TRIS RATING
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EARTH TECH ENVIRONMENT PLC

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CORPORATES

Company Rating: BBB-
Outlook: Stable

RATIONALE

TRIS Rating assigns a company rating of "BBB-" to Earth Tech Environment PLC (ETC) with a "stable" rating outlook. The rating reflects ETC's stable cash generation, backed by long-term power purchase agreements (PPAs) with the Provincial Electricity Authority of Thailand (PEA, rated "AAA/Stable" by TRIS Rating). Conversely, the rating is tempered by its comparatively small power portfolio and susceptibility to fuel price risk. The rating also takes into account the tendency of a hike in financial leverage, given ETC's concerted plan for a hefty growth.

The company rating on ETC also mirrors our view of ETC as a 'core' subsidiary of Better World Green PLC (BWG, rated "BBB-/Stable" by TRIS Rating). In effect, the rating incorporates a one-notch enhancement from ETC's stand-alone credit profile (SACP) of "bb+" to the same level as the rating on BWG.

KEY RATING CONSIDERATIONS

Earnings backed by PPAs with PEA

ETC owns and operates three industrial waste-to-energy (WTE) power plants under the Very Small Power Producer (VSPP) scheme. It holds PPAs with PEA with total contracted capacity of 16.5 megawatt (MW). All of its PPAs are on non-firm basis. The counterparty risk on ETC's earning generation is largely mitigated by the high credit quality of off-takers. The three plants sell electricity under the Feed-in-Tariff (FiT) scheme, with a premium of THB0.70 per kilowatt-hour (kWh) for the first eight years.

Satisfactory performance of power plants

ETC pioneered in the industrial WTE business in Thailand. Its first power plant is the very first of the country. The plant, which is located in Keang Khoi, holds an 8-MW PPA with PEA. The Keang Khoi plant commenced its first commercial operation in 2017. The plant underwent a major maintenance in 2020 to fine-tune the heat control in the combustion chamber. Nevertheless, the availability factor of the plant has been in a satisfactory range of 86%-90% in 2018-2021.

The other two plants comprise one in Ayutthaya province and the other one in Phichit province, with contracted capacity of 5.5 MW and 3.0 MW respectively. Both plants commenced commercial operation in late-2019. The two plants have operated with availability factors between 84%-91% over 2020-2021. Going forward, we expect ETC's in-house contractor for operating and maintenance (O&M) functions to gain more proficiency in operating industrial WTEs and be able to maintain availability factors at a healthy level of about 89%. In our base case, ETC's existing power plants will bring in approximately THB330-THB360 million in earnings before interest, taxes, depreciation, and amortization (EBITDA) per year during 2022-2024.

Relatively small power portfolio

Despite smooth plant operations, ETC's power portfolio is relatively small, across the power producers rated by TRIS Rating. The small and concentrated portfolio could result in lessened negotiation power with vendors and absence of economy of scale. More importantly, an occurrence of operation disruption in one of the three plants could significantly harm the company's overall earnings and debt serviceability.

Contacts:

Tern Thitinuang, CFA
tern@trisrating.com

Narongchai Ponsirichusopol
narongchai@trisrating.com

Parat Mahuttano
parat@trisrating.com

Monthian Chantarklam
monthian@trisrating.com

WWW.TRISRATING.COM

Susceptibility to fuel price risk

While the PPAs help minimizing the market risk and enhance predictability of the revenues, earnings from the power plants remain susceptible to fuel price risk. This is a result of a lack of effective pass-through mechanism. ETC secures the Solid Recovered Fuel (SRF) feedstocks for its power plants almost entirely through long-term supply agreements with BWG, its parent company. BWG possesses abundant raw material supplies for solid SRF production. The SRF procurement agreements stipulate fixed price structures, with 2% annual escalation.

Largely impacted by surging diesel prices in the first half of 2022, BWG endured a rise in costs of SRF production and transportation. As a result, BWG negotiated with ETC for a temporary increase in prices of SRF sold to ETC. We expect the SRF fuel prices to be increased by approximately 30% on average in the second half of 2022, causing tightened margins on electricity revenues. This suggests a mismatch in cost pass-through mechanism, since the VSPP tariff structure only adjust to core inflation index but not the changes in diesel prices.

