

TPC POWER HOLDING PLC

No. 147/2018
9 October 2018

CORPORATES

Company Rating: BBB
Outlook: Stable

RATIONALE

TRIS Rating assigns the company rating on TPC Power Holding PLC (TPCH) at “BBB”. The rating reflects the predictable and strong cash flows the company receives as it has long-term power purchase agreements (PPAs) with state-owned utilities. The rating also recognizes the solid operating performance of TPCH’s power plants. However, the rating is constrained by fluctuations in the supply and prices of biomass feedstock, the execution risks associated with new power projects, and a looming rise in leverage. The rating also takes into consideration the credit profile of Thai Polycons PLC (TPOLY), TPCH’s parent company.

KEY RATING CONSIDERATIONS

Rating determined by the group profile

TPCH is a subsidiary of TPOLY. According to TRIS Rating’s group rating methodology, the rating on TPCH is capped at “BBB”, the company rating we assign on TPOLY. TPOLY owns about 41% of TPCH and has direct control over TPCH’s business and financial policies. These reflect a strong linkage between the two companies. TRIS Rating considers TPCH as the core subsidiary of TPOLY because a substantial part of TPOLY’s earnings comes from TPCH.

Predictable cash flows

The rating embeds TRIS Rating’s expectation that TPCH will continue to earn predictable cash flows from its power plants. TPCH currently has six biomass power plants which are operating, five of which are majority-owned by the company. The contracted capacity of the power plants which are operating, in aggregate, is 52.8 megawatts (MW). All power plants have multi-year PPAs with the state-owned producers and distributors of electricity, namely Electricity Generating Authority of Thailand (EGAT), rated “AAA” by TRIS Rating, and the Provincial Electricity Authority (PEA). The payment risk of the power buyers is minimal.

The PPAs specify a feed-in-tariff (FIT) with a premium for the first eight years. This feature strengthens the viability of the projects.

Fluctuations in supply and prices of feedstock

Since TPCH uses biomass fuel to produce power, it is highly susceptible to fluctuations in the supply and prices of biomass feedstock. The company reduces this risk in two ways. The power plants are near sources of biomass feedstock. TPCH also hires operation and maintenance (O&M) contractors to run most of the power plants. The O&M contractors are responsible for managing the supply of biomass feedstock. Thus, the O&M contractors should carry the price risk for biomass feedstock. However, as a practical matter, TPCH cannot pass the price risk to the O&M contractors. The company agreed to pay higher management fees to the O&M contractors when the prices of biomass feedstock went up.

TPCH plans to operate its new power plants itself, raising the supply risk. The company has secured long-term supply agreements with local suppliers to ensure the availability of fuel. That said, contract enforcement remains a challenge. TPCH fends off this risk by taking in suppliers as partners in the company’s projects. In addition, TPCH is developing its own bio-fuel plantation. In recognition of these efforts, TRIS Rating believes TPCH will manage the

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supply risk prudently.

Execution risks associated with new power projects

TPCH faces execution risks because it has several new power projects. Construction delays, the choices of project location, and environmental issues could have significant impacts on the new projects.

In 2016, the company won contracts for three biomass power projects in Yala and Narathiwat provinces. The contracts cover a combined contracted capacity of 24.7 MW. TPCH also secured a PPA under the Small Power Producer (SPP) scheme to operate a 21-MW biomass power plant in Pattani province. This plant will be the company's largest power project. TPCH is also developing a waste-to-energy project, with a contracted capacity of 8 MW. All projects are currently underway; start dates will come during 2019-2020. Once these new projects are complete, aggregate contracted capacity of TPCH's power plants will double to 106.5 MW, from 52.8 MW.

The significant increase in production capacity will also bring new challenges such as feedstock procurement and manpower recruitment. In addition, the new biomass projects are under a competitive bidding system, yielding much lower tariffs. The tariffs for the new plants range between Bt2.8 and Bt3.4 per kilowatt hour (kWh), versus above Bt4 per kWh for the current plants. Production costs must be tightly controlled for these new projects.

