EASTERN PRINTING PLC

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CORPORATES

Company Rating:	BBB-
Outlook:	Stable

Last Review Date: 07/12/18

Company Rating History:

Date	Rating	Outlook/Alert
07/12/18	BBB-	Stable
01/12/15	BBB	Stable

Contacts:

Narongchai Ponsirichusopol

narongchai@trisrating.com

Auyporn Vachirakanjanaporn

auyporn@trisrating.com

Parat Mahuttano

parat@trisrating.com

Monthian Chantarklam

monthian@trisrating.com

WWW.TRISRATING.COM

RATIONALE

TRIS Rating affirms the company rating on Eastern Printing PLC (EPCO) at "BBB-" with a "stable" outlook. The rating reflects EPCO's strong market presence in the printing industry, and its reliable cash flow from the power business. However, the rating is weighed down by the dismal outlook of the printing industry, high leverage to support growth in the power business, and execution risks from overseas expansion.

KEY RATING CONSIDERATIONS

Strong presence in the printing business

The rating recognizes EPCO's strong market presence as a leading printing service provider, which is the result of its size and broad range of products. EPCO maintains long-term relationships with its customers on the strength of its established track record.

Despite disruption in the printing and publishing industries, EPCO's profit margin is relatively higher than peers. On a stand-alone basis, EPCO's operating margin (operating profit before depreciation and amortization as a percentage of revenue) has exceeded 15% for the past five years.

Printing segment still in the doldrums

The printing business has been EPCO's core revenue contributor in the past. However, the industry has been disrupted by the fast-and-steady growth of digital media, which has resulted in weakening demand for printing services. Consumers gravitate towards the new media, a trend that has been seen globally.

In the past two years, EPCO's revenue from the printing business fell to Bt400-Bt450 million per year, in contrast to Bt500-Bt600 million in previous years. For the first nine months of 2019, EPCO's revenue in the printing business fell short of TRIS Rating's expectations. Gross margin also declined from 22.3% in 2018, to 17.3% in the first nine months of 2019. In TRIS Rating's view, the outlook for the printing business remains bleak.

Strategic move to paper packaging

In view of the rapid growth occurring in the e-commerce and logistics industries, EPCO has positioned paper packaging at the forefront of its growth strategy. The company has spent a total of Bt490 million to acquire a 100% share of WPS (Thailand) Limited (WPS), which will help expand the company's printing facilities. The company has also invested in new packaging machinery.

We believe EPCO's strategic move is being implemented to recoup the growth of its printing business. However, the full operation of its packaging line has been delayed. EPCO is also faced with the challenge of building up a customer base amidst a competitive market. Unlike the metal and glass packaging categories which are dominated by a few large companies, the paper and board category is fragmented with a large number of small and medium-scale companies. We expect the packaging facility to start production in 2020.

Power business is the key growth driver

EPCO's business at present is largely driven by its power operations, given their significant contributions in terms of assets and earnings. The company diversified into the solar power business in 2012 through its main subsidiary, Eastern Power Group PLC (EP; rated "BBB-/Stable"). EPCO currently owns 75% of EP.

The power business has exhibited tremendous growth. EPCO's power business contributed nearly half of total revenues in 2018. As of September 2019, it accounted for around 69% of total assets and contributed around 86% of total EBITDA (earnings before interest, tax, depreciation, and amortization). We expect the power business to remain the key growth driver for EPCO, with a revenue contribution of 51%-65% during 2020-2022.

Reliable cash flow from power portfolio

The rating primarily mirrors the reliable cash flow that EPCO gains from its power portfolio in Thailand and overseas. EPCO currently owns several solar power projects and has invested in two cogeneration power plants under the small power producer scheme (SPP).

For its domestic solar power plants, EPCO has secured long-term power purchase agreements (PPAs) with state-owned utilities and private power buyers. Overseas, EPCO's solar power projects hold long-term PPAs with Vietnam Electricity (EVN) and contracts with reliable power buyers in Japan. The cash flows from the solar power projects are highly predicable, thanks to the committed tariff, and low operational risks. All solar PPAs are operated on a non-firm basis. So far, the performance of the solar projects is deemed satisfactory. On the whole, the actual annual output of the solar plants has reached the level of P50 estimates (the energy production which is reached with a probability of 50%).

EPCO's two SPPs hold a combined contract capacity of 270 megawatts (MW), under PPAs with the Electricity Generating Authority of Thailand (EGAT). The performance of the cogeneration power plants is considered fair as one of the two plants experienced an unplanned outage.

Divestiture of projects strengthens capital structure

EPCO recently announced the divestiture of its first two solar farm projects in Vietnam (Xuan Tho 1 and Xuan Tho 2), with a combined capacity of 99.2 MW. Both projects hold 20-year power purchase agreements (PPAs) with EVN and have been in commercial operation since June 2019. In total, the divestiture will bring in Bt1.26 billion in cash.

