# SNC FORMER PCL

No. 110/2023
19 June 2023

## CORPORATES

| | |
|---|---|
| **Company Rating:** | BBB |
| **Issue Rating:** | |
| Guaranteed | AAA |
| **Outlook:** | Stable |

**Last Review Date:** 21/12/22

**Issue Rating History:**

| Date | Rating | Outlook/Alert |
|---|---|---|
| 21/12/22 | AAA | Stable |

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## RATIONALE

TRIS Rating assigns the company rating of “BBB” to SNC Former PLC (SNC), with a “stable” rating outlook. We also affirm the rating on its guaranteed debenture at “AAA/stable”. The debenture is guaranteed by Credit Guarantee and Investment Facility (CGIF, rated “AAA/stable”), a trust fund of the Asian Development Bank (ADB).

The ratings reflect the company’s long track record of providing parts manufacturing and OEM (Original Equipment Manufacturing) services for the air conditioner industry in Thailand. The ratings also factor in its cost-efficient production, conservative financial policy, and effective working capital management. However, these strengths are partially offset by intense market competition, customer concentration risk, and investment risk in new projects in which the company has limited experience.

## KEY RATING CONSIDERATIONS

### A large manufacturer of air conditioning parts in Thailand

TRIS Rating considers SNC as a large manufacturer of parts in the air conditioner industry in Thailand. The majority of its products is sold to air conditioner producers, accounting for 60%-75% of its total revenue over the past five years. Its main products include copper and aluminum pipes, metal sheets, pipe kits, plastic parts, and heat exchangers. The company also offers manufacturing and assembly services (OEM) for air conditioners, televisions, refrigerators, and toolboxes for branded home appliance manufacturers.

In our view, SNC’s long track record of providing reliable production and good product quality has helped in earning credibility and sustaining its revenue base. As Thailand is the second largest exporter of air conditioners in the world, most well-known brands have production bases in the country. The company has been in operation for 30 years and has established firm relationships with most global air conditioner manufacturers in Thailand, such as Daikin, Mitsubishi, Fujitsu, Sharp, and Toshiba.

With a revenue of THB19 billion in 2022, SNC is one of the largest producers of parts and OEM manufacturers in the Thai air conditioning industry. The company operates through three main business segments: Electrical Parts (Parts), Vehicle Parts (Auto), and Manufacturing and Assembly (OEM). We consider the Parts segment to be core, given its consistent and significant contribution to earnings over a long period of time. However, the OEM business has demonstrated high growth in revenue and earnings over the past few years.

As of 2022, revenue from the OEM segment was the largest, accounting for 76% of the total, followed by the Parts segment at 19%, and the Auto segment at 5%. Earnings before interest, taxes, depreciation, and amortization (EBITDA) from the OEM segment made up 51% of the total, while the Parts segment contributed 41%, and the Auto segment accounted for 7%.

### Rising revenue contribution from OEM business

In our view, SNC’s strategic move towards the OEM business is playing an important role in helping the company capture opportunities in the international air conditioner market. SNC has experienced a lengthy period of flat income in the local market due to limited growth opportunities and intense competition. However, after the company received new OEM orders from

Chinese and Vietnamese customers, revenue almost tripled, reaching THB19 billion in 2022 from THB6.7 billion in 2019. This growth was mainly driven by Chinese manufacturers relocating their production bases to Thailand amid the China-US trade war from 2019 onwards.

Since all OEM orders are for export, SNC's sources of revenue have become geographically diversified with more exposure to the US and Vietnam markets. SNC's revenue contribution from the US and Vietnam markets rose to 48% and 15%, respectively, in 2022, while Thailand made up 31% and France accounted for 5% of the total. Although the profit margin of each business segment is relatively steady, the increasing revenue contribution from the thin-margin OEM segment pulled down the overall profit margin, reducing the company's gross profit margin to 7.2% in 2022 from above 11% in 2019.

**Intense competition with margin pressure from customers**

SNC operates in a highly competitive environment, facing pressure from customers with significant bargaining power that frequently demand lower prices. To remain competitive, SNC continues to lower its manufacturing costs through efficiency improvements and ongoing investments in new production technologies and innovations.

**Cost competitive production with robotics**

SNC's cost-efficient production is a key advantage that has helped the company retain customer's orders over the past several years. This cost competitiveness is underpinned by benefits from large production scale, manufacturing expertise, customizable production, and improved operating efficiency through automated production. The company's sizable factory, spanning approximately 450 rai with multiple production lines and spacious warehouses, provides a competitive edge in manufacturing a diverse range of products and enables the company to obtain sizable OEM orders.

