TPI POLENE PLC

No. 35/2020
25 March 2020

CORPORATES

Company Rating:	BBB+
Issue Ratings:	
Senior unsecured	BBB+
Outlook:	Stable

Last Review Date: 17/10/19

Company Rating History:

Date	Rating	Outlook/Alert
10/04/19	BBB+	Positive
02/10/12	BBB+	Stable

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RATIONALE

TRIS Rating affirms the company rating on TPI Polene PLC (TPIPL) and the ratings on TPIPL's outstanding senior unsecured debentures at "BBB+". At the same time, TRIS Rating revises the outlook to "stable" from "positive".

The outlook revision reflects our view on the ongoing softened demand in construction materials, and expected large capital spending for land procurements and potential investments in new power projects. We believe that TPIPL's financial leverage is likely to remain at a high level over the medium term rather than deleveraging as assumed in our previous forecast.

The ratings continue to mirror TPIPL's strong market position in domestic cement industry, the diversification benefit from the power business, and solid cash flow from power purchase agreements (PPAs) with the Electricity Generating Authority of Thailand (EGAT). However, these strengths are offset by cyclicality of the cement and plastic industries, as well as the operational risks inherent in refuse-derived fuel (RDF) power plants. The ratings are also constrained by TPIPL's concentrated source of borrowings and concerns on refinancing risk.

KEY RATING CONSIDERATIONS

Established position in the cement market

TPIPL is the third-largest cement producer in Thailand. The company's cement production capacity is 13.5 million tonnes per annum, representing 23% of industry-wide capacity. The company's competitive strengths are underpinned by large business scale, vertical integration along the cement production chain, and a broad range of product offering. These strengths in the cement business are held back by various risks, including industry cyclicality, immense price competition, and susceptibility to fluctuations in coal price.

Diversification benefit from the power business

TPIPL's business profile incorporates diversified sources of revenue from three core businesses: cement (50% of total revenue in 2019), plastic (18%), and power generation (20%). However, in terms of net cash flow, the company relies on the power business, operated by TPI Polene Power PLC (TPIPP). TPIPP generates the majority of net cash flow or approximately 70% of the group's earnings before interest, tax, depreciation, and amortization (EBITDA).

The diversification benefit from the power business adequately offsets the volatile nature of cement and plastic businesses and has helped stabilize TPIPL's overall cash flow over the past few years.

Solid cash flow from power business

TPIPL's ratings are largely supported by the strong credit profile of its power business, which is backed by PPAs with EGAT and the received adder. The PPAs materially benefit TPIPL, providing secure long-term cash flow and resulting in improved earnings predictability as well as enlarging the cash-flow base.

The ratings take into consideration TPIPL's strong position as the largest waste-to-energy (WTE) power producer in Thailand. TPIPP, a core subsidiary of TPIPL, owns and operates seven power plants with total installed capacity of 440 megawatts (MW). Of the total, four power plants (180 MW) carry three PPAs to sell its capacity of 163 MW to EGAT. The EGAT PPAs come with an adder of Bt3.50 per unit.

However, these four plants are fueled by RDF and waste heat recovery from the cement plants. The operational risks are relatively high, considering the unsteady supply of waste heat and varying quality of RDF. In addition, the adders of the first two PPAs (73 MW) will expire in January and August 2022. The adder period of the latter PPA (90 MW) will end in April 2025.

Risks from land procurements

The Special Economic Zone (SEZ) project has been initiated by the government with the aim to develop the economy in the strategic regions of Thailand. Early this year, the Cabinet agreed in principal to establish a SEZ in Chana district of Songkhla province. The SEZ, covering 16,700 rai of land, would include deep-sea ports, industrial estates, and power plants (3,700 MW) using natural gas, biomass or other renewable energy sources.

TPIPL is eager to take part in the SEZ project. Currently, the company, through TPIPP, aims to develop a 1,700-MW gas-fired power plant in the SEZ. In preparing the proposal and getting an early foothold for the project, the company assigns TPIPP to gradually acquire lands in those areas since late 2018. TPIPP has entered into several land purchase agreements to gather a total 16,700 rai of land plot. Total land cost is about Bt12 billion. At the end of December of 2019, the company has paid Bt5.6 billion for the procured land and plans to pay for the remainder within 2020-2021.

