TRIS RATING
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EAST COAST FURNITECH PLC

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CORPORATES

Company Rating:	BB+
Outlook:	Stable

Last Review Date: 25/07/18

Company Rating History:

Date	Rating	Outlook/Alert
25/07/18	BB+	Stable
19/06/17	BB	Stable

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RATIONALE

TRIS Rating affirms the company rating on East Coast Furnitech PLC (ECF) at "BB+", with a "stable" outlook. The rating continues to reflect its adequate competitive strength and established distribution channels in the furniture manufacturing industry. The rating also factors in the alleviation of execution risk of its solar power project in Myanmar, as the first phase of the project will commence commercial operation within 2019.

However, the strength of the rating is constrained by an expected rise in financial leverage from substantial investments in the power project in Myanmar and other new projects. The rating strength is weighed down by the high investment risks, in terms of country and counterparty risks, in relation to the project in Myanmar.

KEY RATING CONSIDERATIONS

Adequate competitive strength

ECF's business profile reflects its position as a medium-sized furniture manufacturer in Thailand. The company's products include particle board furniture and rubber wood furniture, contributing about 65%-70% and 12%-15% of total revenue, respectively. The company's products are less differentiated than its competitors' products. About 50%-60% of furniture sales come from simple knockdown furniture and are marketed under customer brands. Its product offerings focus on the low- to medium-priced market segments, indicating limited price premium.

Established distribution channels

The established distribution channels through leading modern trade retailers continue to be ECF's important competitive strength. Leading modern trade retailers in Japan and Thailand make up approximately 80%-90% of ECF's furniture sales. Thanks to growing demand from these retailers, ECF's revenue keeps growing even though demand in Thailand is contracting.

The company is exposed to price-based competition as it could be replaced by lower-cost overseas producers in absence of long-term contracts with these modern trade retailers.

Investment risks in Myanmar

Investment risks in the Minbu power plant project have to some degree been alleviated. ECF finally obtained almost all of the key permits and contracts from the authorities in Myanmar. Construction of the first phase project, 50 megawatts (MW) of capacity, completed in July 2019. The first phase is expected to start commercial operation within 2019. However, the readiness of the national grid at the project location, successful connection with the grid, and payment risk from the utility off-taker are still significant risks that need to be monitored.

For the remaining phases comprising 170 MW, TRIS Rating believes development should require less time as the fundamental infrastructure and main facilities are already installed on the project site. Construction of the rest of the project is expected to take around 2.5-3 years. Given the considerable scale of the project, we view that the company will need injection of new equity or new bond issuance to finance the rest of the project.

Expected growth of profit from power plants

ECF's share of the profits from the power plants is likely to grow significantly over the medium term, driven by the start of operation of the Minbu project. The Minbu project, a 220-MW solar farm in Myanmar, is the largest project in which ECF has invested. Once all phases of the Minbu project are operating for a full year, ECF's share of the profits is forecast to be at least Bt70 million per year in 2023 onwards.

EBITDA holds steady

ECF's financial results remain acceptable, although earnings deteriorated last year. ECF's earnings before interest, taxes, depreciation, and amortization (EBITDA) diminished to Bt246 million in 2018, from Bt253 million in 2017, down by 2.7%. During the same period, funds from operations (FFO) also slipped to Bt129 million from Bt160 million, a 20% drop. The large drop in FFO was due to the costs of bond issuances and rising interest payments as outstanding debts increase. The EBITDA margin slid to 16.3% in 2018 but it was still higher than the five-year average of 15.9%.

Going forward, our forecast shows that ECF's revenue may fall slightly in 2019, affected by the softening demand from the Japanese market and its plan to close all loss-making showrooms. However, we expect that this shrinking revenue will be offset by improving profit margins from the company's cost reduction measures implemented this year. The measures mainly include a modification of furniture packaging and installation of solar rooftops for its furniture factory. We forecast EBITDA will stay between Bt210-Bt240 million yearly over the next three years in line with the past performance. However, interest payments are expected to increase as the company is likely to use most of the debt in financing the rest of the Minbu project. As a result, FFO is likely to decline to around Bt100-Bt120 million per annum.

Weakening financial profile

We forecast that ECF's financial profile will weaken over the next three years but at a slower pace than our previous forecast due to the postponement of investment in a new medium density fiber board (MDF) factory, worth Bt1.45 billion. This postponement is due to the unfavorable market condition for the MDF products and uncertainty surrounding the price of wood in the southern part of Thailand.

We expect ECF's outstanding debt to continue rising over the medium term, based on the planned investments in the Minbu project and other investments in the power business. We expect the debt to capitalization ratio to rise to 60% and the FFO to debt ratio to decline to about 5%-6% over the next three years.

Refinancing risk

The large bond redemption of Bt700 million, coming due in August 2020, represents significantly refinancing risk. The size of the bond repayment is significantly larger than its annual EBITDA, thus the company will have to seek refinancing as source of repayment.

