TRIS RATING
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CreditNews ข่าวเครดิต

GUNKUL ENGINEERING PLC

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CORPORATES

Company Rating: BBB
Issue Ratings:
Senior unsecured BBB-
Outlook: Stable

Last Review Date: 27/04/18

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". At the same time, TRIS Rating affirms the ratings on GUNKUL's senior unsecured debentures at "BBB-". The issue ratings with one notch below the company rating reflect the ratio of the company's secured debt to total assets exceeding 20%, a threshold level under TRIS Rating's rating criteria.

The ratings reflect GUNKUL's strong competitive edge in providing electrical equipment, benefits from vertical integration, satisfactory performance of operating power plants, and predictable cash flows from the power segment. However, the ratings are constrained by the execution risks associated with the power projects and a looming rise in leverage.

KEY RATING CONSIDERATIONS

Strong competitive edge in electrical equipment segment

TRIS Rating believes GUNKUL will keep its position as a key market player in its primary business, the trade and manufacture of electrical equipment. The company has provided both public and private sector clients with an extensive range of products covering all stages of the transmission and distribution of electricity for more than three decades. The long track record and wide range of products create competitiveness. The gross margin of the electrical equipment segment has been fairly stable, with a three-year average of about 30%. The strong primary business has helped GUNKUL keep profits at acceptable levels during its expansion to other businesses.

Vertical integration strengthens business

GUNKUL benefits from business integration as its three existing businesses are complementary in nature. On the strength of its primary business, the trade and manufacture of electrical equipment, in 2010, GUNKUL expanded into the engineering, procurement, and construction (EPC) business and the power business. As an EPC power plant contractor and a supplier of electrical equipment, GUNKUL can provide one-stop service to project owners, which helps increase sales of electrical equipment, albeit indirectly. It can also better control the construction costs of the power plants.

Limited scope of construction work

GUNKUL's scope of construction work is limited, as most of its construction contracts are turnkey projects for solar power plants in Thailand. The limited scope of work is a constraint on growth of the EPC segment. The recent acquisition of the shares of Future Electrical Control Co., Ltd. (FEC) enables GUNKUL to expand into the construction of overhead transmission line systems, underground cable systems, and substations. However, TRIS Rating does not expect enormous growth in the construction segment due to intensified competition.

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 segment satisfactory. 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. GUNKUL has recently expanded its power portfolio, composed of solar and wind power projects. It aims to add new capacity of about 150 MW per annum over the next three years.

GUNKUL's record of operating power projects is proven. Performance has been satisfactory at the solar power plants. During the last three years, the actual annual output of the solar plants, in all, has reached the initial estimates based on P50 (the energy production which is reached with a probability of 50%). The output of the wind power plants has reached an acceptable level of P75. Performance at the wind power plants has varied widely due to fluctuations in wind speed. During 2016-2018, the EBITDA margin (earnings before interest, taxes, depreciation, and amortization as percentage of revenue) of the solar power plants held above 80%, while the EBITDA margin of the wind power plants held above 90%. The average tariff rate of the wind power projects is higher than that of the solar power projects. Also, wind power can produce electricity at night, in contrast to solar power. As a result, the EBITDA margin of the wind power plants has stayed higher than that of the solar power plants.

Predictable cash flows from power segment

The ratings are buoyed by an acceptable risk in the power segment, which is currently the center piece of GUNKUL's operating performance. The power segment provides predictable cash flows, derived from minimal payment risk and low operational risk.

Most of the company's power plants have multi-year power purchase agreements (PPAs) with the state-owned producers and distributors of electricity, namely the Electricity Generating Authority of Thailand (EGAT), the Metropolitan Electricity Authority (MEA), and the Provincial Electricity Authority (PEA). EGAT and PEA are rated "AAA" by TRIS Rating. Therefore, the payment risk of the power buyers is minimal. GUNKUL has recently moved towards selling electricity to the private sector, in addition to the state utilities. The private PPAs generally carry higher payment risk. However, the capacity under this scheme makes up merely about 5% of the company's total capacity. Most of the private power buyers are also large companies with acceptable credit profiles.

