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PADAENG INDUSTRY PLC

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CORPORATES

Company Rating:	BB
Outlook:	Negative

Last Review Date: 08/01/20

Company Rating History:

Date	Rating	Outlook/Alert
08/01/20	BBB-	Negative
08/02/19	BBB-	Stable

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RATIONALE

TRIS Rating downgrades the company rating on Padaeng Industry PLC (PDI) to "BB" from "BBB-", while maintaining the "negative" rating outlook. The rating downgrade reflects our expectation of PDI's weakened business risk profile and the expected material rise in its debt level following its planned acquisition of two brand-new luxury hotels. Given the resolutions of the recent shareholders' meeting, we expect PDI will be shifting entirely away from its existing power business which has been a stable source of revenue. PDI will move into the hospitality industry, focusing on the hotel business. The strategic move into tourism-dependent businesses at a time when the recovery prospects of the pandemic-hit hospitality industry remains highly uncertain is a radical change that has substantially weakened its business risk profile.

The rating reflects our views on good asset quality of the two world-class hotels PDI intends to acquire and its adequate liquidity to get through the market downturn over the next few years. However, the strengths also are offset by the gloomy outlook of the hotel business in Thailand, PDI's high dependency on concentrated operating assets, and the company's very weak cash flow generation against debt during the Coronavirus Disease 2019 (COVID-19) situation.

KEY RATING CONSIDERATIONS

Radical change in core business

We view the acquisition of hotels will shift PDI's core business from the power generating to be the hotel business. According to the resolution of the recent extraordinary general meeting of shareholders, PDI will acquire 51% shares in two holding companies, Urban Resort Hotel Co., Ltd. (URH) and Waterfront Hotel Co., Ltd. (WFH), which will own and operate "Four Seasons Hotel Bangkok at Chao Phraya" (FSH) and "Capella Bangkok" (CPH), respectively. FSH and CPH are two newly-opened hotels, located along the Chao Phraya river. The total investment is worth about THB10.5 billion. PDI will obtain three-year loans totaling THB5 billion and will pay about THB2.8 billion for the purchase of shares.

At the same time, PDI will divest its investment in all of its solar projects in Thailand, which altogether hold about 36.3 megawatts (MW) in power generation capacity. The proceeds from the dispositions are expected to total THB1.7 billion, which will be used to finance PDI's new business. The two mentioned transactions are expected to be completed by the first quarter of 2021.

Given the company's concerted business direction to enter the hotel segment, PDI plans to dispose of its remaining solar projects and other non-core assets, including the industrial land in Tak and Rayong provinces, to support its growth in the new business.

Weakened business risk profile

The rating downgrade reflects PDI's weakening business risk profile due primarily to a larger risk exposure inherent in the hotel business. The relatively high level of uncertainty of the hotel business stands in stark contrast to the stable revenue generation of the existing power business backed by long-term power purchase agreements. Although the acquired assets can immediately generate revenue and have long-term growth potential, the recovery prospects of the tourism and hotel businesses in Thailand remain highly uncertain, therefore limiting visibility of its future performance.

Recovery prospects of hotel business filled with uncertainties

Hotel business has been one of the hardest hit by the COVID-19 fallout. The deep and protracted slump of tourism and hotel businesses worldwide is a result of travel restrictions across countries. For the domestic market, both the occupancy and average daily room rates of high-end hotels have plummeted to unprecedented low levels due to the long absence of foreign tourist arrivals and heavy markdowns by operators to attract domestic clients. On the whole, the recovery path of the hotel business remains unclear due to the lingering effects of the pandemic. The recent surge of COVID-19 cases in Thailand has exacerbated the currently fragile market conditions and raised the uncertainty of business revival.

We expect the hotel business to continue facing an array of downside risks in the next few years. The negative factors suppressing market recovery include the fragile economic recovery, the lingering impact of COVID-19, the strength of the Thai baht, and a fiercely competitive marketplace.

Good asset quality under renowned brands

In our view, the acquired hotels are of good quality, considering their newness, renowned brands, and prime location. Commercially opened in 2020, FSH and CPH are located on 35 rai of land beside the Chao Phraya river. Both hotels are positioned to tap the upscale segment. In total, they offer 400 rooms, with an average room size relatively larger than the closest competitors. In addition, the hotels are operated by “Four Seasons” and “Capella”, which are leading global hotel management companies. We believe that with this asset quality, the company will have the potential to generate earnings higher than the existing solar power investment once the hotel market recovers to pre-COVID-19 conditions.

