STARK CORPORATION PLC

No. 216/2021
1 December 2021

CORPORATES

Company Rating:	BBB+
Outlook:	Stable

Last Review Date: 26/03/21

Company Rating History:

Date	Rating	Outlook/Alert
26/03/21	BBB+	Stable

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RATIONALE

TRIS Rating affirms the company rating on STARK Corporation PLC (STARK) at "BBB+" with a "stable" rating outlook. The rating continues to reflect STARK's leading position in the wire and cable (W&C) business in the ASEAN region, strong reputation and established operating record of Phelps Dodge International Thailand Ltd. (PDITL), as well as enhanced profitability from a strategic shift to focus more on high-margin products, and the cost optimization program. However, the rating is constrained by the company's exposure to raw material price risk and currency exchange risk.

KEY RATING CONSIDERATIONS

Leading position in the ASEAN wire and cable industry

STARK is one of the leading W&C manufacturers in ASEAN region. Currently, the company has W&C production facilities in Thailand and Vietnam. In 2020, the W&C business in Thailand contributes about 58% of total revenue, while the W&C business in Vietnam contribute 32%. The rest comes from the logistics business.

The rating on STARK primarily reflects the business strength of PDITL, a wholly owned subsidiary. PDITL is known as a leading W&C manufacturer in Thailand with production technology from its former owners, Phelps Dodge Corporation, and General Cable. PDITL continues to maintain the No.2 position in Thailand, with a market share of 20% in 2020. PDITL benefits from its solid reputation in product quality, the long-standing operational record in Thailand of over 50 years, and the broadest range of product offerings. PDITL is the only domestic manufacturer capable of producing extra-high-voltage cable (over 230 kilovolts).

STARK's W&C business in Vietnam is operated under Thipha Cables and Dong Viet Non-Ferrous Metal and Plastic (TPC&DVN) which STARK acquired in the first quarter of 2020. TPC&DVN is a large W&C manufacturer in Vietnam. Its manufacturing capacity is approximately 80% larger than PDITL's but their factories were underutilized. Following the integration with PDITL, the performance of Vietnam facilities improved gradually from adopting PDITL's best practices and production knowhow.

Improving profitability from high margin cable and cost optimization

STARK's profit margin has improved materially due to its strategic move to focus more on high margin cables. The company sharply cut sales of low-margin products such as bare cable and metal raw material while accelerating sales in the medium-to-extra high voltage cable, which earn higher margins. The company also implemented operation optimization and integration between Thailand and Vietnam plants such as consolidating purchasing orders for raw materials at PDITL and moving all copper rod production to the lower-cost factories in Vietnam.

These efforts have translated into materially improved cash generation. The normalized earnings before interest, taxes, depreciation, and amortization as percentage of revenue (EBITDA margin), excluding gain or loss from foreign exchange, increased meaningfully from 12.7% in the first quarter of 2020 to 17.2% in the first nine months of 2021.

Exposures to raw material price and exchange rate volatilities

Approximately 70%-80% of W&C production cost is raw material costs of copper and aluminum. In our view, the high proportion of copper and aluminum raw material costs in their cost structure makes the company susceptible to volatility in earnings due to fluctuation of metal prices. Nonetheless, STARK mitigates these risks through a cost-plus pricing strategy and its policy to immediately fix raw material prices and exchange rates after order confirmation. STARK's quarterly gross profit margin was in the range of 16.7%-22.7% during the third quarter of 2020 to the third quarter of 2021, considerably less volatile when compared to an about 65% increase in copper price over the same period.

In contrast, we view the impact of currency exchange on the company's earnings to have intensified due to fast sales growth and longer supplier credit terms for the import of raw materials. The company recorded losses on currency exchange of THB815 million in the first nine months of 2021, which was a significant amount in view of total EBITDA of THB2,578 million over the same period.

