LOXLEY PLC

No. 68/2020
7 May 2020

CORPORATES

Company Rating:	BBB
Issue Ratings:	
Partially guaranteed	BBB+
Outlook:	Stable

Last Review Date: 12/09/19

Company Rating History:

Date	Rating	Outlook/Alert
02/10/15	BBB+	Stable

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RATIONALE

TRIS Rating downgrades the company rating on Loxley PLC (LOXLEY) to "BBB" from "BBB+", with a "stable" outlook. At the same time, we also downgrade the ratings on LOXLEY's partially guaranteed debentures to "BBB+" from "A-". The ratings on the partially guaranteed debentures are based on the credit profiles of both the guarantor and the issuer (LOXLEY), with 45% of outstanding principal plus interest guaranteed by KASIKORNBANK PLC (KBANK), rated "BBB+" (global scale) by S&P Global Ratings, with a "stable" outlook.

The downgrades reflect the company's weaker-than-expected operating performance resulting from project cost overruns. The ratings take into consideration the volatility of LOXLEY's revenue steam and its relatively weak profitability, which are mainly attributed to the nature of its project-based business. On the positive end, the ratings take into consideration LOXLEY's diverse range of businesses, its long-established relationships with customers and suppliers, and the sizable dividends it receives from two major associated companies.

KEY RATING CONSIDERATIONS

Weaker operating profit margin but improvement expected

LOXLEY's operating profit margin declined substantially to -1.7% in 2019, compared with 5.7% in 2018. The decline was mainly attributed to a Bt653-million provision for losses from a project undertaken by its Network Solution Business Group and higher post-retirement expenses. We expect its operating profit margin will recover to around 4% in 2020-2022 as the company implements its business transformation plan to improve operating efficiency and profitability. Under the transformation plan, the company is terminating some unprofitable business units and reducing overhead costs. However, we view its operating profit margin is considerably low as the company carries high selling and administrative expenses, especially overhead costs. In addition, most government projects offer low profit margins as they are awarded through fiercely competitive rounds of bidding.

Sustained revenue expected

We project the company's revenue will be in the range of Bt13-Bt15 billion during 2020-2022. At the end of December 2019, the company's backlog was over Bt14 billion, which will be gradually recognized as revenue over the next one to three years. TRIS Rating believes the government will launch new projects to stimulate the domestic economy, although the bidding process for some projects will be delayed due to the coronavirus (COVID-19) pandemic. We expect the company's trading business, mainly food and consumer goods, will be less affected by the pandemic.

Diverse business mix mitigates risk

LOXLEY offers a variety of products and services through its wholly-owned and majority-owned subsidiaries. The company's businesses can be categorized into five strategic business groups: (1) information technology, (2) energy, (3) network solutions, (4) trading, and (5) services. LOXLEY has also invested in a number of associated companies and joint ventures which widen its scope of business into areas such as the production and distribution of lubricants, as well as industrial coated and pre-painted steel. The diverse sources of revenue from multiple lines of business help smooth out fluctuations in the revenue stream.

Long-established client base

LOXLEY has built long-term relationships with its clients and suppliers. The company has a well-established market presence, particularly in the government sector, backed by its track record of completed projects for several government entities. The company is also a long standing key agent and distributor for a number of internationally recognized suppliers.

LOXLEY has the expertise and capabilities to deliver high-quality products and services across a range of industries. The high-level technical skills possessed by LOXLEY's staff also drive innovation and create new business opportunities. These strengths enable LOXLEY to consistently win bids for both government and corporate projects.

Dividends from associated companies provide a key source of cash flow

For the past five years, share profit from associated companies has contributed a significant portion of LOXLEY's total earnings before interest, taxes, depreciation, and amortization (EBITDA). The key associated companies stem from LOXLEY's partnership with BP PLC, one of the world's largest oil and gas companies, and BlueScope Steel Ltd., a leading steel manufacturer headquartered in Australia. The dividends provide a stable source of cash flow for LOXLEY since the associated companies have strong market presences and solid performances. During the next three years, TRIS Rating projects the dividends from its associated companies will range from Bt400 million to Bt600 million.

Deteriorated financial profile expected to improve

LOXLEY's financial profile weakened in 2019 but is expected to improve in the next few years. The adjusted debt to EBITDA ratio stood at -15.9 times in 2019, compared with 4.5 times in 2018. The significant drop was mainly due to the substantial decline in EBITDA resulting from huge extra costs such as the provision for project loss and post-retirement expenses. The adjusted debt to capitalization ratio also increased to 41.7% in 2019 from 36% in 2018. Based on improvements made from the transformation plan, we forecast the adjusted debt to EBITDA ratio will improve to the range of 5-8 times in the next few years. The adjusted debt to capitalization ratio should also gradually improve to 35% in 2022.