The power segment contains low operational risk as solar power currently makes up the majority (about 70%) of GUNKUL's portfolio in terms of capacity. Solar power has proven to yield predictable power output and reliable cash flow.

Execution risks associated with power projects

GUNKUL continues to face execution risks because it has some sizable power projects under construction and in the development phase. The key projects are three overseas solar power projects, one in Malaysia and two in Japan. The solar power project in Malaysia has a contracted capacity of about 30 MW. It is a joint venture project between GUNKUL and a local partner. GUNKUL, as an equity partner, will inject Bt209 million in this project. GUNKUL expects this project will commence operations by the end of 2019.

The larger-scale projects are Utsunomiya and Iwakuni, with a combined contracted capacity of 142 MW. The two solar power projects in Japan require investments worth nearly Bt18 billion and take about four years to develop and build. The long development period may result in unexpected costs and cost overruns, which could hurt the returns on the investments. GUNKUL is also exposed to downside risks on tariff rates. The feed-in-tariff (FIT) rate on the Iwakuni project may be slashed to JPY21 per kilowatt hour (kWh), from JPY32 per kWh, unless the company obtains approval for grid connection prior to 31 August 2019. TRIS Rating's base case forecast assumes GUNKUL will meet the deadline.

Revenue keeps growing, while profitability stays firm

GUNKUL is on a growth path, bolstered by the power segment. In TRIS Rating's three-year forecast, total operating revenue will reach Bt7.5 billion in 2021, rising from Bt6.5 billion in 2018. We assume the company will add about 260 MW in operating capacity over the next three years. As a result, revenue from the power segment will jump to Bt4.4 billion in 2021, from Bt2.9 billion in 2018. Revenue from the electrical equipment segment, plus revenue from the EPC segment, should vary between Bt2-Bt3 billion per annum over the next three years.

TRIS Rating forecasts the operating margin (operating income before depreciation and amortization as a percentage of total operating revenue) will stay above 50% over the next three years. The power segment, which carries superior returns, will keep the operating margin firm. The operating margin of the power segment should continue to range between 80%-90% while those of the other segments should range between 10%-20%. EBITDA is likely to reach Bt4 billion by 2021, rising from Bt3.4 billion in 2018.

Leverage on the rise

The ratings are weighed down by a debt-heavy structure. The level of leverage should increase further, considering the projects in the pipeline and the target to increase capacity. In our base case, GUNKUL's capital expenditures will range between Bt5-Bt7 billion per annum over the next three years. As a result, the debt to capitalization ratio will rise to 72.4% in 2021, from 68.4% in 2018. As debt grows faster than earnings, cash flow in relation to debt will drop. We project the ratio of funds from operations (FFO) to debt will fall to 8.4% in 2021, from 12% in 2018. The ratio of debt to EBITDA will reach 8 times in 2021, up from 6.1 times in 2018. The declining cash flow in relation to debt during the build-up phase puts a lid on the ratings.

Liquidity should be manageable despite the lingering high debt level. Debts of about Bt6.6 billion will come due in 2019. As of December 2018, GUNKUL had undrawn credit facilities, plus cash and marketable securities, of about Bt7.6 billion, which should be sufficient to cover the debts coming due.

Less room to meet financial covenants

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 because the ratio at the end of 2018 was about 2.5 times. However, a number of large investments ahead could preclude the company from complying with the financial covenant in the next three years. TRIS Rating believes the company will stay in compliance at least in the next 12-18 months. GUNKUL should manage its equity base well to attain enough headroom.

BASE-CASE ASSUMPTIONS

- Aggregate contracted capacity of operating power plants will reach 630 MW in the next three years, from about 370 MW as of December 2018.
- Total operating revenues will rise to Bt7.5 billion in the next three years.
- Operating margin will stay above 50%.
- Total capital spending will range between Bt5-Bt7 billion per annum.

RATING OUTLOOK

The "stable" outlook reflects TRIS Rating's expectation that GUNKUL's solar and wind power plants will perform satisfactorily and generate sizable cash flows as planned. The company is also expected to successfully execute the projects under construction and earn satisfactory returns. Its primary business as a supplier of electrical equipment is expected to remain on solid ground.

