

CH. KARNCHANG PLC

No. 31/2018
29 March 2018

CORPORATES

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

Company Rating History:

Date	Rating	Outlook/Alert
30/01/15	A-	Stable
24/01/14	BBB+	Positive
26/02/13	BBB+	Stable
21/01/11	BBB	Stable
09/06/09	BBB+	Negative
23/07/07	BBB+	Stable
16/02/07	A-	Alert Negative
07/09/04	A-	Stable

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RATIONALE

TRIS Rating affirms the company rating of CH. Karnchang PLC (CK) and the ratings of CK's outstanding senior unsecured debentures at "A-". The ratings reflect CK's position as a top-tier contractor, its ability to undertake large-scale and sophisticated construction projects, as well as the synergy and financial flexibility the company gains from its strategic investments. However, the ratings are constrained by the company's high leverage, as well as the cyclicity of and competitive threats in the engineering and construction (E&C) industry.

KEY RATING CONSIDERATIONS

Position as a top-tier contractor

CK's strong business profile is built on the company's solid competitive position in the domestic E&C industry. CK is one of the three largest E&C companies listed on the Stock Exchange of Thailand (SET) based on revenue and assets. The company's business profile is buoyed by its long-established record in both the submission of competitive bids for projects and the execution of their work.

CK's construction competence encompasses a broad array of construction activities, ranging from general civil work such as roads, expressways, buildings, and bridges, to highly sophisticated mega projects such as under-ground mass transit schemes and hydropower plants. This diverse construction background, spanning several complex projects, enhances the company's competitive position. Furthermore, CK's large capital base helps support the company in bidding on large-scale government infrastructure projects.

Apart from its core construction business, CK engages in investments in infrastructure businesses.

Strategic investments provide synergy and financial flexibility

CK's core business is vulnerable to the cyclicity of the E&C industry. In response to this existential threat, CK has strategically built a strong foundation of recurring income in order to fend off the depressive effect of stagnant construction demand. CK invests and holds stakes in Bangkok Expressway and Metro PLC (BEM), TTW PLC (TTW), and CK Power PLC (CKP). These three firms, all of which are SET-listed, provide products that meet basic needs (i.e., transportation infrastructure and utilities) under concession contracts or multi-year utility purchase contracts.

In TRIS Rating's view, CK, to date, has proven its success in this business approach, with CK's investment companies providing sizable construction projects as they expand. CK's ability to create its own construction work helps reduce its exposure to industry cycles. CK also earns substantial dividends on a recurring basis and capital gains from its strategic investments.

The strategic investments help strengthen CK's business profile and provide the company with financial flexibility.

On the downside, these benefits are partly offset by higher leverage than general contractors, as CK must financially support the concession projects, leaving the company with a debt-heavy capital structure.

Sizable backlog securing revenue for the next two years

CK's backlog at the end of 2017 stood at Bt72.2 billion. Major projects in the backlog include the MRT Orange Line project contracts worth a combined value of Bt25.5 billion, the maintenance and engineering (M&E) equipment contract for the MRT Blue Line worth Bt16.1 billion, and the Xayaburi hydropower dam project worth Bt13.9 billion. These three projects account for 77% of the company's total backlog value.

TRIS Rating's base-case scenario expects CK to generate revenue in a range of Bt35-Bt38 billion per annum during 2018-2020. CK's strong backlog will secure about 80% of the base-case revenue in 2018, 50% in 2019, and 35% in 2020.

TRIS Rating maintains a broadly positive view on the domestic E&C industry over the next few years. This outlook takes into consideration the outlays for a number of large-scale, government-sponsored infrastructure projects. On the strength of its market presence, CK is poised for growth in the years ahead.

That said, severe competition among contractors persists, continuing a downward rating pressure. Most projects are awarded through competitive bidding, which constrains contractors' profit margins.

Operating performance is in line with expectations

CK's operating performance in 2017 was in line with TRIS Rating's expectation. Revenue came in at Bt36 billion, down 21% from the previous year. Revenue in 2016 was record-high at Bt45.8 billion, around half of which was contributed by the Xayaburi hydropower dam project. The gross profit margin in 2017 increased to 8.3%, from 7.2% in 2016. CK's funds from operations (FFO) in 2017 increased to Bt2.8 billion, up from Bt1.5 billion in 2016.

Under TRIS Rating's base case scenario, we assume that CK's gross profit margin will remain at 8%-8.5% on average during 2018-2020. FFO should be at least Bt2.6 billion per annum.

