

# CH. KARNCHANG PLC

No. 69/2017

11 October 2017

<b>Company Rating:</b>	A-
<b>Issue Ratings:</b>	
Senior unsecured	A-
<b>Outlook:</b>	Stable

## Company Rating History:

Date	Rating	Outlook/Alert
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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## Rating Rationale

TRIS Rating affirms the company rating of CH. Karnchang PLC (CK) and the ratings of CK's outstanding senior unsecured debentures at "A-". At the same time, TRIS Rating assigns a rating of "A-" to CK's proposed issue of up to Bt2,000 million in senior unsecured debentures, due within eight years. The company will use the proceeds from the new debentures to repay some of its existing loans. The ratings reflect CK's position as a top-tier contractor, its ability to undertake large-scale and sophisticated construction projects, as well as the synergy and financial flexibility the company gains from its strategic investments. These strengths are partially offset by the cyclical nature of and stiff competition in the engineering and construction (E&C) industry, as well as the company's high financial leverage.

Established in 1972 by the Trivisvavet family, CK initially focused on the public work projects for government agencies. The company later greatly expanded its scope of work and became a listed company on the Stock Exchange of Thailand (SET) in 1995. 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.

The ratings reflect CK's leading position in Thailand's E&C industry. CK is one of the top three contractors listed on the SET, based on revenue. The ratings also recognize its proven record of completing large-scale infrastructure projects and specialized construction projects. CK is amongst a few domestic contractors capable of undertaking large and sophisticated projects. CK secured a sizable backlog of Bt85.8 billion as of June 2017. The major projects value in the backlog include the MRT Orange Line projects worth Bt26.1 billion, the Xayaburi hydropower project worth Bt19.3 billion, and the MRT Blue Line projects worth Bt18 billion. These three projects account for 74% of the company's total backlog value. On the strength of its market presence, CK is poised for the forthcoming infrastructure projects.

In 2016, 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 provides sponsor loan to the project company, Xayaburi Power Co., Ltd. (XPCL), for the amount of Bt13.5 billion, with the schedule for the full loan repayment by 2031. XPCL will repay loan and interest from earnings after the commercial operation date, which is scheduled in 2019. The loan repayment risk thus is tied to the performance of XPCL.

CK's financial performance in the first half of 2017 was in line with TRIS Rating's expectation. Revenue was Bt20.3 billion, down 32% from the same period last year. Revenue in 2016 was record-high at Bt45.8 billion, a half of revenue contribution from the Xayaburi hydropower dam project. The gross profit margin during the first half of 2017 increased slightly to 7.9%, from 7.2% in 2016.

The ratings take into consideration the synergy and financial flexibility the company gains from its strategic investments. CK's business model is to invest in infrastructure projects to augment its primary business as an E&C contractor. CK holds stakes in other businesses, but its strategic investments are in three SET-

*CreditUpdate reviews ratings of companies or debt issues that have already been rated by TRIS Rating. The CreditUpdate occurs when new debt instruments are issued or if significant events have taken place that may impact a company's current ratings or when current ratings are cancelled. The CreditUpdate announces whether a rating has been "upgraded," "downgraded," "affirmed" or "cancelled." The update includes information to supplement the previously published ratings.*

*CreditUpdates are part of TRIS Rating's monitoring process. TRIS Rating monitors every rating it assigns until either the debt instrument matures or the rating contract ends. To keep the public informed of changing situations, TRIS Rating periodically issues announcements about the credit ratings it monitors.*

listed companies: Bangkok Expressway and Metro PLC (BEM), TTW PLC (TTW), and CK Power PLC (CKP). These three firms provide products that meet basic needs (i.e., transportation infrastructure and utilities) under concession contracts or long-term utility purchase contracts. CK expects to earn dividends on a recurring basis from its strategic investments. On top of dividends, these companies provide CK with sizable construction projects as they expand.

Conversely, the ratings are partially offset by the cyclical nature of the E&C industry and the stiff competition among contractors. Most projects are awarded through competitive biddings, which squeeze the profit margins of the contractors. Given a weak private-sector investment, CK is more focused on government-sponsored infrastructure projects. The government has a clear policy to launch several mega-projects as part of an economic rejuvenation campaign. However, delays in bidding and contract awards remain and are beyond the control of the contractors.

The ratings are also constrained by CK's high financial leverage. At the end of June 2017, CK's debt to capitalization ratio was 70.03%, down from 72.39% in 2016. CK's debt to capitalization ratio is expected to stay below 65% as the MRT Purple Line contract 4 has been completed. Nevertheless, the debt to capitalization ratio is expected to remain elevated, taking into consideration the working capital needs and the sponsor loan to the Xayaburi project. As of June 2017, the Xayaburi project drew down loan amounting Bt11.3 billion. CK's ratio of funds from operations (FFO) to total debt was low at 2.6% as of December 2016 and then increased to 3.29% (annualized with trailing 12 months) at the end of June 2017. TRIS Rating considers CK's leverage level to be higher than those of other contractors with the same ratings. However, the leverage level is consistent with CK's credit ratings in light of the company's business model as a contractor and an investment company.

