

ITALIAN-THAI DEVELOPMENT PLC

No. 161/2021

30 September 2021

CORPORATES

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

Last Review Date: 08/04/21

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 affirms the company rating on Italian-Thai Development PLC (ITD) and the rating on its senior unsecured debentures at “BBB-” with a “stable” rating outlook. The ratings mirror ITD’s solid market position as the largest construction contractor, with strong competitive strengths in undertaking large construction projects. The ratings also consider the depth of the company’s project backlog. However, these strengths are weighed down by its high financial leverage, and the fierce competition in the engineering and construction (E&C) industry. The ratings are also constrained by perennial problems surrounding ITD’s ailing investments which continue to hamper a turnaround in operating performance.

KEY RATING CONSIDERATIONS

Largest construction contractor

ITD continues to retain its solid market position as the largest construction contractor in Thailand. ITD’s strong business profile is buoyed by its long-established track record, wealth of experience and resources, and competence in undertaking the complete range of construction and engineering services. ITD has a large and diverse client base in both the public and private sectors. The company is among the country’s top-tier contractors capable of bidding and participating in massive-scale public infrastructure projects, such as high-speed rail.

By revenue, ITD is the top E&C contractor listed on the Stock Exchange of Thailand (SET). The company generated THB48-THB63 billion in yearly revenue over the past five years. Additionally, ITD has established a strong presence in India, through its listed subsidiary, ITD Cementation India Ltd. The company has also undertaken projects in neighboring countries and Bangladesh. In all, overseas operations make up about one-third of revenue.

For the first half of 2021, ITD’s operating performance was slightly better than we expected. Despite the severity of the drawn-out Coronavirus Disease 2019 (COVID-19) pandemic, ITD’s revenue totaled THB30 billion for the first half of 2021, an increase of 11% year-on-year (y-o-y). Gross margin improved to 11.3%, up from 8.9% in 2020.

Hefty project backlog

As of June 2021, ITD pocketed a large and diverse project backlog of THB315.4 billion. The backlog includes a railway and port concession in Mozambique, worth THB113.3 billion, and a toll road concession in Bangladesh worth THB37.6 billion. However, major construction work in Mozambique has not yet begun, while the project in Bangladesh is under joint venture. As such, we leave out these two projects from our forecast in order to take a more conservative view on the size of the backlog.

Despite omitting these two overseas projects, ITD’s backlog remained high at THB164.5 billion, which included some large projects such as the Hongsa mining project in the Lao People’s Democratic Republic (Lao PDR) worth THB13.1 billion, and the Mae Moh mine contract 9 worth THB23.2 billion. The hefty project backlog considerably helps secure a significant amount of future revenue.

Pandemic-hit construction activities

Construction contractors suffered from a range of direct impacts from COVID-19, such as the temporary closure of construction workers' camps, disrupted supply of goods and materials, and delays in work progress. More importantly, the outbreak has induced a contraction in residential demand. The outlook of the residential property market remains dim due in large part to the weak market sentiment, and strained consumer purchasing power. The residential segment, which generally represents around half of the construction in the private sector, is unlikely to recover to pre-COVID levels in the near term.

More confident outlook for public construction

As opposed to the private sector, public construction has a more confident outlook in the near-to-intermediate term. For the first half of 2021, domestic construction grew by 8% y-o-y. The public segment staged a robust 15.5% growth, while private-sector construction reduced by 0.3% y-o-y. We hold the view that government spending and state enterprise outlays will be essential for post-pandemic recovery. We maintain a positive view on the domestic E&C industry over the medium term, considering the government's continued efforts to improve the country's infrastructure. We expect the up-and-coming public infrastructure projects to be concentrated in the transport sector and the Eastern Economic Corridor (EEC).

Intensifying competition

Despite the government pushing ahead several infrastructure projects, we have witnessed repeated delays in the bidding and awarding of much-anticipated public projects for various reasons. These include certain changes in project master plans, disputes over the contract bidding process, prolonged government decision-making process, delay in contract negotiation, etc. Intense competition among contractors persists. Most projects are awarded through competitive biddings that squeeze contractors' profit margins. New waves of COVID-19 outbreaks meanwhile continue to pose threats to the country's economic recovery.

Earnings on uptrend

We expect ITD's earnings to continue on a growth path, given the government's infrastructure projects rollout, and its capability of winning new contracts. In our forecast, we project ITD to generate revenue of THB59 billion in 2021, and THB66 billion annually during 2022-2023. We expect ITD's robust backlog will secure a significant portion of revenue, representing about 75% of the base-case revenue forecast in 2021, 65% in 2022, and 50% in 2023. The earnings before interest, taxes, depreciation, and amortization (EBITDA) margins are forecast to stay around 10%-11% over the next three years, resulting in EBITDA of THB6.8-THB7.1 billion per year.

