TRIS RATING
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GUNKUL ENGINEERING PLC

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CORPORATES

Company Rating:	BBB+
Outlook:	Stable

Last Review Date: 17/03/21

Company Rating History:

Date	Rating	Outlook/Alert
17/03/21	BBB+	Stable
09/03/20	BBB	Positive
11/04/17	BBB	Stable

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RATIONALE

TRIS Rating affirms the company rating on Gunkul Engineering PLC (GUNKUL) at "BBB+" with a "stable" outlook. The rating mirrors the reliability of earnings from the power business, GUNKUL's competitive strengths in the electrical equipment business, and merits from vertical integration. However, the rating is tempered by the more challenging environment of the power industry and associated risks of non-power businesses. The rating also recognizes the execution risks of the company's new ventures in the hemp and cannabis business.

KEY RATING CONSIDERATIONS

Reliability of earnings from power business

The rating is primarily built on the reliability of cash flows from GUNKUL's power business, which is the centerpiece of its earnings and investment. GUNKUL owns more than a hundred solar and wind power generating facilities in diverse locations, marking its low reliance on the performance of just one or a few projects. Currently, GUNKUL's aggregate equity capacity (or contracted capacity in proportion to its ownership stakes in the power plants) totals 640 megawatts (MWe).

Solar power continues to make up the majority of GUNKUL's power-generating assets, representing nearly 75% of the total capacity. Given its low operational risk, solar power has proven to generate highly predictable power outputs and reliable cash flows. GUNKUL's power business is subject to minimal payment risk. Most of its power plants have multi-year power purchase agreements (PPAs) with state-owned power utilities.

GUNKUL has also attained growth in its solar rooftop electricity generation that sells electricity to industrial customers under private PPAs. Most of the private power buyers are companies with acceptable credit profiles. As of December 2021, the capacity under this scheme made up about 15% of total capacity.

Higher country risk of overseas investment

GUNKUL has expanded its footprint outside Thailand. The company has invested in four solar farms in Vietnam, which altogether make up around one-fourth of the total capacity, or 160 MWe. The investments in Vietnam represent about 10% of the company's total assets.

Despite the country's fast-growing demand for electricity, investments in Vietnam carry higher country risk. In addition, we view the credit profile of the state-run Vietnam Electricity (EVN) as not being as strong as the state-owned power buyers in Thailand.

Power plants to continue meeting expectations

During the past three years, the annual output of the solar power portfolio has achieved the initial estimates based on P50 (the energy production which reaches a probability of 50%). Meanwhile, output of the wind power plants has reached the P75 level.

We expect GUNKUL's operating power plants will consistently meet their respective expectations. In our base-case forecast, we project the EBITDA margin (earnings before interest, taxes, depreciation, and amortization as a percentage of revenue) of the solar power and wind power plants to stay at satisfactory levels of above 80% over the next three years.

More challenging business environment

In our view, the domestic power market has become more challenging. Competition has mounted in recent years in the wake of the government's decentralized power policy to tighten electricity costs. Private companies, ranging from very small entrepreneur to large conglomerates, have branched into the power market.

While demand for power has tended to grow modestly due to the pandemic-induced slowdown, the country is currently saddled with a high excess reserve of capacity. Thai power companies are leaning towards investments outside Thailand. However, some overseas expansions entail higher country risk stemming from transparency and consistency of regulations, credit profiles of off-takers, and environmental challenges. Added to that, several power companies are also diversifying into non-power businesses, which generally exposes them to higher risks.

Competitive strengths in electrical equipment business

With respect to the trading and manufacturing of electrical equipment, we expect GUNKUL to remain competitive despite the competition having intensified and eroded the company's gross margin in recent years. GUNKUL's competitive edges are derived from its extensive range of products covering all stages of the transmission and distribution of electricity. It has served both public and private sector clients for more than three decades. Our base-case forecast projects the electrical equipment business will bring in about THB1.5 billion in revenue per annum during 2022-2024.

Vertical integration strengthens business

We also expect GUNKUL to continue benefiting from business integration as its three existing businesses, electrical equipment, engineering, procurement, and construction (EPC), and power, are complementary in nature. As an EPC contractor and supplier of electrical equipment, GUNKUL is well-positioned to offer one-stop services to project owners, helping increase sales of electrical equipment. It can also better control project construction costs.

EPC business expansion

We believe GUNKUL will keep building its record of construction works, alongside its plan to file for the listing of its subsidiary engaging in EPC. We project revenue from its EPC business to grow, propelled by potential public power infrastructure projects, such as power substations, the relocation of overhead transmission lines and telecom cables underground.

