QTC ENERGY PLC

No. 9/2018 15 January 2018

Company Rating:	BBB-
Outlook:	Stable

Company Rating History:

Date	Rating	Outlook/Alert
06/01/17	BBB-	Stable
24/12/14	BBB	Stable

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Rating Rationale

TRIS Rating affirms the company rating of QTC Energy PLC (QTC) at "BBB-". The rating reflects QTC's moderately competitive position in the electrical transformer business, and expected improvement of performance buoyed by a predictable cash flow stream from its newly acquired solar power plant. However, the rating is tempered by significant changes in QTC's shareholding structure, which add concerns over the strengths of its core business. The rating is also weighed down by severe competition in the domestic transformer market, risks associated with renewable energy projects, limited track record in the power business, as well as several sizable investments, all of which will put pressure on QTC's financial profile in the near term.

QTC was founded in 1996 by Mr. Poonphiphat Tantanasin. It was listed on the Market for Alternative Investment (MAI) in July 2011. QTC is a medium-sized manufacturer of electrical transformers, providing products under its own brand "QTC". QTC produces transformers at power levels from 1-30,000 kilovolt-amperes (KVA) at system voltages of up to 72 kilovolts (kv). QTC has recently diversified its business to become a power producer, a move intended to provide recurring income and counterbalance the volatility in revenue from the transformer segment.

QTC's shareholding structure changed significantly after the company raised new equity capital through private placements several times over the past two years. In pursuit of funds to enter the power generating business, QTC allocated newly issued shares to a group of individual investors in 2016, receiving Bt329 million in new funds. In 2017, QTC paid Bt538 million to acquire a 100% stake of L Solar 1 Co., Ltd. (LS1), a solar power producer, from Loxley PLC (LOXLEY), Leonics Co., Ltd. (Leonics), and Colonel Prasert Shusang. The acquisition was made by paying Bt287 million in cash and issuing Bt251 million in new shares to LOXLEY and Leonics.

Further, QTC issued new shares worth Bt910 million to another group of individual investors. QTC has, to date, received part of the new funds, amounting to Bt650 million, with the remainder expected by January 2018. After the series of private placements, the stake of Mr. Poonphiphat and his family diluted from 62% at the end of May 2016 to 7% at the end of 2017. That stake will further drop to 6% after the new shares are fully paid. The new shareholders (comprising seven individual investors) will own 59%, while LOXLEY and Leonics will collectively hold about 6%.

In the wake of the significant changes in shareholders, the management team and QTC's strategy are expected to change as well. TRIS Rating is of the view that such a massive shake-up adds concerns over the continuity and strength of QTC's core business while the new business carries significant execution risks.

The rating reflects QTC's moderately competitive position in the electrical transformer business. QTC provides specialized distribution transformers, with a proven track record as an original equipment manufacturer (OEM). Over the past five years, nearly all (95%) of QTC's revenue came from the sale of distribution transformers, with 2% from power transformers and the remainder from services and sales of transformer components. During the same period, QTC's customer base comprised state enterprises (28% of total revenue), private companies (49%), and export customers (20%).

QTC was considerably hurt by the industry-wide slowdown and intensified competition in 2016, which brought a precipitous falloff in QTC's operating performance. Despite a resurgence in revenue in 2017, QTC's profitability weakened further as competition remained intense, with heavy markdowns taken by domestic transformer makers in order to get purchase orders from private sector and state enterprise clients. Revenue came in at Bt638 million in the first nine months of 2017, up from Bt276 million for the same period of 2016. However, QTC's operating margin (operating income before depreciation and amortization as a percentage of sales) declined substantially, sinking to -8.6% in the first nine months of 2017, following -10.7% in 2016, compared with 13.6%-18.8% in 2012-2015. QTC's earnings before interest, tax, depreciation and amortization (EBITDA) turned to negative Bt48 million in the first nine months of 2017 and negative Bt51 million in 2016, compared with positive Bt111-Bt199 million during 2012-2015.

TRIS Rating expects a modest revival of the electrical transformer market, partly helped by the development of a number of domestic solar power projects. However, the intense competition will keep the rating under pressure, hindering QTC's efforts to solidify earnings and attain the healthy profit margins achieved in previous years.

The rating affirmation is built on an expected improvement of QTC's performance, largely buoyed by a predictable cash flow stream from the newly acquired solar power producer. LS1 owns and operates a solar power plant located in Prachinburi Province. LS1 secures multi-year power purchase agreement with the Provincial Electricity Authority (PEA) under the Very Small Power Producer (VSPP) scheme. With contractual capacity of 8 megawatts (MW), LS1 receives an adder of Bt8 per kilowatt hour (kWh) on top of the power tariff for 10 years, starting from its commercial operating date since December 2011.

