Press Release

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TRIS Rating Downgrades Company Rating of "QTC" to "BBB-" from "BBB", with "Stable" Outlook

TRIS Rating has downgraded the company rating of QTC Energy PLC (QTC) to "BBB-" from "BBB" with "stable" outlook. The downgrade reflects the company's precipitous falloff in operating performance, a worrisome outlook for the domestic electrical transformer market, and its susceptibility to the severe repercussions of a market downturn. The "BBB-" rating still reflects QTC's ability to provide specialized distribution transformers, and its proven track record as an original equipment manufacturer (OEM). However, these strengths are partially offset by these major factors: intense competition in the domestic market, the execution risks associated with the power projects QTC plans to undertake abroad, and the sizable investment, which will put pressure on its financial profile in the near term. A recent significant change in QTC's shareholding structure also adds to concerns over the strengths of its core business.

The "stable" outlook reflects the expectation that QTC will maintain its competitive position in the electrical transformer industry. QTC is expected to secure more orders and profitability is expected to rebound as the market recovers. QTC's rating and/or outlook could be revised upward if the performance of the transformer segment returns to former levels or if the diversification into power production is successful and generates material earnings and cash flows. In contrast, the rating and/or outlook could be downgraded if the profitability deteriorates further or if aggressive investments lead to significant increases in debt and a weaker liquidity profile.

QTC was established in 1996 by Mr. Poonphiphat Tantanasin. It was listed on the Market for Alternative Investment (MAI) in July 2011. QTC is a medium-sized manufacturer of electrical transformers, providing products under its own brand "QTC". QTC can produce transformers at power levels from 1-30,000 kilovolt-amperes (KVA) at system voltages of up to 72 kilovolts (kv). During 2011-2015, nearly all (97%) of QTC's revenue came from the sale of distribution transformers, with 2% from power transformers, and the remainder from services and the sales of transformer components. During the same period, QTC's customer base comprised state enterprises (26% of total revenue), private companies (51%), and export customers (21%). QTC recently diversified to become a power producer, a move made so as to earn recurring income and counterbalance the volatility in revenues from the transformer segment.

Since inception, Mr. Poonphiphat, the chief executive officer (CEO), and his family were QTC's major shareholders. At the end of May 2016, they held a combined stake of 62%. In mid-2016, there was a significant change in the shareholder structure. In pursuit of funds to enter the power generating industry, QTC raised new equity capital through a private placement (PP). Newly issued shares were acquired by Mr. Sathit Limpongpan, Mr. Chanthanome Phommany, and Mr. Thatnakhone Thammavong (collectively called "the group of new shareholders"). After the private placement and subsequent tender offer, the group of new shareholders became the major shareholders, owning 63% of QTC at the end of November 2016. The stake of Mr. Poonphiphat and his family was substantially diluted from 62% to 8.9%. QTC announced that there would not be any significant changes in its business for a full year after the acquisition. However, the management team and QTC's strategy are expected to change thereafter. TRIS Rating is of the view that such a massive shake-up adds concerns over the continuity and strength of QTC's core business, and the new business carries significant execution risks.

The current rating reflects QTC's ability to provide specialized distribution transformers, and its proven track record as an OEM for an Australian agent. QTC has a long-established relationship with this agent to supply OEM transformers. Revenue from this Australian agent contributed around 12% of QTC's total sales during 2012 through the first nine months of 2016.

The rating downgrade is predominantly based on the precipitous falloff in QTC's operating performance, and a worrisome outlook for the domestic transformer market. QTC's operating performance significantly deteriorated during the first nine months of 2016, due in large part to an industry-wide slowdown. Total revenue fell far short of estimates, plunging by nearly 60% to Bt276 million, compared with Bt670 million during the same period a year earlier. The drop-off was caused by a lack of revenue from state enterprises and a slump in private sector investment spending. The

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Metropolitan Electricity Authority (MEA) suspended the bidding for electrical transformers throughout 2016, while the Provincial Electricity Authority (PEA) delayed bidding during the first nine months of 2016. In addition, QTC received fewer orders from the solar power sector, a key revenue generator in 2015. Revenue from solar power sector plummeted to merely Bt11 million in the first nine months of 2016, compared with Bt404 million in 2015. Export sales remained flat at Bt83 million.

Prospects for the transformer industry remain encouraging, backed by the growing need for electricity. However, delays in bidding and contract awards from both private sector and public sector buyers continue. The delays are out of hands of transformer producers. More importantly, heightened competition made bidding even more competitive, which depressed QTC's profitability in 2016. For the first nine months of 2016, QTC's gross margin slumped to a record low of 5%, from 22.3% during the same period of 2015. The whopping slide was largely due to heavy markdowns taken by domestic transformer makers in order to get purchase orders from private sector and state enterprise clients. QTC substantially underperformed in both segments. QTC's earnings before interest, tax, depreciation, and amortization (EBITDA) turned to negative Bt37 million in the first nine months of 2016, compared with positive Bt85 million the year-ago period. The operating performance is expected to improve slightly in the last quarter of 2016, thanks to a sizable order backlog. As of September 2016, QTC had a backlog of Bt345 million. Total revenue in 2016 will hover around Bt550 million, which is significantly lower than the peak of Bt1.2 billion recorded in 2015, and the level of Bt800 million QTC achieved, on average, annually in 2011-2014. QTC's profitability for the entire year is forecast at a very low level as some orders in the backlog bear low profit margins. TRIS Rating is of the view that the intense competition in the industry will keep the rating under pressure, hindering QTC's efforts to solidify earnings and attain the healthy profit margins achieved in the previous years.

Given the current scale and scope of its business, QTC is susceptible to the severe repercussions of a market downturn, despite strengthening balance sheet with the recent capital increase. Total debt declined from Bt243 million in 2015 to Bt204 million at the end of September 2016. The total debt to capitalization ratio decreased from 29.8% at the end of 2015 to 20.8% as of September 2016. At the end of September 2016, QTC had cash and marketable securities amounting to Bt415 million. The funds are earmarked for power projects. As profits tumbled, QTC's cash flow protection weakened considerably. The funds from operations (FFO) to total debt ratio was 25.7% (annualized, from the trailing 12 months) at the end of September 2016, compared with 79% in 2014 and 72.2 % in 2015.

QTC is striving to expand into a new industry and become a producer of electricity. The expansion into the power business is a bid to make revenues less volatile. QTC is conducting feasibility studies and due diligence for several projects, including hydro-power plants in the Lao People's Democratic Republic (Lao PDR) and a solar power plant in Myanmar. On one hand, the diversification effort would enlarge QTC's revenue base and strengthen its business profile. On the flipside, the new business carries execution risks, in particular, those risks associated with projects abroad. The sizable investment needed in order to enter the power business will put pressure on QTC's financial profile in the near term. Going forward, leverage will rise and cash flow protection will weaken as QTC takes on more debt to fund the power projects. The company is expected to manage its capital structure prudently. The debt to capitalization ratio is expected to stay below 55% over the next three years.

QTC Energy PLC (QTC)	
Company Rating:	BBB-
Rating Outlook:	Stable

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