TRIS RATING
A Strategic Partner of S&P Global

CreditNews ข่าวเครดิต

NAWARAT PATANAKARN PLC

No. 23/2019
28 February 2019

CORPORATES

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

Last Review Date: 29/06/18

Company Rating History:

Date	Rating	Outlook/Alert
28/02/18	BBB-	Negative
01/04/14	BBB-	Stable

Contacts:

Auyporn Vachirakanjanaporn

auyporn@trisrating.com

Rapeepol Mahapant

rapeepol@trisrating.com

Monthian Chantarklam

monthian@trisrating.com

WWW.TRISRATING.COM

RATIONALE

TRIS Rating affirms the company rating on Nawarat Patanakarn PLC (NWR) and the rating on its outstanding senior unsecured debentures at "BBB-". At the same time, TRIS Rating revises the outlook to "stable" from "negative". The "stable" outlook reflects the new contracts NWR has signed, which is expected to lead to improved operating results.

The ratings reflect the company's track record of undertaking a broad range of construction projects for the public and private sectors. The ratings also take into account a promising outlook for the domestic construction opportunities over the next few years. Conversely, the ratings are tempered by high financial leverage, the cyclical nature and competitive threats in the engineering and construction (E&C) industry, and NWR's underperforming residential property segment.

KEY RATING CONSIDERATIONS

Acceptable track record and competitiveness

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 of the contractors listed on the Stock Exchange of Thailand (SET), as judged by annual revenue and assets.

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

NWR remains focused on public infrastructure projects. However, on its own, the company has a limited ability to bid for large projects. Large projects generally require a contractor for with specific expertise, a past record of successful projects, and a substantial amount of funds. As a result, NWR generally submits bids for large projects as a joint venture partner or as a sub-contractor.

TRIS Rating previously placed a "negative" outlook on the ratings as NWR's financial profile had deteriorated. NWR was not able to outbid other E&C companies in the race for construction projects. This led to a drop in revenue and a dwindling backlog. NWR obtained fewer new contracts for two years in a row. The project backlog tumbled to roughly Bt10 billion at the end of 2017, the lowest level in years. The smaller backlog portended a drop in operating cash flow.

Project backlog healthy again

The revision of the outlook to "stable" is primarily predicated on resurgence in the backlog, which could lead to a turnaround. NWR signed Bt12.5 billion in new contracts in 2018. The value of the backlog rose to Bt15.3 billion at the end of 2018.

In efforts to rapidly replenish its dissipating reservoir, NWR secured new contracts as sub-contractor for a number of huge projects. The major contracts signed in 2018 comprised structural and architectural work for the Yellow Line and Pink Line, two monorail mass transit projects. These two contracts are worth Bt6.0 billion, nearly half of the value of the new contracts NWR secured. In all, about three-fourths of the new projects, in terms of project value, were awarded from a leading contractor. The credit risk of the project owner is considered low.

Promising outlook for domestic construction

TRIS Rating maintains a broadly positive view on the domestic E&C industry for the next few years. This outlook takes into consideration the outlays for a number of large, government-sponsored infrastructure projects, particularly those in the much-anticipated Eastern Economic Corridor (EEC) area. NWR still has a significant number of opportunities to secure contracts for the forthcoming projects, serving as either the main contractor or as a sub-contractor.

That said, the ratings are constrained by the stiff competition within the industry, particularly in times of delayed project bidding and awarding. The cyclical nature of the E&C industry also poses some downside risks.

Underperformance in the residential property segment

The execution risks that come with the foray into the residential property development industry remain rating constraints. NWR has expanded into the property development industry, a strategic shift designed to ramp up its revenue base. NWR, through a wholly-owned subsidiary, launched two single-detached house (SDH) projects and a low-rise condominium project, with a combined value of around Bt3.4 billion. Given the highly competitive nature of the residential property market and its lesser-known brand, success has not yet arrived. For instance, sales in the SDH projects remain lower than expectations.

The property development segment remains small. Revenues are inadequate to meaningfully strengthen NWR's overall profitability. Looking ahead, TRIS Rating does not expect steady growth in this business segment. NWR has a pile of unsold housing units in inventory and must shoulder the financial burden for the projects.

Core business expected to improve

Given the current backlog and opportunities, TRIS Rating expects NWR will pull in Bt9-Bt12 billion in annual revenue over the next three years. This is an increase from our previous forecast. On the downside, TRIS Rating expects that gross margin of construction will remain under pressure. NWR is likely to secure new contracts as sub-contractor, the contracts generally carry low gross margins. As such, TRIS Rating maintains the view that NWR must wring significant costs out of operations in order to fortify operating cash flow.

