SAHAKOL EQUIPMENT PLC

No. 86/2022
30 May 2022

CORPORATES

Company Rating: BBB-
Outlook: Stable

Last Review Date: 11/06/21

Company Rating History:

Date	Rating	Outlook/Alert
11/06/21	BBB-	Stable
22/06/20	BBB-	Negative
08/06/18	BBB-	Stable

Contacts:

Auyporn Vachirakanjanaporn
auyporn@trisrating.com

Rapeepol Mahapant
rapeepol@trisrating.com

Parat Mahuttano
parat@trisrating.com

Suchada Pantu, Ph.D.
suchada@trisrating.com

RATIONALE

TRIS Rating affirms the company rating on Sahakol Equipment PLC (SQ) at "BBB-" with a "stable" rating outlook. The rating reflects SQ's competitive strengths in mining services and the predictable income streams from long-term service contracts with creditworthy clients. These strengths are partially offset by the company's high leverage and narrow scope of business with the dependency on a few large projects. The rating also takes into consideration our concerns over the rising inflation which will likely push up construction materials and labor costs.

KEY RATING CONSIDERATIONS

Long-established track record and strengths in mining services

SQ provides extensive mining services. The company has a long track record in mining operations as it has served as the main contractor or a joint operator for several phases of the Mae Moh mining operations of the Electricity Generating Authority of Thailand (EGAT) over the past three decades. SQ's competitive strengths are built from its wealth of experienced mining engineers and its fleet of specialized mining equipments.

SQ has undertaken mining projects in the Lao People's Democratic Republic (Lao PDR) since 2015. The company currently holds a lignite mining service agreement with Hongsa Power Co., Ltd. (HPC), a leading power producer in the Lao PDR. The project is viewed as the start of SQ's overseas expansion. HPC continually feeds works related to the Hongsa mine to the company.

Predictable income streams from long-term contracts

SQ's predictable income streams are underpinned by its long-term service contracts and the low credit risk of its contract counterparties who are the mining project sponsors, EGAT and HPC. SQ has a reasonable level of contracted work backlog, which will help secure revenue in the medium term. As of March 2022, SQ's backlog stood at THB22.6 billion. The projects in backlog comprise the soil and coal excavation project of Mae Moh Phase 8 (THB8.9 billion), as well as the projects related to the Hongsa mine including Hongsa mine (THB6.7 billion), operation and maintenance (O&M) services for the conveyor system (THB1.7 billion), North pit wall expansion (THB0.8 billion), build lease & transfer (BLT) of the conveyor belt system (THB2.2 billion), and O&M for the conveyor system expansion (THB2.3 billion). About 80% of the backlog is scheduled for completion in 2025-2027 and the rest in 2033.

Lower gross margins due to rising construction costs and higher revenue contribution from the BLT project

SQ's operating performance in 2021 through the first quarter of 2022 met our expectations. Its revenues in 2021 and the first quarter of 2022 were THB4.8 billion and THB1.2 billion, respectively. SQ reported gross margin of 21.5% in 2021 and 27.0% in the first quarter of 2022. Based on information on its backlog, we forecast SQ will generate revenue of around THB5.3 billion per annum during 2022-2023 and will drop to around THB4.5 billion in 2024 if no new contracts are added.

Looking forward, we expect SQ's gross profit margin to slightly decline amid concerns over rising raw material and labor costs and the higher contribution of revenue from the BLT project, which has a lower profit margin. SQ's gross margin will likely stay at 20%-21% this year and will drop to 16%-17% in 2023-

2024. However, SQ's earnings before interest, taxes, depreciation, and amortization as a percentage of revenues (EBITDA margin) may improve slightly this year in absence of the extraordinary administrative expenses from the Mai Khot project. In our base-case forecast, we project SQ's EBITDA margin to be 30%-35% over the forecast period, with its EBITDA to be THB1.5-THB1.8 billion per year.

Narrow business scope and high project concentration

In our view, SQ's scope of business is narrow and highly concentrated. The company focuses only on the mining business. In addition, its backlog consists of only a couple of large projects from EGAT and HPC. Currently, the largest project in the backlog is Mae Moh Phase 8, which accounts for 39% of the value of the backlog, with the rest of the backlog from the Hongsa mine. Currently, the Mae Moh mine generates around 70%-75% of its revenue. Underperformance in any of these projects could significantly hurt the company's overall financial profile. In addition, failing to secure new projects at the time the existing projects are closing out will raise questions regarding the company's long-term business prospects.