We view that the early land procurement exposes TPIPL and TPIPP to several risks. The project commencement is still uncertain. The early decision may put the company under pressures from a risk of project delay, possible changes in the government's policy, and the possibility of opposition from local communities. Further, the project may take years for prior bidding. The company is likely to carry the lands without any return for an extended period. However, the risks will be confined for the time being as we believe that TPIPP will not make any further investments in the project unless it obtains official agreements from the government, such as the new PPA.

In case TPIPP wins the bid to develop the project, its financial leverage will rise substantially. TPIPP will need to spend over Bt100 billion for the first phase of the project development, including the construction of the power plant worth Bt70-80 billion. TPIPP's large debt-financed investment will materially deteriorate its parent's financial profile which may lead to a rating downgrade of TPIPL or even the breach of TPIPL's bond covenant. Therefore, we believe TPIPP would need to seek capable partners or come up with a well-suited financing scheme to avert an overleveraged structure.

EBITDA to peak in 2021

TPIPL's financial performance continues to improve as expected, primarily driven by rising sales of power to EGAT. EBITDA surged to Bt7.7 billion in 2019 from Bt5.9 billion in 2018 while funds from operations (FFO) also escalated to Bt5.7 billion in 2019 from Bt3.9 billion in 2018. However, the cement business staged flat earnings due to lingering slowdown in domestic cement consumption while the anticipated cost-saving benefits from the new 150-MW coal-fired power plant are yet to materialize. The coal-fired power plant falls short of its optimal levels since its operation is constrained by the inconsistent electricity demand from TPIPL's cement factories.

In our base-case scenario, TPIPL's EBITDA is expected to grow, reaching a peak of about Bt8.3 billion in 2021 before declining to Bt7.5 billion in 2022. The drop is due to the expiration of adders for the first two PPAs. We hold the view that steady performance of TPIPL's power business will continue to be the core cash flow contributor, adequately counterbalancing the subdued cement business. The utilization rates of core RDF-fired power plants will increase in 2020 after the installation of new boilers is completed. The cement market is expected to remain sluggish considering the long-delayed public investment outlays and current glut of residential properties.

Leverage remains high

We expect TPIPL's financial leverage to remain elevated over the next 2-3 years due to TPIPP's hefty capital expenditures, including the committed land procurements in Songkhla province and investments in new WTE power projects. In order to maintain earnings growth, TPIPP plans to participate in bidding a number of projects, including two WTE power plants (9.9 MW each) in Songkhla and Nakhon Ratchasima provinces, new power plants under the Power Development Plan (PDP) 2018, and acquisitions of PPAs from the not-yet-operating projects.

In our base-case forecast, we assume that TPIPL's total capital spending during 2020-2022 will be about Bt20.6 billion, comprising land procurement of Bt6.5 billion, improvement and maintenance of cement and power plants of Bt6.1 billion, and investment budgets for new WTE power plants of Bt8 billion. As a result, the debt to EBITDA ratio is projected to range between 7-7.5 times. The ratio of FFO to debt will be below 10% while the debt to capitalization ratio will rise to stay around 53%.

In the base case scenario, we do not incorporate the investment outlays in the first phase of the SEZ project, given the unforeseeable project timeline and financing structure.

Looming refinancing risk

TPIPL's ratings are constrained by the refinancing risk in relation to the two bonds worth Bt9.6 billion that will come due in April 2021. We expect the risk will be mitigated somewhat by the company's proactive actions, such as securing of back-up bank facilities and early issuance of bonds. However, the success of the bond issuance still depends on good debt market conditions.

The ratings are also tempered by TPIPL's lack of diversifying sources of borrowings. TPIPL's bond financing has continued to account for 80% of total outstanding debts in the past several years. TPIPL continues to comply with the financial covenant of its bonds, which requires the interest-bearing debt to equity ratio to stay below 1.5 times. As of December 2019, the ratio stood at 1.03 times.

BASE-CASE ASSUMPTIONS

- Revenues from the cement segment to slightly drop in 2020 and then grow by 1%-1.5% during 2021-2022.
- Revenues from the plastic segment to be flat during the projected period.
- Revenues from the power segment to grow by 2%-4% in 2020-2021 before declining in 2022.
- EBITDA margin to be in the range of 19%-21%.
- Capital expenditures to total Bt20.6 billion during 2020-2022.
- Dividend per share to be between Bt0.03-Bt0.05 during 2020 and 2022.