Single-asset risk

We view FSH and CPH collectively as a single asset in PDI’s hotel investment portfolio. This is because both hotels are apparently connected and situated in the same location. In addition, despite the difference in product position in terms of pricing and room size, they focus on the same market segment, i.e., high-end local visitors and deep-pocket foreign tourists. Currently, PDI is developing a more affordable luxury hotel on Sathorn road, and the construction is expected to finish in 2024. As a result, PDI’s earnings will largely hinge on a specific group of customers and rely solely on the performances of FSH and CPH over the next three years.

Compared with most of its listed peers in the hotel sector, PDI’s hotel portfolio is geographically concentrated. Therefore, we believe that PDI’s performance could be more volatile to economic conditions than those with more diversified hotel portfolios.

Expected weak cash flow against debt obligations

We expect PDI’s financial risk profile to deteriorate substantially once the asset acquisition transaction is completed. Its cash flow generation against debt is likely to drop to a very weak level over the next three years, underpinned by sluggish hotel operations with a surge of its outstanding debt. In our base-case scenario for 2021-2023, PDI’s financial performance will primarily reflect the operations of FSH and CPH. We expect PDI to incur losses in the first two years of hotel operation and assume that the company will divest its solar farms in Japan by 2021.

With the gradual recovery of the tourism industry chiefly aided by mass vaccinations globally, we forecast that PDI’s revenue will arrive at about THB1.4 billion in 2021 before recovering to THB2-THB2.5 billion a year in 2022-2023. We expect PDI’s earnings before interest, taxes, depreciation, and amortization (EBITDA) to decline steeply in 2021 but it should improve each year thereafter. We project PDI’s hotel operation to deliver EBITDA of THB300-THB500 million a year in 2022-2023. In our forecast, PDI’s hotel business should outpace the former power business in terms of cash flow generation from 2023 onwards.

At the same time, PDI’s consolidated debt is expected to soar to THB6-THB6.5 billion in 2022-2023 from THB3.1 billion as of September 2020 because of the sizable debt-financed acquisitions. The debt to capitalization ratio is projected to rise to 34%-38% over the forecast period from 15.6% as of September 2020. We expect the debt to EBITDA ratio to remain at very high levels above 10 times over the next three years. We project the company’s funds from operations (FFO) to be negative in the first two years due to impact from the COVID-19, before turning positive in 2023. However, FFO to net debt ratio will be below 5%. These financial metrics indicates a very weak cash flow against debt obligations.

Adequate liquidity for 2021-2022

We expect PDI’s ample cash position will be an important factor helping the company get through the stressful period of the hotel business. As of September 2020, PDI had hefty amounts of cash, deposits, and short-term investments, totaling about THB2.89 billion. This amount, plus the proceeds PDI will receive from the sales of solar plants in Thailand, should be more than enough to fund the shares acquisition of the two hotels. The remaining amount can cover interests, debt payments, and working capital needs during 2021-2022. We expect the only major debt payment due during 2021-2022 will be the company's debentures of THB1.03 billion due in December 2021. The company plans to roll over the maturing debentures for cash preservation.

The company's plan to raise new capital and to sell its solar farms in Japan and non-core assets is additional positive factor to enhance its liquidity position. However, we note that PDI will face refinancing risk as the THB5 billion long-term loans for financing the acquisitions are scheduled to be repaid over the next three years or by 2024. The company intends to refinance the amount with bank loans. The success of the refinancing is expected to rely on PDI's hotel operations at that time.

BASE-CASE ASSUMPTIONS

- Total revenue will arrive at around THB1.4 billion in 2021, before increasing to THB2.5 billion in 2023.
- Overall gross margin (including food and beverage) will range between 44%-55%.
- Total amount of capital expenditures, including hotel acquisition of THB10.5 billion and construction of "Sathorn Project One", will be THB11.4 billion over 2021-2023.
- Divestment of all Japan-based solar power projects to be undertaken in 2021.
- No dividends to be paid during 2021-2022.

RATING OUTLOOK

The "negative" outlook reflects the high degree of uncertainty over the pace of recovery in the hotel business. There remains a possibility that PDI's hotel business could endure a protracted slump in the tourism sector, given the recent resurgence of virus infections globally.

RATING SENSITIVITIES

We view that an upward rating revision over the next 1-2 years is unlikely due to the highly uncertain prospects of the hotel business. In contrast, a rating downgrade could occur if PDI's performance turns out to be significantly below our forecast, which could be the result of a slower-than-expected recovery in domestic tourism. Negative pressure on the rating could also emerge upon signs of inadequate liquidity to meet debt obligations, or additional debt-financed investments.