Given the dearth of new viable mining projects in Thailand, SQ has sought opportunities to expand into the renewable power business. However, the lingering Coronavirus Disease 2019 (COVID-19) pandemic has delayed its plans to diversify into other businesses. Currently, the company has no concrete plan for new businesses.

Leverage expected to decline

We expect SQ's financial leverage to gradually decline over the next three years. SQ typically carries a heavy debt load at the commencement of each project, due to hefty capital expenditure for new heavy-duty machinery and equipments. The debt level then declines over the course of the project. As of March 2022, SQ's debt to capitalization ratio stood at 65.6%, a consistent decline from 68.1% as of 2021 and 73.4% as of 2020. In our base-case projection, we forecast SQ's debt to capitalization ratio will decline to 60% in 2024 from 65% in 2022. SQ's debt to EBITDA ratio is expected to stay at 3.0-3.5 times while the FFO to debt ratio should hold at above 20%.

The financial covenant on its bank loan obligations requires maintenance of a debt service coverage ratio above 1.2 times, an interest-bearing debt (IBD) to equity ratio below 2 times, and IBD to EBITDA lower than 4 times. Under the covenant in relation to SQ's outstanding debentures, the company is obliged to keep its interest-bearing debt to equity ratio below 3.5 times. As of March 2022, the company remained in compliance with all financial covenants. Based on the expected decline in its debt level, we believe that SQ should be able to comply with all financial covenants over the next 12 months.

Most of SQ's debts are secured loans. At the end of March 2022, SQ's priority debt to total debt ratio was 70%, exceeding the 50% threshold of TRIS Rating's "Issue Rating Criteria". Thus, we consider SQ's unsecured creditors to be significantly disadvantaged to its priority debt holders with respect to the priority of claims against the company's assets.

Tight liquidity

SQ's liquidity is tight. As of March 2022, the company's liquidity sources comprised cash on hand of THB223 million plus undrawn credit lines of about THB300 million. We forecast SQ will generate FFO of around THB1.3-THB1.5 billion over the next 12 months. SQ's uses of funds over the next 12 months include maturing debts of about THB2.7 billion, capital expenditure of around THB1.1 billion, and dividend payments of around THB0.1 billion. Debts coming due over the next 12 months comprise THB2.0 billion scheduled project loan repayments and THB0.7 billion maturing debentures. The company will repay the project loans with the cash it receives from project progress payments. The company plans to refinance maturing debentures with new debenture issuance.

BASE-CASE ASSUMPTIONS

- SQ's revenue to be around THB4.5-THB5.3 billion per annum over the next three years.
- EBITDA margin to hold in the 30%-35% range.
- Capital expenditure of around THB1.5 billion in total over the next three years.

RATING OUTLOOK

The "stable" outlook reflects our expectation that SQ will maintain its competitive strengths in the mining business, and that the company will perform in accordance with the terms of the contracts and generate an acceptable level of cash flow over the course of the undertaken projects. We expect its EBITDA margin will remain in the 30%-35% range while the FFO to debt ratio will stay above 20% over the next three years.

RATING SENSITIVITIES

The rating could be revised downward if the operating performance of SQ falls significantly short of expectations. A negative rating pressure could develop if the FFO to debt ratio of SQ falls below 20% for a sustained period. A rating upside is limited. However, the rating or outlook could be revised upward if the company successfully diversifies its sources of income and lowers its leverage materially.

COMPANY OVERVIEW

SQ was established in May 2001 by the Sirison and Areekul families, but its roots date back to 1983. In that year, mining operations at the Mae Moh Phase 1 project were undertaken by Sahakol Engineer Co., Ltd., a predecessor company. SQ is currently the largest mining contractor in Thailand, providing a complete range of mining engineering services, including mine planning, open-pit mining operations, mining consultancy, and heavy-duty mining equipment rental and maintenance.

The company is primarily engaged in overburden and lignite removal services for the Mae Moh mine in Lampang province. The mine supplies lignite to the Mae Moh coal-fired power plants owned and operated by EGAT. SQ has conducted mining operations for several phases of the Mae Moh mine over the past 35 years. Projects at the Mae Moh mine have accounted for more than 70% of the company's total annual revenue over the past three years.

SQ went public in 2015 and was listed on the Stock Exchange of Thailand (SET) in October 2016. The Sirison family has been the company's major shareholder since its inception. As of April 2022, this founding family held a 25% stake in the company.

SQ's revenue has grown continually over the past few years after winning contracts for the Hongsa mine and the Mae Moh Phase 8 project. The latter is currently the largest project in the company's backlog. Revenue in the last three years has been in the THB4.7-THB4.8 billion per annum range, up from THB3.6 billion in 2018. The EBITDA margin had been maintained in the 25%-35% range over the past five years.

