company resilient to the cyclicality of the construction business. BEM and CKP currently have strong business profiles and staged sound performances. These affiliates also bring construction business opportunities to CK when they expand. Furthermore, CK earns substantial dividends on a recurring basis and capital gains from occasional divestments. The strategic investments also provide CK with financial flexibility as they are marketable and their market values have risen over time.

Severe competition and delays in project bidding

In 2019, domestic construction grew by 1.9% year-over-year (y-o-y). Public construction rose by 2.4% while private construction increased merely by 1.4%. The outlook of private construction remains bleak as residential construction represents around half of this segment. Given the current glut of property for sale, we expect the sluggish domestic private construction will continue in the near term. At the same time, we expect the public segment to remain the key driver of domestic construction.

The downside risks comprise the long-delayed budget disbursements and stiff competition. The fiscal budget legislative process has been long-delayed. This has disrupted budget disbursements and caused delays in the commencement of large-scaled projects. We expect the competition in the industry to heighten in the wake of delays in project bidding and awarding.

In addition, we view that the coronavirus (COVID-19) pandemic will likely exacerbate the situation. The pandemic exacts an array of downside risks, such as further delays in large project bidding, interruptions of works in progress, shortages of workers, etc. These threats could erode profitability. That being said, we maintain a positive view on the domestic E&C industry over the medium term. With the backdrop of an eroding economy, the public investment budget and state enterprise outlays will continue to play a major role in the government's efforts to revive the economy amid the damaging effects of the COVID-19.

Earnings in contraction

Like other large contractors, CK has endured the lingering effects of the long-awaited fiscal budget disbursements. The delays in launching several mass public projects considerably cut the company's new contracts over the past two years. In total, CK mustered merely Bt14 billion in new contracts during 2018-2019. As a result, CK's operating performance in 2019 fell short of our expectation. Revenue came in at Bt23.4 billion, a staggering 21% decline from the previous year. Given high operating expenses, CK reported Bt2.7 billion in EBITDA (earnings before interest, tax, depreciation, and amortization), the lowest in several years.

With a streak of lukewarm biddings, CK's backlog stood at Bt38.6 billion at the end of 2019, leaving the company with immense pressure to replenish the diminishing construction projects in hands. In our view, the bidding for large infrastructure projects will likely be postponed at least until the second half of this year, due to the impact of the COVID-19. As such, we expect CK's revenue to continue its sluggish mode in 2020. Yet, we expect CK's performance will improve each year thereafter when the large public infrastructure projects in the pipeline start to come on stream.

Leverage expected to maintain

In our base case forecast, we project CK's revenue to decline to Bt22 billion in 2020, and to increase to Bt28 billion in 2021 and Bt40 billion in 2022. Gross profit margin for construction is projected to range 7%-8%. We expect CK to recognize shared profits from BEM and CKP of around Bt1.6-Bt1.8 billion per annum over the next three years. TTW, meanwhile, should bring in stable dividend income of around Bt450-Bt500 million per year. We expect CK will arrive at Bt2.8 billion in EBITDA in 2020. EBITDA will then range Bt3-Bt4 billion per year in 2021-2022.

As of 2019, CK's total debt stood at Bt37 billion, most of which were for financing its strategic investments, as well as the sponsor loan to the Xayaburi hydropower project in the Lao People's Democratic Republic (Lao PDR). The debt to capitalization ratio was at 51.2% as of 2019. In our base case forecast, we project CK will maintain its leverage ratio at 50%-55% on the assumption that CK will no longer need to financially support its affiliates. The ratio of debt to EBITDA is projected to stay at about 10 times in 2020-2021, before declining to around 7-8 times in 2022. We view CK's leverage level is commensurate with its ratings, in light of the company's business model as a contractor and an investment company. CK's gearing could decrease further if the Xayaburi sponsor loan is repaid by way of refinancing.

Acceptable liquidity profile

We assess CK's liquidity to be at acceptable levels over the next 12 months. The company had Bt9.2 billion in cash plus current investments as of December 2019. We forecast CK's FFO over the next 12 months to be around Bt1.6-Bt1.8 billion while the company is expected to spend approximately Bt1-Bt1.5 billion in capital expenditures and distribute dividends of around Bt0.6-Bt0.8 billion. Debts maturing in the next 12 months comprise Bt1.9 billion in short-term loans, Bt0.5 billion in long-term loans, and Bt1 billion in debentures.