SNC is well-known for using robots in its production processes. TRIS Rating takes into consideration SNC's in-house expertise in designing and building robotics and control systems. This expertise grants the company advantages in lowering its production and maintenance costs for those robots. SNC's current strategy is to replace much of its workforce with self-developed robots. As of 2022, the company operated 400 robots. It aims to increase this number to 1,000 by the end of 2023.

We believe that SNC's policy toward automated production and the use of robots will enhance its productivity and operating efficiency. At the same time, it will help attract more customers to its manufacturing services. This approach should lead to improved profitability and will alleviate cost pressures from customers. We view the transition to full automation to be SNC's another key advantage over other players, given the capital and know-how required.

**High customer concentration risk**

SNC's customer concentration has the potential to amplify business uncertainty. In 2022, the company's five key OEM customers contributed approximately 75% of its total revenue. The largest customer, Hisense International (Hongkong) (Hisense), accounted for 41% of the total.

We believe such customer concentration will continue in the coming years. Revenue from the major customer has the potential to increase further, considering Hisense's efforts to expand its production base in Thailand to avoid the intensifying US-China trade war. Nevertheless, this risk is partially mitigated by the robust credit profile of Hisense and its strong commitments to SNC as Hisense has invested in half of the new production and assembly lines at SNC's factory.

**Investment risk from WTE power plant and industrial estate development.**

We view that SNC's expansion into the power and industrial estate development businesses poses a significant risk to the company's credit profile. The company is developing a 3-MW waste-to-energy (WTE) power plant in Yala Province. The project's development cost is estimated at THB550 million, which will be funded 80% by debt. We consider the WTE power project to have high operating risk due to its complexity and the inconsistent quality of municipal waste.

In addition, SNC plans to acquire 1,104 rai of land in Chonburi Province to develop a green industrial park. The industrial estate is expected to feature technologies and robotics developed by SNC. We view the project cost of THB2,579 million, with 67% debt funding, to be sizable for the company's balance sheet. As SNC has no track record in developing industrial estates and intends to hold 100% ownership of the project, the development and execution risks of the industrial estate may put a strain on the company's credit profile.

**Expected revenue to drop in 2023 due to slowdown in the US and Vietnam**

We expect SNC's OEM business to face downside risks in 2023, prompted by weakening demand in the US and turmoil in the real estate market in Vietnam. The company has taken proactive measures to prevent potential bad debts from the Vietnam market, reducing OEM sales to Vietnamese customers since the second half of 2022. For the first quarter of 2023, the revenue fell by 43% year-on-year (y-o-y) to about THB3.9 billion from THB6.8 billion in the same period last year.

We forecast SNC's financial performance to weaken in 2023 before recovering in the following years, primarily driven by growing orders from Hisense and through the company's efforts to explore new orders from local and international markets. We anticipate that SNC's Parts business will remain relatively steady, generating core revenue and earnings. We assume new income streams from the WTE power plant and land sales of the green industrial park to begin in 2025.

SNC's revenue is likely to fall to THB14-THB15 billion in 2023 before recovering to THB18.5 billion in 2025. Likewise, EBITDA is expected to drop to THB1.25 billion in 2023 before rebounding to THB1.9 billion in 2025, which would include THB250 million in earnings from the power plant and land sales. EBITDA margin is expected to stay in the 8%-10% range throughout the forecast period.

### Leverage on the rise from new business investments

We believe that SNC's financial leverage will increase over the near term due to its substantial investments. During 2023-2024, the company's capital expenditure will total approximately THB4.8 billion, with THB2.58 billion earmarked for the industrial park development, THB0.55 billion for the WTE power plant, and THB0.9 billion for robots and other machines. We expect SNC's debt will peak at around THB6 billion in 2024 before declining in 2025. SNC's net debt to EBITDA is forecast to touch 3.0-3.5 times in 2024. The ratio of funds from operations (FFO) to net debt will fall but should stay above 20% throughout the forecast period.

### Prudent financial policy and working capital management

SNC's strong financial profile is supported by its conservative financial policy and effective working capital management. Despite the need for OEM manufacturing services to hold stock for 2-3 months before delivery, SNC has managed to maintain low working capital requirements. This is largely due to the company's ability to negotiate with suppliers to extend credit terms to match rising accounts receivable and inventory days. Furthermore, SNC's policy of holding high levels of cash provides additional support to its debt servicing ability and liquidity.

### Adequate liquidity

We assess SNC's sources of funds will cover its uses of funds over the next 12 months. The company's sources of funds included cash on hand of THB1.91 billion as of March 2023, and estimated FFO over the next 12 months of THB1 billion. We expect the company will obtain new loans of about THB1.73 billion to support its WTE project and industrial park development. Uses of funds will comprise long-term loan repayments of THB0.57 billion, capital expenditures of THB3.4 billion and estimated dividend payments of THB0.28 billion over the next 12 months.