COMPANY OVERVIEW

PDI was founded in 1981 to engage in zinc mining and the production of high-grade zinc metal and value-added zinc alloys. PDI's zinc mine was located in Mae Sod district, Tak province. PDI also owned a smelter located in the Muang district of Tak province, and a roaster plant in Rayong province.

In 2014, PDI announced plans to shut down its zinc business after 33 years of operations. This crucial decision took into account a number of issues, including the exhaustion of zinc resources at its Mae Sod mine, the remote likelihood of the government granting new concessions, and strong opposition by environmentalists. PDI also wanted to move away from the volatility inherent in global zinc prices and shrinking domestic demand. The company's zinc business ceased operations completely in the first quarter of 2019.

PDI is currently an investment holding company, focusing on renewable energy. Country Group Holdings PLC (CGH) has been the major shareholder of PDI since 2016 with a 25% stake. CGH has played a number of key roles in PDI's business transformation from zinc mining and trading to more sustainable businesses. CGH has recruited a new management team, carried out cost-cutting measures, and also revisited potential projects in which PDI planned to invest.

The company entered the renewable energy business by acquiring two Japanese solar farms and the 6.3-MW Mae Ramat Solar Farm in 2016. In 2017, the company acquired six operating solar projects with total installed capacity of 30 MW from Symbior Element Pte. Ltd. As of September 2020, the company owns nine operating solar farms with total installed capacity of 49.3 MW.

On 1 February 2021, PDI's shareholders approved PDI's divestment of all solar projects in Thailand and the use of the proceeds to finance its new business. The transactions follow PDI's move to shift away from the power business to the hotel business.

KEY OPERATING PERFORMANCE

Table 1: PDI's Power Project Portfolio as of Sep 2020

Project/Country	Held by PDI (%)	Status	Installed Capacity (MW)	Contracted Capacity (MW)	Tariff
Thailand					
Solar					
PDI Mae Ramat	100	Operating	6.3	6.3	Adder THB6.50
ATCE1 (Prachinburi)	100	Operating	8.0	8.0	FIT THB5.66
ATCE2 (Prachinburi)	100	Operating	8.0	8.0	FIT THB5.66
ATCE3 (Prachinburi)	100	Operating	3.0	3.0	FIT THB5.66
ATCE4 (Samutsakhon)	100	Operating	6.0	6.0	FIT THB5.66
ATCE5 (Samutsakhon)	100	Operating	4.0	4.0	FIT THB5.66
PPS (Khon Kaen)	100	Operating	1.0	0.99	Adder THB8.00
			36.3	**36.3**	
Overseas (Japan)					
Solar					
Nanao	TK-GK	Operating	2.27	2.27	FIT JPY32
Nagota	TK-GK	Operating	10.73	10.73	FIT JPY36
			13.0	**13.0**	
Grand total			**49.3**	**49.3**	

Source: PDI

FINANCIAL STATISTICS AND KEY FINANCIAL RATIOS*

Unit: Mil. THB

		-------------Year Ended 31 December ------------			
	Jan-Sep 2020	2019	2018	2017	2016
Total operating revenues	413	540	545	6,315	5,283
Earnings before interest and taxes (EBIT)	92	130	146	985	521
Earnings before interest, taxes, depreciation, and amortization (EBITDA)	232	312	330	1,151	1,259
Funds from operations (FFO)	123	187	222	1,015	1,177
Adjusted interest expense	110	127	103	35	11
Capital Expenditure	503	90	8	30	15
Total assets	8,507	8,911	8,550	7,596	5,794
Adjusted debt	875	392	710	276	0
Adjusted equity	4,745	4,705	4,703	5,084	4,017
Adjusted Ratios					
EBITDA margin (%)	56.1	57.8	60.5	18.2	23.8
Pretax return on permanent capital (%)	1.4 **	1.7	2.1	16.8	11.1
EBITDA interest coverage (times)	2.1	2.4	3.2	33.0	114.2
Debt to EBITDA (times)	2.9 **	1.3	2.2	0.2	0.0
FFO to debt (%)	17.7 **	47.5	31.2	368.1	n.m.
Debt to capitalization (%)	15.6	7.7	13.1	5.1	0.0

* *Consolidated financial statements*
** *Annualized with 12 months trailing*
Note: *The figures and financial ratios since 2016 are adjusted by including financial performance of Green Brilliant GK (a 13-MW solar farm project in Japan) on consolidation basis, instead of initial recognition as long-term investments.*
n.m *Not meaningful*

RELATED CRITERIA

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

Padaeng Industry PLC (PDI)

Company Rating:	BB
Rating Outlook:	Negative

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