We expect the divestiture process to be completed in early 2020. The divestment will strengthen EPCO's capital structure and enlarge covenant headroom as the company will recognize a gain on disposal of approximately Bt500 million. We forecast a debt to capitalization ratio of 70.3% at the end of 2019, which will decline to 61.3% after the transaction is completed. For the same period, we expect the ratio of net debt to equity to decline to 1.6 times, against the limit of 3.25 times under the bond conditions.

Added to that, the proceeds will enhance the company's liquidity profile, given that EPCO has a total of Bt1.1 billion in bonds coming due in the next 12 months.

Overseas expansion to continue

After the divestiture of the solar projects, we expect EPCO will seek to replenish its power portfolio. As growth opportunities in the domestic market have languished, EPCO intends to expand its power business overseas. The company is now considering development of several large-scale wind and solar power projects in Vietnam with a total installed capacity of nearly 400 MW.

We view that EPCO is likely to invest in on-shore wind farms as the tariff for these projects is set at US$8.5 cents per kilowatt-hour (kWh) which is higher than the declining tariff for solar projects. In our base case for 2020-2022, we assume EPCO will develop a 96-MW wind power project, with construction spanning the period 2020-2021. As such, the company's power plants in Vietnam could account for almost 40% of its total power portfolio.

In our base-case forecast, EBITDA is projected to be around Bt900 million per year in 2020-2021, and reaching Bt1.2 billion in 2022. Funds from operations (FFO) are forecast to be in the Bt430-Bt480 million per year range in 2020-2021, before rising to Bt690 million in 2022.

Execution risks of overseas projects

Although EPCO has been successful in developing large-scale solar farms in Vietnam within tight schedules, TRIS Rating is of the view that wind farm development entails relatively high construction risks due to the complexity of technology selection and plant designs. Wind farms generally carry higher operation risks than solar projects too.

Added to that, EP's growth strategy will broaden the company's exposure to higher country risk. Despite fast-growing demand for electricity and the government's supportive measures, power projects in Vietnam carry several risks, including changes in regulations, contract enforcement, and curtailment risks. Counterparty risk is also higher. We are also of the opinion that the credit profile of the state-run EVN is not as strong as the Thai state-owned power buyers.

Potential surge in leverage

Although EPCO's leverage is likely to fall following the asset divestiture, we believe the low level will only be temporary as the company will probably choose to develop new power projects. In our base-case forecast for 2020-2022, we assume that EPCO's new power projects will initially be financed by the engineering, procurement, and construction contractors (EPC contractors) and then replaced by bank loans a year after the projects start commercial operations. This type of financing scheme would help lessen debt loads during the construction period.

In our base case, total debt is forecast to decrease to about Bt6.5-Bt7.3 billion in 2020-2021 before surging to Bt10.3 billion in 2022 when loans from new projects are counted-in. As a result, the debt to capitalization ratio is forecast to drop to 53%-61%, then increase to 65% in 2022. The ratio of net debt to equity could increase to about 2 times and the ratio of debt to EBITDA could peak at 8 times during 2020-2022 while the FFO to debt ratio should remain low at about 4%-9%.

We expect that EPCO will maintain this level of leverage over the course of rebuilding its power portfolio. If EPCO's expansion is larger than our estimates, we believe the company will maintain leverage at the expected levels, with capital injections and further divestiture of existing projects being options.

Tight liquidity

We see significant refinancing risk in the company's debt profile. Some of EPCO's Japan-based solar farm projects are funded by bank loans with tenors of up to three and a half years. The company is obliged to make bullet payments at maturity. The tenors of the loans do not match the long-term nature of the projects. In addition, EPCO has raised funds to partially fund the power segment in the form of bonds and short-term bills of exchange.

EPCO's liquidity is tight. For the next 12 months, the company has long-term debt obligations coming due, including bonds of around Bt1.1 billion. Meanwhile, FFO is expected to be Bt430 million. EPCO would need to refinance the maturing bonds. However, the proceeds from the divestiture of the Vietnam solar projects should enhance EPCO's liquidity and alleviate refinancing risk.

BASE-CASE ASSUMPTIONS

- Revenue from printing and packaging is estimated at Bt820 million per year during 2020-2022, with a gross profit margin of around 24%-25%.
- Total operating revenues in the range of Bt1.7-Bt2.3 billion per annum during 2020-2022.
- Aggregate capacity of operating power plants to reach 171 MW in the next three years.
- EBITDA of Bt900 million per year in 2020-2021, and Bt1.2 billion in 2022.
- Total capital spending of Bt4.9 billion during 2020-2021.
- EPCO obtains long credit terms from EPC contractors for the construction of new projects in Vietnam.

RATING OUTLOOK

The "stable" outlook reflects the expectation that EPCO's power plants will continue to perform satisfactorily while its efforts to rebuild its power portfolio will not significantly deteriorate its capital structure. The packaging production line will start as planned and steer the printing segment out of its revenue slump. We expect EPCO to prudently manage its liquidity as well.

RATING SENSITIVITIES

A rating upgrade may occur if EPCO can significantly strengthen its capital structure or its power plants perform beyond expectation. Conversely, negative rating pressure could build up if EPCO's operating performance falls short of estimates or if the company expands through the liberal use of debt.