### Debt structure

At the end of March 2023, SNC's reported debt, excluding financial lease, was THB3.14 billion. Priority debt, including secured debts and debts of subsidiaries, totaled about THB2.17 billion. The ratio of priority debt to total debt was about 69%. As its priority debt ratio is above our threshold of 50%, we view that SNC's unsecured creditors are significantly disadvantaged to secured creditors with respect to claims against its assets.

## BASE-CASE ASSUMPTIONS

- Revenues to drop to THB14 billion in 2023 before growing to THB18.5 billion in 2025.
- EBITDA margin to stay at around 8%-9% during 2023-2024, rising to 10% in 2025 due to contributions from the power plant and the industrial estate.
- Total capital spending of THB4.8 billion during 2023-2024 and THB0.6 billion in 2025.
- Dividend payout at 50%.

## RATING OUTLOOK

The "stable" outlook reflects the expectation that SNC will be able to deliver financial performance in line with our forecasts. Despite the negative prospects of the Vietnam market, the company should be able to maintain its OEM business performance from other key customers. We expect the company's Parts segment will continue to be the core cash flow contributor over the forecast period.

## RATING SENSITIVITIES

SNC's rating upside would materialize if the company's cash flow increases significantly from the current level on a sustainable basis with improved revenue diversification. On the contrary, the ratings and/or outlook could be revised downward if SNC's operating results are materially weaker than our forecast. This could occur if the company's revenue from existing OEM or parts customers materially declines further from the current level. A weakened financial profile from large debt-funded investments or substantial losses from new investments could also trigger negative rating actions.

The rating on SNC's guaranteed bonds may change if the rating on its guarantor, CGIF, changes.

## COMPANY OVERVIEW

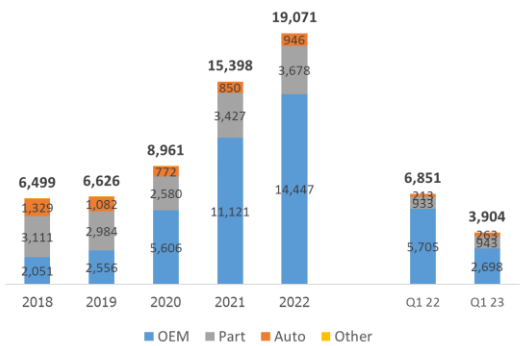
SNC was established in 1994. The company originally engaged in the manufacture of parts for air conditioners, household appliances, and air conditioning parts in cars. The main products included copper and aluminum pipes, metal sheets, pipe kits, plastic parts, and heat exchangers. In 2007, the company expanded into the manufacturing and assembly business (OEM) for leading air conditioner producers. Currently, the company's OEM products consist of air conditioners, televisions, refrigerators, heat pumps, toolboxes, etc. The company has two factories in Rayong and Samutprakarn provinces with annual production capacity of 3 million units of air conditioners.

The company has been listed on the Stock Exchange of Thailand since 2004. As of October 2022, the major shareholder was the Thaisa-nguanvolrakul family, owning about 34% of total outstanding shares.

SNC's businesses can be separated into three units, comprising Electrical Parts (Parts), Vehicle Parts (Auto) and Manufacturing and Assembly (OEM). In 2022, the OEM segment accounted for 76% of total revenue, Parts 19%, and Auto 5% of total revenue. Besides manufacturing, the company is currently developing a 3-MW waste-to-energy power plant in Yala province and plans to secure 1,104 rai of land in Chonburi province to develop a green industrial park.

