GUNKUL ENGINEERING PLC

No. 29/2021
17 March 2021

CORPORATES

Company Rating:	BBB+
Issue Rating:	
Senior unsecured	BBB
Outlook:	Stable

Last Review Date: 09/03/20

Company Rating History:

Date	Rating	Outlook/Alert
09/03/20	BBB	Positive
11/04/17	BBB	Stable

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RATIONALE

TRIS Rating upgrades the company rating on Gunkul Engineering PLC (GUNKUL) to "BBB+" from "BBB" and the rating on GUNKUL's senior unsecured debentures to "BBB" from "BBB-". The issue rating's one-notch below the company rating reflects the structural subordination of claims under the debentures. At the same time, TRIS Rating revises the rating outlook on GUNKUL to "stable" from "positive". The upgrade of ratings mirrors GUNKUL's heightened cash flow as well as improvement in its debt serviceability.

The ratings continue to reflect GUNKUL's strong competitive edge in the electrical equipment business, merits from vertical integration, and predictable cash flows from the power business. However, the ratings are held back by growing overseas investments which entail higher country risk and concerns over expansion of the company's engineering, procurement, and construction (EPC) business.

KEY RATING CONSIDERATIONS

Cash flow on uptrend

GUNKUL's cash flows have increased remarkably over the past five years as the power projects are paying off. Its earnings before interest, taxes, depreciation, and amortization (EBITDA), excluding extraordinary items, tripled to THB3.7 billion in 2020, from THB1.2 billion in 2016. GUNKUL's debt serviceability also improved. Its debt to EBITDA ratio dropped to below 6 times in 2020, from a peak of nearly 8 times in 2016.

Given the company's ongoing investment strategy, we expect GUNKUL will continue to acquire new power assets. Its existing power plants should also perform in line with respective guidance. To manage development risk, we expect GUNKUL to focus on prospective projects which are in operation or about to operate. In which case, the company could reap benefits from the investments straight away. In our base-case forecast, we project EBITDA will continue to grow, reaching THB5.5 billion in the next three years.

A shift in investment strategy

Consistent with the aforementioned investment strategy, GUNKUL decided to exit two solar farms projects in Japan, "Utsunomiya" and "Iwakuni". The company had been saddled with both projects, which required a hefty sum of THB16 billion in investments and long construction periods of about three years. GUNKUL opted to sell both projects and replace them with two brand-new solar farms in Vietnam, "Phong Dien 2" and "Tan Chau". The replacements require lower investment costs and provide a faster start on cash generation. Paying about THB2.7 billion for the two solar farms in Vietnam, GUNKUL started to recognize cash flows in the last quarter of 2020.

Debt serviceability to improve

The divestment of the two projects in Japan also brought in considerable gains of almost THB2 billion in 2020. More importantly, the construction risks associated with these projects were lifted. In our base-case forecast, we project the debt to EBITDA ratio will range between 5-6 times during 2021-2023, levels slightly lower than our previous forecast. The debt to capitalization ratio should range between 65%-68%.

Satisfactory performance of operating power plants

We believe GUNKUL's operating power plants will continue to perform satisfactorily, given the company's proven record of developing and operating power projects. During the past three years, the annual output of the solar power portfolio has achieved the initial estimates based on P50 (the energy production which reaches a probability of 50%). Meanwhile, output of the wind power plants has reached the P75 level, except last year. In 2020, the output of the wind power plants came in below estimates because of the irregular monsoon. Despite being highly volatile, output of the wind power plants is expected to reach the P75-P90 levels over the medium to long terms. In our base-case forecast, the EBITDA margin (EBITDA as a percentage of revenue) of the solar power and wind power plants should stay at satisfactory levels of above 80% over the next three years.

Predictable cash flows from power business

The ratings take into consideration the low-risk nature of the power business, the core driver of GUNKUL's operating performance. The power business provides predictable cash flows, derived from low operational risk and minimal payment risk. Most of GUNKUL's power plants have multi-year power purchase agreements (PPAs) with state-owned power utilities. The company has also branched into selling electricity to the private sector. Private PPAs generally entail higher payment risk. However, the capacity under this scheme should continue to make up less than 15% of total capacity. Moreover, most of the private power buyers are large companies with acceptable credit profiles.