In addition, the liquidity profile is enhanced by the company's financial flexibility through its investments in the three SET-listed companies. At the end of 2019, the fair market value of CK's investments in those companies was Bt77.1 billion, or about 2.1 times the company's total debt. It is likely that CK will maintain a significant percentage of shareholding in these companies.

According to the key financial covenant on its debentures, CK has to maintain its net interest-bearing debt to equity ratio at lower than 3 times. The ratio stood at 1 times as of December 2019. Given the large covenant headroom, we expect that the company will continue to comply with its financial covenant over the next 12 to 18 months.

BASE-CASE ASSUMPTIONS

These are the key assumptions in TRIS Rating's base-case forecast for 2020-2022:

- Revenue is projected at around Bt22 billion in 2020, Bt28 billion in 2021, and Bt40 billion in 2022.
- Gross profit margin for construction to maintain at 7%-8%.

- On average, CK to secure new construction contracts worth a total of Bt30 billion per year.
- The Xayaburi sponsor loan to hold in several years ahead.
- There will be no extensive investments or financial supports granted to related companies.

RATING OUTLOOK

The "stable" outlook reflects our expectation that CK will remain highly competitive in securing sizable new contracts in connection with the prospective infrastructure projects. We also expect CK to sustain its gross margin of construction at 7%-8% despite stiff competition, while manage its debt to capitalization ratio in the range of 50%-55% over the next three years, and its strategic investments remain fruitful.

RATING SENSITIVITIES

The ratings are unlikely to be upgraded in the near term, but it could occur if CK could significantly uplift its cash flow protection such that the debt to EBITDA ratio will stay below 5 times for a sustained period, and the debt to capitalization ratio stays below 50%.

Contrarily, a pressure on the ratings could develop if CK's operating cash flow drops significantly, possibly due to delays and cost overruns in major projects. A plunge in operating performance, or a deluge of investments, or extensive financial support provided to its affiliates, which causes the debt to capitalization ratio to stay above 60% for a sustained period, could also trigger a rating downgrade.

COMPANY OVERVIEW

CK was established in 1972 by the Trivisvavet family. CK initially focused on public work projects for government agencies. The company later greatly expanded its business scope and became a listed company on the SET in 1995. As of March 2020, the Trivisvavet family held approximately 31% of CK's shares outstanding. The family plays an important role in formulating and executing the company's strategies and overall business directions.

CK's business is divided into two segments: construction and investment. In the construction segment, CK has a long-established presence in the E&C sector, with experience and expertise in all kinds of construction ranging from general civil works to highly sophisticated projects. This diverse construction background, spanning several complex projects, enhances the company's competitive position. Furthermore, CK's large capital base helps support the company in bidding on large-scale government infrastructure projects.

The investment segment includes significant holdings in the three SET-listed companies (BEM, TTW, and CKP). These strategic investments help strengthen CK's business profile and provide the company with financial flexibility. The market values of these investments have risen.

CK's revenue in 2016 was record-high at nearly Bt46 billion, around half of which was contributed by the Xayaburi hydropower dam project. CK was awarded an additional contract worth Bt19.4 billion to enhance environmental aspects of the project. Despite a significant amount of additional recognized revenue, CK, as a project sponsor, needs to finance the additional construction in the form of a sponsor loan to the project. CK is providing sponsor loans to the project's operating company, Xayaburi Power Co., Ltd. (XPCL), in the amount of Bt13.5 billion. XPCL will repay the loan and interest from earnings after the commercial operation date. The loan repayment risk, thus, is tied to XPCL's performance.