Improved financial leverage

The ratings are constrained by CK's high financial leverage. At the end of 2017, CK's debt to capitalization ratio was 62.21%, down from 72.39% in 2016. This ratio improved after CK transferred the project loan of the MRT Purple Line project to BEM, which was in line with TRIS Rating's expectation. Nevertheless, the debt to capitalization ratio is expected to remain elevated, taking into consideration working capital needs and the sponsor loan to the Xayaburi project.

As of December 2017, the Xayaburi project drew down loans amounting to Bt11.2 billion. CK's FFO to total debt ratio was low at 2.64% at the end 2016, but improved to 7.10% at the end of 2017. TRIS Rating considers CK's leverage level to be higher than those of other contractors with the same ratings. However, the leverage level is consistent with CK's ratings in light of the company's business model as a contractor and an investment company.

Acceptable liquidity

CK's liquidity profile is acceptable. The company had Bt6.7 billion in cash plus current investments of Bt2.2 billion as of December 2017. CK's funding for the next 12 months will include approximately Bt1.5 billion in capital expenditures and dividend payments of around Bt600-Bt800 million. The company has Bt3.7 billion in long-term debts maturing in the next 12 months, and these are expected to be repaid by the revenue from construction projects or refinanced by new debentures.

The liquidity profile is enhanced by the company's financial flexibility through its investments in the three SET-listed companies. At the end of 2017, the fair market value of CK's investments in the SET-listed companies was Bt54.2 billion, or about 1.4 times the company's total debt. It is likely that CK will maintain a certain percentage of shareholding in these companies.

During 2018-2020, the ratio of earnings before interest, tax, depreciation, and amortization (EBITDA) interest coverage is expected to stay above 3 times. The FFO to total debt ratio is expected to range from 6%-8%. CK must maintain a debt to equity ratio below 3 times in order to comply with the financial covenants specified in the outstanding bonds. The ratio was 1.27 times at the end of 2017.

RATING OUTLOOK

The "stable" outlook reflects TRIS Rating's expectations that CK will remain highly competitive in securing new projects. In the base case scenario, TRIS Rating assumes CK's revenue will be around Bt35-Bt38 billion per annum during 2018-2020. CK's strong backlog should secure future revenue. Moreover, CK could sustain its gross margin above 8% on average despite stiff competition and the total debt to capitalization ratio could stay below 65% over the next three years.

RATING SENSITIVITIES

A credit upside is possible if CK could significantly enhance cash flow protection by generating stronger-than-expected FFO, as well as maintain its debt to capitalization ratio below 60% for a sustained period. A credit downside will be caused by significant cost overruns in major projects or unanticipated, extensive financial support provided to its affiliates, which would markedly hurt CK's cash flow.

COMPANY OVERVIEW

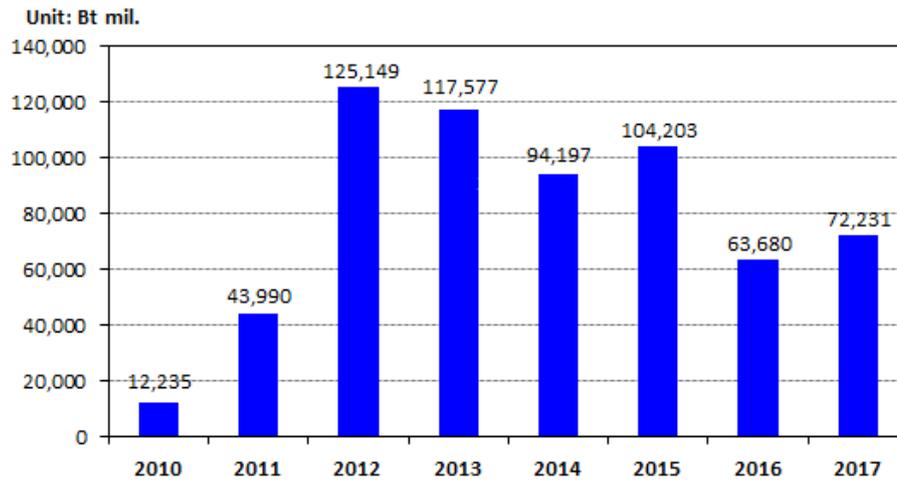
CK was established in 1972 by the Trivisvavet family. CK initially focused on public work projects for government agencies. The company later greatly expanded its business scope and became a listed company on the SET in 1995. As of September 2017, the Trivisvavet family held approximately 34% of CK's shares outstanding. The family plays an important role in formulating and executing the company's strategies and overall business directions. CK has a long-established presence in the E&C sector with experience and expertise in all kinds of construction, ranging from general civil works to highly sophisticated projects.

