CreditNews ข่าวเครดิต

AAPICO HITECH PLC

No. 102/2020
7 July 2020

CORPORATES

Company Rating:	BBB+
Outlook:	Negative

Last Review Date: 22/07/19

Company Rating History:

Date	Rating	Outlook/Alert
22/07/19	BBB+	Stable
24/08/18	BBB+	Positive
12/11/14	BBB+	Stable

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RATIONALE

TRIS Rating affirms the company rating on AAPICO Hitech PLC (AH) at "BBB+". At the same time, we revise the rating outlook to "negative" from "stable". The change in outlook reflects a continued rise in leverage and a large impairment loss on the investment in Sakthi Group. An increasing exposure to overseas operations could also challenge AH's cost controls and weaken the company's credit profile.

The rating continues to reflect AH's strong competitive position as a Tier-1 automotive parts manufacturer in Thailand, solid core operations, and efficient control of costs. These strengths are partially offset by rather thin profit margins, customer concentration risk, and the cyclical nature of the automotive industry.

KEY RATING CONSIDERATIONS

Leverage on the rise

The rating is pressured by a steady increase in financial leverage, resulting from a recent large investment. The debt to capitalization ratio surged to 54.2% at the end of March 2020, from below 40% in the past. During 2017-2019, AH injected about THB7 billion into the Sakthi Group, by purchasing ordinary shares and providing loans. The Sakthi Group is an automotive supplier with production bases in Portugal, India, the United States (US), and China. In 2019, AH incurred an impairment loss of almost THB1.1 billion on its investment in the Sakthi Group. This large expense lowered AH's equity base.

The ratio of debt to EBITDA (earnings before interest, taxes, depreciation, and amortization) increased to 3.3 times in the first quarter of 2020, compared with the past level of below 3 times. The ratio of debt to EBITDA in 2020 could spike to about 7 times, based on our forecast that the impacts of the corona virus (Covid-19) pandemic will substantially lower EBITDA during the remaining nine months of this year. We expect the ratio to improve from 2021 onwards, dropping to about 3 times in 2022.

Increasing exposure to overseas operations

AH has expanded its footprint internationally to unlock growth opportunities and create sustainability. During the last three years, the company purchased 49.99% of the ordinary shares of Sakthi Global Auto Holdings Ltd. (SGAH) and provided loans to SGAH. SGAH is a holding company of the Sakthi Group.

Nevertheless, SGAH could not repay the loans to AH in March 2019. This led AH to impair its investment and make appropriation over the remaining ordinary shares (50.01%) of SGAH. AH also purchased a 100% stake in Sakthi Portugal S.A., owned indirectly by SGAH, from a secured lender in order to obtain full management control. Sakthi Portugal S.A. was later renamed AAPICO Maia S.A.

The operating performance of SGAH and AAPICO Maia S.A. has been incorporated into AH's consolidated financial statements since October 2019. Additional revenue from the overseas investment boosted revenue in the first quarter of 2020. Apart from growing the revenue base, the investment in the Sakthi Group helps AH enter the European market. Revenue from this new market made up about 20% of AH's total revenue in the first quarter of 2020. The overseas investment also helps AH expand to high-value added cast products at which the Sakthi Group is specialized.

On the downside, exposure to overseas operations has risen as AH recognizes the full results of the Sakthi Group. In addition to the different business environment, overseas operating expenses are relatively high. This could challenge AH's ability to control costs. The EBITDA margin of AH has been more stable than that of the Sakthi Group. The underperformance of the overseas operations could weaken AH's credit profile. In contrast, the successful expansion abroad would be a plus for AH's rating.

Core operations remain strong despite a drop this year

TRIS Rating expects the Covid-19 pandemic to affect AH's operating performance significantly this year. Our base-case projection assumes revenue will decline by almost 30% to about THB13.8 billion in 2020 and recover gradually to THB21.2 billion in 2022. Orders for chassis frames for the new Isuzu D-Max and the new Mazda BT-50 should boost revenue growth after the Covid-19 situation improves.