Stronger-than-forecast performance

For the first nine months of 2021, STARK's revenue was THB19.7 billion, representing a year-on-year (y-o-y) growth of 65.2%. The revenue growth was mainly driven by a consolidation of its subsidiaries in Vietnam and sizable W&C orders received in the third quarter of 2021. EBITDA was about THB2.6 billion, an increase of 33% y-o-y. The net debt to EBITDA multiples declined to 3.4 times in September 2021 from 3.8 times at the end of 2020.

We view the profitability from the W&C business has improved but the huge exchange losses due to the weakening of Thai Baht pulled down the overall profit margin. EBITDA margin in the first nine months of 2021, based on our calculation, fell to 13.1% from 16.1% in the same period last year.

Revenue growth driven by W&C operation in Vietnam

We believe the Vietnamese operation will be an essential growth driver for STARK, underpinned by the fast economic growth of the country and high potential for production improvement. We believe that operating efficiency in Vietnam will enhance gradually with the assistance of PDITL. TPC&DVN are likely to benefit from leveraging PDITL's reputation to promote sales and penetrate into a high margin segment in Vietnam.

We expect 2021's revenue and earnings to be exceptionally due to its surging revenue in the third quarter of 2021. In our base-case scenario, STARK's revenue is projected to be THB24 billion that translates into EBITDA of THB3.4 billion in 2021. We project revenue generation of about THB20 billion in 2022, and annual revenue growth rates of 4%-5% after that. The EBITDA margin is set to be at least 14%-15% in our base-case scenario, implying an average annual EBITDA of approximately THB2.8-THB3 billion.

Recovering balance sheet before next major expansion

We forecast that STARK's financial leverage is likely to decline, following STARK's deleveraging plan to restore its balance sheet. The company has also undertaken several measures to lower the need for working capital and improve its capital structure. The company has expressed its intention to have no sizable merging and acquisition transactions and no dividend payment between 2021 and 2022.

During 2021-2023, we predict that the net debt to EBITDA ratio will improve, decreasing to around 3 times and the ratio of funds from operations (FFO) to net debt improving to above 15% over the forecast period. After that, we believe STARK will start pursuing its growth strategy through acquisitions again to expand its presence in W&C or related businesses.

Manageable liquidity

We assess STARK's liquidity as manageable over the next 12 months. The sources of liquidity consist of cash on hand of THB1.13 billion at the end of September 2021 and an estimated FFO of THB2 billion over the next 12 months. The primary uses of funds are total debt repayments of about THB2.44 billion. We expect capital spending of THB0.9 billion in the next 12 months to be partly funded by external financing.

Debt structure

At the end of September 2021, STARK's reported debt, excluding financial lease, was THB13.6 billion. The priority debt, including secured debts and debts of subsidiaries, totaled about THB11.2 billion. The ratio of priority debt to total debt was about 82%. As its priority debt ratio is above the threshold of 50%, we view that STARK's unsecured creditors are significantly disadvantaged with respect to claims against its assets.

BASE-CASE ASSUMPTIONS

- Revenue of about THB24 billion in 2021 and THB20-THB21 billion during 2022-2023.
- EBITDA of THB3.4 billion in 2021 and in the range of THB2.8-TH3.0 billion per annum during 2022-2023.
- Capital expenditure of THB0.4-THB1.4 billion per annum during 2021-2023.
- No dividend payment during 2021-2022 and 50% dividend payout in 2023.

RATING OUTLOOK

The "stable" outlook reflects our expectation that STARK will maintain its market position in the W&C manufacturing industry in Thailand and Vietnam. We expect the company's strengthening profit margin will be sustainable, given more contribution from high voltage cable and ongoing cost optimization programs.

RATING SENSITIVITIES

An upward revision on the rating and/or outlook could happen if STARK's revenue base and cash flow materially enlarge from the current levels. This may arise from the successful expansion of the company's W&C business or other businesses.

The rating and/or outlook could be revised downward if the company's net debt to EBITDA ratio stays above 5 times for a sustained period. This could result from new M&A transactions involving excessive debt-financing that materially weakens the company's financial profile.