RATING SENSITIVITIES

A rating upside is limited during a large expansion. However, it could occur if GUNKUL's operating performance and capital structure are significantly stronger than expectations. On the contrary, the ratings could be lowered if the performance of the power projects falls short of the initial estimates or the respective guidance, or the capital structure deteriorates due to the failure to generate sufficient cash flows, or aggressively debt-funded investments, or cost overruns.

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 December 2018, the Dhumrongpiyawut family remained the major shareholder, holding approximately 54% of the company's interest.

The power segment accounted for the majority, or nearly half of GUNKUL's total revenue in 2018, followed by the EPC segment (30%) and the electrical equipment segment (22%).

As of December 2018, GUNKUL's aggregate capacity was 597 MW, across 71 solar power projects (427 MW) and five wind power projects (170 MW). The operating power plants consist of 35 solar power projects (196 MW) and five wind power projects (170 MW). The remainder, or 231 MW, comprises 36 solar power projects which are in the construction and development stages.

KEY OPERATING PERFORMANCE

Table 1: Revenue Breakdown

	2014	2015	2016	2017	2018
Electrical equipment	50%	85%	42%	25%	22%
Construction	47%	13%	28%	41%	30%
Power projects	1%	0%	27%	32%	47%
Others	2%	2%	3%	2%	1%
Total	**100%**	**100%**	**100%**	**100%**	**100%**
Total revenue (Bt million)	**2,977**	**4,460**	**3,209**	**4,767**	**6,230**

Source: GUNKUL

Table 2: Power Project Portfolio

Company/Country	Hold by GUNKUL	No. of Projects	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	58.3	Fit
SES	100%	34	26.7	26.7	Fit/elec bill.
Japan	100%	4	207.0	207.0	Fit
Malaysia	49%	1	30.0	14.7	Fit
Others	-	11	19.1	9.9	Adder/Fit
Sub total - Solar	**-**	**71**	**426.6**	**342.8**	
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	-	**76**	**596.6**	**512.8***	

* *Excluding the gas engine power project in Myanmar*

Source: GUNKUL

FINANCIAL STATISTICS AND KEY FINANCIAL RATIOS*

Unit: Bt million

	------------------- Year Ended 31 December -------------------				
	2018	**2017**	**2016**	**2015**	**2014**
Total operating revenues	6,447	4,867	3,283	4,547	3,035
Operating income	3,308	1,637	921	638	413
Earnings before interest and taxes (EBIT)	2,682	1,478	988	925	683
Earnings before interest, taxes, depreciation, and amortization (EBITDA)	3,382	1,861	1,229	927	632
Funds from operations (FFO)	2,467	1,138	748	675	490
Adjusted interest expense	812	631	440	116	58
Capital expenditures	6,303	4,716	7,697	5,919	322
Total assets	35,625	30,726	25,596	18,815	7,239
Adjusted debt	20,585	14,269	9,646	3,255	740
Adjusted equity	9,500	10,184	9,749	8,590	3,360
Adjusted Ratios					
Operating income as % of total operating revenues (%)	51.31	33.64	28.06	14.02	13.60
Pretax return on permanent capital (%)	8.85	5.87	5.05	8.58	14.57
EBITDA interest coverage (times)	4.17	2.95	2.80	7.96	10.83
Debt to EBITDA (times)	6.09	7.67	7.85	3.51	1.17
FFO to debt (%)	11.98	7.98	7.76	20.74	66.21
Debt to capitalization (%)	68.42	58.35	49.73	27.48	18.06

* *Consolidated financial statements*

RELATED CRITERIA

- Key Financial Ratios and Adjustments, 5 September 2018
- Rating Methodology – Corporate, 31 October 2007

Gunkul Engineering PLC (GUNKUL)

Company Rating:	BBB
Issue Ratings:	
GUNKUL19OB: Bt1,265.50 million senior unsecured debentures due 2019	BBB-
GUNKUL214A: Bt1,819 million senior unsecured debentures due 2021	BBB-
Rating Outlook:	Stable

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