

ITALIAN-THAI DEVELOPMENT PLC

No. 55/2023
10 April 2023

CORPORATES

Company Rating:	BBB-
Issue Ratings:	
Senior unsecured	BBB-
Outlook:	Negative

Last Review Date: 29/09/22

Company Rating History:

Date	Rating	Outlook/Alert
08/04/21	BBB-	Stable
19/01/21	BBB-	Alert Negative
30/09/13	BBB-	Stable
27/08/12	BB+	Negative
02/07/12	BB+	Alert Negative
08/06/12	BBB-	Negative
06/05/11	BBB	Stable
30/04/09	BBB+	Negative
13/09/07	BBB+	Stable
11/01/07	A-	Negative
23/11/05	A-	Stable

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RATIONALE

TRIS Rating revises the rating outlook of Italian-Thai Development PLC (ITD) to “negative” from “stable” and affirms the company rating on ITD and the ratings on its existing senior unsecured debentures at “BBB-”. We also assign a rating of “BBB-” to ITD’s proposed issue of up to THB4 billion senior unsecured debentures due within three years. The proceeds from the new debenture issuance will be used to repay some of its existing debentures.

The “negative” outlook reflects ITD’s weaker-than-expected operating performance which led to thin headroom of compliance with the key financial covenant on its debentures and loan obligations.

The ratings continue to reflect ITD’s leading position in the domestic engineering and construction (E&C) industry and its large and diverse project backlogs. The ratings are weighed down by its high financial leverage resulting from sizable investments that turned into non-performing investments and high working capital funding needs, as well as its susceptibility to the intense competition and cyclicity of the E&C business.

KEY RATING CONSIDERATIONS

Weaker-than-expected operating performance

ITD incurred significant losses from several construction projects in 2022. Besides the relatively thin margins of the E&C business amid the intense competition, ITD’s operating performance was hampered by rising raw material costs induced by supply disruptions. Also, the acceleration of construction projects, delayed due to the Coronavirus Disease 2019 (COVID-19) pandemic, also resulted in the cost overruns of several projects. ITD’s revenue increased by 14% year-on-year (y-o-y) to THB67.6 billion in 2022. However, its gross profit margin fell to only 4.6%, down from 9.4% in 2021 and lower than our prior forecast of 7.1%.

ITD also suffered from its share of loss of THB1.1 billion from its joint control company (JC) which owns a toll road concession of the First Dhaka Elevated Expressway (FDEE) in Bangladesh. The loss was mainly attributed to the unrealized foreign exchange loss on the JC’s US dollar loans amid the sharp depreciation of the Bangladeshi Taka against the US dollar. Thus, the company reported a huge net loss of THB4.8 billion in 2022.

Limited headroom under financial covenant

The significant losses incurred in 2022 have put ITD on the edge of a financial covenant breach as its equity base shrank to THB11 billion from THB16 billion at the end of 2021. The key financial covenants on its debentures and bank loan obligations require the company to maintain its net interest-bearing debt to equity ratio below 3.0 times. The ratio at the end of December 2022 was 2.97 times.

Given the tight covenant headroom, a slight loss in its construction work could easily lead to a breach of the financial covenant. However, since several loss-making projects like the Mass Rapid Transit (MRT) in Bangladesh and several building projects are near completion and construction material prices become more stabilized, ITD’s gross margins should gradually recover to around 7%-8% in 2023 and 8%-9% in 2024-2025.

In addition, ITD's plans to divest its non-core assets should help improve its balance sheet. Recently, the company was granted a potash mining license to operate the "South Udon Mine". Given that the mining license has been granted, and the price of potassium remains high, the divestment of this concession has become increasingly likely. The divestment, if successful, should materially improve ITD's capital structure.

High leverage from non-performing investments and huge working capital needs

The ratings on ITD are held back by its non-performing investments that contribute to its huge debt and annual interest expenses. In addition to a potash mine in Thailand, ITD has made significant and costly investments in the "Dawei Special Economic Zone Project (DSEZ Project) in Myanmar, a bauxite mine in the Lao People's Democratic Republic (Lao PDR), as well as a railway and port concession in Mozambique. These projects to date have cost ITD about THB16.6 billion and are not progressing as originally planned. Also, the hefty interest cost on the debts incurred to support these non-performing projects has been the key factor eroding ITD's bottom line every year.

In addition to the debt used to finance the company's non-performing investments, the huge working capital needs of its active projects is another key factor keeping its leverage elevated. The company also has carried sizable overdue receivables related to several state enterprise projects. As of December 2022, its debt to capitalization ratio was 80.1%, up from 73.7% in 2021. ITD's interest burden is piling up to over THB2.5 billion a year, draining its free cash flow. The earnings before interest, taxes, depreciation, and amortization (EBITDA) interest coverage ratio stood at 2.1 times in 2022 while the ratio of funds from operations (FFO) to debt remained weak at about 5%.