As of December 2021, GUNKUL's backlog stood at about THB3.2 billion. We project the EPC business should bring in THB2-THB3 billion in revenue per annum during 2022-2024, up from about THB2 billion per annum during 2020-2021. However, earnings from the EPC business are more volatile, given the multiple risks involved, such as severe competition, delays in bidding and awarding of contracts, as well as unforeseeable hold ups and cost overruns. Larger construction contracts will also challenge the company's cost controls and working capital management. The EPC business typically provides inferior margins to the power business.

New ventures in hemp and cannabis business

GUNKUL is investing in new ventures for hemp and cannabis plantation and production. The company is currently planting hemp to produce upstream and midstream products, such as dry flower, full spectrum cannabidiol (CBD), and CBD isolate. GUNKUL uses vacant land in a wind power project for hemp plantation and CBD-extracting facilities. It expects to harvest about 1,100 kilograms of dry flower per day in 2022, the first year of operation.

In addition, GUNKUL has recently acquired a 50% stake in THCG Group Co., Ltd. (THCG). THCG has about 2 years of experience in hemp and cannabis production, and it has a sales contract for dry flower with the Government Pharmaceutical Organization (GPO). THCG is also developing a wide range of CBD-based products.

Risks associated with new ventures

GUNKUL views hemp and cannabis products to have high growth potential thanks to emerging demand in both local and overseas markets. However, the new business is subject to an array of execution risks. In its early stage of development, regulatory permits are still pending, and specific cultivation techniques and know-how are needed to attain satisfactory plantation results. The company aims to focus on premium-grade products which involve meticulous production processes. Moreover, the company has yet to firmly establish the market base.

Notwithstanding the associated risks, GUNKUL's capital spending on the hemp and cannabis business is expected to be about THB2 billion, accounting merely for 4%-5% of total assets. The tally of investment should not pressure GUNKUL's financial profile over the next three years. The performance of the new ventures remains to be seen over the long-term. In the absence of track record, we conservatively project the new ventures to add THB0.4-THB2 billion in revenue per annum during 2022-2024.

Revenue and earnings to keep growing

In our base case, we project GUNKUL's revenue will increase further. The power business should remain the key contributor. We expect the company's power plants to gross THB5-THB5.5 billion in annual revenue during 2022-2024. We anticipate the growth driver to come mainly from new solar private PPA projects in Thailand. Our base-case forecast assumes GUNKUL to secure a total of about 150 MWe in new solar rooftop power generation during 2022-2024, boosting the aggregate capacity of its power projects to about 800 MWe. We exclude any potential acquisitions of operating projects due to uncertainties. Combined with revenues from the other businesses, the company's total operating revenue and EBITDA is projected to reach THB12 billion and THB5.5 billion, respectively, in 2024. Its EBITDA margin should stay between 40%-50% during 2022-2024.

Debt serviceability to stay firm

We expect GUNKUL's debt serviceability to remain sound over the next three years. As the company tends to focus on developing projects with short development periods, such as solar private PPAs, and acquiring projects which are already in operation or about to operate, the company could instantly reap benefits from the investments. We view GUNKUL's current earnings base will also help support expansion in case of greenfield investments.

Our base-case projection assumes annual capital expenditure will range between THB1.5-3 billon during 2022-2024. Its debt to EBITDA ratio will likely hover around 5 times and its debt to capitalization ratio should range between 60%-70% over the forecast period.

Debt structure

As of December 2021, GUNKUL's consolidated debt was about THB24.7 billion, of which THB17.2 billion was priority debt, comprising secured debt owed by GUNKUL and all borrowings incurred by its operating subsidiaries. The priority debt to total debt ratio was 69%, suggesting that GUNKUL's unsecured creditors are significantly disadvantaged to its priority debt holders with respect to claims against the company's assets.

Liquidity remains manageable

We expect GUNKUL to continue to manage its liquidity properly. Debts of about THB6.2 billion will mature in 2022. As of December 2021, the company had undrawn credit facilities, plus cash and marketable securities, of about THB9 billion. This should be sufficient to cover the repayments coming due. GUNKUL plans to refinance debentures worth about THB2.8 billion that will mature in July 2022 with an issuance of debentures and/or new bank loans.

A key financial covenant on GUNKUL's debentures requires the company's net interest-bearing debt to equity ratio to stay below 3 times. As of December 2021, the ratio was at 1.8 times. We believe the company will stay compliant with the covenant over the forecast period.

BASE-CASE ASSUMPTIONS

- Contracted capacity of power plants to reach 800 MWe in the next three years.
- GUNKUL to secure new EPC contracts for THB2 billion per year during 2022-2024
- Total operating revenues to reach THB12 billion in 2024.
- EBITDA margin to range between 40%-50%.
- Annual capital spending to range between THB1.5-THB3 billion per year.

RATING OUTLOOK

The "stable" outlook embeds our expectation that GUNKUL's power plants, as the core earnings drivers, will perform satisfactorily and generate sizable and stable cash flows as planned, and that its other businesses will also deliver decent results over the forecast period. We expect its earnings and debt serviceability metrics will be in line with our estimates.