COMPANY OVERVIEW

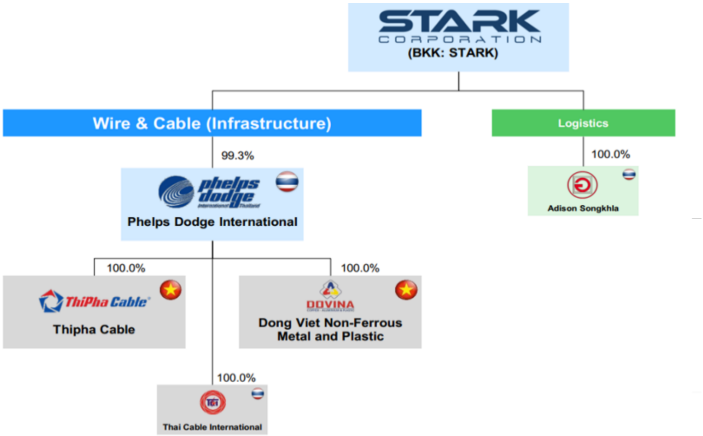
STARK is a leading W&C manufacturer in ASEAN. The company became a listed company on the SET in July 2019 following the incorporation of PDITL into Siam Inter Multimedia PLC and the transformation of its business to W&C manufacturing. The company simultaneously divested its legacy media business and was renamed STARK in July 2019. STARK's major shareholder is Mr. Vonnarat Tangkaravakoon, holding approximate 70% stake in the company at the end of April 2021.

STARK's businesses consist of W&C manufacturing and logistics services. The W&C business is operated through four subsidiaries, PDITL, TPC, DVN, and TCI. PDITL is well-known W&C manufacturer with holding the 2nd largest market share in Thailand. TPC is a W&C manufacturer and DVN is a producer of copper and aluminum rod in Vietnam. TPC and DVN are both located in the same area and cooperate with each other. TCI is a small W&C manufacturing company in Thailand, targeting on the retail market. STARK acquired TPC&DVN and TCI in March 2020. The logistics business solely consists of ADS, a company offering manpower and recruitment services for oil and gas companies. STARK took over ADS in December 2019.

In 2020, the company's revenue was THB18 billion. The W&C business contributed about 91% of total revenue, with the remainder coming from the logistics business. PDITL contributed about 53% of the total revenue, followed by TPC&DVN with 36% and 2% from TCI. ADS's revenue accounted for 9% of total revenue. For the W&C segment in 2020, the revenue from Thailand accounted for about 60%, while the revenue in Vietnam made up 27% and export revenue was about 13%

GROUP STRUCTURE

Chart 1: STARK's Business Structure



Source: STARK

FINANCIAL STATISTICS AND KEY FINANCIAL RATIOS*

Unit: Mil. THB

		---------------Year Ended 31 December -----------			
	Jan-Sep 2021	2020	2019	2018	2017
Total operating revenues	19,702	16,899	11,539	11,864	451
Earnings before interest and taxes (EBIT)	2,257	2,606	1,057	1,134	(33)
Earnings before interest, taxes, depreciation, and amortization (EBITDA)	2,578	2,965	1,260	1,310	14
Funds from operations (FFO)	1,387	1,884	624	701	(32)
Adjusted interest expense	675	662	491	426	31
Capital expenditures	171	320	478	376	18
Total assets	38,502	27,358	12,655	13,781	973
Adjusted debt	12,764	11,257	3,772	4,566	486
Adjusted equity	5,872	3,676	2,313	1,818	282
Adjusted Ratios					
EBITDA margin (%)	13.1	17.5	10.9	11.0	3.0
Pretax return on permanent capital (%)	18.0 **	21.9	14.4	28.8	(4.1)
EBITDA interest coverage (times)	3.8	4.5	2.6	3.1	0.4
Debt to EBITDA (times)	3.4 **	3.8	3.0	3.5	35.5
FFO to debt (%)	17.2 **	16.7	16.5	15.4	(6.5)
Debt to capitalization (%)	68.5	75.4	62.0	71.5	63.3

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

RELATED CRITERIA

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

STARK Corporation PLC (STARK)

Company Rating:	BBB+
Rating Outlook:	Stable

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