In our base-case forecast, we expect the interest servicing burden to continue weighing on ITD's cash flow and debt servicing ability. We project ITD to generate FFO of THB4.4 billion in 2023 and around THB5.0-THB5.2 billion per annum during 2024-2025. The FFO to debt ratio should improve to around 10% during 2023-2025 from only 5% in 2022, while the EBITDA interest coverage ratio is expected to stay above 2.5 times over the forecast period. The debt to capitalization ratio will likely remain elevated at 80% over the next three years.

Leading position in domestic E&C business with diverse backlog

The ratings on ITD continue to reflect its leading position in the domestic E&C business. By revenue, ITD is the largest E&C contractor listed on the Stock Exchange of Thailand (SET). Its annual revenues ranged from THB55 billion to THB67 billion over the past five years. The company has an extensive track record of undertaking projects for clients in both the public and private sectors. Given its wealth of experience and resources, ITD is among the country's top-tier contractors capable of bidding and participating in almost every massive-scale public infrastructure project. ITD also has expanded its business overseas. The company has established a strong presence in India, represented by its listed subsidiary, ITD Cementation India Ltd. The company has also undertaken projects in neighboring countries, including Lao PDR, the Philippines, and Bangladesh. In all, overseas operations make up about one-third of its revenues.

As of December 2022, ITD's construction backlog stood at THB218 billion, including the backlog of ITD Cementation India of around THB80 billion. Currently, the three largest projects in backlog include the MRT Purple Line (southern extension) Contract 3, Contract 5, and Contract 6 worth THB22.1 billion, the Den Chai-Chiang Rai-Chiang Khong Railway, Contract 1, worth THB21.2 billion, and the Mae Moh Mining, Phase 9, worth THB18.8 billion. We forecast ITD to generate revenue of THB68 billion in 2023, and THB72-THB77 billion annually during 2024-2025. ITD's sizable backlog will secure about 70%-85% of the base-case revenue forecast during 2023-2025. The EBITDA margins are forecast to stay around 9%-11% over the next three years, resulting in EBITDA of THB7.0-THB7.7 billion per year.

Tight liquidity

ITD's liquidity profile is tight. As of December 2022, its sources of liquidity included cash on hand of THB4.5 billion, unused uncommitted bank facilities of THB15.6 billion, and FFO of around THB4.4 billion per annum. The company had a total of THB27.9 billion debts coming due over the next 12 months, including THB4.0 billion in senior unsecured debentures, THB19.4 billion in bank loans, and THB4.5 billion in leases and other financial liabilities. Its annual capital expenditures are expected to total around THB3.0 billion. After assessing its sources of liquidity, we expect ITD will need to refinance most of its maturing debts to maintain adequate liquidity and to fund construction projects in the pipeline.

Since most of its bank loans are secured by assignments of payments from construction contracts, ITD's priority debt, including secured debt of ITD and total debt of its subsidiaries, was THB21.6 billion. These translate into a priority debt to total consolidated debt ratio of 49.8%, close to triggering a one-notch downgrade on its senior unsecured debt obligations.

BASE-CASE ASSUMPTIONS

- ITD to secure new contracts worth THB35-THB45 billion in 2023, and THB40 billion per annum in 2024-2025.
- Overall gross profit margin will be 7.7% in 2023 and improving to 8.8%-8.9% during 2024-2025.
- EBITDA margin to be in the 9%-11% range during 2023-2025.
- Capital expenditures for the construction segment are set at THB3.0-THB3.3 billion per year during 2023-2025.

RATING OUTLOOK

The “negative” outlook reflects ITD’s continued weaker-than-expected earnings. The significant losses in 2022 resulted in thin headroom for compliance with the financial covenant. Thus, further losses in its operations, without other mitigating factors, could easily lead to a breach of its financial covenant.

RATING SENSITIVITIES

The ratings and/or outlook could be revised upward should ITD’s operating performance and/or capital structure improve materially. On the other hand, the ratings could be revised downward should its profitability weaken further. A downgrade scenario could be triggered by a rise in the debt to EBITDA ratio above 8 times or the FFO to debt ratio falling below 5%. In addition, a breach in its financial covenant could also trigger a rating downgrade.