The predictable cash flow is predicated on the committed tariff and minimal payment risk of the power buyer. In addition, the solar power plant carries low operational risk. LS1 generated EBITDA of around Bt130 million per year during 2014-2016. During the first 10 months of 2017, LS1 reported EBITDA of Bt66.5 million. QTC has consolidated LS1's performance since late September 2017. The profitable LS1 should help strengthen QTC's overall performance in the years ahead.

QTC's balance sheet remains acceptable, as a result of several capital increases. Total debt increased from Bt243 million in 2015 to Bt433 million at the end of September 2017.The total debt to capitalization ratio increased slightly from 29.8% at the end of 2015 to 31.1% as of September 2017. As profits tumbled, QTC's cash flow protection ratio weakened considerably. The ratio of funds from operations (FFO) to total debt was -16.6% (annualized, from the trailing 12 months) at the end of September 2017, compared with 65%-84% in 2012-2015.

QTC desires to expand into the power generating business a new industry and become a producer of electricity, in a bid to decrease volatility in its revenue. QTC is conducting feasibility studies and due diligence for several projects, including hydro-power plants in the Lao People's Democratic Republic (Lao PDR) and a solar power plant in Myanmar. QTC has pledged to pay about Bt267 million to acquire a 15% stake in Green Earth Power (Thailand) Co., Ltd. (GEP Thailand), a holding company to invest in the Minbu project, a Myanmar-based 220-MW solar power project. QTC, to date, has paid a sum of around Bt202 million. The remaining installment is pending the fulfillment of several conditions by the project company. In our view, there is a strong likelihood that such conditions will not be met, whereby QTC has the right to call off the investment and sell back all purchased shares to the seller.

TRIS Rating is of the view that the diversification effort will enlarge QTC's revenue base and strengthen its business profile. On the flipside, the new business carries execution risks and the company's track record in the power business is very limited. The overseas projects under consideration also contain risks, country and regulatory risks, in particular, as well as off-taker risks.

Under TRIS Rating's base case, revenue from the transformer segment will grow modestly by around 5%-7% per year in the next three years, to range between Bt0.9-Bt1.0 billion. The gross margin could slightly recover to 15%, yet it is far below the 24%-28% achieved during 2012-2015. QTC's overall performance would be supported by a profit-making power segment. LS1 is expected to generate around Bt130 million in EBITDA per year towards the end of 2021.

Given the amount of new capital, TRIS Rating expects that QTC will further invest in more power projects, particularly if the investment in the Minbu project is cancelled. TRIS Rating assumes QTC will make sizable investments during 2019-2020 to grow its stake in the power business. The investments will put pressure on QTC's financial profile in the near term but could generate recurring income to make up for softened profits from the transformer segment. Leverage will rise and cash flow protection will weaken. The company is expected to manage its capital structure prudently. The debt to capitalization ratio is expected to stay below 50% through the build-up phase.

Rating Outlook

The “stable” outlook reflects the expectation that QTC will maintain its competitive position in the electrical transformer industry. QTC is expected to secure more orders, and profitability is expected to rebound as the market recovers. The rating or outlook upside is limited during the investment period. In contrast, the rating or outlook could be revised downward if the operating performance falls short of expectations or if aggressive investments lead to significant increases in debt and a weaker liquidity profile.

QTC Energy PLC (QTC)

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Rating Outlook:	Stable

Financial Statistics and Key Financial Ratios*

Unit: Bt million

			-------------------- Year Ended 31 December -----------------				
	Jan-Sep 2017		2016	2015	2014	2013	2012
Total revenue	638		531	1,229	761	804	960
Gross interest expense	11		8	9	8	7	8
Net income from operations	(83)		(82)	119	51	75	119
Funds from operations (FFO)	(61)		(72)	178	93	90	157
Capital expenditures	28		44	22	47	82	78
Total assets	1,979		1,221	1,069	713	736	789
Total debt	433		317	243	118	136	187
Shareholders’ equity	958		758	573	488	475	463
Operating income before depreciation and amortization as % of sales	(8.61)		(10.72)	15.69	13.56	16.01	18.80
Pretax return on permanent capital (%)	(9.02)	**	(9.91)	22.36	11.98	15.93	29.46
Earnings before interest, tax, depreciation, and amortization (EBITDA) interest coverage (times)	(4.45)		(6.55)	22.71	14.73	19.65	24.67
FFO/total debt (%)	(16.63)	**	(22.86)	73.01	79.03	65.84	83.73
Total debt/capitalization (%)	31.12		29.47	29.81	19.47	22.28	28.80

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

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