Operating performance on solid course

TPCH's power plants have exhibited solid performance over the past three years. The actual output of most power plants has surpassed 80% of the full capacity, which is a high level. As a result, the EBITDA margin (earnings before interest, taxes, depreciation, and amortization as percentage of revenues) of the power plants has held at a high level of about 50%.

Some of TPCH's power plants are built through joint ventures (JVs). TPCH guarantees the debts of the incorporated JVs in proportion to its stakes in the JVs. In assessing the financial profile and performance of TPCH, TRIS Rating includes assets, liabilities, and the respective financial performances of the JVs in TPCH's consolidated accounts, in proportion to the ownership stake in each venture.

As TPCH expands, TRIS Rating forecasts the company's total operating revenues will grow steadily, reaching Bt3 billion in 2021, from about Bt1.6 billion in 2018. Our forecast assumes the company's operating performance will stay solid over the next three years. The new biomass plants carry lower tariff rates. As a result, the gross margin will slide. However, the new projects will drive revenue, boosting economies of scale and reducing selling and administrative expenses as a percentage of revenue.

Under TRIS Rating's base-case forecast, the operating margin (operating income before depreciation and amortization as a percentage of total operating revenues) will range from 40%-50% over the next three years. The operating margin improved to 49.2% in the first half of 2018, from 30%-40% during 2013-2015. The margin rose because TPCH added more capacity. The level of the operating margin is considered high for a biomass power producer. We forecast EBITDA will grow to nearly Bt1.3 billion in 2021, from about Bt800 million in 2018.

Leverage on the rise

The debt level will increase as TPCH expands. The company plans to spend up to Bt5.5 billion on the new projects during 2018 and 2019. Despite a rise in leverage, the debt to capitalization ratio should not exceed 60%. As of June 2018, the debt to capitalization ratio stood at 40.9%. Equity injections from partners in each project will reduce the borrowing needs. The cash flows from the operating power plants will help keep leverage at an acceptable level. The forecast includes the debts of JVs on a proportional basis.

Cash flow in relation to debt will drop over the period of expansion. TRIS Rating forecasts the ratio of funds from operations (FFO) to total debt will decline to about 17% in 2019, before improving gradually to about 22% in 2021. The ratio ranged from 20%-30% during the past three years. The EBITDA interest coverage ratio will also drop but should stay above 4 times. TPCH's cash flow in relation to debt is high because the operating power plants run at high efficiency. Moreover, TPCH's expansion has not been overly aggressive.

Liquidity stays manageable

TRIS Rating believes TPCH will manage its liquidity prudently. The company has a fairly low debt level and has no funding mismatch. Debts of about Bt180 million will come due during the second half of 2018. All the debts are long-term project loans. We forecast EBITDA for the same period at Bt400 million, which is sufficient to repay the debts coming due. As of June 2018, TPCH also had undrawn credit facilities, plus cash and marketable securities, of about Bt450 million, as other sources of liquidity. Over the next three years, we expect EBITDA to range from Bt800-Bt1,300 million per annum. Long-term debt repayment will be Bt400-Bt500 million per annum.

TPCH has no financial covenants in its bank loans. However, its subsidiaries and JVs are required to maintain a debt service coverage ratio above 1.1 times or 1.2 times, and keep the debt to equity ratio below 2.5 times. All the subsidiaries and JVs comply with the respective financial covenants. TRIS Rating believes they will stay in compliance for the next 12-18 months.

RATING OUTLOOK

The “stable” outlook reflects TRIS Rating’s expectation that TPCH’s power plants will perform satisfactorily and generate the sizable cash flows as planned. We assume the new power projects will be completed as planned and earn satisfactory returns. TPCH’s status as a core subsidiary of TPOLY will continue. Given the parent-subsidiary relationship, any changes in the company rating of TPOLY will affect the company rating of TPCH.