Concerted plan for hefty growth

We see the growth opportunities of renewable power in Thailand as the government is bent on increasing the proportion of renewable energy, propelled by its long-term commitments to net-zero greenhouse gas emission. With WTE being a part of the government's renewable energy development, the Energy Regulatory Commission (ERC) has invited open bidding for the development of new industrial WTE plants, with a quota of 100 MW in 2022. ERC expects the new WTE projects to start commercial run in 2025-2026. ETC has stated its ambition to grow its power portfolio to a great extent. The company has recently participated in the new WTE bid, with an ambitious number of proposed projects.

Financial leverage tends to hike

The rating on ETC is heavily weighed down by the potential surge in its financial leverage, given the company’s tendency to load up on debt in the foreseeable future. In our base case, we assume that ETC will invest in four new WTE plants, each of which has 9.9 MW capacity. We project ETC will defray a tally of THB5.8 billion spreading over 2023-2025. ETC has maintained most of its THB1.5 billion proceeds from the Initial Public Offering (IPO). That said, we expect the cash pile to gradually run out during the build-up phase.

With the ambitious investment plan, we forecast the debt to EBITDA ratio to soar to nearly 11 times and the debt to capitalization ratio to climb to 54% in 2024. We project ETC’s net debt to peak at THB5 billion in 2025. However, the leverage ratio will likely gradually decline after the commencement of commercial operation of each new plant, which is subject to construction risk over a 2-year of development phase.

Excessive liquidity before expansion

We assess the ETC’s current liquidity outstrips its financial obligations in the near term before new investments start from the mid-2023 onwards. The IPO in 2020 has provided ETC with excessive liquidity. The company’s sources of liquidity at the end of June 2022 comprised cash on hand of THB1.2 billion and total undrawn bank credit facilities of THB25 million. In addition, we forecast ETC to generate funds from operations (FFO) over the following 12 month of THB200-THB240 million. These should be sufficient to cover maintenance capital expenditures and debts coming due over the same period, totaling THB 412 million.

A core subsidiary of BWG

We view ETC as a ‘core’ subsidiary of BWG. BWG has significant controlling power over ETC in terms of operation, finance, and business development functions. The power portfolio under ETC helps BWG create a WTE value chain from its abundant raw material for SRF production. Through ETC, BWG has grown its power portfolio significantly over the past six years. The power portfolio contributes about two-thirds of BWG’s EBITDA in 2021, having surpassed the contribution from its waste management business since 2020. Added to that, the stability of earnings from the power business largely helps offset the more volatile nature of profits from waste management business. The importance of ETC to BWG will likely grow over the upcoming years. The growth prospect of the BWG group will largely depend on its expansion in WTE business.

We note that BWG’s effective stakes in ETC could be reduced to 44% in the foreseeable future, given the decision of BWG to divest its indirect holding of 7%. BWG’s ownership in ETC could be further diluted from ETC’s capital increases through private placements of new shares. However, we expect that BWG will, after all, maintain its majority control over ETC and provide strong financial support in times of need.

Capital Structure

At the end of June 2022, ETC’s total debt, excluding lease liabilities, was THB855 million. All of which are secured debts under the company and its subsidiaries. The ratio of priority debt to total debt is effectively 100%, suggesting that the company's unsecured creditors could be significantly disadvantaged to the priority debt holders with respect to claims against the company's assets.

BASE-CASE ASSUMPTIONS

- Availability factors of the existing plants to average around 89% in 2022-2024.
- EBITDA margin (EBITDA as a percentage of total operating revenue) of around 43%-47% during 2022-2024.
- ETC to invest up to four new 9.9-MW WTE power plants, with a project cost between THB1.4-THB1.5 billion each.
- Capital expenditure for the new industrial WTE power plants totaling about THB5.8 billion over 2022-2025.
- Annual maintenance capital expenditure of about THB65-75 million over 2022-2024.

RATING OUTLOOK

The "stable" outlook reflects our expectation that ETC's existing power plants will continue to perform at satisfactory levels, and that the level of investment in the new WTE projects will be in line with our projection. We also expect BWG to maintain its majority control over ETC even with a prospect of divestment of its indirect stake in the company, and a potential control dilution due to ETC's private placement of new shares.

RATING SENSITIVITIES

The credit upside for the company is limited over the near term, given the impending rise in financial leverage over the developing period of the potential projects. An upward rating revision, however, could occur once the benefits from new investments become more tangible in terms of larger and more diversified cash flows.

A downward pressure on the rating could arise if the performances of its power plants significantly deteriorate from our expectation. A more aggressive investment plan which results in an even higher-than-expected leverage could also trigger a rating downgrade.

Any material changes in the credit profile of BWG will have direct impact on the rating on ETC. Furthermore, a material dilution in parental control and support from BWG could also affect the rating on ETC.

