ITALIAN-THAI DEVELOPMENT PLC

No. 182/2019
31 October 2019

CORPORATES

Company Rating:	BBB-
Issue Rating:	
Senior unsecured	BBB-
Outlook:	Stable

Last Review Date: 26/10/18

Company Rating History:

Date	Rating	Outlook/Alert
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 affirms the company rating on Italian-Thai Development PLC (ITD) and the rating on its senior unsecured debentures at "BBB-". The ratings reflect the company's robust market position in the domestic engineering and construction (E&C) industry, its sizable project backlog, and a promising outlook for the domestic E&C industry over the next few years. Conversely, the ratings are constrained by ITD's precarious financial profile and the cyclical nature of the E&C industry. The ratings are also weighed down by several unproductive investments which remain burdensome and impede turnaround.

KEY RATING CONSIDERATIONS

Strong presence in domestic market

The rating affirmation is largely built on ITD's strong market presence as the leader in the domestic E&C industry. By revenue, ITD is the largest E&C contractor listed on the Stock Exchange of Thailand (SET). Revenue ranged between Bt48-Bt61 billion per annum over the past five years.

ITD's solid business profile is underpinned by its extensive track record of undertaking projects for clients in both the public and private sectors. Given its wealth of experience and resources, ITD provides a complete range of construction and engineering services around the country. The company has a diverse base of customers.

ITD has expanded abroad in search of new business opportunities. This strategic move is aimed at reducing business concentration risks because ITD can offer a broad range of customers, located in and outside Thailand, with a wide range of products and services.

Large and diverse projects backlog

ITD has racked up a large and diverse projects backlog of Bt319.3 billion as of June 2019. The backlog includes a railway and port concession in Mozambique, worth Bt113.4 billion, and a toll road concession in Bangladesh, worth Bt37.6 billion. However, major the construction work in Mozambique has not yet begun, while the project in Bangladesh is set under a joint venture. Therefore, TRIS Rating leaves these two projects out of our forecast in order to take a more conservative view of the size of the backlog.

That said, ITD's remaining backlog stood at Bt168.3 billion, which includes other large projects such as the Hongsa mining project in the Lao People's Democratic Republic (Lao PDR), worth Bt17.0 billion, and the Mae Moh mine contract #9, worth Bt28.8 billion. The large number of projects in the backlog is expected to secure a significant amount of future revenues, as long as ITD can deliver as planned.

Revenue will stay on a roll

ITD's operating performance during the first half of 2019 was in line with our expectation, with revenue driven by infrastructure and industrial construction projects abroad, including a mass transit project in Bangladesh.

In addition to ITD's solid market position, new opportunities in the years ahead will help maintain the current ratings. The government is still pushing ahead with large-scale infrastructure projects as part of the country's long-term development strategy. As such, TRIS Rating maintains a broadly positive view on the domestic E&C industry. As ITD is poised for substantial growth in light of its ability to win contracts, we expect ITD to attain robust revenue growth over the next few years.

For the first nine months of 2019, ITD garnered around Bt10 billion in new contracts. In our base case forecast, revenue will grow from Bt59 billion in 2019 to Bt74 billion by 2021. ITD's robust backlog will secure a notable portion of revenue, about 87% of the base case revenue in 2019, 73% in 2020, and 57% in 2021. The operating margin (operating profit before depreciation and amortization as a percentage of revenue) is forecast to stay above 9%.

Despite a positive view on domestic construction, the cyclicality of the E&C industry remains a downside risk. If domestic construction loses steam, the downturn could cut deeply into ITD's revenues and operating profit.

Leverage will stay elevated

ITD's leverage has been increasing over the past three years due in large part to the huge working capital needs of its active projects. Moreover, the company has shouldered sizable receivables related to some state enterprises projects which remain uncollected and lead to a higher-than-expected leverage. Total debt rose to Bt50.7 billion as of June 2019, from Bt46.9 billion as of 2018. The debt to capitalization ratio climbed to 75.6% as of June 2019, up from 72.9% at the end of 2018. In addition, we expect ITD to spend Bt4.0-Bt5.5 billion per year acquiring new machinery and equipment during 2019-2021, most of which are for the Mae Moh mine contract #9 project. In all, we expect leverage to stay elevated, given the company's tendency to incur additional borrowings. In our base case forecast, the debt to capitalization could remain at around 75% during 2019-2021, leaving ITD with a precarious financial profile.

Unproductive investments impeding a turnaround

For many years, ITD has been burdened by investment missteps which hamper its efforts to decrease debt. ITD has defrayed billions to five large projects: a potash mine in Thailand, the Dawei industrial estate in Myanmar, a toll road in Bangladesh, a bauxite mine and alumina plant in Lao PDR, and a railway and port concession in Mozambique. However, these projects are not paying off, particularly the long-delayed potash mine and the Dawei projects, which together have cost ITD about Bt11 billion to date.