KEY OPERATING PERFORMANCE

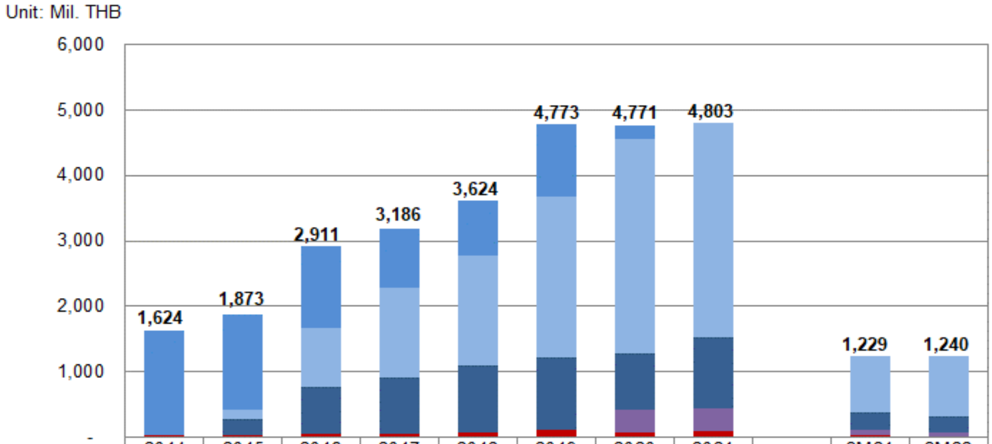
Table 1: SQ's Projects in the Backlog as of Mar 2022

Unit: Mil. THB

Projects	Duration	Project Value (Mil. THB)	Backlog Value (Mil. THB)	Total Backlog (%)
Mae Moh Phase 8	2016-2025	22,871	8,857	39
Hongsa Mine Phase D	2015-2026	12,779	6,652	30
O&M Hongsa	2020-2026	1,676	1,676	7
North pit wall expansion	2022-2027	837	837	4
Build lease & transfer (BLT)	2021-2033	2,245	2,245	10
O&M Hongsa expansion	2027-2033	2,342	2,342	10
Total		**43,338**	**22,607**	**100**

Source: SQ

Chart 1: Revenue Breakdown



	2014	2015	2016	2017	2018	2019	2020	2021		3M21	3M22
Mae Moh Phase 7	1,585	1,445	1,238	905	848	1,090	223			-	-
Mae Moh Phase 8	-	146	897	1,376	1,673	2,461	3,277	3,269		850	916
Hongsa	-	247	731	857	1,027	1,107	850	1,104		259	244
Hongsa O&M	-	-	-	-	-	-	353	340		97	67
Others	39	35	46	47	77	116	68	91		23	12

Source: SQ

FINANCIAL STATISTICS AND KEY FINANCIAL RATIOS*

Unit: Mil. THB

		---------------Year Ended 31 December ----------			
	Jan-Mar 2022	2021	2020	2019	2018
Total operating revenues	1,240	4,803	4,771	4,773	3,624
Earnings before interest and taxes (EBIT)	268	595	547	386	(123)
Earnings before interest, taxes, depreciation, and amortization (EBITDA)	511	1,605	1,650	1,564	913
Funds from operations (FFO)	450	1,343	1,333	1,163	620
Adjusted interest expense	61	265	317	391	287
Capital expenditures	139	152	310	463	2,268
Total assets	9,539	9,210	10,009	11,106	11,987
Adjusted debt	5,473	5,676	6,669	7,544	7,639
Adjusted equity	2,867	2,658	2,412	2,165	2,166
Adjusted Ratios					
EBITDA margin (%)	41.23	33.41	34.58	32.77	25.18
Pretax return on permanent capital (%)	6.28 **	6.67	5.67	3.82	(1.37)
EBITDA interest coverage (times)	8.44	6.07	5.21	4.00	3.18
Debt to EBITDA (times)	3.52 **	3.54	4.04	4.82	8.37
FFO to debt (%)	23.71 **	23.65	19.99	15.42	8.12
Debt to capitalization (%)	65.62	68.10	73.44	77.70	77.91

* *Consolidated financial statements*
** *Annualized with trailing 12 months*

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

Sahakol Equipment PLC (SQ)

Company Rating:	BBB-
Rating Outlook:	Stable

TRIS Rating Co., Ltd.
Silom Complex Building, 24th Floor, 191 Silom Road, Bangkok 10500, Thailand Tel: +66 2 098 3000