COMPANY OVERVIEW

EPCO was established in 1990 as a printing service provider. The company was listed on the Stock Exchange of Thailand in 1993. As of November 2018, Aqua Corporation PLC (AQUA) held approximately 38% of EPCO while the Chinsupakul family, the company's founders, owned 17%. EPCO provides a full range of printing services, serving both domestic and foreign customers. EPCO prints newspapers, magazines, product manuals, educational books, calendars, and advertising materials. The company has transitioned to focus heavily on the power business to make up for the drop-off in the printing business.

EPCO diversified into the solar power business in 2012, primarily through its main subsidiary, Eastern Power Group PLC (EP). EPCO currently owns 75% of EP. EP launched two pilot solar farm projects in Kanchanaburi Province in 2012. The contracted capacity of the two farms is 10 MW. In 2013, EP added a 5-MW solar farm project in Lopburi Province. During

2014-2015, EP developed eight solar rooftop projects in Bangkok and Samutprakan Province, with a contracted aggregate capacity of 1.5 MW. EP later expanded to solar power projects outside Thailand, as well as cogeneration power. EP has invested in two cogeneration power companies, which have enhanced its overall profit. EP holds 49.5% of PPTC Co., Ltd. (PPTC) and 40% of SSUT Co., Ltd. (SSUT). Both companies produce cogeneration power under the SPP scheme, through 25-year PPAs with EGAT and long-term contracts with industrial users.

KEY OPERATING PERFORMANCE

Table 1: Revenue Breakdown

	2014	2015	2016	2017	2018	9M'18	9M'19
Printing business	61%	57%	58%	46%	35%	42%	27%
Power business	36%	40%	39%	50%	48%	54%	70%
Others	3%	3%	3%	3%	17%	4%	3%
Total	100%	100%	100%	100%	100%	100%	100%
Total Revenue (Bt million)	**896**	**890**	**881**	**963**	**1,185**	**710**	**1,141**

Source: EPCO

Table 2: Power Project Portfolio (After the divestment of Xuan Tho 1&2)

Project	Plant Type	Held by EP (%)	Installed (MW)	Equity (MWe)	SCOD/COD
OPERATING			**430.2**	**222.1**	
JKR	Solar Farm	100	5.5	5.5	Oct-13
RVP	Solar Farm	100	5.5	5.5	Oct-13
LOPBURI	Solar Farm	100	6.0	6.0	Feb-14
PS	Solar Farm	48	5.0	2.4	Dec-16
Solar rooftop	Solar Rooftop	100	1.5	1.5	Sep-14
KYOTEMBA	Solar Farm	98	12.0	11.8	Nov-16
KURIHARA1	Solar Farm	98	11.7	11.4	Oct-18
Commercial rooftop	Solar Rooftop	100	5.4	5.4	2018-2019
PPTC	CCGT [(1)]	50	120.0	59.4	Mar-16
SSUT	CCGT [(1)]	40	240.0	96.0	Dec-16
KURIHARA2	Solar Farm	98	17.6	17.2	Nov-19
CONSTRUCTING & DEVELOPING			**4.4**	**4.3**	
SHICHI KACHUKU1, 2	Solar Farm	98	4.4	4.3	Q4-20
Total Portfolio			**434.6**	**226.4**	

Remark: [(1)] Combined cycle gas turbine
Source: EP

FINANCIAL STATISTICS AND KEY FINANCIAL RATIOS

Unit: Bt million

		------------Year Ended 31 December -----------			
	Jan-Sep 2019	2018	2017	2016	2015
Total operating revenues	1,140	1,052	955	880	890
Earnings before interest and taxes (EBIT)	611	550	466	264	311
Earnings before interest, taxes, depreciation, and amortization (EBITDA)	550	473	434	371	416
Funds from operations (FFO)	266	201	200	240	352
Adjusted interest expense	258	251	211	115	52
Capital expenditures	3,641	818	935	1,092	256
Total assets	13,678	10,599	8,508	6,930	2,579
Adjusted debt	8,812	6,331	5,472	2,608	1,014
Adjusted equity	3,690	3,280	2,473	2,191	1,381
Adjusted Ratios					
EBITDA margin (%)	48.26	44.94	45.46	42.15	46.75
Pretax return on permanent capital (%)	6.75	5.94	6.22	5.73	12.28
EBITDA interest coverage (times)	2.13	1.89	2.05	3.24	8.06
Debt to EBITDA (times)	12.47	13.40	12.60	7.03	2.44
FFO to debt (%)	3.82	3.17	3.66	9.19	34.75
Debt to capitalization (%)	70.49	65.87	68.87	54.35	42.33

RELATED CRITERIA

- Rating Methodology – Corporate, 26 July 2019
- Key Financial Ratios and Adjustments, 5 September 2018
- Group Rating Methodology, 10 July 2015

Eastern Printing PLC (EPCO)

Company Rating:	BBB-
Rating Outlook:	Stable

TRIS Rating Co., Ltd.
Silom Complex Building, 24th Floor, 191 Silom Road, Bangkok 10500, Thailand Tel: 0-2098-3000