COMPANY OVERVIEW

Established in 2004, ETC is a subsidiary of BWG, a leading service provider in industrial waste management. In 2020, ETC was listed on the Market for Alternative Investment (MAI) and later moved to trade on the Stock Exchange of Thailand (SET). ETC received proceeds from the IPO for THB1.5 billion. Currently, BWG has effective shareholding of 47.6% in ETC.

ETC and its subsidiaries produce electricity from industrial waste and sell to the PEA under VSPP scheme. In all, ETC has total installed capacity of 20.4 MW and total contracted capacity of 16.5 MW under the FiT structure. The fuel feedstock for each of the three plants is secured by the long-term purchase agreements of SRF with its parent -- BWG.

ETC's first power plant started its commercial run in March 2017. It has installed capacity of 9.4 MW, operating in Kaeng Khoi Industrial Estate. The second project is own and operated by its subsidiary, Recovery House Co., Ltd. (RH). Located in NakornLuang Industrial Estate, the power plant commenced its operation in September 2019, with 7-MW installed capacity. ETC's third power project is own by AVA Grand Energy Co., Ltd. (AVA). Located in Phichit Industrial Estate, the 4-MW power plant started operation in December 2019.

Currently, ETC is participating in the bidding for VSPP PPAs in the current industrial WTE scheme with the total quota of 100 MW.

ETC's Power Portfolio as of 30 Jun 2022

Projects in operation	Plant type	Installed capacity (MW)	Contracted capacity (MW)	ETC holding (%)	PPA term (Year)	Expiry year
1. ETC PP	Industrial WTE	9.4	8.0	100.0	20	2037
2. RH PP	Industrial WTE	7.0	5.5	94.9	20	2039
3. AVA PP	Industrial WTE	4.0	3.0	97.0	20	2039
Total		***20.4***	***16.5***			

Source: ETC

KEY OPERATING PERFORMANCE

Plant Performance Statistics

	Unit	Jan-Jun 2022	-------------- Year Ended 31 December --------------- 2021	2020	2019	2018
Waste-to-Energy VSPP power plants						
ETC PP – Net output	GWh	29.1	51.7	49.3	56.6	56.0
ETC PP – Availability factor		81.8%	86.3%	87.4%	90.1%	87.4%
RH PP – Net output	GWh	19.4	39.8	39.1	* n.a.	* n.a.
RH PP – Availability factor		80.8%	91.3%	89.1%	* n.a.	* n.a.
AVA PP– Net output	GWh	9.8	22.9	20.6	* n.a.	* n.a.
AVA PP– Availability factor		72.0%	89.5%	83.7%	* n.a.	* n.a.

* *Not available as a full-year record*
Source: ETC

FINANCIAL STATISTICS AND KEY FINANCIAL RATIOS*

Unit: Mil. THB

	Jan-Jun 2022	------------Year Ended 31 December ----------- 2021	2020	2019	2018
Total operating revenues	408	749	673	370	326
Earnings before interest and taxes (EBIT)	147	259	282	113	116
Earnings before interest, taxes, depreciation, and amortization (EBITDA)	206	370	388	190	177
Funds from operations (FFO)	174	301	303	105	124
Adjusted interest expense	29	69	85	78	53
Capital expenditures	17	98	96	429	628
Total assets	3,911	3,970	4,025	2,596	2,339
Adjusted debt	0	0	0	1,422	1,125
Adjusted equity	2,878	2,762	2,569	893	837
Adjusted Ratios					
EBITDA margin (%)	50.40	49.38	57.64	51.30	54.24
Pretax return on permanent capital (%)	6.69 **	6.71	8.83	4.84	5.90
EBITDA interest coverage (times)	7.13	5.38	4.55	2.42	3.33
Debt to EBITDA (times)	0.00 **	0.00	0.00	7.48	6.36
FFO to debt (%)	n.m. **	n.m.	n.m.	7.36	11.00
Debt to capitalization (%)	0.00	0.00	0.00	61.41	57.35

* *Consolidated financial statements*
** *Annualized with trailing 12 months*
n.m. = Not measurable

RELATED CRITERIA

- Group Rating Methodology, 7 September 2022
- Corporate Rating Methodology, 15 July 2022
- Key Financial Ratios and Adjustments for Corporate Issuers, 11 January 2022

Company Rating:	BBB-
Rating Outlook:	Stable

TRIS Rating Co., Ltd.
Silom Complex Building, 24th Floor, 191 Silom Road, Bangkok 10500, Thailand Tel: +66 2 098 3000