TRIS RATING
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AAPICO HITECH PLC

No. 98/2021
30 June 2021

CORPORATES

Company Rating:	BBB+
Outlook:	Stable

Last Review Date: 07/07/20

Company Rating History:

Date	Rating	Outlook/Alert
07/07/20	BBB+	Negative
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 "stable" from "negative". The change in the rating outlook reflects an expected recovery in the company's operating performance, which will improve its earnings and financial leverage.

The rating continues to reflect AH's strong competitive position as a Tier-1 automotive parts manufacturer in Thailand, its solid core operations, and efficient cost control. These strengths are partially offset by the company's rather thin profit margins, customer concentration risk, and the cyclical nature of the automotive industry. The rating also takes into consideration increasing exposure to overseas operations which could pose significant challenges while presenting opportunities to broaden market coverage.

KEY RATING CONSIDERATIONS

Performance on recovery path

TRIS Rating expects AH's operating performance to bottom out and recover in 2021. Our base-case forecast projects its total operating revenue to rise to THB20.5-THB21.5 billion per annum over the next three years, boosted by both of its two key lines of business, original equipment manufacturer (OEM) auto parts and car dealership. Orders for chassis frames for Isuzu D-Max and Mazda BT-50 in Thailand as well as casting products in Europe will likely boost revenue from the OEM auto part business. More new showrooms will also add revenue from the car dealership business.

Profitability should also improve gradually as a rise in production volume increases economies of scale. During 2021-2023, we expect the company's earnings before interest, taxes, depreciation, and amortization (EBITDA) to rise to THB2.1-THB2.3 billion per annum, with expected EBITDA margins of 10%-11%.

Despite AH's profit margins being rather thin, its ability to pass-through raw material costs to automakers should keep profit margins stable and predictable. AH has also put efforts to improve production efficiency and reduce costs, helping increase profit margins during the few years prior to the Coronavirus Disease 2019 (COVID-19) outbreak took place in 2020. The company has recently stepped up its efforts to control costs and tighten inventory management to lessen the adverse impacts from COVID-19 pandemic.

Increasing exposure to overseas operations

AH has invested nearly THB7 billion in the Sakthi Group, whose main production bases are in Portugal and India. Initially, the investment included 1) a 49.99% of the ordinary shares of Sakthi Global Auto Holdings Ltd. (SGAH), a holding company of the Sakthi Group, and 2) loans to SGAH. In March 2019, SGAH failed to repay the loans to AH, resulting in AH appropriating the remaining ordinary shares (50.01%) of SGAH and impairing its investment, amounting to THB1.1 billion. Currently, AH holds a 100% stake in SGAH, which owns about 77% shares in Sakthi Auto Component Limited in India. AH also directly owns 100% shares in Sakthi Portugal S.A. in Portugal, later renamed AAPICO Maia S.A.

The operating performance of the Sakthi Group has been incorporated into AH since October 2019. In 2020, this overseas investment contributed THB3.2 billion to revenue, making up nearly 20% of AH's total revenue. Apart from growing the revenue base, the investment in the Sakthi Group helps AH enter the European market and expand to high-margin cast products. On the downside, the investment in the Sakthi Group has increased operational risk. In addition to the different business environment, overseas operating expenses are relatively high, posing significant challenges to AH's efforts to improve earnings. AH's credit profile could deteriorate if the overseas operations underperform. We expect AH to carefully handle the risks associated with its overseas operations. The long-term operating results remain to be seen.

Strong competitive position in OEM auto part business

TRIS Rating expects AH to maintain its strong position in the OEM auto part business, accounting for 70%-80% of its total revenue. This business had boosted the company's revenue during the few years prior to the COVID-19 outbreak took place. AH managed to attain revenue growth despite little growth in the domestic automotive industry.

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, Continental, Auto Alliance (AAT; a Ford and Mazda joint venture), DANA, and Nissan. Automakers are also reluctant to change their major suppliers due to the high switching costs. AH is the sole chassis frame supplier for Isuzu in Thailand. Isuzu is AH's major customer, accounting for about one-fourth of AH's total revenue. The long and close relationships with major customers and high switching costs for automakers help mitigate the concentration risk. In fact, this business reliance results from the small number of major automakers in the automotive industry.

Leverage to improve

The large investment in the Sakthi Group and the adverse impacts from COVID-19 pandemic have resulted in a significant increase in AH's financial leverage in recent years. The debt to capitalization ratio reached a peak of 54.7% in 2020, from below 40% in the past. The ratio of debt to EBITDA surged to 5.4 times in 2020, compared with the past level of below 3 times. Nonetheless, given the earnings recovery prospect, we expect the company's capital structure and debt serviceability to gradually improve to historic levels. We project the debt to capitalization ratio will fall steadily to below 40% and the debt to EBITDA ratio will decline gradually to below 3 times in the next three years.

As of March 2021, total debt was reported at THB9.8 billion, of which TH3.1 billion was considered as priority debt. The priority debt included THB1 billion of secured debt and THB2.1 billion of unsecured debt at the subsidiary level. This means the ratio of priority debt to total debt was about 34%. Since AH's priority debt ratio was below our trigger of 50%, we do not expect unsecured creditors to be significantly disadvantageous to the priority debt holders.

