TRIS RATING
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GUNKUL ENGINEERING PLC

No. 22/2020
9 March 2020

CORPORATES

Company Rating:	BBB
Issue Rating:	
Senior unsecured	BBB-
Outlook:	Positive

Last Review Date: 21/03/19

Company Rating History:

Date	Rating	Outlook/Alert
11/04/17	BBB	Stable

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RATIONALE

TRIS Rating affirms the company rating on Gunkul Engineering PLC (GUNKUL) at "BBB" and also affirms the ratings on GUNKUL's senior unsecured debentures at "BBB-". The issue rating's one notch below the company rating reflects the ratio of the company's secured debt to total assets exceeding 20%, a threshold level under TRIS Rating's rating criteria.

At the same time, TRIS Rating revises the rating outlook of GUNKUL to "positive" from "stable" to mirror a steady rise in its operating cash flow, which will strengthen its debt serviceability.

The ratings reflect GUNKUL's strong competitive edge in the electrical equipment business, benefits from vertical integration, predictable cash flows from the power business, and satisfactory performance of operating power plants. However, the ratings are tempered by the execution risks of the power projects, concerns over rapid expansion of the engineering, procurement, and construction (EPC) business, and a potential rise in leverage.

KEY RATING CONSIDERATIONS

Improved cash flows against debt

GUNKUL's cash flows have increased steadily over the past few years, with a series of renewable power projects starting operations one after another. The first two projects in Japan, Sendai and Kimitsu, commenced commercial operations as planned, bringing in sizable cash flows. As a result, EBITDA (earnings before interest, taxes, depreciation, and amortization) soared to Bt4.3 billion in 2019. Given our base case forecast, EBITDA will grow further, ranging between Bt4.5-Bt5 billion per year over the next three years.

Cash flows in relation to debt have improved significantly as the power projects are paying off. The ratio of debt to EBITDA should rise from 4.3 times in 2019 due to further investments. However, the ratio will likely hover around 6 times, compared with 8 times in our previous forecast. Over the next three years, we do not expect GUNKUL to spend so heavily that its financial profile deteriorates significantly. Funds from operations (FFO) should stay at about Bt3.2 billion per annum, while the ratio of FFO to debt should stay above 10% during 2020-2022.

Satisfactory performance of operating power plants

TRIS Rating views that GUNKUL's experience in developing and operating power projects will keep the performance of the power business satisfactory.

The company's record of operating power projects is proven. During the last three years, the annual output of the solar power plants, in all, has reached the initial estimates based on P50 (the energy production which reaches a probability of 50%). The output of the wind power plants has reached an acceptable level of P75. The EBITDA margin (as percentage of revenue) of the solar power and wind power plants held at satisfactory levels of above 80%.

Predictable cash flows from power business

The ratings incorporate the low risk nature of the power business, which should continue to be the centerpiece of GUNKUL's operating performance. The power business provides predictable cash flows, derived from low operational risk and minimal payment risk.

In addition, GUNKUL owns more than 100 power generating facilities in diverse locations, which helps reduce reliance on the performance of one or just a few projects. At the end of January 2020, the company had mustered an aggregate equity capacity (or contracted capacity in proportion to its ownership stakes in the power plants) of 625 megawatts (MWe), including two new solar projects in Vietnam. Solar power remains the majority of GUNKUL's power-generating assets (455 MWe). Solar power has proven to yield predictable power outputs and reliable cash flows.

Most of GUNKUL's power plants have multi-year power purchase agreements (PPAs) with state-owned power utilities. The payment risk of the power buyers is minimal. GUNKUL recently moved towards selling electricity to the private sector. The private PPAs generally entail higher payment risk. However, the capacity under this scheme makes up less than 10% of the company's total capacity. Moreover, most of the private power buyers are also large companies with acceptable credit profiles.

Strong competitive edge in electrical equipment business

GUNKUL is a key market player in its original business of trading and manufacturing of electrical equipment. With an extensive range of products covering all stages of the transmission and distribution of electricity, the company has served both public and private sector clients for more than three decades. A long track record and a wide range of products underpin its competitiveness. The electrical equipment segment has an average gross margin of about 31% over the past four years, suggesting a fairly stable profitability.

GUNKUL continues to benefit from business integration, as its three existing businesses are complementary in nature. As an EPC power plant contractor and a supplier of electrical equipment, the company can provide one-stop service to project owners, which helps increase sales of electrical equipment. It can also better control the construction costs of the power plants.