In the forecast for 2019-2021, TRIS Rating expects NWR to maintain operating margin (operating profit before depreciation and amortization as a percentage of revenue) at above 6%. Earnings before interest, tax, depreciation, and amortization (EBITDA) will hold at around Bt600-Bt700 million per year. Funds from operations (FFO) will come in at around Bt400 million per year. These levels are higher than those in our previous forecast.

Financial leverage remains high

NWR has shouldered a much higher debt load over the past five 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. In our base case, TRIS Rating expects the debt to capitalization ratio will stay around 50% during 2019-2021. The ratio of FFO to debt will hover around 12%-15%. EBITDA interest coverage will stay at around 3 times.

Looking ahead, the debt level will stay elevated unless working capital is managed more efficiently and sales at the residential property projects accelerate. TRIS Rating views that this level of leverage is somewhat high, considering the company's business profile. Any drop in revenue or weaker profitability would further jeopardize the financial profile.

Liquidity concerns ease

Short-term liquidity should be more manageable over the next 12 months. In mid-2018, NWR won a pending court case and received a cash payment of around Bt300 million. At the end of September 2018, the company had Bt788 million in cash and Bt597 million in undrawn credit facilities. FFO over the next 12 months is forecast at around Bt400 million.

NWR has a substantial amount of debts coming due, comprising short-term loans of Bt1.3 billion, and long-term loans of Bt657 million. Most of the short-term debts are project finance loans. NWR uses the progress payments to repay the loans. We expect that NWR will be able to roll over most of its debts, given larger backlog.

NWR must keep the net total liabilities to equity ratio below 2.5 times in order to comply with the financial covenants specified in the outstanding bonds. The ratio was 2.1 times at the end of September 2018.

BASE-CASE ASSUMPTIONS

- Under TRIS Rating's base case scenario, we assume that NWR's revenue will gradually increase from Bt9.2 billion in 2019 to Bt11.7 billion in 2021.
- We expect the overall gross profit margin will stay at around 7%-8% and the operating margin will stay above 6%.
- We assume NWR will sign new contracts of construction projects worth Bt12.5 billion in 2018, Bt9 billion in 2019, and Bt7 billion per year in 2020 and 2021.
- The debt to capitalization ratio is expected to stay around 50% over the next three years.

RATING OUTLOOK

The "stable" outlook embeds our expectation that NWR will sustain its competitive edge in its core business and able to secure sizeable contracts, given the promising public infrastructure projects. Profitability should be in line with our expectation, such as the operating margin staying above 6%. The debt to capitalization ratio is expected to stay around 50%. Further, we expect NWR to remain in compliance with the financial covenants over the next three years.

RATING SENSITIVITIES

The ratings are unlikely to be upgraded over the next 12-18 months. Leverage is expected to remain high, while the revenue contribution from the property development segment will remain small. NWR's success in the property development segment, coupled with a significant drop in the debt load and heightened profitability, would be positive factors for the ratings and/or outlook.

In contrast, the ratings and/or outlook could be lowered if the company is unable to add to the backlog or if profitability falls below expectation. A downgrade may occur if the financial profile weakens, such as, the FFO to debt ratio falls below 10% or the debt to capitalization ratio rises to 60% over the next three years.

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 2018, 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 in Thailand and in neighboring countries such as Myanmar and Cambodia. In 2001, NWR acquired a 60% stake in Utility Business Alliance Co., Ltd., which manages wastewater treatment plants. In addition, NWR had 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 was undertaken by NWR-SBCC Joint Venture (JV). NWR owned a 50% stake in the JV.

In 2013, NWR set up a wholly-owned property developer, Mana Patanakarn Co., Ltd. (MANA). MANA develops residential property projects under the "Baranee" brand. In November 2014, MANA launched an SDH project, Baranee Park Romklao, valued at Bt1.0 billion. 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 Bt800 million.

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 (82%) of total revenue. 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.

For the first nine months of 2018, NWR's performance was slightly better than TRIS Rating's expectation. In assessment of NWR's performance, we employ 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 Joint Venture (JV) and NWR's potential exposure to the JV are taken into account.

With proportionate inclusion of revenue from the JV, NWR reported Bt8.2 billion in the first nine months of 2018, up 5% from the same period last year. The gross profit margin improved to 8.4% from 6.7% in 2017. The gross profit margin of the construction segment stood at 6.2% while that of the property development segment was 24.9%. However, these levels were lower than the margins at the SET-listed peers.

The operating margin in the first nine months of 2018 was 11.7%, up from 8.4% in 2017. Operating expenses have remained elevated in an effort to support the property development segment. Operating expenses were 6% of total revenue in 2017 through the first nine months of 2018, up from 4.5%-5.0% during 2014-2016. NWR reported a net profit of Bt353 million in the first nine months of 2018, mostly from a reversal of doubtful debts amounting to Bt322 million.

