TTCL PLC

No. 22/2019

15 March 2019

CORPORATES

Company Rating:	BB+
Outlook:	Stable

Last Review Date: 11/10/18

Company Rating History:

Date	Rating	Outlook/Alert
11/10/18	BBB-	Stable
29/12/17	BBB	Stable
28/03/14	BBB+	Stable

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RATIONALE

TRIS Rating downgrades the company rating on TTCL PLC (TTCL) to "BB+" from "BBB-", with "stable" outlook. The downgrade reflects TTCL's deteriorated capital structure resulting from the substantial provision for receivables related to the troubled project in the Lao People's Democratic Republic (Lao PDR). Moreover, the downgrade also recognizes TTCL's continued weak operating performance and lingering heavy debt loads.

The rating continues to reflect TTCL's track record in EPC (engineering, procurement, and construction) for the industrial segment, its capability to undertake large projects in Thailand and abroad, as well as its strategic diversification into the power business. However, these strengths are weighed down by precarious capital structure, execution risks of projects abroad, cyclicality of the EPC industry, and severe competition.

TTCL's subdue performance has carried on over the past few years, caused by the slowdown in investment of private refining and petrochemical companies. TTCL's revenue totaled Bt8.4 billion in 2018, a continued decline from Bt10.5 billion in 2017 and around Bt20 billion per annum during 2014-2016. TTCL is highly susceptible to the cyclicality of the EPC segment. TTCL's growth languished as its backlog started to dissipate.

In 2018, TTCL's operating performance continued to weaken and fell short of TRIS Rating's expectation. TTCL reported a gross loss of Bt70 million in 2018 as the company suffered from cost overruns in some projects. This led to a gross margin of -0.8%, a plunge from the range of 7%-8% over the three years earlier. The operating margin (operating profit before depreciation and amortization as a percentage of revenue) in 2018 fell to -24.4%, down from 7.6% in 2017.

In addition to the precipitous drop-off in revenue, TTCL suffers from substantial overdue payments in relation to the Rock Salt Processing project, a contract to build a rock salt exploiting and processing plant in the Lao PDR. TTCL commenced construction in 2016. However, the project owner suspended construction in mid-2017, leaving TTCL with a substantial Bt2.3 billion in accounts receivable and unbilled receivables. TTCL currently leaves off the construction and undergoes legal arbitration to claim the unpaid amount related to the work delivered. TRIS Rating does not expect that both parties will arrive at an agreement any time soon.

As a result, TTCL put aside a hefty allowance for doubtful accounts of around Bt1.3 billion. The company reported a net loss of Bt2 billion in 2018. The massive loss almost entirely wipes out TTCL's retained profits, causing further deterioration of its capital structure. The ratio of debt to capitalization rose to 74.2% at the end of 2018, increasing from 71.2% in 2017 and around 50%-55% during 2015-2016. TTCL issued subordinated perpetual debentures of Bt500 million to prop up its equity base while it used proceeds from the divestiture of a subsidiary and cash on hand to partially repay debt. As such, the interest-bearing debt to equity ratio arrived at 2.85 times, which remained compliant with the limit of 3.0 times as per the financial covenant of the outstanding debentures.

TRIS Rating views that the loss incurred from the project is massive. TTCL's precarious capital structure triggers the rating downgrade. TTCL's adjusted equity reduced by half over the past two years, to Bt2.7 billion as of 2018 from Bt6.3 billion as of 2016. Looking ahead, TTCL's leverage is likely to remain elevated.

In TRIS Rating's base case for 2019-2021, TTCL's total debt will stay at around Bt8-Bt10 billion. The debt to capitalization ratio will stay over 70%, which transcends our previous forecast. TTCL is at risk of breaching the financial covenant. Funds from operations (FFO) will arrive at around Bt600-Bt700 million per year. The ratio of FFO to total debt will remain low at about 5%, compared with about 5%-8% in our previous forecast.