Execution risks associated with power projects

GUNKUL is currently developing two large-scale solar farms in Japan, the Utsunomiya and Iwakuni projects, with a combined capacity of 142 MWe. These two projects require hefty investments of approximately Bt16 billion and take 3-4 years to complete. The long construction period may result in unexpected costs and cost overruns, which could hurt returns on investments. TRIS Rating believes GUNKUL will be able to handle the construction risk. The risk is partially mitigated by terms and conditions under the EPC contracts. Last year, we expressed concerns that the Iwakuni project could obtain much lower feed-in-tariff (FIT). However, the company managed to meet the deadline of grid connection approval. As a result, the tariff rate on this project remains at JPY32 per kilowatt hour (kWh).

Larger exposure overseas

GUNKUL recently acquired a nearly 100% stake in two solar projects located in Tay Ninh, Vietnam. The two projects (60 MWe) started operations in May 2019. The projects in Vietnam generally carry higher risks than those in Japan, due to the higher regulatory and counter party risks. TRIS Rating views that the credit profile of the state-run Vietnam Electricity (EVN) is not as strong as the state-owned power buyers in Thailand. Additionally, the national power grid in some provinces is currently facing overcapacity.

That said, the risks associated with the projects in Vietnam are acceptable. The two solar projects are located in low risk areas of curtailments. Outputs from both projects have not been curtailed since commercialization. The outputs have reached the initial estimates based on P50. In addition, investments in Vietnam currently represent less than 5% of GUNKUL's total assets.

EPC business to drive revenue growth, but could weaken financial profile

In 2018, GUNKUL acquired shares of Future Electrical Control Co., Ltd. (FEC) in an attempt to grow its EPC business. In 2019, GUNKUL, in collaboration with a local partner, won bids for two large underground cable projects, boosting its backlog to hit a record high of almost Bt8 billion. The sizable backlog should drive revenue growth of the EPC business considerably over the coming years. TRIS Rating forecasts the EPC business to bring in Bt2-Bt4 billion in revenue per annum during 2020-2022, up from below Bt2 billion per annum during the last three years. As a result, GUNKUL's total revenue is forecast to hover around Bt10 billion per annum.

On the contrary, an expansion of the EPC business could pose downside risks, such as construction delays and squeezed margins resulting from competitive bidding. Larger construction contracts will also challenge the company's cost controls as well as working capital management. The EPC business typically renders inferior margins to the power business. As we expect revenue contribution from the EPC business to increase, GUNKUL's overall profitability should drop. However, the EBITDA margin should remain high, ranging between 45%-50% during 2020-2022.

Leverage on the rise

The ratings are weighed down by a debt-heavy structure, particularly during expansion. GUNKUL is about to reach financial close on the Kimitsu project. The respective project loans will be drawn to pay off the EPC contractor, resulting in a rise in leverage. The expansion in the EPC business should also raise debts due to a rise in working capital needs.

At of the end of 2019, adjusted total debt stood at Bt22.8 billion and the debt to capitalization ratio stood at 61.7%. Given our base case forecast, adjusted total debt should reach Bt36.6 billion and the debt to capitalization ratio should reach about 70% over the next three years.

Liquidity stays firm

Liquidity should be manageable despite the lingering high debt levels. Debts of about Bt3.4 billion will come due in 2020. As of December 2019, GUNKUL had undrawn credit facilities, plus cash and marketable securities, of about Bt4.6 billion, which should be sufficient to cover the debts coming due. The company plans to refinance the debentures worth Bt1 billion coming due in 2020 with new debentures.

A key financial covenant in GUNKUL's debentures requires the net interest-bearing debt to equity ratio to stay below 3 times. GUNKUL was in compliance with this key financial covenant as the ratio at the end of 2019 was about 1.9 times. TRIS Rating believes the company will stay in compliance at least in the next 12-18 months.

BASE-CASE ASSUMPTIONS

- Contracted capacity of operating power plants to reach 700-800 MWe in the next three years.
- Total operating revenues to range between Bt9-Bt11 billion.
- EBITDA margin to range between 45%-50%.
- Capital spending during 2020-2022 will total Bt18.2 billion.

RATING OUTLOOK

The "positive" outlook embeds our expectation that GUNKUL will deliver operating performance as expected, leading to a larger cash flow base and strengthened debt serviceability.

RATING SENSITIVITIES

A rating upgrade could happen if the performance of solar and wind power projects remains satisfactory and the electrical equipment business remains on a solid ground. Besides, the EPC business should perform well as the company expects. In addition, the debt to EBITDA ratio will stay at around 6 times for a sustained period.

