

ITALIAN-THAI DEVELOPMENT PLC

No. 134/2020

8 September 2020

CORPORATES

Company Rating:	BBB-
Issue Rating:	
Senior unsecured	BBB-
Outlook:	Stable

Last Review Date: 31/10/19

Company Rating History:

Date	Rating	Outlook/Alert
30/09/13	BBB-	Stable
27/08/12	BB+	Negative
02/07/12	BB+	Alert Negative
08/06/12	BBB-	Negative
06/05/11	BBB	Stable
30/04/09	BBB+	Negative
13/09/07	BBB+	Stable
11/01/07	A-	Negative
23/11/05	A-	Stable

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RATIONALE

TRIS Rating affirms the company rating on Italian-Thai Development PLC (ITD) and the rating on its senior unsecured debentures at “BBB-” with a “stable” outlook. The ratings reflect the company’s solid market position in the domestic engineering and construction (E&C) industry and its sizable project backlog. Conversely, the ratings are constrained by ITD’s debt-heavy financial profile, the intense competition, and potential delays in public construction project bidding. The ratings are also held back by several ailing investments which remain burdensome and impede turnaround.

KEY RATING CONSIDERATIONS

Largest domestic contractor

The ratings mirror ITD’s solid market presence as the leader in the domestic E&C industry. ITD provides a complete range of construction and engineering services around the country. By revenue, ITD is the largest E&C contractor listed on the Stock Exchange of Thailand (SET). The company generated at THB48-THB63 billion in yearly revenue over the past five years.

ITD’s solid business profile is built on its extensive track record of undertaking projects for clients in both the public and private sectors. Given its wealth of experience and resources, ITD is among the country’s top-tier contractors capable of bidding and participating in massive-scale public infrastructure projects. The company also has a diverse customer base.

Given its wide-ranging product and service offering, ITD has expanded overseas operations. ITD has established a strong presence in India, represented by its listed subsidiary, ITD Cementation India Ltd. The company has also undertaken projects in neighboring countries and Bangladesh. In all, overseas operations make up about one-thirds of revenue.

Large and diverse project backlog

As of June 2020, ITD has mustered a large and diverse project backlog of THB303.1 billion. The backlog includes a railway and port concession in Mozambique, worth THB113.3 billion, and a toll road concession in Bangladesh, worth THB37.6 billion. However, major construction work in Mozambique has not yet begun, while the project in Bangladesh is set under a joint venture. As such, TRIS Rating omits these two projects from our forecast in order to take a more conservative view of the size on the backlog.

That said, ITD’s backlog remained high at THB152.2 billion, which included other large projects such as the Hongsa mining project in the Lao People's Democratic Republic (Lao PDR), worth THB15 billion, and the Mae Moh mine contract #9, worth THB27 billion. The large number of projects in the backlog is expected to secure a significant amount of future revenues.

Intense competition and delays in project bidding

Domestic construction grew by 1.9% in 2019. Public construction rose by 2.4% while private construction increased merely by 1.4%. For the first half of 2020, domestic construction shrank by 1.25% year-over-year (y-o-y), led by a 3.16% contraction in the private sector while public construction remained flat. The outlook for private construction remains glum as residential construction represents around half of this segment. Given the oversupply of property for sale, we expect domestic private construction industry to remain sluggish. In

contrast, we expect the public segment to remain the key driver of domestic construction.

The Coronavirus Disease 2019 (COVID-19) pandemic has somewhat disrupted domestic construction during the lockdown. The outbreak poses several downside risks, such as the interruption of work in progress, difficulties in importing machinery and equipment, etc. We expect construction activities will resume from the back-half of 2020 onwards, given the easing of lockdown measures. Over the medium term, we maintain a positive view on the domestic E&C industry. With the backdrop of a weak economy, the public investment budget and state enterprise outlays will continue to play a major role in government efforts to revive the economy from the damaging effects of COVID-19.

On the downside, domestic construction contractors have endured the lingering effects of the long-delayed fiscal budget disbursements. Furthermore, we view that the major impending risks of E&C industry are the intense competition and potential delays in contract bidding and awarding for public projects. This is, despite the government being intent on pushing ahead several infrastructure projects. Delays in launching several large public projects are considerably cutting ITD's new contracts over the past two years.

Potential growth of earnings

ITD's operating performance during the first half of 2020 was lower than our expectation. Revenue dropped by 14% y-o-y due in part to the COVID-19 induced difficulties and delay in project bidding. Gross margin softened to 10.5%, down from 11.3% in 2019. However, we expect a revival in ITD's performance from the second half of the year. Looking beyond that, we expect ITD's revenue growth to continue on a roll, considering the new opportunities in the years ahead. Given ITD's capabilities of winning new contracts, we expect ITD could maintain revenue at THB60 billion in 2020 and grow to THB70 billion in the next two years.