RATING OUTLOOK

The "stable" outlook reflects TRIS Rating's expectation that TTCL could secure sizable new contracts to replenish its backlog and improve its profitability. Under TRIS Rating's base-case forecast during 2019-2021, we expect TTCL's revenue will be around Bt13-Bt15 billion per annum. The operating margin is expected to stay between 6%-7% and the debt to capitalization ratio will stay between 70%-75% over the next three years.

RATING SENSITIVITIES

A rating upgrade is unlikely in the near term but could occur if TTCL considerably strengthens its profitability and solidifies its operating cash flow. An upside rating could also develop if its leverage falls significantly such that the debt to capitalization ratio will be around 65% and there is enough headroom for the financial covenant. Conversely, the rating and/or outlook could be revised downward if TTCL's operating performance and capital structure deteriorate further.

COMPANY OVERVIEW

TTCL is an EPC contractor based in Thailand. TTCL was established in 1985 as a joint venture between Italian-Thai Development PLC (ITD) and Toyo Engineering Corporation (TEC), a Japanese EPC firm. TTCL went public in 2008 and was listed on the Stock Exchange of Thailand (SET) a year later. TTCL is positioned as an integrated EPC contractor for industrial plants, including refineries and plants which produce petrochemicals, chemicals, fertilizer, oil and gas, and electrical power.

TEC gradually reduced its stake in TTCL from 22% to 10% during 2015-2017. In February 2018, TEC sold off its shares in the company. In August 2018, Sojitz, the seventh-largest general trading and investment company in Japan, acquired shares in TTCL and became the company's major shareholder. As of August 2018, Sojitz held approximately 9.1% of TTCL's shares outstanding. TTCL expects to gain synergy in business and collaboration from its major shareholder.

TTCL's track record of project execution is substantiated by a list of large refining and petrochemical companies. TTCL is among the top five SET-listed contractors, in terms of revenue base and asset size. The company is capable of undertaking large EPC projects and expanding geographically. As of December 2018, TTCL's backlog stood at around Bt17.7 billion.

TTCL has a strategy to expand into the power business, a move that helps TTCL secure EPC contracts and earn a steady revenue stream. TTCL has invested in power projects in order to have steady sources of income from multi-year power purchase agreements. Moreover, TTCL undertook all the EPC work for the power projects. The company has invested in natural gas-fired, biogas, and solar power plants.

TTCL entered the power business in 2010 when it invested in Nava Nakorn Electricity Co., Ltd. (NNE). NNE operates a 110-megawatts (MW) combined cycle gas turbine power plant. The company invested in and built a 120-MW gas-fired power plant in Ahlone, Myanmar, the "Ahlone project". TTCL, through its Myanmar-based subsidiary, owns 100% of the Ahlone project, which carries a total investment cost of about Bt5.5 billion.

TRIS Rating views that TTCL is highly vulnerable to the cyclicality of the EPC business, given the scope of its expertise and end market served. TTCL's core business has been markedly hurt by dismal investment sentiments in the petrochemical sector over the past few years. In addition, the severe competition slashed TTCL's overall gross margin to below 10%.

Despite the benefits TTCL receives from geographical diversification, the company is exposed to execution risks associated with projects abroad, including cost overruns, changes in laws and regulations, contract enforcement, exchange rate risk, etc. Failures in project execution could cause significant negative repercussions for TTCL's performance.

TTCL undertook construction of the Rock Salt Processing project in 2016. The project owner is a joint venture with Vietnam National Chemical Group (Vinachem), a Vietnamese state-controlled enterprise. The joint venture receives a long-term concession from the Lao government to mine salt in the area. However, the project owner suspended construction in mid-2017, following orders from the Vietnamese government. The project suspension leaves TTCL with a substantial Bt2.3 billion in accounts receivable and unbilled receivables, leading to the sizable provision.

RELATED CRITERIA

- Key Financial Ratios and Adjustments, 5 September 2018
- Rating Methodology – Corporate, 31 October 2007

TTCL PLC (TTCL)

Company Rating:	BB+
Rating Outlook:	Stable

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