Likewise, profitability will likely slump this year as a decline in production volume reduces economies of scale. We expect the EBITDA margin to bottom out at about 8.4%, dropping EBITDA to a record low of THB1.2 billion in 2020. The EBITDA margin and EBITDA will likely improve to about 11% and THB2.3 billion, respectively, in 2022. The high operating expenses of overseas operations could challenge the company's earnings improvement. We maintain our views over AH's ability to improve production efficiency and reduce costs.

AH's profit margins are stable, albeit thin. The predictable margins come from the company's ability to pass through raw material costs to automakers. A share of profits and dividends received from its investments in associate companies have helped enhance AH's profitability over the past few years.

Strong competitive position in OEM auto parts segment

AH has a strong position in the original equipment manufacturer or OEM auto parts segment. This segment accounts for the major portion of AH's revenue, making up 70%-80% of total revenue in a year. As evidence of its strong competitive position, revenue has grown steadily since 2016. The growth came despite little growth in the domestic automotive industry. TRIS Rating believes AH will be able to maintain its competitive position in the OEM auto parts segment.

AH's competitive position is attributable to its lengthy track record of producing auto parts for several automakers. The company has never lost orders from its major customers. The reliability of its operations and its credibility have helped establish strong relationships with major customers such as Isuzu, Auto Alliance (AAT; a Ford and Mazda joint venture), and Nissan. Automakers are also reluctant to change their major suppliers due to high switching costs. AH is the sole chassis frame supplier for Isuzu in Thailand. Isuzu is AH's major customer, making up about one-fourth of AH's revenue. The long and close relationships with major customers and high switching costs for automakers help mitigate the concentration risk. In fact, the business reliance results from a few number of major auto makers in the automotive industry.

Liquidity remains manageable

TRIS Rating believes AH will be able to manage its liquidity adequately. The company could negotiate a debt payment deferral for at least 6 months on most of its bank lines in connection with the impacts of the Covid-19 pandemic. During the remaining nine months of 2020, debts of about THB2.9 billion will come due. Of this total, short-term loans for working capital comprise nearly THB2.2 billion, long-term bank loans comprise THB0.4 billion, and outstanding debentures amount to THB0.3 billion. At the end of March 2020, cash and marketable securities, plus unused credit facilities amounted to approximately THB3.1 billion. AH also received almost THB0.3 billion in cash dividends from its associates in May 2020. Additionally, the company is about to receive payments of THB0.3 billion from its customers. Funds from operations (FFO) during the remaining nine months of 2020 are expected at THB0.3 billion. As a result, sources of liquidity totaled THB4 billion, which should cover all the debts coming due.

A financial covenant in the debentures requires AH to maintain the net total liabilities to equity ratio below 2 times. The company has been able to comply with this covenant. However, the company breached three financial covenants in its bank loans in 2019, due mainly to the large impairment loss. AH has already received covenant waivers from its lenders. Based on our forecast, the company may breach some financial covenants in its bank loans in 2020, due to the impacts of the Covid-19 pandemic. We believe AH will be able to receive covenant waivers, considering its close relationship with the banks and solid business prospects.

BASE-CASE ASSUMPTIONS

- Total operating revenue to drop to THB13.8 billion in 2020, before recovering to THB21.2 billion in 2022.
- The EBITDA margin to range 8%-11%.
- Annual investments and capital expenditures to range THB0.4-THB0.8 billion per annum.

RATING OUTLOOK

The "negative" outlook reflects a steady increase in financial leverage and a significant impairment loss on the investment abroad. The escalating exposure to overseas operations could also challenge the company's cost controls and weaken its risk profile.

RATING SENSITIVITIES

A rating downgrade could occur if the financial profile deteriorates further, possibly due to additional impairment on the company's overseas investment or from excessive investment. Weaker-than-expected operating performance could also pressure the rating. The rating outlook could be revised to "stable" if operating performance improves and leverage declines and if overseas operations are well-managed as planned.