GUNKUL owns more than a hundred power generating facilities in diverse locations, suggesting its low reliance on the performance of one or just a few projects. At the end of December 2020, GUNKUL had mustered an aggregate equity capacity (or contracted capacity in proportion to its ownership stakes in the power plants) of 604 megawatts (MWe). Solar power continues to make up the majority of GUNKUL's power-generating assets (434 MWe). Solar power has proven to yield predictable power outputs and reliable cash flows.

Strong competitive edge in electrical equipment business

We expect GUNKUL to remain a key market player in the trading and manufacturing of electrical equipment, the company's original business. With an extensive range of products covering all stages of the transmission and distribution of electricity, the company has served both public and private sector clients for more than three decades. The long track record and a wide range of products underpin its competitiveness. The electrical equipment segment has offered a fairly stable gross margin of 25%-30% over the past five years.

GUNKUL should continue to benefit from business integration as its three existing businesses, electrical equipment, EPC, and power, are complementary in nature. As an EPC power plant contractor and a supplier of electrical equipment, the company can provide one-stop services to project owners, helping increase sales of electrical equipment. It can also better control the construction costs of the power plants.

Increasing exposure in Vietnam

GUNKUL is expanding in Vietnam. Before purchasing the Phong Dien 2 and the Tan Chau projects, the company had already acquired two solar farms in Vietnam ("Tri Viet 1" and "Bach Khoa A Chau 1"). Currently, GUNKUL's power capacity in Vietnam totals 160 MWe, making up 26.5% of the aggregate power capacity. The investments in Vietnam represent about 10% of the company's total assets.

Investment opportunities in renewable power in Thailand appear to be less attractive, due in part to the immensely competitive market, repeated delays in public project bidding, and Thailand's high reserve of power generation capacity. Given the dearth of new opportunities, acquisitions and divestiture of existing power projects have become the trend. In effect, we expect GUNKUL to continue to explore investment opportunities overseas, particularly in Vietnam where the growth of and demand for power are strong.

However, the projects in Vietnam generally carry higher risks than those in Thailand and Japan, due to the higher regulatory and counterparty risks. We view the credit profile of the state-run Vietnam Electricity (EVN) not to be as strong as the state-owned power buyers in Thailand. Additionally, the national power grid in some provinces is currently facing overcapacity. Nonetheless, the risks associated with the projects in Vietnam are acceptable in our view. GUNKUL's four solar power projects are located in areas of low curtailment risk. The electricity outputs of the projects in Vietnam, in aggregate, have reached the P75 level of electricity production.

EPC business to grow

GUNKUL aims to grow its EPC business. It won bids for two large underground cable projects in 2019 and numerous small-to medium-sized projects in 2020, boosting backlog to hit a record high of about THB8 billion. Based on the backlog, the

EPC business should bring in THB3-THB4 billion in revenue per annum during 2021-2023, up from THB2 billion in 2020.

Nevertheless, we view an expansion of the EPC business could pose downside risks, such as construction delays and squeezed margins resulting from competitive bidding. Larger construction contracts will also challenge the company's cost controls and working capital management. The EPC business typically provides inferior margins to the power business. As we expect revenue contribution from the EPC business to increase, GUNKUL's overall profitability will likely drop. However, the EBITDA margin should remain high in the 40%-50% range over the next three years. In our view, any adverse impact on the financial profile should be limited as the power business will continue to be GUNKUL's core performance driver.

Liquidity remains manageable

GUNKUL's liquidity should remain strong. Debts of about THB8 billion will come due in 2021. As of December 2020, the company had undrawn credit facilities, plus cash and marketable securities, of about THB9 billion, which should be sufficient to cover the repayments coming due. GUNKUL plans to refinance the debentures worth about THB1.8 billion coming due in April 2021 with the issuance of new debentures.

A key financial covenant on GUNKUL's debentures requires the net interest-bearing debt to equity ratio to stay below 3 times. At the end of 2020, GUNKUL was in compliance with this key financial covenant with the ratio at 1.8 times. We believe the company will stay compliant with the financial covenant.

BASE-CASE ASSUMPTIONS

- Contracted capacity of operating power plants to reach 800 MWe in the next three years.
- Total operating revenues to reach THB12 billion.
- EBITDA margin to range between 40%-50%.
- Annual capital spending to range between THB3-THB5 billion per year.

RATING OUTLOOK

The "stable" outlook embeds our expectation that GUNKUL's power projects will perform satisfactorily and generate sizable and stable cash flows as planned. Its electrical equipment business is expected to remain on solid ground. We also expect the growing EPC business will not significantly weaken its financial profile.

