

EAST COAST FURNITECH PLC

No. 108/2018
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CORPORATES

Company Rating: BB+
Outlook: Stable

Company Rating History:

| Date | Rating | Outlook/Alert |
|----------|--------|---------------|
| 19/06/17 | BB | Stable |

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RATIONALE

TRIS Rating upgrades the company rating on East Coast Furnitech PLC (ECF) to “BB+” from “BB”. The upgrade reflects the stronger-than-forecast financial position after the company successfully raised a sizable amount of new equity to fund new project investments. The upgrade also factors in the company’s success in executing the first biomass power plant.

The rating on ECF continues to reflect its moderate market position in the furniture business with established distribution channels. However, the strength of the rating is constrained by the prospect of a weakening financial profile from its substantial investments and high execution risks of the solar power project in Myanmar.

KEY RATING CONSIDERATIONS

Moderate competitive position

ECF’s competitiveness is characterized by its medium business size in the furniture manufacturing industry and product positioning in the low- to medium-priced market segment. The company’s products are less differentiated and have limited pricing premium, as about 65% of its manufactured products are simple knockdown furniture and sold under customer brands.

Moderate growth from leading modern trade clients

The established distribution channels to the leading modern trades continue to be ECF’s important competitive strengths. Since approximately 80%-90% of ECF’s furniture sales come from leading modern trade retailers in Japan and Thailand, the increasing demands from these clients allowed ECF to grow its revenue by 4.5% per annum, in contrast to an industry decline in Thailand.

However, ECF exposes to customer concentration risk, as sales from the five largest customers account for 75%-80% of the total sales. ECF faces price competition risk since it may be replaced by lower-cost overseas producers due to the lack of long-term contracts with these customers.

Backward integration to MDF manufacturing

On 28 June 2018, ECF decided to invest for a 57% stakes in Planet Board Company (Planet). Planet is set up for manufacturing and distributing medium density fiber board (MDF), a raw material for wood furniture. The total investment, worth Bt1,456 million, is for the construction of a factory in Narathiwat Province. The company plans to finance the project with debt to equity of 60:40 and targets to start operation in 2020.

The partnership structure in Planet plays an important role to project achievement. The cooperation between three strategic partners, including ECF as a furniture producer, a wood supplier in Narathiwat Province, and the management and owners of a Thai well-known furniture retailer - Index Living Malls will help mitigate risks related to feedstock procurement and product distribution.

Rising contribution from the power generating business

ECF’s business profile gradually strengthens as TRIS Rating expects more contribution from cash flows from the power projects during 2018-2019. The

company has two power projects in Thailand. The first, a 7.5-megawatt (MW) biomass power plant, started operation in June 2017. The plant performance continuously improved and demonstrated smooth operations in the first half of 2018. The power plant will deliver shared profit of about Bt15-Bt20 million per year. The second project is two biomass gasification power plants each with 1 MW capacity. The project is under construction. The company targets to start full commercial operation of the two plants within December 2018.

Constraints from the projects in Myanmar

The investment in the Minbu project continues to put pressure on the rating. The Minbu project, a 220-MW solar farm in Myanmar, is the largest project ECF invested. Currently, the project has been delayed for 7 months and may extend further due to a prolonged process of getting important documents in Myanmar. The Minbu project posts a high investment risk to the company, given its exposure to country risks and concentration risk as the size of the investment is substantial relative to the company's equity. However, if successfully executed, the project will significantly raise overall earnings.

Leverage to increase despite new equity injection

ECF's success in new capital injection leads to a significantly improved financial profile. The company's equity doubled from Bt659 million in 2016 to Bt1,029 million in 2017. As a result, ECF's debt to capitalization ratio improved to below 60%, better than our forecast of the ratio exceeding 70%.

However, we forecast that ECF's financial profile will weaken due to its aggressive investments. The company's investments primarily comprised 1) construction for the Minbu project of Bt697 million, 2) a new warehouse of Bt300 million, and 3) a new MDF factory of Bt1,456 million. ECF will finance these investments in part with additional equity of Bt573 million, including Bt258 million from exercised warrants and private placements of new shares in the first half of 2018, and Bt315 million from remaining warrants (ECF-W2) which should be exercised within February 2019. In our base-case scenario, we expect the debt to capitalization ratio will escalate to 60%-65% and funds from operations to total debt should be below 8% over the next three years.