Non-performing investments hampering a turnaround

The ratings are heavily weighed down by ITD's unproductive investments which continue to set back financial recuperation. ITD has disbursed huge investment amounts to a number of large concession projects, including a potash mine in Thailand, the Dawei Special Economic Zone project (the DSEZ project) in Myanmar, a bauxite mine and alumina plant in Lao PDR, and a railway and port concession in Mozambique.

These projects, which to date have cost ITD about THB14.6 billion, are not progressing as originally planned. This is particularly the case for the DSEZ project with ITD having already invested substantial amounts on land clearing and infrastructure construction. In our view, the associated project risks including country risks and regulatory risks, raise serious questions regarding the costs and benefits of the projects. The hefty interest cost on the debts incurred to support these non-performing projects has been eating away ITD's operating profit for many years, with no signs of any returns from these investments over the next few years.

The DSEZ project dispute

We expect the dispute between ITD and the DSEZ management committee with respect to the committee's unilateral decision to terminate the concession contracts to not reach conclusion in the near term. The termination, if materialized, could potentially cause significant impairment to ITD's assets and equity, triggering non-compliance with the financial covenant on its outstanding debentures. However, it remains unclear whether the dispute will lead to the eventual termination of concession agreements as the Thai government is supporting to resolve the issues. The dispute is unlikely to be resolved soon, given the ongoing political turmoil in Myanmar. We view the risk of potential impairment to not be an imminent threat.

In assessing ITD's financial profile, we have consistently left out the ailing investment projects in ITD's backlog and our financial forecast, including the DSEZ project. Therefore, the termination of contracts or concession cancellation would not impact our forecast of ITD's funds from operations (FFO), and the ratio of FFO to debt.

Financial leverage to remain elevated

ITD's debt-heavy capital structure remains a key constraint to the ratings, despite its competitive strengths in the business. 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 carried sizable receivables related to several state enterprise projects that remain unpaid. As of June 2021, the debt to capitalization ratio remained high at 73.7%. ITD's interest burden is piling up to over THB2 billion a year, draining its free cash flow. The EBITDA interest coverage ratio stood at 3.5 times in the first half of 2021. FFO to debt ratio was 9.5%, improved from about 6%-7% over the past several years.

In our base-case forecast, we expect the interest servicing burden to continue taking a toll on ITD's cash flow and debt servicing ability. We expect ITD to generate FFO in the range of THB4.2-THB4.5 billion per annum during 2021-2023. The FFO to debt ratio should remain about 9%-9.5%, while the EBITDA interest coverage ratio will stay above 2.7 times. We project the debt to capitalization ratio will remain elevated at about 75%.

Capital Structure

The assigned issue rating on ITD's senior unsecured debentures is equal to the company rating on ITD, as the priority debt to total debt ratio is below the threshold of 50%. As of June 2021, ITD's total debt, excluding financial leases, was THB45.9 billion, of which THB22.1 billion was priority debt according to the TRIS Rating "Issue Rating Criteria". The ratio of priority debt to total debt was 48%.

ITD is obliged to keep its net interest-bearing debt to equity ratio below 3.0 times, under the key financial covenants on its outstanding bonds. The ratio at the end of June 2021 was 2.31 times. We believe the company will be able to meet the condition during the forecast period.

Liquidity tightening, but should be manageable

We hold the view that ITD's liquidity is tight. As of June 2021, the company had a total of THB31.5 billion in debt coming due over the next 12 months. After assessing its sources of liquidity comprising its annual cash inflow, cash on-hand, and undrawn facilities, we expect ITD will need to refinance most of its maturing debts to maintain adequate liquidity and to fund projects in the pipeline.

We expect that ITD should be able to manage the refinancing of maturing debts, much of which are secured by assignments of payments from construction contracts. The refinancing risk is largely mitigated by ITD's strong capability of completing construction projects and the acceptable payment risks of project sponsors.

BASE-CASE ASSUMPTIONS

These are the key assumptions in TRIS Rating's base-case forecast for 2021-2023:

- ITD to secure new contracts worth THB45 billion per annum over the next three years.
- Overall gross profit margin will be around 10% on average.
- Overall EBITDA margin to be in the 10%- 11% range.
- Capital expenditures for the construction segment are set at THB3.6-THB4.1 billion per year.

RATING OUTLOOK

The "stable" outlook reflects our expectation that ITD will maintain its solid market position and competence, enabling the company to secure sizable projects. Its profitability and liquidity should gradually improve. We expect ITD to keep the EBITDA margin at or above 10%. We also expect the company's financial leverage to be in the range of our forecast levels. As such, we expect ITD should gradually increase the amount of cash available for debt service.

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. However, the ratings could be upgraded if the company significantly reduces its debt load. On the other hand, downward revision to the ratings could develop if profitability weakens. This could occur as a result of aggressive biddings, delays in construction, or cost overruns. A downgrade scenario could be triggered if the EBITDA margin declines to 7% or if the FFO to debt ratio falls below 5% for a sustained period.