We expect ITD's robust backlog will secure a meaningful portion of revenue about 75% of the base case revenue in 2020, 55% in 2021, and 40% in 2022. The earnings before interest, taxes, depreciation, and amortization (EBITDA) margin (EBITDA as a percentage of total operating revenues) is forecast to stay above 9%.

Ailing investments impeding a turnaround

The ratings are held back by ITD's ailing investments which have been the main reason hindering the company's efforts to lower its debt burden. ITD has defrayed large investment amounts to a number of large concession projects, including a potash mine in Thailand, the Dawei industrial estate in Myanmar, a toll road in Bangladesh, a bauxite mine and alumina plant in Lao PDR, and a railway and port concession in Mozambique. These projects have not progressed as originally planned, particularly the long-delayed potash mine and the Dawei projects, which together have cost ITD about THB11 billion to date.

Given the slight chance of these investments come to fruition in the near term, we view them as continuing to saddle ITD with a heavy debt load. Moreover, in our view, the associated project risks including country risks and regulatory risks, raise serious questions regarding the costs and benefits of the projects. The hefty interest cost on the debts incurred to support these non-productive projects has been a key factor eroding ITD's operating profit for many years.

Saddled with heavy debt load

ITD's debt-heavy capital structure continues to hold back the ratings, countervailing its competitive strengths in the business. ITD's leverage has been increasing over the past three years due in large part to the huge working capital needs of its active projects. Moreover, the company has carried sizable receivables related to several state enterprise projects which remain uncollected. Total debt was THB48 billion and the debt to capitalization ratio remained high at 75.4% as of June 2020. ITD's interest burden is piling up at over Bt2 billion a year, which heavily runs off its free cash flow. EBITDA interest coverage ratio remained low at 2.2 times in the first half of 2020. The funds from operations (FFO) to debt ratio remained weak at about 7%.

In our base case forecast, we expect ITD to generate FFO of at least Bt3.0 billion in 2020. FFO should improve to a range of Bt4.5-Bt5.0 billion per annum in 2021-2022. The FFO to debt ratio should also improve each year towards 9%-10%, while the EBITDA interest coverage ratio will stay above 2 times. We project the debt to capitalization ratio will be about 75%. We expect the interest servicing burden to continue straining the company's cash flow and its debt servicing ability.

Liquidity tightening, but should be manageable

We hold the view that ITD's liquidity is tight. As of June 2020, the company had a total of THB28.3 billion in debt coming due over the next 12 months. After assessing its sources of liquidity (comprising its annual cash inflow, cash on-hand, and undrawn facilities), we expect ITD would need to refinance most of its debts in order to maintain liquidity for upcoming projects.

We believe that ITD could manage to refinance such debts, much of which are secured by assignments of payments from

construction contracts. Refinancing risks are largely mitigated by ITD's strong capability of completing construction projects and the acceptable payment risks of project owners.

ITD is obliged to keep its net interest-bearing debt to equity ratio below 3.0 times, under the key financial covenants of its outstanding bonds. In seeking more covenant headroom to support potential growth, ITD has obtained consent from bondholders to waive (i) the covenant during 2019-2020 plus (ii) apply a new and more relaxed calculation method of the leverage ratio. The ratio at the end of June 2020 was 2.57 times. We believe the company will be able to meet the condition during the forecast period.

BASE-CASE ASSUMPTIONS

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

- ITD to secure new contracts worth THB45 billion per annum during 2020-2022.
- Overall gross profit margin will be around 10% on average.
- Overall EBITDA margin to be in the 9%- 11% range.
- Capital expenditures for the construction segment are set at Bt3.7-Bt4.5 billion per year.

RATING OUTLOOK

The "stable" outlook embeds our expectation that ITD will continue to secure sizable projects, maintain its strong market position, and improve profitability and liquidity. Moreover, we expect ITD to keep the EBITDA margin at or above 9%. We also expect the company's financial leverage to be in the range of our forecast level. On that basis, we hold the view that ITD should gradually increase the amount of cash available for debt service.

RATING SENSITIVITIES

Given ITD's relatively weak financial profile, a rating upgrade is unlikely over the next 12-18 months. Leverage is expected to remain elevated. However, the ratings could be upgraded if the company significantly reduces its debt load. In contrast, rating downward pressure could arise if profitability weakens. This could occur as a result of aggressive bidding, delays in construction, or cost overruns. A downgrade scenario could occur if the EBITDA margin declines to 7% or if the FFO to debt ratio falls below 5% for a sustained period.