Liquidity to be manageable

AH should be able to manage its liquidity appropriately. During the remaining nine months of 2021, debts of about THB3.5 billion will come due, comprising THB1.9 billion short-term loans for working capital, THB1 billion long-term bank loans, and THB0.6 billion debentures. At the end of March 2021, cash and marketable securities were THB0.7 billion. Funds from operations (FFO) during the remaining nine months of 2021 are projected to be THB1.4 billion. As a result, the liquid assets and cash from operations are forecast to total THB2.1 billion. The shortfall of THB1.4 billion should be covered by the company's undrawn credit facilities of about THB3.1 billion. Also, AH has recently sold its investments and received about USD20 million in cash. The proceeds are planned to be used to repay the debentures worth THB0.6 billion due in September 2021.

A financial covenant of 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 2020, due to the impacts of the COVID-19 pandemic. It received covenant waivers from its lenders. Given the earnings recovery prospect, we expect AH to be compliant with its financial covenants over the next three years.

BASE-CASE ASSUMPTIONS

- Total operating revenue to increase to THB20.5-THB21.5 billion per annum over the next three years.
- EBITDA margin to range from 10%-11%.
- Investments and capital expenditures to range from THB0.4-THB0.9 billion per annum.

RATING OUTLOOK

The "stable" outlook reflects our expectations that AH's operating performance will recover gradually, resulting in a decline in its financial leverage, while risks associated with overseas operations will be well managed. We also expect the company to maintain its strong market position in its core lines of business.

RATING SENSITIVITIES

The prospect of a rating upgrade is limited in the near term. However, it could develop if the company's overseas investments prove to be successful, adding sizable cash flows, while leverage remains under control. In contrast, a rating downside could occur if AH's performance turns out to be weaker than expected and/or its financial profile deteriorates materially from the current level, possibly due to additional impairment on overseas investments or from excessive investments. The rating could also be lowered if the debt to capitalization ratio exceeds 50% or AH is unable to comply with the financial covenants of its loans for an extended period.

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 2021, the major shareholder of AH remained the Yeap family, holding about 39% of the outstanding shares.

AH has two core lines of businesses: 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 business sells Ford, Mitsubishi, and MG vehicles in Thailand and Honda and Proton vehicles in Malaysia. AH has also established a joint venture in Thailand to import and distribute three brands of motorcycles including Bajaj, KTM, and Husqvarna.

The OEM auto part business accounts for 70%-80% of its total revenue annually, while the car dealership business constitutes the rest. In the first quarter of 2021, AH's operations in Thailand contributed 61% of total revenue, followed by operations in Portugal (21%), Malaysia (14%), and China (4%).

KEY OPERATING PERFORMANCE

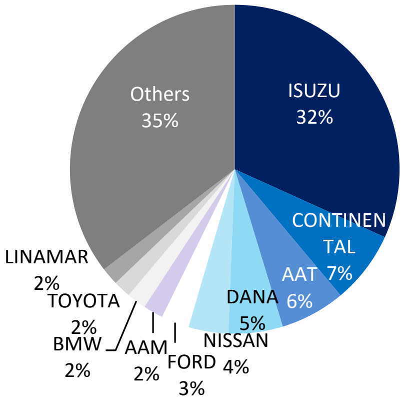
Table 1: Revenue Breakdown

Unit: %

Sources of Revenue	2017	2018	2019	2020	Jan-Mar 2021
OEM auto parts	62	64	70	70	76
Car dealership	38	36	30	30	24
Total	**100**	**100**	**100**	**100**	**100**
Total revenue (mil. THB)	**15,776**	**16,738**	**18,386**	**17,619**	**5,846**

Source: AH

Chart 1: AH's Major OEM Customers in 1Q21



Source: AH

FINANCIAL STATISTICS AND KEY FINANCIAL RATIOS*

Unit: Mil. THB

		-------------- Year Ended 31 December -----------			
	Jan-Mar 2021	2020	2019	2018	2017
Total operating revenues	5,637	17,798	18,959	17,370	16,288
Earnings before interest and taxes (EBIT)	424	550	1,493	1,538	1,277
Earnings before interest, taxes, depreciation, and amortization (EBITDA)	607	1,742	2,923	2,490	1,588
Funds from operations (FFO)	494	1,353	2,386	2,308	1,394
Adjusted interest expense	87	376	312	212	162
Capital expenditures	486	638	1,003	915	173
Total assets	23,138	22,346	21,293	17,891	14,721
Adjusted debt	9,075	9,351	8,580	6,087	4,764
Adjusted equity	8,221	7,741	7,481	7,947	7,183
Adjusted Ratios					
EBITDA Margin (%)	10.76	9.79	15.42	14.34	9.75
Pretax return on permanent capital (%)	3.87 **	3.20	9.55	11.37	11.90
EBITDA interest coverage (times)	6.94	4.63	9.36	11.74	9.78
Debt to EBITDA (times)	4.77 **	5.37	2.94	2.44	3.00
FFO to debt (%)	17.23 **	14.47	27.81	37.92	29.26
Debt to capitalization (%)	52.47	54.71	53.42	43.37	39.88

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

RELATED CRITERIA

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

Company Rating:	BBB+
Rating Outlook:	Stable

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