NWR has shouldered a much higher debt load over the past five years. NWR's financial profile, as reported, does not fully reflect its debt exposure. As a result, TRIS Rating includes the debts of the JV in the rating assessment to reflect the company's potential exposure as a JV partner and guarantor.

At the end of September 2018, NWR had Bt3.8 billion in adjusted debts. The debt to capitalization ratio decreased slightly from above 50% in the past three years to 49.2% as of September 2018.

KEY OPERATING PERFORMANCE

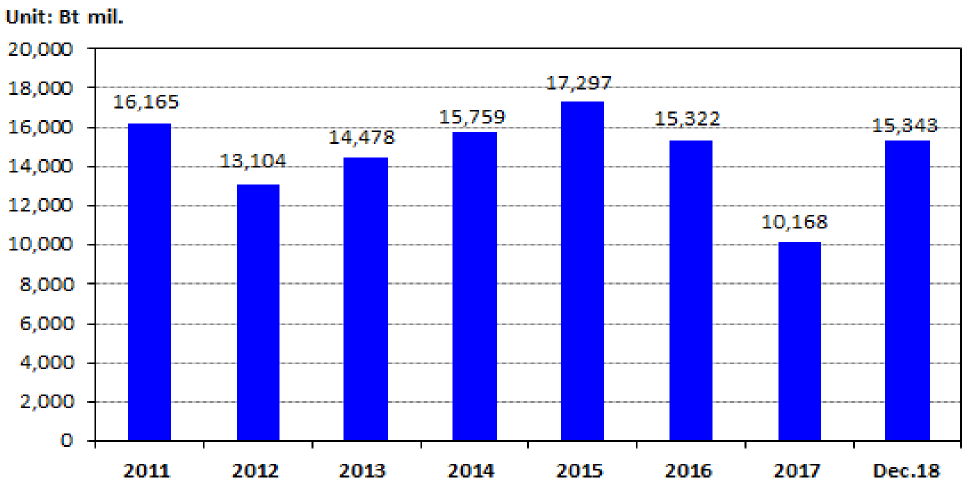
Table 1: Construction Revenue Breakdown by Type of Project

Unit: %

Type of Project	2011	2012	2013	2014	2015	2016	2017	Jan-Sep 2018
Buildings, factories, plants	42	53	54	51	32	21	26	36
Transportation infrastructure	24	33	29	28	40	48	45	49
Coal excavation	22	12	15	12	12	11	13	7
Tunnels & pipe jacking	3	0	1	7	11	15	10	8
Marine work	9	2	0	2	6	5	6	0
Total	**100**	**100**	**100**	**100**	**100**	**100**	**100**	**100**

Source: NWR

Chart 1: Backlog as of Dec 2018



Source: NWR

FINANCIAL STATISTICS AND KEY FINANCIAL RATIOS*

Unit: Bt million

		----------------Year Ended 31 December -----------			
	Jan-Sep 2018	2017	2016	2015	2014
Total operating revenues	8,193	10,611	9,372	8,729	7,837
Operating income	962	889	974	612	704
Earnings before interest and taxes (EBIT)	562	106	317	65	171
Earnings before interest, taxes, depreciation, and amortization (EBITDA)	1,005	901	984	626	720
Funds from operations (FFO)	816	648	726	388	552
Adjusted interest expense	168	246	234	227	171
Capital expenditures	147	362	921	753	615
Total assets	13,108	13,206	13,869	12,865	11,257
Adjusted debt	3,769	4,225	3,750	3,908	2,584
Adjusted equity	3,886	3,531	3,746	3,683	3,874
Adjusted Ratios					
Operating income as % of total operating revenues (%)	11.74	8.38	10.39	7.01	8.98
Pretax return on permanent capital (%)	5.89 **	1.20	3.56	0.77	2.54
EBITDA interest coverage (times)	5.98	3.66	4.21	2.76	4.22
Debt to EBITDA (times)	3.22 **	4.69	3.81	6.25	3.59
FFO to debt (%)	24.74 **	15.35	19.37	9.94	21.35
Debt to capitalization (%)	49.24	54.47	50.03	51.48	40.02

* *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.

RELATED CRITERIA

- Key Financial Ratios and Adjustments, 5 September 2018
- Rating Methodology – Corporate, 31 October 2007

Nawarat Patanakarn PLC (NWR)

Company Rating:	BBB-
Issue Rating:	
NWR208A: Bt1,720.1 million senior unsecured debentures due 2020	BBB-
Rating Outlook:	Stable

TRIS Rating Co., Ltd.
Silom Complex Building, 24th Floor, 191 Silom Road, Bangkok 10500, Thailand Tel: 0-2098-3000