TRIS RATING
A Strategic Partner of S&P Global

CreditNews ข่าวเครดิต

THAI POLYCONS PLC

No. 189/2020
30 October 2020

CORPORATES

Company Rating:	BBB
Outlook:	Stable

Last Review Date: 04/10/19

Company Rating History:

Date	Rating	Outlook/Alert
09/10/18	BBB	Stable

Contacts:

Rapeepol Mahapant
rapeepol@trisrating.com

Narongchai Ponisirichusopol
narongchai@trisrating.com

Parat Mahuttano
parat@trisrating.com

Monthian Chantarklam
monthian@trisrating.com

WWW.TRISRATING.COM

RATIONALE

TRIS Rating affirms the company rating on Thai Polycons PLC (TPOLY) at "BBB" with a "stable" outlook. The rating reflects the sound operating performance and the predictable cash flows of the power business. These factors offset the impact from the cyclical nature of the construction business. However, the rating is weighed down by uncertainties in feedstock supply for power plants and volatile prices. The rating also recognizes the increasingly challenging business environment of the power industry. The rating also takes into consideration TPOLY's mediocre competitive position and stiff competition in the construction business.

KEY RATING CONSIDERATIONS

Predictable cash flows from power business

TPOLY's rating is chiefly predicated on the predictable cash flows of its power business, which should remain the centerpiece of TPOLY's earnings. The power business accounts for more than 90% of TPOLY's earnings before interest, taxes, depreciation, and amortization (EBITDA) and brings in stable cash flows, resulting from multi-year power purchase agreements (PPAs) with the state-owned producers and distributors of electricity. Each PPA contains contractually committed tariff rates.

The power business is carried out by its core and profit-making subsidiary, TPC Power Holding PLC (TPCH). Currently, TPCH owns and operates seven biomass power plants, with a combined contracted capacity of 73.8 megawatts (MW). TPCH is adding more capacity to enlarge its power portfolio. The core subsidiary will add a total of 32.7 MW in contracted capacity from new power projects in the pipeline, comprising three biomass power plants (24.7 MW) and one waste-to-energy plant (8 MW). Some of the new projects have experienced construction delays due to the Coronavirus Disease 2019 (COVID-19) pandemic. However, the investment budgets remain under control. These new projects are scheduled to commence operations within the next six months, lifting the aggregate contracted capacity to 106.5 MW. Together with the additional capacity from new projects in the pipeline, we assume TPCH will add another 9 MW in new capacity over the forecast period. In our base-case forecast, the aggregate contracted capacity of TPCH's operating power plants is projected to increase to 115.5 MW in 2022.

Sound performance of power plants

The operating power plants consistently stage solid performance. In all, the EBITDA margin (EBITDA as a percentage of revenues) of the power plants has remained at high levels of 48%-50% over the past three years. We view the reliable cash flows from the power-generating assets to largely countervail the cyclicality of the construction business. In our base case, we expect the power plants to continue to deliver strong performance over the next three years.

Feedstock supply and price risks

The power business is highly exposed to the risks of shortages and volatile prices of biomass feedstock. The key feedstocks for biomass power generation are derived from agricultural and forestry waste, such as woodchip, rice husk, coconut shells, and other fast-growing plants. The availability of feedstock is subject to several factors, such as seasonality, the use of biomass in other industries, and an increasing number of biomass power plants. Biomass power producers who do not have their own farm waste need to compete with others to secure feedstock. The prices of biomass fuel could also fluctuate greatly while feedstock varies in terms of humidity and calorific value.

TPCH hires operation and maintenance (O&M) contractors to run most of the operating power plants. For some of the projects, the O&M contractors are responsible for managing the supply of biomass feedstock, carrying the price risk. TPCH plans to hire O&M contractors to operate its new power plants, but manage the supply of biomass feedstock itself. This could heighten exposure to supply risk. To address the lack of its own farm waste, TPCH has secured long-term supply agreements with local suppliers to ensure the availability of fuel. However, contract enforcement remains a challenge. TPCH mitigates this risk by taking in suppliers as partners in the company's projects. In addition, TPCH has developed its own bio-fuel plantation.

Increasingly challenging environment of power business

We view the renewable power business as becoming increasingly challenging, given the cut-off of incentive tariff and intensified bidding competition. Revision of the country's Power Development Plan (PDP) has long been pending final approval. The government aims to promote the community power project, a scheme which allows private companies to co-invest with local communities in rural areas to operate renewable power generation, including biomass, biogas, and so on. However, the respective criteria for the purchase of electricity have yet to be finalized. Despite the government's intent to support the use of renewable power, delay in public project bidding and awarding remain possible. At present, the country's high reserve of generation capacity and the pandemic-induced decline of power demand are downside factors to the growth of renewable power. Given the dearth of new opportunities, acquisitions and divestiture of existing power projects are trend being seen.

