

NAWARAT PATANAKARN PLC

No. 20/2018
28 February 2018

CORPORATES

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

Company Rating History:

Date	Rating	Outlook/Alert
01/04/14	BBB-	Stable

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RATIONALE

TRIS Rating affirms the company rating of Nawarat Patanakarn PLC (NWR) and the ratings of NWR's outstanding senior unsecured debentures at "BBB-". At the same time, TRIS Rating revises the company's outlook to "negative" from "stable". The "negative" outlook reflects concerns over the lingering high level of leverage. In addition, the size of the project backlog and the recent operating performance of NWR are both below expectations.

The ratings continue to reflect the company's acceptable track record of undertaking a broad range of construction projects for the public and private sectors. Conversely, the ratings are tempered by high financial leverage, the cyclical nature of the engineering and construction (E&C) industry, competitive threats, and the execution risks associated with residential property projects.

KEY RATING CONSIDERATIONS

Acceptable track record

NWR's moderate business profile reflects its acceptable track record of executing and completing projects. The company can undertake construction projects for both public and private sector clients. NWR is the sixth largest among the contractors listed on the Stock Exchange of Thailand (SET), judged by annual revenue and assets.

NWR provides a broad range of civil construction work services, including the construction of buildings, factories, transportation infrastructure, ports, irrigation works, tunnels, and pipe jacking projects.

In addition, NWR has a significant revenue stream from a nine-year contract to remove soil and excavate coal at the Mae Moh mine. The contract covers 2009-2018. The Mae Moh project is undertaken by NWR-SBCC Joint Venture (JV). NWR owns a 50% stake in the JV.

Backlog is smaller than expected

NWR signed fewer new contracts in 2017 than TRIS Rating's forecast. For this reason, TRIS Rating places a "negative" outlook on the ratings. For the first nine months of 2017, NWR racked new contracts worth Bt4.7 billion, a value is considered somewhat low. NWR failed to outbid other E&C companies in the races for large public infrastructure projects which were recently awarded by the government.

Without a large number of new contracts, future revenue will be less than expected, particularly when the Mae Moh project tails off. As of September 2017, NWR's backlog stood at Bt11 billion, the equivalent of revenue for one year.

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. NWR still has a significant number of opportunities to secure contracts for the forthcoming projects, serving as the main contractor or as a sub-contractor. If NWR is successful, the new contracts will replenish backlog, which is rapidly dissipating.

The ratings are still constrained by the cyclical nature of the E&C industry and the stiff competition within the industry. These factors remain as downside risks for NWR's revenues and profits.

Execution risks in residential property projects

NWR has expanded into the property development industry, a strategic shift designed to ramp up its revenue base. Since 2013, the property development segment has been handled by a wholly-owned subsidiary, Mana Patanakarn Co., Ltd. (MANA). MANA launched two single-detached house (SDH) projects and one low-rise condominium project, with a combined value of around Bt3.4 billion. Sales at these three housing projects have been slow. As a result, revenue from property development segment remains small and inadequate to strengthen NWR's overall profitability.

The property development industry is especially competitive. MANA has not yet demonstrated success in the housing and condominium segments. Its ability to sell the housing units it has developed is in question.

The ratings therefore take into account NWR's short track record of developing residential property projects. The execution risks that come with the foray into residential property development remain a rating concern. For instance, while the sales in the SDH projects remain lower than expectations, NWR must carry the financial burden for the projects. TRIS Rating does not expect a steady growth in this business segment either.

Operating performance slips

NWR's financial performance for the first nine months of 2017 fell short of TRIS Rating's expectation. Revenue was Bt6.8 billion in line with the forecast value. In assessment of NWR's performance, TRIS Rating employs the proportionate consolidation accounting method to reflect the overall performance of the company. The use of this method means the performance of the NWR-SBCC JV and NWR's potential exposure to the JV are taken into account.

With proportionate inclusion of revenue from the JV, NWR reported Bt7.74 billion in total revenue, a 16% year-on-year (y-o-y) rise. The gross profit margin of the construction segment stood at 7% while that of the property development segment was 22% in the first nine months of 2017. These levels were lower than the margins at the SET-listed peers. TRIS Rating estimated NWR's overall gross margin at 7%-8%, but the gross margin undershot the estimate at 6.4%.

The operating margin (operating profit before depreciation and amortization as a percentage of revenue) in the first nine months of 2017 was 8.41%, down from 9.75% in 2016. Operating expenses rose steeply in an effort to support the property development segment. NWR reported a net loss of Bt66 million in the first nine months of 2017.