COMPANY OVERVIEW

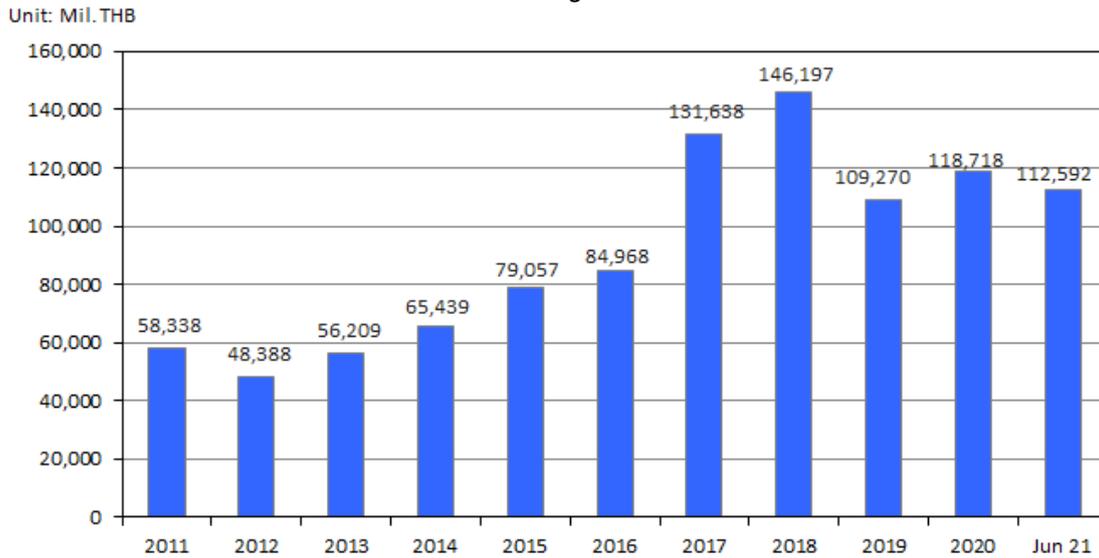
ITD was established in 1958 by Dr. Chaijudh Karnasuta and Mr. Giorgio Berlingieri, an Italian naval architect. The company was listed on the SET in 1994. ITD's business is divided into three segments: domestic construction, overseas construction, and long-term investments. ITD faced difficulties during the 1997 financial crisis. Subsequent restructuring completed in

2002 diluted the ownership stake of the Karnasuta family from 64% to 48%. The family owned 25% as of March 2021. 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.

KEY OPERATING PERFORMANCE

Table 1: Backlog at Year End



Source: ITD

Note: Excluding 1) A railway and port concession in Mozambique worth THB113.3 billion, 2) A toll road concession Bangladesh worth THB37.6 billion, and 3) Backlog of subsidiary company

Table 2: Revenue Breakdown by Location

Unit: %

Location	2014	2015	2016	2017	2018	2019	2020	Jan-Jun 2021
Domestic	76.2	61.8	61.1	71.2	64.1	66.2	69.9	62.1
Overseas	23.8	38.2	38.9	28.8	35.9	33.8	30.1	37.9
Total	100.0							
Revenue (Mil. THB)	48,082	51,297	47,320	55,096	60,644	62,221	53,968	29,477

Source: ITD

FINANCIAL STATISTICS AND KEY FINANCIAL RATIOS*

Unit: Mil. THB

	Jan-Jun 2021	-----Year Ended 31 December -----			
		2020	2019	2018	2017
Total operating revenues	29,850	54,627	62,780	61,245	55,571
Earnings before interest and taxes (EBIT)	2,117	1,737	3,420	3,564	3,079
Earnings before interest, taxes, depreciation, and amortization (EBITDA)	4,460	5,825	6,567	6,443	5,440
Funds from operations (FFO)	2,809	2,860	3,284	3,328	2,618
Adjusted interest expense	1,265	2,573	2,743	2,435	2,386
Capital expenditures	2,198	2,823	4,294	6,511	3,611
Total assets	110,924	107,873	105,085	98,015	87,829
Adjusted debt	46,029	45,659	46,549	44,224	37,647
Adjusted equity	16,403	15,444	16,977	16,470	14,773
Adjusted Ratios					
EBITDA margin (%)	14.94	10.66	10.46	10.52	9.79
Pretax return on permanent capital (%)	4.44 **	2.60	5.20	5.89	5.76
EBITDA interest coverage (times)	3.53	2.26	2.39	2.65	2.28
Debt to EBITDA (times)	6.20 **	7.84	7.09	6.86	6.92
FFO to debt (%)	9.45 **	6.26	7.06	7.53	6.95
Debt to capitalization (%)	73.73	74.72	73.28	72.86	71.82

* Consolidated financial statements

** Annualized with trailing 12 months

RELATED CRITERIA

- Issue Rating Criteria, 15 June 2021
- 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: THB6,000 million senior unsecured debentures due 2022	BBB-
Rating Outlook:	Stable

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