We expect the power business will render lower gross margin over the next few years. TPCH's new biomass power projects are under a competitive bidding system, yielding much lower tariffs. The tariffs for most of the new biomass power plants range between THB2.8 and THB3.4 per kilowatt hour (kWh), versus above THB4 per kWh for the existing plants. This requires the company to double-down on production cost control. However, the new projects will drive revenue, boosting economies of scale and reducing selling and administrative expenses as percentage of revenue.

Mediocre competitive position in construction business

The rating mirrors TPOLY's mediocre competitive position in the domestic construction industry. This business is rather small, compared with other contractors rated by TRIS Rating. A typical contract for TPOLY's construction work has been worth below THB1 billion per contract during the past three years. Revenue from the construction business has held at about THB2 billion per annum. TPOLY engages in a narrow scope of construction work, focusing on the construction of buildings such as hospitals, universities, hotels, and shopping malls. Earnings from the construction business have declined recently, due to fiercer competition, workforce expansion, and cost overruns in some projects. Gross margin of the construction business slumped to 4.6% in the first half of 2020, from 6.4% in 2019 and 9.6% in 2018.

The COVID-19 pandemic disrupted domestic construction activities during the lockdown, causing delays in new project biddings and rising competition among contractors. We maintain a positive view on the domestic construction industry over the medium term. With the backdrop of an eroding economy, construction work in the public segment will continue to play a major role. TPOLY aims to expand to public infrastructure construction work. However, the company has a limited track record in this segment and it has to compete with a large number of contractors.

Looking ahead, we expect the company will continue to undertake construction work mainly for the private sector. At the same time, we do not expect TPOLY to undertake large-scale projects as a main contractor over the coming years. We forecast the gross margin of the construction business will remain low at about 5%, considering the highly competitive environment during the slowing domestic economy.

Power business to remain key growth driver

We expect the power business to drive the company's growth over the next three years. In our base case forecast, TPOLY's total operating revenues should increase steadily, reaching THB6 billion in 2022, from THB3.95 billion in 2020. Revenue from the sale of electricity will likely increase to THB3.15 billion in 2022, from about THB2 billion in 2020. At the same time, we forecast revenue from the construction business to range between THB1.8-THB2.8 billion per annum, based on our assumption that TPOLY will acquire contracts for construction projects worth THB1.5-THB2 billion per year. As of June 2020, TPOLY had a backlog worth THB2.13 billion. The backlog will help partly secure revenue over the forecast periods.

We also assume sales in the residential property business will stay below THB150 million a year over the next three years. TPOLY had about THB40 million of the value in unsold units as of June 2020. We do not expect the residential property business will grow tremendously in coming years, given the slowdown in the residential property market. The company plans to launch new housing projects in 2021, but the launch plan will depend on market conditions. In all, we forecast the company's EBITDA margin will range between 19%-20% during 2020-2022.

Leverage to stay at current level

TPCH guarantees the debts of the incorporated joint ventures (JVs) in proportion to its stakes in the JVs. In assessing the financial profile and performance of TPOLY, we include the assets, liabilities, and respective financial performances of the JVs in TPOLY's consolidated accounts, in proportion to the ownership stake of TPCH in each venture.

TRIS Rating expects TPOLY's gearing to stay at the current level over the next three years. Cash flows from the operating power plants will support further expansion in the power business. We expect TPOLY to manage its working capital for the construction business efficiently to avoid a rise in financial leverage. As a result, we project the debt to capitalization ratio will range between 50%-55% over the next three years, compared with 52.7% as of June 2020. The ratio of funds from operations (FFO) to debt is forecast to fall to 12%-17% and the debt to EBITDA ratio should stay about 5-6 times during 2020-2022.

Manageable liquidity

We expect TPOLY to manage its liquidity prudently. The company has a low debt level and has no funding mismatch. As of June 2020, TPOLY had short-and long-terms loans coming due in the next 12 months totaling about THB1.46 billion. The company had undrawn credit facilities, plus cash and marketable securities, of THB453 million. FFO is forecast at THB726 million. We expect TPOLY to be able to rollover its short-term loans, which are mainly utilized for construction activities.

There are no financial covenants imposed on TPOLY's banks loans. However, TPCH's subsidiaries and JVs are required to maintain a debt service coverage ratio above 1.1 times or 1.2 times and keep the debt to equity ratio below 1.2 times, 1.5 times, or 2.5 times. All the subsidiaries and JVs have complied with their respective financial covenants. We believe they will stay in compliance for the next 12-18 months.

BASE-CASE ASSUMPTIONS (2020-2022)

- Aggregate contracted capacity of TPCH's operating power plants to increase to 115.5 MW in the next three years.
- New contracts for construction works will be worth THB1.5-THB2 billion per annum.
- Gross margin of construction business to stay about 5%.
- EBITDA margin to range between 19%-20%.
- Total capital spending to range between THB1-THB2 billion per annum.

RATING OUTLOOK

The "stable" outlook reflects TRIS Rating's expectation that the power business will continue to be the core earner and generate sizable cash flows as planned. We expect the new power projects to earn satisfactory returns. In addition, we expect TPOLY to manage its working capital for the construction business efficiently to avoid increasing financial leverage.