RATING SENSITIVITIES

A rating upgrade could occur if GUNKUL's earnings, cash generation against debt, and capital structure improve significantly. The power business remains its core cash generator. In contrast, a downward revision to the rating could develop if GUNKUL's financial profile deteriorates materially. This could arise if the performance of the power generation assets significantly falls short of initial estimates or respective guidance or if the company invests aggressively with huge debt financing.

COMPANY OVERVIEW

GUNKUL was founded in 1982 by Mr. Gunkul Dhumrongpiyawut as a provider of electrical equipment. In 2010, the company expanded into the EPC business and the power business and was also listed on the Stock Exchange of Thailand (SET) in the same year. As of January 2022, the Dhumrongpiyawut family remained the major shareholder, holding 52.5% of the company's interest.

The company was one of the first movers in the renewable power business, as it started to develop solar power projects of 57 MWe in 2010. The power business accounted for the majority, or 51%, of GUNKUL's total revenue in 2021, followed by the EPC business (30%) and the electrical equipment business (16%).

In the power business, GUNKUL currently holds an aggregate equity capacity of 640 MWe, comprising 136 solar power projects (470 MWe) and five wind power projects (170 MWe). The operating power plants consist of 387 MWe solar power projects and 170 MWe wind power projects.

In the EPC business, GUNKUL's construction works mainly comprise electrical substations, solar rooftops, and underground cables. Through the trading and manufacture of its electrical equipment business, GUNKUL provides both public and private sector clients with an extensive range of products covering all stages of the transmission and distribution of electricity.

In 2021, GUNKUL unveiled its new ventures into the hemp and cannabis business. The company is currently planting hemp to produce upstream and midstream products, such as dry flower, full spectrum CBD, and CBD isolate. In addition, the company has acquired a 50% stake in THCG. THCG has about 2 years of experience in hemp and cannabis production and a sales contract for dry flower with GPO. THCG is also developing a wide range of CBD-based products.

KEY OPERATING PERFORMANCE

Table 1: Revenue Breakdown

Unit: %

	2017	2018	2019	2020	2021
Electrical equipment	25	22	22	17	16
EPC	41	30	14	34	30
Power	32	47	63	47	51
Hemp and cannabis	-	-	-	-	-
Others	2	1	1	2	3
Total	**100**	**100**	**100**	**100**	**100**
Total revenue (million THB)	**4,767**	**6,230**	**7,099**	**8,649**	**9,318**

Source: GUNKUL

Table 2: Power Project Portfolio (as of Dec 2021)

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 and GIG	100	97	96.6	96.6	FiT/Elec. Bill
Japan	100	2	65.3	65.3	Fit
Malaysia	70	1	30.0	21.0	Fit
Vietnam	100	4	160.0	160.0	Fit
Others	25-100	11	19.0	14.1	Adder/FiT
Sub total - Solar		**136**	**514.7**	**470.1**	
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		**141**	**684.7**	**640.1**	

Source: GUNKUL

FINANCIAL STATISTICS AND KEY FINANCIAL RATIOS*

Unit: Mil. THB

	---------------------Year Ended 31 December --------------------				
	2021	2020	2019	2018	2017
Total operating revenues	9,380	8,727	7,157	6,447	4,867
Earnings before interest and taxes (EBIT)	3,165	2,235	3,186	2,682	1,478
Earnings before interest, taxes, depreciation, and amortization (EBITDA)	4,706	3,714	4,252	3,382	1,861
Funds from operations (FFO)	3,577	2,734	3,286	2,320	1,138
Adjusted interest expense	973	915	923	905	631
Capital expenditures	3,017	3,505	776	6,303	4,716
Total assets	42,485	46,032	39,042	35,625	30,726
Adjusted debt	21,627	21,155	18,228	20,585	14,269
Adjusted equity	13,283	12,475	11,333	9,500	10,184
Adjusted Ratios					
EBITDA margin (%)	50.17	42.55	59.41	52.47	38.23
Pretax return on permanent capital (%)	7.98	6.01	9.42	8.85	5.87
EBITDA interest coverage (times)	4.84	4.06	4.61	3.74	2.95
Debt to EBITDA (times)	4.60	5.70	4.29	6.09	7.67
FFO to debt (%)	16.54	12.93	18.03	11.27	7.98
Debt to capitalization (%)	61.95	62.90	61.66	68.42	58.35

* *Consolidated financial statements*

RELATED CRITERIA

- Key Financial Ratio and Adjustments for Corporate Issuers, 11 January 2022
- Issue Rating Criteria, 15 June 2021
- Rating Methodology – Corporate, 26 July 2019

Gunkul Engineering PLC (GUNKUL)

Company Rating:	BBB+
Rating Outlook:	Stable

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