TRIS Rating's base-case scenario expects CK to generate a revenue range of Bt38-Bt42 billion per annum during 2017-2020. The revenue from the Xayaburi project is expected at Bt7-Bt9 billion per annum, or 15%-20% of the base-case revenue. In addition, CK's strong backlog will secure about 80% of the base-case revenue in 2017, 70% in 2018, 50% in 2019, and 30% in 2020. CK's operating margin (operating income before depreciation and amortization, as a percentage of revenue) during 2017-2020 will stay above 6% on average. FFO should be at least Bt2.7 billion per annum.

CK's liquidity profile is acceptable. The company had Bt6.2 billion in cash plus current investments of Bt1.3 billion as of June 2017. The debts due over the next 12 months are around Bt3.6 billion. The liquidity profile is enhanced by the company's financial flexibility through its investments in the three SET-listed companies. At the end of June 2017, the fair value of CK's investments in the SET-listed companies was Bt50.1 billion, or about 96% of the company's total debt. During 2017-2020, the EBITDA (earnings before interest, tax, depreciation, and amortization) interest coverage ratio is expected to stay above 3 times. The FFO to total debt ratio is expected to range from 6%-8%.

### Rating Outlook

The "stable" outlook reflects TRIS Rating's expectations that CK will remain highly competitive in securing new projects in the face of forthcoming infrastructure projects. CK will be able to sustain its operating margin above 6% on average despite a stiff competition and the total debt to capitalization ratio staying below 65% over the next three years.

A credit upside is possible if CK could significantly enhance cash flow protection by generating stronger-than-expected FFO, as well as maintain its debt to capitalization ratio below 60% for a sustained period. A credit downside will be caused by the significant cost overruns in major projects or unanticipated, extensive financial support provided to its affiliates, which would markedly hurt CK's cash flow.

## CH. Karnchang PLC (CK)

<b>Company Rating:</b>	A-
<b>Issue Ratings:</b>	
CK187A: Bt1,000 million senior unsecured debentures due 2018	A-
CK188A: Bt1,000 million senior unsecured debentures due 2018	A-
CK193B: Bt1,500 million senior unsecured debentures due 2019	A-
CK197A: Bt2,500 million senior unsecured debentures due 2019	A-
CK198A: Bt500 million senior unsecured debentures due 2019	A-
CK215A: Bt2,250 million senior unsecured debentures due 2021	A-
CK228A: Bt3,000 million senior unsecured debentures due 2022	A-
CK233A: Bt4,000 million senior unsecured debentures due 2023	A-
CK245A: Bt1,600 million senior unsecured debentures due 2024	A-
CK247A: Bt1,500 million senior unsecured debentures due 2024	A-
CK267A: Bt2,700 million senior unsecured debentures due 2026	A-
CK275A: Bt1,150 million senior unsecured debentures due 2027	A-
CK283A: Bt800 million senior unsecured debentures due 2028	A-
CK295A: Bt1,000 million senior unsecured debentures due 2029	A-
Up to Bt2,000 million senior unsecured debentures due within 8 years	A-
<b>Rating Outlook:</b>	Stable

**Financial Statistics and Key Financial Ratios\***

Unit: Bt million

	Year Ended 31 December					
	Jan-Jun 2017	2016	2015	2014	2013	2012
Revenues	20,290	45,809	34,851	32,870	32,677	20,824
Finance cost	713	1,166	1,545	1,468	1,538	1,421
Net income from operations	970	2,002	2,193	2,261	3,221	544
Funds from operations (FFO)	1,578	1,510	3,161	3,222	5,410	755
Capital expenditures	600	1,886	1,660	1,405	2,864	2,401
Total assets	90,246	94,928	93,066	80,872	72,034	51,221
Total debts	51,975	57,303	53,841	42,392	37,332	28,475
Total liabilities	68,005	73,074	72,210	61,402	55,194	42,712
Shareholders' equities	22,242	21,854	20,856	19,471	16,841	8,509
Depreciation & amortization	485	953	981	988	697	451
Dividends	450	1,146	1,061	701	936	427
Operating income before depreciation and amortization as % of sales	5.78	5.35	5.99	7.77	8.07	5.98
Pretax return on permanent capital (%)	5.08 **	4.27	6.25	7.12	13.89	6.96
Earnings before interest, tax, depreciation, and amortization (EBITDA) interest coverage (times)	3.13	3.64	3.40	3.49	4.57	1.94
FFO/total debt (%)	3.29 **	2.64	5.87	7.60	14.49	2.65
Total debt/capitalization (%)	70.03	72.39	72.08	68.53	68.91	76.99

\* Consolidated financial statements

\*\* Annualized with trailing 12 months

**TRIS Rating Co., Ltd.**

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