RATING SENSITIVITIES

A rating upgrade is limited in the near term. However, it could occur if TPOLY's operating performance and cash flows improve significantly. Conversely, downward rating pressure would emerge if the performance of the construction business and/or the power business fall significantly short of our estimates, or if the capital structure deteriorates materially due to aggressive debt-funded investments.

COMPANY OVERVIEW

Established in 1988, TPOLY is a construction contractor, providing engineering and construction (E&C) services to the public and private sectors. The company focuses on constructing buildings and civil works. The company was listed on the Market for Alternative Investment (MAI) in 2009 and moved to trade on the Stock Exchange of Thailand (SET) in 2010. TPOLY expanded into the residential property business and the power business in 2010. It spun off the power business to TPCH, its subsidiary, in 2012. The Chanpalangsri family remained the major shareholder, holding an approximately 44% interest in TPOLY, as of June 2020.

The construction business made up more than a half of total revenue. However, the power business accounted for the majority of TPOLY's earnings. EBITDA of the power business made up more than 90% of TPOLY's EBITDA during the past three years.

KEY OPERATING PERFORMANCE

Table 1: Revenue Breakdown

Unit: %

Segment	2016	2017	2018	2019	Jan-Jun 2020
Construction	71	60	49	53	56
Property	4	8	3	1	0
Power	25	32	46	42	43
Trading	-	1	1	0	0
Total	**100**	**100**	**100**	**100**	**100**
Total revenue (Mil. THB)	**2,708**	**3,432**	**3,367**	**3,798**	**1,921**

Source: TPOLY

Table 2: Power Project Portfolio

Company/Country	Held by TPCH (%)	Status	Installed Capacity (MW)	Contracted Capacity (MW)	Tariff
Biomass Projects					
CRB	73	Operating	9.5	9.2	Fit
MWE	85	Operating	9.0	8.0	Fit
MGP	46	Operating	9.5	8.0	Fit
TSG	65	Operating	9.5	9.2	Fit
PGP	60	Operating	9.9	9.2	Fit
SGP	51	Operating	9.9	9.2	Fit
PTG	69	Developing	23.0	21.0	Adder
TPCH1	88	Developing	9.9	9.2	Fit
TPCH2	88	Developing	9.9	9.2	Fit
TPCH5	89	Developing	6.3	6.3	Fit
Sub total - Biomass			**106.4**	**98.5**	
Waste Projects					
SP	50	Developing	9.5	8.0	-
Sub total - Waste			**9.5**	**8.0**	
Grand total			**115.9**	**106.5**	

Source: TPCH

CRB = Chang Raek Bio Power
MWE = Maewong Energy
MGP = Mahachai Green Power
TSG = Thungsung Green
PGP = Phathalung Green Power
SGP = Satun Green Power
PTG = Pattani Green
TPCH1 = TPCH Power 1
TPCH2 = TPCH Power 2
TPCH5 = TPCH Power 5
SP = Siam Power

FINANCIAL STATISTICS AND KEY FINANCIAL RATIOS*

Unit: Mil. THB

		-------------- Year Ended 31 December -----------			
	Jan-Jun 2020	2019	2018	2017	2016
Total operating revenues	1,996	3,981	3,564	3,599	2,843
Earnings before interest and taxes (EBIT)	260	614	690	574	335
Earnings before interest, taxes, depreciation, and amortization (EBITDA)	358	795	863	702	424
Funds from operations (FFO)	317	708	746	592	365
Adjusted interest expense	49	101	108	91	71
Capital expenditures	758	1,707	731	872	1,028
Total assets	10,867	10,159	7,496	6,993	6,570
Adjusted debt	4,802	3,831	2,097	1,995	1,446
Adjusted equity	4,303	4,197	3,785	3,262	2,854
Adjusted Ratios					
EBITDA Margin (%)	17.92	19.97	24.21	19.50	14.92
Pretax return on permanent capital (%)	6.68 **	8.38	11.39	10.50	7.23
EBITDA interest coverage (times)	7.31	7.84	7.97	7.73	5.95
Debt to EBITDA (times)	6.42 **	4.82	2.43	2.84	3.41
FFO to debt (%)	13.88 **	18.48	35.59	29.69	25.25
Debt to capitalization (%)	52.74	47.72	35.65	37.95	33.63

Note: The figures include assets, liabilities, and the respective financial performances of MGP and SP, in proportion to the ownership stake in these JVs.
* *Consolidated financial statements*
** *Adjusted with trailing 12 months*

RELATED CRITERIA

- Rating Methodology – Corporate, 26 July 2019
- Key Financial Ratios and Adjustments, 5 September 2018
- Group Rating Methodology, 10 July 2015

Thai Polycons PLC (TPOLY)

Company Rating:	BBB
Rating Outlook:	Stable

TRIS Rating Co., Ltd.
Silom Complex Building, 24th Floor, 191 Silom Road, Bangkok 10500, Thailand Tel: 02-098-3000