RATING SENSITIVITIES

A rating upgrade could occur if the company's cash flows against debt and capital structure improve significantly. The power business remains its core cash flow generator. In contrast, a downward revision to the ratings could develop if GUNKUL's financial profile deteriorates materially. This could arise if the performance of the power generation assets significantly falls short of initial estimates or respective guidance, or the company invests aggressively with huge debt financing, or the rapid expansion of the EPC business materially weakens the company's financial profile.

COMPANY OVERVIEW

GUNKUL was founded in 1982 by Mr. Gunkul Dhumrongpiyawut as a provider of electrical equipment. The company expanded into the EPC business and the power business in 2010. It was listed on the Stock Exchange of Thailand (SET) in 2010. As of December 2020, the Dhumrongpiyawut family remained the major shareholder, holding approximately 53% of the company's interest.

The company was one of the first movers in the renewable power business, as it started to develop solar power projects of 57 MWe in 2010. The power business accounted for the majority, or 47%, of GUNKUL's total revenue in 2020, followed by the EPC business (34%) and the electrical equipment business (17%).

As of December 2020, GUNKUL's aggregate capacity was 604 MWe across 123 solar power projects (434 MWe) and five wind power projects (170 MWe). The operating power plants consisted of 381 MWe solar power projects and 170 MWe wind power projects.

KEY OPERATING PERFORMANCE

Table 1: Revenue Breakdown

Unit: %

	2016	2017	2018	2019	2020
Electrical equipment	42	25	22	22	17
EPC	28	41	30	14	34
Power	27	32	47	63	47
Others	3	2	1	1	2
Total	**100**	**100**	**100**	**100**	**100**
Total revenue (million THB)	**3,209**	**4,767**	**6,230**	**7,099**	**8,649**

Source: GUNKUL

Table 2: Power Project Portfolio (as of Dec 2020)

Company/Country	Held by GUNKUL (%)	No. of Project	Gross Contracted Capacity (MW)	Equity Contracted Capacity (MWe)	Tariff
Solar Projects					
GPS	40	4	26.0	10.4	Adder
GCPG	51	6	30.9	15.8	Adder
RNS	67	11	87.0	87.0	Fit
SES	100	79	62.2	62.2	Elec. bill
Japan	100	2	65.3	65.3	Fit
Malaysia	70	1	30.0	21.0	Fit
Vietnam	100	4	160.0	160.0	Fit
Others	25-100	16	21.3	12.2	Adder/Fit/Elec. bill
Sub total - Solar		**123**	**482.7**	**433.9**	
Wind Projects					
WED	100	3	60.0	60.0	Adder
GNP	100	1	60.0	60.0	Adder
KWE	100	1	50.0	50.0	Adder
Sub total - Wind		**5**	**170.0**	**170.0**	
Grand total		**128**	**652.7**	**603.9**	

Source: GUNKUL

FINANCIAL STATISTICS AND KEY FINANCIAL RATIOS*

Unit: Mil. THB

	Year Ended 31 December				
	2020	2019	2018	2017	2016
Total operating revenues	8,727	7,157	6,447	4,867	3,283
Earnings before interest and taxes (EBIT)	2,235	3,186	2,682	1,478	988
Earnings before interest, taxes, depreciation, and amortization (EBITDA)	3,714	4,252	3,382	1,861	1,229
Funds from operations (FFO)	2,679	3,288	2,374	1,138	748
Adjusted interest expense	915	923	905	631	440
Capital expenditures	3,505	776	6,303	4,716	7,697
Total assets	46,032	39,042	35,625	30,726	25,596
Adjusted debt	21,155	18,228	20,585	14,269	9,646
Adjusted equity	12,475	11,333	9,500	10,184	9,749
Adjusted Ratios					
EBITDA Margin (%)	42.55	59.41	52.47	38.23	37.44
Pretax return on permanent capital (%)	6.01	9.42	8.85	5.87	5.05
EBITDA interest coverage (times)	4.06	4.61	3.74	2.95	2.80
Debt to EBITDA (times)	5.70	4.29	6.09	7.67	7.85
FFO to debt (%)	12.66	18.04	11.53	7.98	7.76
Debt to capitalization (%)	62.90	61.66	68.42	58.35	49.73

* *Consolidated financial statements*

RELATED CRITERIA

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

Gunkul Engineering PLC (GUNKUL)

Company Rating:	BBB+
Issue Rating:	
GUNKUL214A: THB1,819 million senior unsecured debentures due 2021	BBB
Rating Outlook:	Stable

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