Financial leverage remains high

The "negative" outlook is also built on the level of financial leverage, which lingers at high levels. NWR has shouldered a much higher debt load over the past three years. The debt level has increased significantly since 2014 for three reasons: rising working capital needs, increasing activity in the property development segment, and needed capital expenditures. NWR's financial profile, as reported, does not fully reflect its debt exposure. As a result, TRIS Rating includes the debts of the NWR-SBCC JV in the rating assessment to reflect the company's potential exposure as a JV partner and guarantor.

At the end of September 2017, NWR had Bt5 billion in consolidated debt, including debts at the JV on pro-rata basis. The debt to capitalization ratio remained high at 57.75% as of September 2017. NWR also suffers from long overdue receivables, which hurt cash flow considerably.

In TRIS Rating's view, it is important for NWR to make a concerted effort to strengthen profitability. The company should wring significant costs out of operations. Looking ahead, the debt level will stay elevated unless working capital is managed more efficiently and sales at the residential property projects accelerate. Any drop in revenue or weaker profitability would further jeopardize the financial profile.

Rather tight liquidity

NWR's liquidity profile is somewhat tight. At the end of September 2017, the company had Bt796 million of cash and Bt932 million of undrawn credit facilities. Over the next 12 months, NWR has a substantial amount of long-term debts coming due, comprising bank loans (around Bt676 million), and bonds (Bt1.5 billion). NWR plans to refinance these debts with new bond issues. Considering the large sum of maturing debts, refinancing risk also adds further concern.

NWR must maintain a debt to equity ratio below 2.5 times in order to comply with the financial covenants specified in the outstanding bonds. The ratio was 1.13 times at the end of September 2017.

RATING OUTLOOK

The “negative” outlook reflects NWR’s faltering operating performance and persistently high level of leverage. Over the next three years, NWR’s financial profile is likely to weaken as the size of the project backlog shrinks and property sales remain modest. TRIS Rating’s base-case forecast assumes revenue will average Bt8.5 billion per year. The operating margin is expected to range between 6%-9%. The debt to capitalization ratio is expected to stay around 55%.

The ratings could be downgraded if operating performance falls below expectations or the debt to capitalization ratio exceeds 60%, or the earnings before interest, tax, depreciation and amortization (EBITDA) interest coverage ratio remains below 3 times.

The outlook could be revised to “stable” if the operating performance and leverage improve to sustainable levels. Examples of improved, sustainable levels are a debt to capitalization ratio of around 50%, or an EBITDA interest coverage ratio above 4 times.

RATING SENSITIVITIES

The ratings are unlikely to be upgraded over the next 12-18 months as leverage is expected to remain high while the revenue contribution from the property development segment remains small. NWR’s success in the property development segment, coupled with a significant falloff in its debt load, would be positive factors for the ratings and/or outlook.

In addition to weaker operating performance, downward pressure on the ratings could also develop if the company makes any large investment in the property development segment.

COMPANY OVERVIEW

NWR, a general contractor, was established in 1976 by Mr. Mana Karnasuta. The company was listed on the SET in 1995. As of March 2017, NWR’s major shareholder was Mr. Polpat Karnasuta (son of Mr. Mana Karnasuta), holding 10.5% of the total shares outstanding.

The company provides a broad range of civil construction work services. NWR set up Myanmar NWR Co., Ltd. in 2000 and NWR (Cambodia) Co., Ltd. in 2007 to expand its construction business into neighboring countries. In 2001, NWR acquired a 60% stake in Utility Business Alliance Co., Ltd., which manages wastewater treatment plants.

NWR expanded into the property development business when it joined with Charn Issara Development PLC (CI) in C.I.N. Estate Co., Ltd. (CIN) to develop two condominium projects during 2006-2013. CIN developed “The Issara Ladprao”, a condominium project, worth Bt1.87 billion, in 2006 and the “ISSI Condominium Suksawat”, worth Bt2 billion, in 2013.

NWR has developed a number of residential property projects during the past few years. For example, NWR took a 25% stake in VSPN Property Co., Ltd. VSPN was created to develop a seaside housing project in Chonburi province in 2007. NWR launched its first SDH project in 2012, the Villa Baranee project, valued at Bt600 million. The project is located in the Rungsit-Klong 3 area.

In 2013, NWR set up a wholly-owned property developer, MANA. MANA develops residential property projects under the “Baranee” brand. In November 2014, MANA launched an SDH project, Baranee Park Romklao, valued at Bt900 million. In August 2015, MANA launched “Aspen Condo”, its first low-rise condominium project, targeting the middle- to low-end market segments. The Aspen Condo has four phases, consisting of 1,448 units. The project value is Bt2.8 billion. The average selling price is Bt2 million per unit. In October 2015, MANA launched another housing project, Baranee Residence, worth around Bt760 million. Early in 2017, CIN launched one SDH project, Baan Issara Bangna, worth around Bt2.6 billion.