In our view, these investments will continue to burden ITD with a heavy debt load, given the remote likelihood these huge investments will generate return in the near term. In addition, the associated project risks, including country risks and regulatory risks, appear to outweigh the benefits of the projects. The substantial interest burden could outstrip ITD's operating profit if overall margins plunge or if ITD incurs significant losses on some projects.

Precarious financial profile

ITD's debt-heavy capital structure remains a drag on the ratings, despite its competitive strengths in the business. ITD has a pile-up of interest burden of over Bt2 billion a year, which drastically drains away its free cash flow. Earnings before interest, tax, depreciation, and amortization (EBITDA) interest coverage ratio remained low at 2.2 times in the first half of 2019. The funds from operations (FFO) to debt ratio was weak at 7.5% as of 2018, then fell to 6.4% (annualized, based on the trailing 12 months) in the first half of 2019.

In our base case forecast, we expect ITD to generate FFO of at least Bt3.0 billion in 2019. FFO should improve to a range of Bt4.5-Bt5.0 billion per annum in 2020-2021. The FFO to debt ratio should improve each year towards 8%-9%, while the EBITDA interest coverage ratio to stay above 2 times. With the magnitude of interest burden, we see significant risk of ITD facing difficulty in generating enough cash to meet its debt obligations.

Potential breach of financial covenant

ITD is on the verge of a financial covenant breach. The company has to maintain its net interest-bearing debt to equity ratio below 3.0 times, according to the key financial covenants of its bonds and bank loans. The ratio at the end of June 2019 was 2.99 times. We view that the risk of a financial ratio covenant breach for the period thereafter is high. Given the tight covenant headroom, the ratio could exceed the threshold in our forecast unless ITD manages working capital more efficiently, in particular, by collecting overdue receivables. We emphasize that non-compliance with the covenant or failure to obtain waivers, if needed, could trigger a negative rating action.

Liquidity tightening, but should be manageable

We hold the view that ITD's liquidity is tight. As of June 2019, the company had debts coming due over the next 12 months totaling Bt23 billion. After assessing its sources of liquidity (comprising its annual cash inflow, cash on-hand, and undrawn facilities), we expect that ITD would need to refinance most of its debts in order to maintain liquidity for upcoming projects.

We believe that ITD could manage to refinance such debts, much of which are secured by assignments of payments from construction contracts. This is because of ITD's capability to complete projects and acceptable payment risks of project owners.

BASE-CASE ASSUMPTIONS

These are the key assumptions in TRIS Rating's base-case forecast:

- ITD to secure new contracts worth Bt17 billion in 2019 and Bt45 billion per annum during 2020-2021.
- Overall gross profit margin will be around 10% on average.
- Overall operating margin to be in the 9.5%- 10.5% range.
- Capital expenditures for the construction segment are set at Bt4.0-Bt5.5 billion per year.

RATING OUTLOOK

The "stable" outlook embeds our expectation that ITD will continue to secure sizable projects, maintain its strong market position, and boost profitability and liquidity. Moreover, we expect ITD to keep the operating margin at or above 9%. Base on that, we hold the view that ITD should gradually increase the amount of cash available to service its debt obligations. Furthermore, we expect ITD to remain compliant with its financial covenants, despite a forecasted rise in leverage.

RATING SENSITIVITIES

Given ITD's relatively weak financial profile, a rating upgrade is unlikely over the next 12-18 months. Leverage is expected to remain elevated. In contrast, rating downward pressure could develop if profitability weakens. This could occur as a result of aggressive bidding, delays in construction, or cost overruns. A downgrade could come if the operating margin declines to 7% or if the FFO to debt ratio falls below 5% over the next 2-3 years. In addition, non-compliance with the financial covenants or failure to obtain waivers, if needed, could trigger a rating downgrade.