COMPANY OVERVIEW

Established in 1996, AH is a large Tier-1 manufacturer of automotive parts in Thailand. The company started as a Ford distributor, before expanding to the manufacture of auto parts. It was listed on the Stock Exchange of Thailand (SET) in 2002. As of March 2020, the major shareholder of AH remained the Yeap family, holding about 39% of the outstanding shares.

AH has two core lines of business: OEM auto parts and car dealerships. The company's OEM products are stamped or pressed parts, forged, cast and machined parts, plastic parts, and jigs and dies. Stamped or pressed parts, which include chassis frames, are the key OEM products. The car dealership segment sells Ford and Mitsubishi vehicles in Thailand and Honda and Proton vehicles in Malaysia. AH has recently established a joint venture in Thailand to import and distribute three brands of motorcycles including Bajaj, KTM, and Husqvarna.

The OEM auto parts segment accounts for 60%-80% of total revenue annually, while the car dealership segment constitutes the rest. In the first quarter of 2020, AH's operations in Thailand contributed 67% of total revenue, followed by operations in Portugal (20%), Malaysia (10%) and China (2%).

KEY OPERATING PERFORMANCE

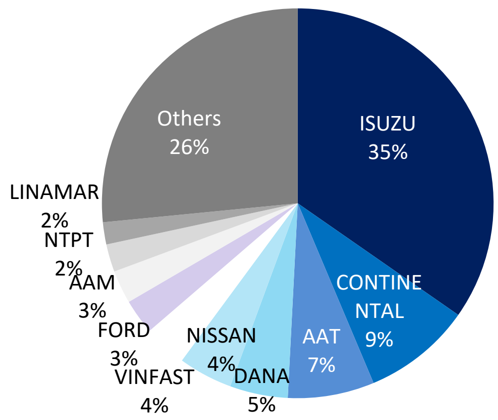
Table 1: Revenue Breakdown

Unit: %

	2016	2017	2018	2019	Jan-Mar 20
OEM auto parts	63	62	64	70	77
Car dealership	37	38	36	30	23
Total	**100**	**100**	**100**	**100**	**100**
Total revenue (Mil. THB)	**14,731**	**15,776**	**16,738**	**18,389**	**4,850**

Source: AH

Chart 1: AH's Major OEM Customers in 1Q20



Source: AH

FINANCIAL STATISTICS AND KEY FINANCIAL RATIOS*

Unit: Mil. THB

	Jan-Mar 2020	2019	2018	2017	2016
		-------------- Year Ended 31 December ----------			
Total operating revenues	5,009	18,959	17,370	16,288	15,137
Earnings before interest and taxes (EBIT)	285	1,490	1,538	1,277	740
Earnings before interest, taxes, depreciation, and amortization (EBITDA)	471	2,923	2,490	1,588	1,393
Funds from operations (FFO)	309	2,386	2,308	1,394	1,222
Adjusted interest expense	96	312	212	162	144
Capital expenditures	153	1,003	915	173	167
Total assets	23,071	21,246	17,891	14,721	11,113
Adjusted debt	9,182	8,293	6,087	4,764	2,366
Adjusted equity	7,765	7,480	7,947	7,183	6,236
Adjusted Ratios					
EBITDA Margin (%)	9.41	15.42	14.34	9.75	9.21
Pretax return on permanent capital (%)	8.65 **	9.62	11.37	11.90	7.98
EBITDA interest coverage (times)	4.91	9.36	11.74	9.78	9.67
Debt to EBITDA (times)	3.30 **	2.84	2.44	3.00	1.70
FFO to debt (%)	24.05 **	28.78	37.92	29.26	51.65
Debt to capitalization (%)	54.18	52.58	43.37	39.88	27.51

* *Consolidated financial statements*
** *Adjusted with trailing 12 months*

RELATED CRITERIA

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

AAPICO Hitech PLC (AH)

Company Rating:	BBB+
Rating Outlook:	Negative

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