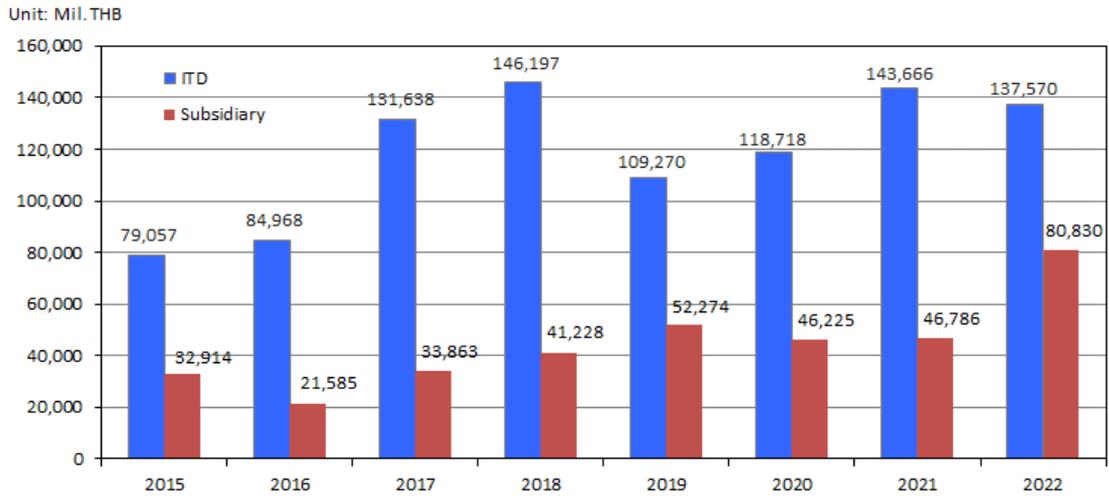
COMPANY OVERVIEW

ITD was established in 1958 by Dr. Chaijudh Karnasuta and Mr. Giorgio Berlingieri, an Italian naval architect. The company was listed on the SET in 1994. ITD’s business comprises three main areas: domestic construction, overseas construction, and long-term investments. ITD faced difficulties during the 1997 financial crisis. Subsequent restructuring completed in 2002 diluted the ownership stake of the Karnasuta Family from 64% to 48%. The family owned a 24% stake as of January 2023.

The company is engaged in a broad range of civil construction work, ranging from constructing buildings, industrial plants, pipelines, railways, expressways, airports, seaports, power plants, hydro-electric dams, and mines. In all, domestic projects comprise 60%-70% of the company’s total revenue annually while overseas projects make up the rest. E&C projects undertaken by its India-based subsidiary, ITD Cementation India, make up most of the revenue from overseas projects.

KEY OPERATING PERFORMANCE

Table 1: Construction Backlog at Year End



Source: ITD

Table 2: Revenue Breakdown by Location

Unit: %

Location	2015	2016	2017	2018	2019	2020	2021	2022
Domestic	61.8	61.1	71.2	64.1	66.2	69.9	61.2	59.2
Overseas	38.2	38.9	28.8	35.9	33.8	30.1	38.8	40.8
Total	100.0							
Revenue (Mil. THB)	51,297	47,320	55,096	60,644	62,221	53,968	58,742	67,074

Source: ITD

FINANCIAL STATISTICS AND KEY FINANCIAL RATIOS*

Unit: Mil. THB

	-----Year Ended 31 December -----				
	2022	2021	2020	2019	2018
Total operating revenues	67,607	59,272	54,627	62,780	61,245
Earnings before interest and taxes (EBIT)	(1,412)	3,189	1,737	3,420	3,564
Earnings before interest, taxes, depreciation, and amortization (EBITDA)	5,411	7,785	5,825	6,567	6,443
Funds from operations (FFO)	2,207	4,668	2,901	3,333	3,302
Adjusted interest expense	2,538	2,598	2,573	2,743	2,435
Capital expenditures	2,996	3,772	2,823	4,294	6,511
Total assets	115,857	113,238	107,873	105,085	98,015
Adjusted debt	44,263	45,409	45,659	46,549	44,224
Adjusted equity	11,011	16,223	15,444	16,977	16,470
Adjusted Ratios					
EBITDA margin (%)	8.00	13.13	10.66	10.46	10.52
Pretax return on permanent capital (%)	(2.22)	4.78	2.60	5.20	5.89
EBITDA interest coverage (times)	2.13	3.00	2.26	2.39	2.65
Debt to EBITDA (times)	8.18	5.83	7.84	7.09	6.86
FFO to debt (%)	4.99	10.28	6.35	7.16	7.47
Debt to capitalization (%)	80.08	73.68	74.72	73.28	72.86

* Consolidated financial statements

RELATED CRITERIA

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

Italian-Thai Development PLC (ITD)

Company Rating:	BBB-
Issue Ratings:	
ITD254A: THB6,000 million senior unsecured debentures due 2025	BBB-
Up to THB4,000 million senior unsecured debentures due within 3 years	BBB-
Rating Outlook:	Negative

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