CK's business is divided into two segments: construction and investment. The construction segment includes the undertaking of construction projects ranging from general civil works to large-scale infrastructure projects, such as expressways and mass transit schemes. The investment segment includes partial interest holdings in the three SET-listed companies (BEM, TTW, and CKP).

In 2016, CK was awarded an additional contract worth Bt19.4 billion to enhance environmental aspects of the project. Despite a significant amount of additional recognized revenue, CK, as a project sponsor, needs to finance the additional construction in the form of a sponsor loan to the project. CK provides sponsor loans to the project company, Xayaburi Power Co., Ltd. (XPCL), for the amount of Bt13.5 billion, with a schedule for full loan repayment by 2031. XPCL will repay the loan and interest from earnings after the commercial operation date, which is scheduled for 2019. The loan repayment risk, thus, is tied to XPCL's performance.

KEY OPERATING PERFORMANCE

Chart 1: Backlog at Year End



Source: CK

Table 1: CK's Investments (As of Dec 2017)

Company Name	CK Holding (%)	Type of Investment	Customer(s)	Remaining Contract Life (Years)
BEM	30.87	BTO concession	Public	2-24
		AOT concession	Public	32
		PPP Gross Cost	Public	25
TTW	19.40	BOO water purchase agreement	PWA	16
CKP	27.41	Holding company of six power plants	EGAT, PEA	-

Notes: PWA = Provincial Water Works Authority of Thailand
EGAT = Electricity Generating Authority of Thailand
PEA = Provincial Electricity Authority

Source: CK

FINANCIAL STATISTICS AND KEY FINANCIAL RATIOS*
Unit: Bt million

	----- Year Ended 31 December -----				
	2017	2016	2015	2014	2013
Revenue	36,071	45,809	34,851	32,870	32,677
Finance cost	1,393	1,166	1,545	1,468	1,538
Net income from operations	1,810	2,002	2,193	2,261	3,221
Funds from operations (FFO)	2,790	1,510	3,161	3,222	5,410
Capital expenditures	911	1,886	1,660	1,405	2,864
Total assets	79,274	94,928	93,066	80,872	72,034
Total debts	39,294	57,303	53,841	42,392	37,332
Total liabilities	55,401	73,074	72,210	61,402	55,194
Shareholders' equities	23,873	21,854	20,856	19,471	16,841
Depreciation & amortization	993	953	981	988	697
Dividends	874	1,146	1,061	701	936
Operating income before depreciation and amortization as % of sales	5.11	5.35	5.99	7.77	8.07
Pretax return on permanent capital (%)	4.69	4.27	6.25	7.12	13.89
Earnings before interest, tax, depreciation, and amortization (EBITDA) interest coverage (times)	3.11	3.64	3.40	3.49	4.57
FFO to total debt (%)	7.10	2.64	5.87	7.60	14.49
Total debt to capitalization (%)	62.21	72.39	72.08	68.53	68.91

* Consolidated financial statements

CH. Karnchang PLC (CK)

Company Rating:	A-
Issue Ratings:	
CK187A: Bt1,000 million senior unsecured debentures due 2018	A-
CK188A: Bt1,000 million senior unsecured debentures due 2018	A-
CK193B: Bt1,500 million senior unsecured debentures due 2019	A-
CK197A: Bt2,500 million senior unsecured debentures due 2019	A-
CK198A: Bt500 million senior unsecured debentures due 2019	A-
CK20NA: Bt1,000 million senior unsecured debentures due 2020	A-
CK215A: Bt2,250 million senior unsecured debentures due 2021	A-
CK233A: Bt4,000 million senior unsecured debentures due 2023	A-
CK245A: Bt1,600 million senior unsecured debentures due 2024	A-
CK247A: Bt1,500 million senior unsecured debentures due 2024	A-
CK25NA: Bt1,000 million senior unsecured debentures due 2025	A-
CK267A: Bt2,700 million senior unsecured debentures due 2026	A-
CK275A: Bt1,150 million senior unsecured debentures due 2027	A-
CK283A: Bt800 million senior unsecured debentures due 2028	A-
CK295A: Bt1,000 million senior unsecured debentures due 2029	A-
Rating Outlook:	Stable

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