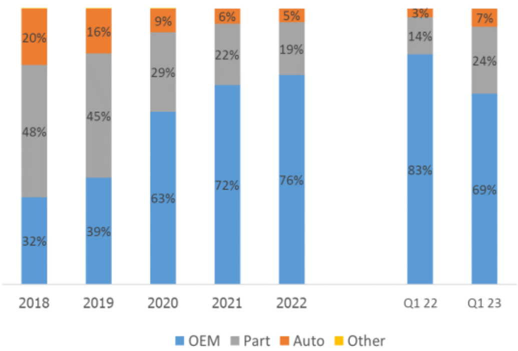
## KEY OPERATING PERFORMANCE

**Chart 1: Revenue Breakdown (THB Mil) by Business Units**



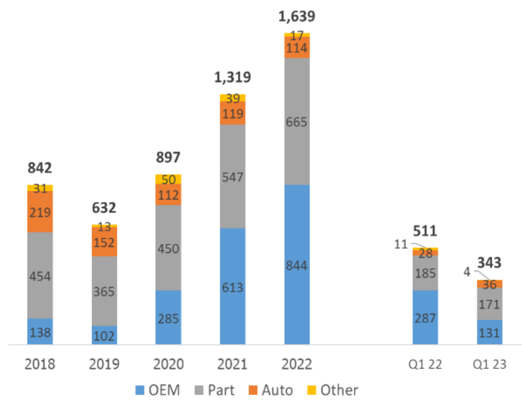

*Source: SNC*

**Chart 2: Revenue Mix (%) by Business Units**



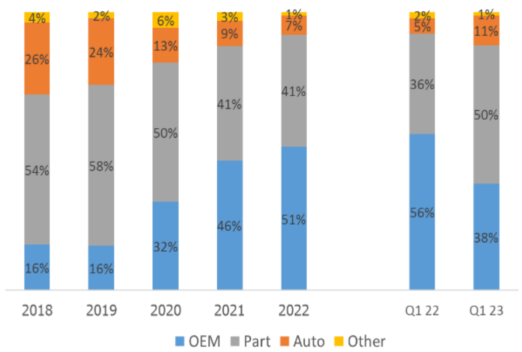

*Source: SNC*

**Chart 3: EBITDA Breakdown (THB Mil) by Business Units**



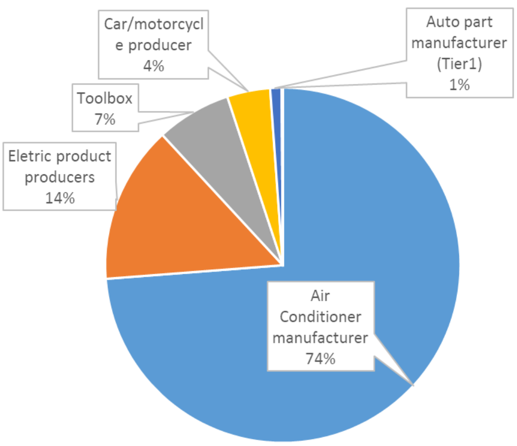

*Source: SNC*

**Chart 4: EBITDA Mix (%) by Business Units**




*Source: SNC*

**Chart 5: Revenue Mix (%) by Types of Customers for 2022**




*Source: SNC*

## FINANCIAL STATISTICS AND KEY FINANCIAL RATIOS*

*Unit: Mil. THB*

| | Jan-Mar 2023 | | ------------Year Ended 31 December ---------- 2022 | 2021 | 2020 | 2019 |
|---|---|---|---|---|---|---|
| Total operating revenues | 3,916 | | 19,126 | 15,561 | 9,080 | 6,715 |
| Earnings before interest and taxes (EBIT) | 162 | | 995 | 819 | 473 | 319 |
| Earnings before interest, taxes, depreciation, and amortization (EBITDA) | 343 | | 1,640 | 1,320 | 899 | 691 |
| Funds from operations (FFO) | 284 | | 1,406 | 1,161 | 809 | 569 |
| Adjusted interest expense | 39 | | 113 | 76 | 52 | 18 |
| Capital expenditures | 213 | | 1,433 | 1,772 | 1,133 | 534 |
| Total assets | 13,105 | | 13,657 | 13,947 | 7,770 | 5,397 |
| Adjusted debt | 1,519 | | 1,324 | 769 | 569 | 0 |
| Adjusted equity | 5,218 | | 5,259 | 4,911 | 3,578 | 3,398 |
| **Adjusted Ratios** | | | | | | |
| EBITDA margin (%) | 8.8 | | 8.6 | 8.5 | 9.9 | 10.3 |
| Pretax return on permanent capital (%) | 9.5 | ** | 11.6 | 12.2 | 10.3 | 8.5 |
| EBITDA interest coverage (times) | 8.8 | | 14.5 | 17.3 | 17.3 | 37.8 |
| Debt to EBITDA (times) | 1.0 | ** | 0.8 | 0.6 | 0.6 | 0.0 |
| FFO to debt (%) | 82.9 | ** | 106.2 | 151.0 | 142.3 | n.m. |
| Debt to capitalization (%) | 22.6 | | 20.1 | 13.5 | 13.7 | 0.0 |

*	*Consolidated financial statements*
**	*Annualized with 12 months trailing*
*n.m. =	not meaningful*

## RELATED CRITERIA

- Corporate Rating Methodology, 15 July 2022
- Key Financial Ratios and Adjustments for Corporate Issuers, 11 January 2022
- Issue Rating Criteria, 15 June 2021

## SNC Former PLC (SNC)

| | |
|---|---|
| **Company Rating:** | BBB |
| **Issue Rating:** | |
| SNC281A: THB1,000 million guaranteed debentures due 2028 | AAA |
| **Rating Outlook:** | Stable |

**TRIS Rating Co., Ltd.**
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