Acceptable liquidity profile

We assess the company to have an adequate liquidity position over the next 12 months. As of December 2019, LOXLEY's sources of funds comprised cash on hand of Bt2.25 billion and short-term investments worth Bt212 million. We project funds from operations (FFO) will be around Bt400 million in the next 12 months. The company also has undrawn credit facilities of around Bt3.9 billion. These sources of funds should be sufficient to cover the cash needed for debt service and investments over the next 12 months. LOXLEY has long-term debt repayment obligations of around Bt590 million coming due in the next 12 months. As of December 2019, the company's outstanding short-term obligations were Bt2.8 billion. The company's investment budget for 2020 is approximately Bt28 million.

TRIS Rating believes LOXLEY will comply with its debenture covenants over the next 12 to 18 months. The debt to equity ratio at the end of December 2019 was 1.25 times, below the debenture covenant of 2.5 times.

BASE-CASE ASSUMPTIONS

TRIS Rating's assumptions for LOXLEY's operations for the period of 2020-2022 are as follows:

- Revenues in the Bt13-Bt15 billion per annum range.
- EBITDA margin to improve from -1.7% in 2019 to around 4% in 2020-2022.
- Capital expenditure to total around Bt84 million over the forecast period.
- Adjusted debt to capitalization ratio to gradually drop to 35% in 2022.
- Adjusted FFO to total debt ratio to gradually improve from -15% in 2019 to 14% in 2022.
- Adjusted debt to EBITDA of 5-8 times in 2021.

RATING OUTLOOK

The "stable" outlook reflects the expectation of TRIS Rating that LOXLEY's operating profit margin will improve in accordance with the implementation of the company's transformation plan. In addition, we expect the company to maintain its competitive position in bidding for projects and continue to show a sustainable level of project-based revenue.

RATING SENSITIVITIES

LOXLEY's ratings could be upgraded if the company's operating profit margin increases significantly and its financial leverage, as measured by adjusted debt to EBITDA, improves to a level below 5 times on a sustainable basis. In contrast, a rating downgrade is possible should LOXLEY's financial performance show a deepened deterioration, which could be caused by a further drop in profitability or a material decline in the dividend amounts received.

COMPANY OVERVIEW

LOXLEY was established in 1939 by the two co-founders, Mr. Ng Yuk Long Lamsam and Mr. Andrew Beattie of W.R. Loxley Company of Hong Kong. Its original business was the export of primary products, such as rice and lumber. In the late 1950s, LOXLEY moved into the trading of industrial and advanced technology products. The company went public in 1993 and was listed on the Stock Exchange of Thailand (SET) in 1994. In the past several years, LOXLEY has enlarged and diversified its scope of business through its own operations and through a number of subsidiaries, associated companies, and joint ventures. LOXLEY currently has 38 subsidiaries, 16 associated companies, and four joint ventures.

KEY OPERATING PERFORMANCE

Table 1: LOXLEY's Revenue Breakdown

Unit: %

Strategic Business Group	2014	2015	2016	2017	2018	2019
1. Information Technology	22	22	22	21	27	26
2. Trading	28	36	31	25	30	26
3. Energy	10	11	11	11	11	14
4. Network Solution	10	9	18	26	13	19
5. Services	11	13	12	13	19	17
6. Others	17	7	6	6	4	2
Total	**98**	**98**	**100**	**102**	**104**	**104**
Less related transaction	2	2	0	-2	-4	-4
Total	**100**	**100**	**100**	**100**	**100**	**100**

Source: LOXLEY

FINANCIAL STATISTICS AND KEY FINANCIAL RATIOS*

Unit: Bt million

	-----------------------Year Ended 31 December				----------------------
	2019	**2018**	**2017**	**2016**	**2015**
Total operating revenues	13,613	13,188	15,639	13,710	11,472
Earnings before interest and taxes (EBIT)	(499)	377	181	422	475
Earnings before interest, taxes, depreciation, and amortization (EBITDA)	(226)	750	593	766	769
Funds from operations (FFO)	(543)	447	313	503	547
Adjusted interest expense	220	221	223	220	181
Capital expenditures	110	105	150	546	109
Total assets	16,197	15,097	16,210	15,710	14,283
Adjusted debt	3,594	3,370	3,285	2,667	3,138
Adjusted equity	5,015	6,000	6,294	6,625	6,593
Adjusted Ratios					
EBITDA margin (%)	(1.66)	5.69	3.79	5.59	6.70
Pretax return on permanent capital (%)	(4.55)	3.39	1.62	3.82	4.58
EBITDA interest coverage (times)	(1.03)	3.40	2.66	3.49	4.25
Debt to EBITDA (times)	(15.90)	4.49	5.54	3.48	4.08
FFO to debt (%)	(15.10)	13.27	9.53	18.87	17.43
Debt to capitalization (%)	41.74	35.96	34.29	28.70	32.24

* *Consolidated financial statements*

** *Annualized from the trailing 12 months*

RELATED CRITERIA

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

Loxley PLC (LOXLEY)

Company Rating:	BBB
Issue Ratings:	
LOXLEY20DA: Bt300 million partially guaranteed debentures due 2020	BBB+
LOXLEY22DA: Bt700 million partially guaranteed debentures due 2022	BBB+
Rating Outlook:	Stable

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