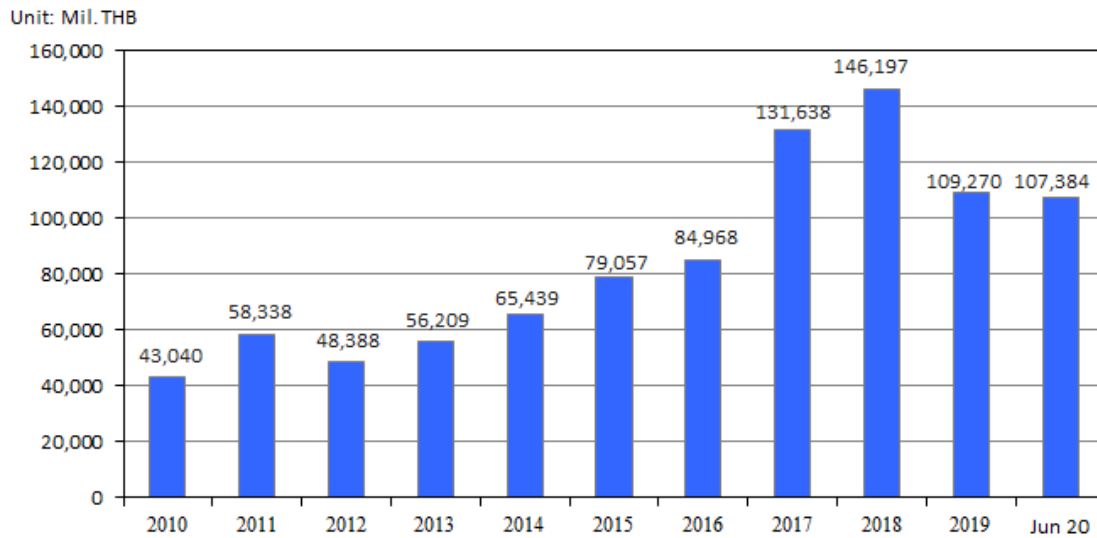
COMPANY OVERVIEW

ITD was established in 1958 by Dr. Chaijudh Karnasuta and Mr. Giorgio Berlingieri, an Italian naval architect. The company was listed on the SET in 1994. ITD's business is divided into three segments: domestic construction, overseas construction, and long-term investments. ITD faced difficulties during the 1997 financial crisis. Subsequent restructuring completed in 2002 diluted the ownership stake of the Karnasuta family from 64% to 48%. The family owned 25% as of June 2020. Mr. Premchai Karnasuta, the founder's son, has served as president since 1985.

The company is engaged in a broad range of civil construction work, ranging from constructing buildings, industrial plants, pipelines, railways, expressways, airports, seaports, power plants, hydro-electric dams, and mines. In all, domestic projects comprise 60%-70% of total revenue annually while overseas projects make up the rest. E&C projects undertaken by its India-based subsidiary, ITD Cementation India Limited, make up most of the revenue from overseas projects.

KEY OPERATING PERFORMANCE

Table 1: Backlog at Year End



Source: ITD

Note: Excluding 1) A railway and port concession in Mozambique worth Bt113.3 billion, 2) A toll road concession Bangladesh worth Bt37.6 billion, and 3) Backlog of subsidiary company

Table 2: Revenue Breakdown by Location

Unit: %

Location	2013	2014	2015	2016	2017	2018	2019	Jan-Jun 2020
Domestic	75.8	76.2	61.8	61.1	71.2	64.1	66.2	69.4
Overseas	24.2	23.8	38.2	38.9	28.8	35.9	33.8	30.6
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
Revenue (Mil. THB)	43,913	48,082	51,297	47,320	55,096	60,644	62,221	26,489

Source: ITD

FINANCIAL STATISTICS AND KEY FINANCIAL RATIOS*

Unit: Mil. THB

	Jan-Jun 2020	-----Year Ended 31 December -----			
		2019	2018	2017	2016
Total operating revenues	26,888	62,780	61,245	55,571	47,669
Earnings before interest and taxes (EBIT)	910	3,326	3,564	3,079	2,230
Earnings before interest, taxes, depreciation, and amortization (EBITDA)	2,864	6,474	6,443	5,440	4,811
Funds from operations (FFO)	1,317	3,191	3,328	2,618	2,277
Adjusted interest expense	1,278	2,743	2,435	2,386	2,439
Capital expenditures	1,214	4,293	6,511	3,611	4,224
Total assets	105,979	103,790	98,015	87,829	78,120
Adjusted debt	46,241	46,549	44,224	37,647	32,788
Adjusted equity	15,078	15,682	16,470	14,773	14,333
Adjusted Ratios					
EBITDA margin (%)	10.65	10.31	10.52	9.79	10.09
Pretax return on permanent capital (%)	4.36 **	5.11	5.89	5.76	4.48
EBITDA interest coverage (times)	2.24	2.36	2.65	2.28	1.97
Debt to EBITDA (times)	7.28 **	7.19	6.86	6.92	6.81
FFO to debt (%)	6.86 **	6.85	7.53	6.95	6.94
Debt to capitalization (%)	75.41	74.80	72.86	71.82	69.58

* Consolidated financial statements

** Annualized with trailing 12 months

RELATED CRITERIA

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

Italian-Thai Development PLC (ITD)

Company Rating:	BBB-
Issue Rating:	
ITD226A: THB6,000 million senior unsecured debentures due 2022	BBB-
Rating Outlook:	Stable

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