COMPANY OVERVIEW

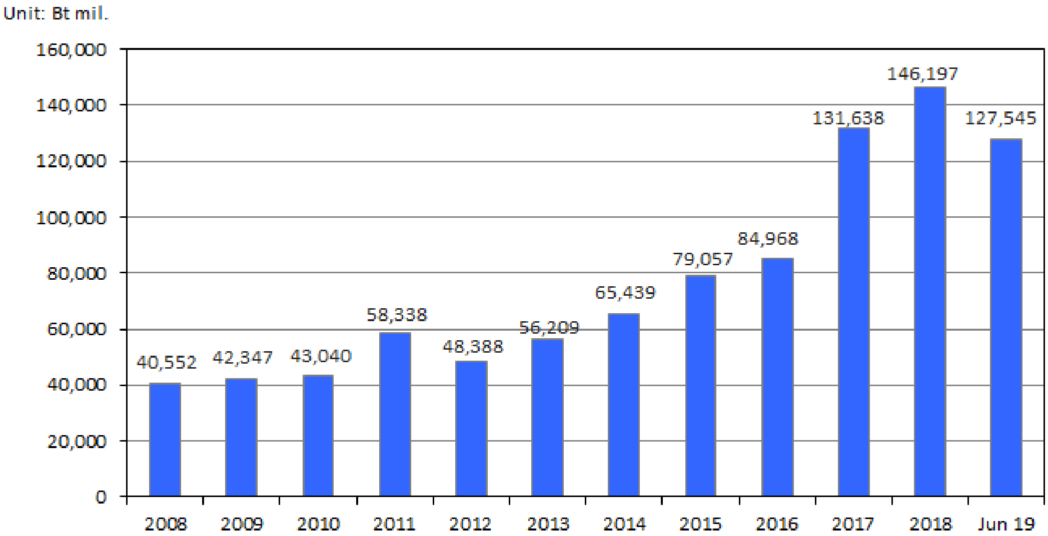
ITD was established in 1958 by Dr. Chaijudh Karnasuta and Mr. Giorgio Berlingieri, an Italian naval architect. The company was listed on the SET in 1994. ITD's business is divided into three segments: domestic construction, overseas construction, and long-term investments. ITD faced difficulty during the 1997 financial crisis. A restructuring completed in 2002 diluted the ownership stake of the Karnasuta family from 64% to 48%. The family owned 25% as of March 2019. Mr. Premchai Karnasuta, the founder's son, has served as president since 1985.

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 total revenue annually while overseas projects make up the rest. E&C projects undertaken by its India-based subsidiary, ITD Cementation India Limited, make up most of the revenue from overseas projects.

ITD's operating performance during the past 12 months was in line with TRIS Rating's base case forecast. Revenue in the first half of 2019 was Bt31.2 billion, increasing 6.4% from the same period in the previous year. Revenue was driven from infrastructure and industrial construction projects abroad, including mass transit projects in Bangladesh. The operating margin (operating profit before depreciation and amortization as a percentage of revenue) in the first half of 2019 was 9.9%, decreasing from 10.6% in 2018. The drop in operating margin was due to ITD setting aside extra employee benefit expenses of Bt311 million in this year.

KEY OPERATING PERFORMANCE

Table 1: Backlog at Year End



Source: *ITD*

Note: *Excluding 1) A railway and port concession in Mozambique worth Bt113.4 billion, 2) A toll road concession Bangladesh worth Bt37.6 billion, and 3) Backlog of subsidiary company*

Table 2: Revenue Breakdown by Location

Unit: %

Location	2012	2013	2014	2015	2016	2017	2018	Jan-Jun 2019
Domestic	70.9	75.8	76.2	61.8	61.1	71.2	64.1	65.5
Overseas	29.1	24.2	23.8	38.2	38.9	28.8	35.9	34.5
Total	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**
Revenue (Bt mil.)	**46,291**	**43,913**	**48,082**	**51,297**	**47,320**	**55,096**	**60,644**	**30,957**

Source: ITD

FINANCIAL STATISTICS AND KEY FINANCIAL RATIOS*

Unit: Bt million

		-----------Year Ended 31 December ----------			
	Jan-Jun 2019	2018	2017	2016	2015
Total operating revenues	31,243	61,245	55,571	47,669	51,539
Operating income	3,082	6,488	5,632	4,428	3,845
Earnings before interest and taxes (EBIT)	1,335	3,564	3,079	2,230	1,905
Earnings before interest, taxes, depreciation, and amortization (EBITDA)	2,989	6,443	5,440	4,811	4,410
Funds from operations (FFO)	1,335	3,328	2,618	2,277	1,794
Adjusted interest expense	1,337	2,435	2,386	2,439	2,626
Capital expenditures	2,562	6,511	3,611	4,224	2,948
Total assets	103,357	98,015	87,829	78,120	78,095
Adjusted debt	48,432	44,224	37,647	32,788	31,773
Adjusted equity	15,658	16,470	14,773	14,333	14,577
Adjusted Ratios					
Operating income as % of total operating revenues (%)	9.87	10.59	10.13	9.29	7.46
Pretax return on permanent capital (%)	4.89 **	5.89	5.76	4.48	3.97
EBITDA interest coverage (times)	2.24	2.65	2.28	1.97	1.68
Debt to EBITDA (times)	7.54 **	6.86	6.92	6.81	7.20
FFO to debt (%)	6.40 **	7.53	6.95	6.94	5.65
Debt to capitalization (%)	75.57	72.86	71.82	69.58	68.55

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

RELATED CRITERIA

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

Italian-Thai Development PLC (ITD)

Company Rating:	BBB-
Issue Rating:	
ITD226A: Bt6,000 million senior unsecured debentures due 2022	BBB-
Rating Outlook:	Stable

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