The ratings and/or outlook could be revised downward if GUNKUL's financial profile deteriorates materially. This could arise if the performance of the power projects falls short of the initial estimates or respective guidance, or GUNKUL invests aggressively with huge debt financing, or the rapid expansion of the EPC business takes a toll on the company's performance.

COMPANY OVERVIEW

GUNKUL was founded in 1982 by Mr. Gunkul Dhumrongpiyawut as a provider of electrical equipment. The company expanded into the EPC business and the power business in 2010. It was listed on the Stock Exchange of Thailand (SET) in 2010. As of January 2020, the Dhumrongpiyawut family remained the major shareholder, holding approximately 53% of the company's interest.

The company is one of the first movers in the renewable power business, as it started to develop 57-megawatt (MW) solar power projects in 2010. The company recently succeeded in developing the first two solar projects in Japan, Sendai and Kimitsu. Both of the projects have performed satisfactorily since commercialization.

In all, the power business accounted for the majority, or 63%, of GUNKUL's total revenue in 2019, followed by the electrical equipment business (22%) and the EPC business (14%).

As of January 2020, GUNKUL's aggregate capacity was 625 MWe across 108 solar power projects (455 MWe) and five wind power projects (170 MWe). The operating power plants consisted of 275 MWe solar power projects and 170 MWe wind power projects.

KEY OPERATING PERFORMANCE

Table 1: Revenue Breakdown

Unit: %

	2015	2016	2017	2018	2019
Electrical equipment	85	42	25	22	22
EPC	13	28	41	30	14
Power	0	27	32	47	63
Others	2	3	2	1	1
Total	**100**	**100**	**100**	**100**	**100**
Total revenue (Bt million)	**4,460**	**3,209**	**4,767**	**6,230**	**7,099**

Source: GUNKUL

Table 2: Power Project Portfolio

Company/Country	Held by GUNKUL (%)	No. of Project	Gross Contracted Capacity (MW)	Equity Contracted Capacity (MWe)	Tariff
Solar Projects					
GPS	40	4	26.0	10.4	Adder
GCPG	51	6	30.9	15.8	Adder
RNS	67	11	87.0	87.0	Fit
SES	100	55	40.5	40.5	Fit/elec bill.
Japan	100	4	207.0	207.0	Fit
Malaysia	49	1	30.0	14.7	Fit
Vietnam	100	2	60.0	60.0	Fit
Others	-	25	29.0	19.9	Adder/Fit
Sub total - Solar	**-**	**108**	**510.4**	**455.3**	
Wind Projects					
WED	100	3	60.0	60.0	Adder
GNP	100	1	60.0	60.0	Adder
KWE	100	1	50.0	50.0	Adder
Sub total - Wind	-	**5**	**170.0**	**170.0**	
Grand total	-	**113**	**680.4**	**625.3***	

* *Excluding the gas engine power project in Myanmar*

Source: GUNKUL

FINANCIAL STATISTICS AND KEY FINANCIAL RATIOS*

Unit: Bt million

	Year Ended 31 December				
	2019	2018	2017	2016	2015
Total operating revenues	7,157	6,447	4,867	3,283	4,547
Earnings before interest and taxes (EBIT)	3,186	2,682	1,478	988	925
Earnings before interest, taxes, depreciation, and amortization (EBITDA)	4,252	3,382	1,861	1,229	927
Funds from operations (FFO)	3,288	2,374	1,138	748	675
Adjusted interest expense	923	905	631	440	116
Capital expenditures	776	6,303	4,716	7,697	5,919
Total assets	39,042	35,625	30,726	25,596	18,815
Adjusted debt	18,228	20,585	14,269	9,646	3,255
Adjusted equity	11,333	9,500	10,184	9,749	8,590
Adjusted Ratios					
EBITDA Margin (%)	59.41	52.47	38.23	37.44	20.38
Pretax return on permanent capital (%)	9.42	8.85	5.87	5.05	8.58
EBITDA interest coverage (times)	4.61	3.74	2.95	2.80	7.96
Debt to EBITDA (times)	4.29	6.09	7.67	7.85	3.51
FFO to debt (%)	18.04	11.53	7.98	7.76	20.74
Debt to capitalization (%)	61.66	68.42	58.35	49.73	27.48

* *Consolidated financial statements*

RELATED CRITERIA

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

Gunkul Engineering PLC (GUNKUL)

Company Rating:	BBB
Issue Rating:	
GUNKUL214A: Bt1,819 million senior unsecured debentures due 2021	BBB-
Rating Outlook:	Positive

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