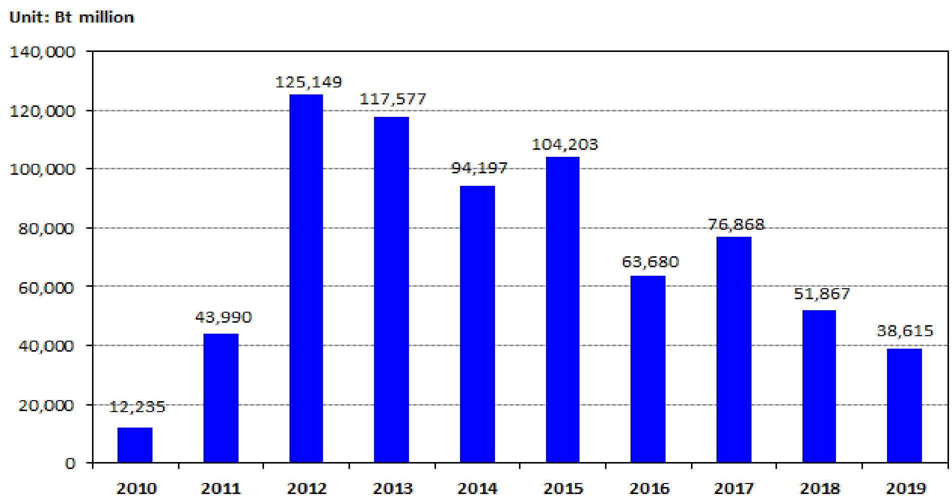
KEY OPERATING PERFORMANCE

Table 1: CK's Investments (As of Dec 2019)

Company Name	CK Holding (%)	Consolidate Investment Cost (Bt Mil.)	Fair Value (Bt Mil.)	Type of Investment	Customer(s)
BEM	32.21	20,771	53,669	BTO concession AOT concession PPP gross cost	Public Public Public
TTW	19.40	5,810	10,605	BOO water purchase agreement	PWA
CKP	31.90	8,061	12,861	Holding company of power plants	EGAT, PEA, EDL-Gen
Total Investment		**34,642**	**77,135**		

Notes: PWA = Provincial Water Works Authority of Thailand
EGAT = Electricity Generating Authority of Thailand
PEA = Provincial Electricity Authority
EDL-Gen = EDL-Generation Public Company
Source: CK

Chart 1: Backlog at Year End



Source: CK

FINANCIAL STATISTICS AND KEY FINANCIAL RATIOS*

Unit: Bt million

	-----------------------Year Ended 31 December -------------------				
	2019	**2018**	**2017**	**2016**	**2015**
Total operating revenues	23,408	29,634	36,225	45,929	35,059
Earnings before interest and taxes (EBIT)	3,123	3,632	3,049	3,029	2,270
Earnings before interest, taxes, depreciation, and amortization (EBITDA)	2,685	3,362	3,920	3,999	3,305
Funds from operations (FFO)	1,307	1,956	2,419	2,742	1,285
Adjusted interest expense	1,251	1,267	1,410	1,179	1,562
Capital expenditures	2,245	2,555	913	1,886	1,668
Total assets	82,586	83,501	79,274	94,928	93,066
Adjusted debt	29,117	28,999	31,882	45,819	49,834
Adjusted equity	27,813	25,829	23,873	21,854	20,856
Adjusted Ratios					
EBITDA margin (%)	11.47	11.34	10.82	8.71	9.43
Pretax return on permanent capital (%)	4.82	5.68	4.23	3.90	3.29
EBITDA interest coverage (times)	2.15	2.65	2.78	3.39	2.12
Debt to EBITDA (times)	10.84	8.63	8.13	11.46	15.08
FFO to debt (%)	4.49	6.74	7.59	5.98	2.58
Debt to capitalization (%)	51.15	52.89	57.18	67.71	70.50

* *Consolidated financial statements*

RELATED CRITERIA

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

CH. Karnchang PLC (CK)

Company Rating:	A
Issue Ratings:	
CK20NA: Bt1,000 million senior unsecured debentures due 2020	A
CK215A: Bt2,250 million senior unsecured debentures due 2021	A
CK217A: Bt820 million senior unsecured debentures due 2021	A
CK225A: Bt1,600 million senior unsecured debentures due 2022	A
CK226A: Bt3,000 million senior unsecured debentures due 2022	A
CK227A: Bt910 million senior unsecured debentures due 2022	A
CK235B: Bt2,700 million senior unsecured debentures due 2023	A
CK245A: Bt1,600 million senior unsecured debentures due 2024	A
CK246B: Bt3,500 million senior unsecured debentures due 2024	A
CK247A: Bt1,500 million senior unsecured debentures due 2024	A
CK25NA: Bt1,000 million senior unsecured debentures due 2025	A
CK267A: Bt2,700 million senior unsecured debentures due 2026	A
CK283A: Bt800 million senior unsecured debentures due 2028	A
CK287A: Bt1,020 million senior unsecured debentures due 2028	A
CK296A: Bt3,500 million senior unsecured debentures due 2029	A
Rating Outlook:	Stable

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