RATING SENSITIVITIES

A rating upgrade could occur if TPCH’s operating performance and capital structure are significantly stronger than expectations. For example, if EBITDA improves significantly and the leverage level is prudently managed. On the contrary, downward rating pressure would emerge if the performances of the power projects fall significantly short of our estimates, or if the capital structure deteriorates on account of aggressive debt-funded investments.

COMPANY OVERVIEW

TPCH was founded in 2012 specifically to receive the power projects owned by TPOLY. TPCH was listed on the Market for Alternative Investment (MAI) in 2015. As of June 2018, TPOLY remained the major shareholder of TPCH, holding a 41.3% stake.

As of June 2018, TPCH’s aggregate contracted capacity was 106.5 MW, across 10 biomass power projects (98.5 MW), and one waste-to-energy project (8 MW). Six biomass power plants are currently operating (52.8 MW).

KEY OPERATING PERFORMANCE

Table 1: Power Project Portfolio

Company/Country	Held by TPCH	Status	Installed Capacity (MW)	Contracted Capacity (MW)	Tariff
Biomass Projects					
CRB	73%	Operating	9.5	9.2	Fit
MWE	85%	Operating	9.0	8.0	Fit
MGP	46%	Operating	9.5	8.0	Fit
TSG	65%	Operating	9.5	9.2	Fit
PGP	60%	Operating	9.9	9.2	Fit
SGP	51%	Operating	9.9	9.2	Fit
PTG	65%	Developing	23.0	21.0	Adder
TPCH1	65%	Developing	9.9	9.2	Fit
TPCH2	65%	Developing	9.9	9.2	Fit
TPCH5	65%	Developing	6.3	6.3	Fit
Sub total - Biomass			106.4	98.5	
Waste Projects					
SP	50%	Dealing PPA	9.5	8.0	-
Sub total - Waste			9.5	8.0	
Grand total			115.9	106.5	

Source: TPCH

CRB : Chang Raek Bio Power
MGP : Mahachai Green Power
PGP : Phthalung Green Power
PTG : Pattani Green
TPCH2 : TPCH Power 2
SP : Siam Power

MWE : Maewong Energy
TSG : Thungsung Green
SGP : Satun Green Power
TPCH1 : TPCH Power 1
TPCH5 : TPCH Power 5

FINANCIAL STATISTICS AND KEY FINANCIAL RATIOS*

Unit: Bt million

	Jan-Jun 2018	-----Year Ended 31 December -----			
		2017	2016	2015	2014
Total operating revenues	806	1,232	759	312	259
Operating income	396	517	358	115	95
Earnings before interest and taxes (EBIT)	308	400	293	91	71
Earnings before interest, taxes, depreciation, and amortization (EBITDA)	400	522	365	126	98
Funds from operations (FFO)	355	448	310	103	77
Adjusted interest expense	45	74	52	28	28
Capital expenditures	138	772	860	582	707
Total assets	5,605	5,346	4,688	3,494	3,082
Adjusted debt	2,073	1,851	1,387	602	0
Adjusted equity	2,992	2,754	2,437	2,137	1,948
Adjusted Ratios					
Operating income as % of total operating revenues (%)	49.19	41.99	47.20	36.95	36.76
Pretax return on permanent capital (%)	10.61 **	8.62	7.61	2.90	3.44
EBITDA interest coverage (times)	8.87	7.08	6.98	4.58	3.51
Debt to EBITDA (times)	3.04 **	3.55	3.80	4.78	0.00
FFO to debt (%)	28.71 **	24.20	22.38	17.07	n.m.
Debt to capitalization (%)	40.93	40.19	36.26	21.98	0.00

* Consolidated financial statements

** Adjusted with trailing 12 months

n.m Not meaningful

TPC Power Holding PLC (TPCH)
Company Rating:

BBB

Rating Outlook:

Stable

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