RATING OUTLOOK

The "stable" outlook reflects the expectation that ECF's furniture business will continue to grow moderately and the company will be able to maintain its operating margin before depreciation and amortization within a range of 10%-13%. The modern trade channel from Japan and Thailand will remain the core distribution channel.

RATING SENSITIVITIES

The rating or outlook could be upgraded if the power projects execute successfully as expected, leading to materially enlarge earnings and cash flows while the company can maintain its capital structure at an acceptable level.

The rating could be downgraded if the operating performance of the furniture business is significantly weaker than expected for an extended period and/or if the Minbu project is unsuccessful and cause material losses. Aggressive debt-funded investments which will lift the debt to capitalization ratio to over 70% for a sustained period may trigger negative rating actions.

COMPANY OVERVIEW

Established in 1999, ECF is a manufacturer and distributor of home furnishings in Thailand. ECF owns two factories in Rayong Province and makes furniture from particle board and rubber wood. Revenue from selling furniture contributes about 92% of total revenue; the remainder is derived from selling decorative foil paper, dried rubber wood, and retail shops franchised from Can Do Co., Ltd. in Japan. ECF has been listed on the Market for Alternative Investment (MAI) since 2013. The Suksawad family has been a main shareholder, holding approximately 50% of the outstanding shares as of May 2018.

In 2017, ECF had four main distribution channels, including made-to-order (56.5% of total furniture sales), Thai modern trade (30.3%), owned showrooms (5.7%), and dealers (7.5%). Almost all made-to-order furniture is exported to leading furnishing distributors and large modern trade retailers in Japan. Meanwhile, ECF distributes furniture under its own brands through well-known modern trade retailers in Thailand, such as Home Pro, Big C, Mega Home, Thai Wasadu, and Tesco Lotus. The company has 18 showrooms to sell rubber wood furniture and other types of wood furniture sourced from Thailand and abroad. The company sells its "fighting brand" products through the dealer channel. ECF's revenues from the export and Thai markets account for 52% and 48% of total sales, respectively. The Japan market accounts for about 85% of total exports.

ECF's power generating segment is operated under ECF Power Co., Ltd. ECF has three power projects invested through its associates. The first project is a 7.5-megawatt (MW) biomass power plant in Narathiwat Province. The second is a 2-MW

biogas project in Phrae Province. The last project is a 220-MW solar farm project, called Minbu, in Myanmar.

FINANCIAL STATISTICS AND KEY FINANCIAL RATIOS*

Unit: BT million

| | Jan-Mar 2018 | Year Ended 31 December | | | |
|---|-----------------|------------------------|-------|-------|-------|
| | | 2017 | 2016 | 2015 | 2014 |
| Revenue | 370 | 1,445 | 1,371 | 1,334 | 1,209 |
| Gross interest expense | 23 | 79 | 54 | 39 | 31 |
| Net income from operations | 10 | 74 | 27 | 70 | 68 |
| Funds from operations (FFO) | 34 | 121 | 94 | 127 | 141 |
| Earnings before interest, tax, depreciation, and amortization | 56 | 243 | 166 | 187 | 181 |
| Capital expenditures | 55 | 32 | 35 | 27 | 28 |
| Total assets | 3,078 | 2,783 | 2,357 | 1,506 | 1,239 |
| Total debts | 1,523 | 1,316 | 1,339 | 751 | 593 |
| Total liabilities | 1,946 | 1,754 | 1,698 | 1,053 | 840 |
| Shareholders' equity | 1,131 | 1,029 | 659 | 454 | 399 |
| Depreciation & amortization | 21 | 85 | 71 | 69 | 69 |
| Dividends | 0 | 30 | 32 | 36 | 16 |
| Operating income before depreciation and amortization as % of sales | 12.2 | 13.1 | 10.6 | 12.7 | 13.6 |
| Pretax return on permanent capital (%) | 6.2 ** | 7.3 | 5.9 | 10.7 | 12.4 |
| EBITDA interest coverage (times) | 2.5 | 3.1 | 3.1 | 4.8 | 5.9 |
| FFO/total debt (%) | 7.4 ** | 9.2 | 7.0 | 16.9 | 23.8 |
| Total debt/capitalization (%) | 57.4 | 56.1 | 67.0 | 62.3 | 59.8 |

* Consolidated financial statements

** Trailing with the last 12 months

East Coast Furnitech PLC (ECF)

Company Rating:

BB+

Rating Outlook:

Stable

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