BASE-CASE ASSUMPTIONS

- Revenue to drop slightly in 2019 before growing by 1%-2% per year during 2020-2021.
- EBITDA margin will range between 15%-17%.
- Shared profits from investments in the power business will be about Bt5 million in 2019 before rising to Bt30 million in 2021.
- Dividend payout ratio will be 50%.

RATING OUTLOOK

The "stable" outlook reflects TRIS Rating's expectation that ECF's furniture business will continue to grow slowly and the company will be able to maintain its EBITDA margin within the historical range. The modern trade channels in Japan and Thailand will remain the core distribution channels. The shares of profit from its invested power projects are likely to increase over time.

RATING SENSITIVITIES

The prospect of a rating upgrade is limited in the medium terms, given the expected rise in financial leverage from new investments. However, the rating upgrade could occur if the company enlarges its cash flow base significantly, while maintaining its capital structure at an acceptable level.

The rating could be downgraded if the operating performance of the furniture business is significantly weaker than expected for an extended period or if the company has material losses from the power projects. Aggressive debt-funded investments, which will lift the debt to capitalization ratio to a high level for a sustained period, could also trigger negative rating actions.

COMPANY OVERVIEW

Established in 1999, ECF is a manufacturer and distributor of home furnishings in Thailand. ECF owns two factories in Rayong province and makes furniture from particle board and rubber wood. Revenue from selling furniture contributes over 90% of total revenue; the remainder is derived from selling decorative foil paper, and dried rubber wood. ECF has been listed on the Market for Alternative Investment (MAI) since 2013. The Suksawad family has been the main shareholder, holding approximately 50% of the outstanding shares as of 30 April 2019.

In 2018, ECF had four main distribution channels, including made-to-order (51% of total furniture sales), Thai modern trade (32%), owned showrooms (4%), and dealers (13%). Almost all made-to-order furniture is exported to leading furnishing distributors and large modern trade retailers in Japan. ECF distributes furniture under its own brands through well-known modern trade retailers in Thailand, such as Home Pro, Big C, Mega Home, Thai Wasadu, Tesco Lotus and Global House. Revenues from the export and Thai markets accounted for 47% and 53% of total sales, respectively in 2018. The Japanese market accounts for about 44% of total sales.

ECF's power generating segment is operated under ECF Power Co., Ltd. ECF has three power projects invested through its associates. The first project is a 7.5 MW biomass power plant in Narathiwas province. The second is a 2-MW biogas project in Phrae province. The last project is a 220-MW solar farm project, located in Myanmar.

KEY OPERATING PERFORMANCE

Table 1: ECF's Power Project Portfolio as of 30 Jun 2019

Project/Country	Type	Hold by ECF (%)	Installed Capacity (MW)	Contracted Capacity (MW)	COD
Thailand					
PWGE	Biomass	33.37	7.5	7.0	Jun 2017
Bina Puri	Biomass	16.3	1	0.92	Aug 2018
			8.5	7.92	
Myanmar					
Minbu project					
- phase 1	Solar	20	50	40	2019
- phase 2	Solar	20	50	40	2020
- phase 3	Solar	20	50	40	2021
- phase 4	Solar	20	70	50	2022
			220	170	
Total			**228.5**	**177.92**	

Source: ECF

FINANCIAL STATISTICS AND KEY FINANCIAL RATIOS*

Unit: Bt million

	Jan-June 2019	-------------- Year Ended 31 December ---------- 2018	2017	2016	2015
Total operating revenues	694	1,504	1,479	1,392	1,353
Operating income	114	244	254	193	203
Earnings before interest and taxes (EBIT)	72	145	157	134	123
Earnings before interest, taxes, depreciation, and amortization (EBITDA)	113	246	253	216	205
Funds from operations (FFO)	55	129	160	147	149
Adjusted interest expense	54	104	81	58	42
Capital expenditures	34	136	33	37	27
Total assets	3,493	3,396	2,780	2,357	1,506
Adjusted debt	1,424	1,299	1,176	901	717
Adjusted equity	1,429	1,447	1,027	659	454
Adjusted Ratios					
Operating income as % of total operating revenues (%)	16.5	16.2	17.2	13.8	15.0
Pretax return on permanent capital (%)	5.2 **	5.4	7.1	8.1	10.7
EBITDA interest coverage (times)	2.1	2.4	3.1	3.7	4.9
Debt to EBITDA (times)	5.8 **	5.3	4.6	4.2	3.5
FFO to debt (%)	8.7 **	9.9	13.6	16.3	20.7
Debt to capitalization (%)	49.9	47.3	53.4	57.7	61.3

* *Consolidated financial statements*
** *Trailing with the last 12 months*

RELATED CRITERIA

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

East Coast Furnitech PLC (ECF)

Company Rating:	BB+
Rating Outlook:	Stable

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