UNIVERSAL UTILITIES PLC

No. 79/2017

7 July 2017

Company Rating: A-

Outlook: Stable

Company Rating History:

Date	Rating	Outlook/Alert
30/06/15	A-	Stable

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Rating Rationale

TRIS Rating affirms the company rating of Universal Utilities PLC (UU) at "A-". The rating reflects the company's low operating risk, the resilient demand for tap water, and the steady cash flows backed by long-term offtake agreements which include price escalation formulas. The rating is partly enhanced by UU's strategic importance to its parent company, Eastern Water Resources Development and Management PLC (EASTW; rated "A+/Stable"). However, these strengths are partially offset by UU's customer concentration risk, limited opportunities to expand into new service areas, and high leverage.

UU is a wholly-owned subsidiary of EASTW. The company was established in December 1998 as EASTW's arm, being responsible for waterworks services. Currently, UU provides tap water services in 13 service areas with a total production capacity of 366,660 cubic meters (cu.m.) per day and a committed minimum offtake quantity (MOQ) of 190,805 cu.m./day. The services UU provides are based on contractual agreements, such as concessions, management contracts, and management lease contracts. UU also has a related business of engineering services.

UU's satisfactory business profile is supported by resilient demand for tap water and the nature of the tap water business, which has low operating risk. Generally, the provision of tap water services does not require the use of complicated technology. However, the industry poses some barriers to entry due to the limited availability of raw water resources, rights of way for pipelines, and the necessity of securing permission or a concession from the authorities in order to operate a water treatment plant.

UU carries customer concentration risk. The Provincial Waterworks Authority (PWA) is its major customer, contributing over 70% of UU’s revenue annually during the past five years. However, since the PWA is a state enterprise, its credit profile is acceptable. The prospects for UU to expand are moderate since the PWA does not incline to grant any new concessions or outsource its operations. In order to keep growing, UU has to seek opportunities to get contracts directly from municipalities and formulate a service model for unserved areas. TRIS Rating holds the view that the development of the Eastern Economic Corridor (EEC) will be a key factor driving UU's growth opportunities over the next two to three years.

UU's credit profile is enhanced by the support it receives from its parent company, EASTW. Currently, four of UU's operating platforms are under concessions which EASTW is the concessionaire. The synergies between UU and EASTW, in terms of raw water supply and tap water operations, enhance the group benefits. TRIS Rating holds the view that EASTW would be willing to provide operational and financial support to UU, should the need arise, since UU is a strategically important subsidiary of EASTW.

UU's financial profile is underpinned by its high profitability and reliable cash flows. UU sold a total of 93.1 million cu.m. of tap water in 2016, an 11% rise year-on-year (y-o-y). The double-digit growth was partly due to the acquisition of Egcom Tara Co., Ltd. (Egcom Tara) in August 2015. Revenue from operations was Bt1,322 million in 2016. For the first quarter of 2017, the volume of tap water sold grew marginally to 23.4 million cu.m. with an average per-unit tariff of Bt14.2/cu.m. UU reported revenue of Bt332 million in the first quarter of 2017. Revenue dropped slightly by 1.4% due to lower service revenue of laying pipeline in Bowin area.

Despite the slight drop in revenue, UU's operating margin (operating profit before depreciation and amortization, as a percentage of sales) remained high at 46.96% in the first quarter of 2017.

Under TRIS Rating's base case scenario, we expect UU's revenue to grow by at least 3% per annum during 2017-2018. The growth will be driven by the resilient demand for tap water and the ongoing expansion of communities benefitting from the development of the EEC. TRIS Rating expects UU to maintain an operating margin above 45% during 2017-2018.

UU's capital structure has weakened, due mainly to the debt-financed acquisition of Egcom Tara. At the end of March 2017, UU reported the total debt of Bt2,369 million while the ratio of debt to capitalization stood at 58.49%. UU initially planned to deleverage by raising capital via an initial public offering (IPO). However, the company has decided to postpone the IPO and will convert the bridge loan of Bt1,600 million for the Egcom Tara acquisition into a long-term loan. As a result, leverage will stay elevated over the next one to two years. TRIS Rating expects UU's debt to capitalization ratio to stay at 50%-52% in 2017-2018.

UU’s liquidity remained sound. For the first quarter of 2017, the ratio of funds from operations (FFO) to total debt was 21.44% (annualized, from the trailing 12 months). The earnings before interest, taxes, depreciation and amortization (EBITDA) interest coverage ratio has stayed high and stood at 12.32 times at the end of March 2017.

Over the next 12-24 months, TRIS Rating holds the view that UU's sources of funds will be sufficient to cover the uses. The funding needs are: scheduled debt repayments of Bt385 million and planned capital expenditures of Bt550 million. The funding sources are FFO of at least Bt510 million per annum plus cash and cash equivalents of Bt500 million on hand at the end of March. TRIS Rating believes that UU will receive support from EASTW in case of any financial distress.

Rating Outlook

The “stable” outlook reflects UU’s low operating risk and reliable streams of cash flow from tap water operations. UU's credit upside scenario could materialize if the company is able to expand without further weakening its capital structure. A rating downgrade will be triggered if UU makes any aggressive debt-funded investments which push higher leverage or if TRIS Rating believes that EASTW will materially lower the level of support it provides to UU. A change in EASTW's credit profile will affect UU's credit quality.

Universal Utilities PLC (UU)

Company Rating:	A-
Rating Outlook:	Stable

Financial Statistics and Key Financial Ratios*

Unit: Bt million

	Jan-Mar 2017	------------------- Year Ended 31 December ------------------- 2016	2015	2014	2013	2012
Total sales**	332	1,322	1,145	994	947	997
Gross interest expense	13	57	39	40	33	27
Net income from operations	61	224	181	118	76	140
Funds from operations (FFO)	151	501	417	256	160	220
Total capital expenditures	94	137	128	350	153	271
Total assets	4,761	4,672	4,736	2,158	1,986	1,937
Total debt	2,369	2,369	2,561	738	658	671
Shareholders' equity including minority interest	1,681	1,614	1,497	1,161	1,067	1,034
Operating income before depreciation and amortization as % of sales	46.96	46.68	37.85	30.75	22.10	28.94
Pretax return on permanent capital (%)	8.69 ***	8.90	9.17	10.86	7.73	12.47
Earnings before interest, tax, depreciation, and amortization (EBITDA) interest coverage (times)	12.32	11.13	11.92	7.98	6.77	11.31
FFO/total debt (%)	21.44 ***	21.16	16.27	34.68	24.37	32.74
Total debt/capitalization (%)	58.49	59.47	63.11	38.86	38.16	39.35

* *Consolidated financial statements*
** *Excluding construction revenue under concession agreements*
*** *Annualized from the trailing 12 months*

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