The company expanded into the production and distribution of construction materials in December 2013 when NWR established “Advance Prefab Co., Ltd.”. Advance Prefab manufactures concrete products and supplies these products to NWR’s construction projects and sells the products to the public.

The construction segment comprises most of total revenue (82%). The company plans to increase the portion of revenue coming from the residential property segment in order to reduce fluctuations in its operating performance. During the past five years, the building and transportation infrastructure segments contributed the majority of revenue, accounting for 70%-80% of revenue each year.

KEY OPERATING PERFORMANCE

Table1: Construction Revenue Breakdown by Type of Project

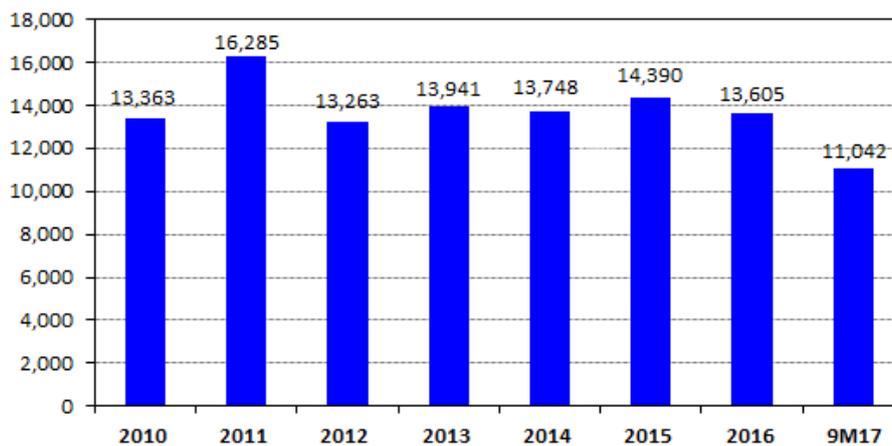
Unit: %

Type of Project	2011	2012	2013	2014	2015	2016	Jan-Sep 2017
Buildings, factories, plants	42	53	54	51	32	21	25
Transportation infrastructure	24	33	29	28	40	48	44
Coal excavation	22	12	15	12	12	11	13
Tunnels & pipe jacking	3	0	1	7	11	15	10
Marine work	9	2	0	2	6	5	8
Total	100						

Source: NWR

Chart 1: Backlog at the End of September 2017

Unit: Bt mil.



Source: NWR

FINANCIAL STATISTICS AND KEY FINANCIAL RATIOS*

Unit: Bt million

	Jan-Sep 2017	----- Year Ended 31 December -----			
		2016	2015	2014	2013
Revenue	6,793	8,312	7,586	6,826	6,727
Finance cost	189	228	186	101	134
Net income from operations	(66)	52	(174)	8	58
Funds from operations (FFO)	311	445	69	186	430
Capital expenditures	249	715	671	445	407
Total assets	12,959	12,577	11,435	9,445	8,988
Total debts	4,959	4,550	4,349	2,658	2,385
Total debts adjusted	5,029	4,871	5,031	3,860	-
Total liabilities	9,280	8,831	7,752	5,571	5,960
Shareholders' equity	3,680	3,746	3,683	3,874	3,028
Depreciation & amortization	283	317	275	226	479
Dividends	-	-	-	-	188
Operating income before depreciation and amortization as % of sales	8.41	9.75	5.93	7.98	8.58
Pretax return on permanent capital (%)	2.81 **	3.54	0.69	2.49	4.54
Earnings before interest, tax, depreciation, and amortization (EBITDA) interest coverage (times)	3.66	3.86	2.73	4.07	5.23
FFO/total debt (%)	15.51 **	16.57	8.51	13.04	18.04
Total debt to capitalization	57.75	56.53	57.74	49.91	44.07

* Consolidated financial statements

** Annualized with trailing 12 months

Note: All ratios have been adjusted by including JV's financial performance (NWR-SBCC JV) on pro-rata basis since 2014. A new accounting standard has taken effect since 2015. The standard covers recognition of the performance of the JV companies. The new standard meant NWR has had to change the accounting method to recognize the performance of its JV from the proportionate consolidation method to the equity method. As a result, some financial figures in 2014 and beyond may not be directly comparable to the values prior to 2014.

Nawarat Patanakarn PLC (NWR)

Company Rating:	BBB-
Issue Ratings:	
NWR188A: Bt1,500 million senior unsecured debentures due 2018	BBB-
NWR208A: Bt1,720.1 million senior unsecured debentures due 2020	BBB-
Rating Outlook:	Negative

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