RATING OUTLOOK

The "stable" outlook reflects our expectation that TPIPL's competitive positions in the cement and plastic businesses will be maintained, whilst its power business will continue to exhibit satisfactory performance and remain the largest cash flow contributor. We also expect the company's financial leverage to be in the range of our forecast level.

RATING SENSITIVITIES

The possibility of a rating upgrade is limited in the near term but it could emerge if the debt to EBITDA ratio falls below 6 times for a sustained period and TPIPL diversifies its sources of borrowings. Positive rating factors could develop from financial deleveraging or forecast-beating performance.

The ratings and/or outlook could be revised downward if TPIPL's debt to EBITDA ratio stays above 8 times for a sustained period. The rating downside would stem from deterioration of the cement business, weaker-than-expected performance of power plants, as well as a deluge of debt-fueled investments. A large equity loss from pending legal claims could also trigger a negative rating action.

COMPANY OVERVIEW

TPIPL operates in three industries: cement, plastic, and power generation. The cement segment produces and sells clinker, cement, mortar, concrete, fiber cement, and concrete roof tiles. The plastic segment manufactures and sells LDPE (low-density polyethylene) and EVA (ethylene vinyl acetate) products. The power segment generates electricity using mainly RDF and waste heat recovery. The company sells the power to EGAT and also supplies within the group.

The company was founded by the Leophairatana family in 1987. Following the financial crisis in 1997, TPIPL signed a Master Restructuring Agreement (MRA) and entered a debt restructuring program in July 2000. As part of the debt restructuring program, the company raised capital twice: Bt11 billion in 2004 and Bt12 billion in 2006. The company exited the rehabilitation process in 2009. The Leophairatana family is major shareholder, owning approximately 58% of the company. The family members have served as the company's board members and management team since the firm was founded.

FINANCIAL STATISTICS AND KEY FINANCIAL RATIOS*

Unit: Bt million

	----------------------Year Ended 31 December -------------------				
	2019	**2018**	**2017**	**2016**	**2015**
Total operating revenues	38,758	36,851	30,726	30,735	29,064
Earnings before interest and taxes (EBIT)	4,311	3,002	567	1,156	(808)
Earnings before interest, taxes, depreciation, and amortization (EBITDA)	7,650	5,889	3,318	3,706	1,436
Funds from operations (FFO)	5,684	3,927	1,884	2,336	864
Adjusted interest expense	1,988	1,744	1,675	1,673	1,035
Capital expenditures	9,905	7,409	7,536	6,259	5,819
Total assets	114,368	110,488	103,178	92,618	107,645
Adjusted debt	51,634	45,041	37,243	45,124	37,227
Adjusted equity	51,493	50,937	52,086	36,755	55,966
Adjusted Ratios					
EBITDA margin (%)	19.7	16.0	10.8	12.1	4.9
Pretax return on permanent capital (%)	4.1	3.0	0.6	1.3	(0.9)
EBITDA interest coverage (times)	3.8	3.4	2.0	2.2	1.4
Debt to EBITDA (times)	6.7	7.6	11.2	12.2	25.9
FFO to debt (%)	11.0	8.7	5.1	5.2	2.3
Debt to capitalization (%)	50.1	46.9	41.7	55.1	39.9

* *Consolidated financial statements*

RELATED CRITERIA

- Rating Methodology – Corporate, 26 July 2019
- Key Financial Ratios and Adjustments, 5 September 2018
- Group Rating Methodology, 10 July 2015

TPI Polene PLC (TPIPL)

Company Rating:	BBB+
Issue Ratings:	
TPIPL207A: Bt2,000 million senior unsecured debentures due 2020	BBB+
TPIPL208A: Bt2,205 million senior unsecured debentures due 2020	BBB+
TPIPL214A: Bt1,600 million senior unsecured debentures due 2021	BBB+
TPIPL214B: Bt8,000 million senior unsecured debentures due 2021	BBB+
TPIPL218A: Bt3,600 million senior unsecured debentures due 2021	BBB+
TPIPL221A: Bt3,530 million senior unsecured debentures due 2022	BBB+
TPIPL224A: Bt1,200 million senior unsecured debentures due 2022	BBB+
TPIPL228A: Bt4,000 million senior unsecured debentures due 2022	BBB+
TPIPL231A: Bt3,000 million senior unsecured debentures due 2023	BBB+
TPIPL231B: Bt4,400 million senior unsecured debentures due 2023	BBB+
TPIPL234A: Bt2,645 million senior unsecured debentures due 2023	BBB+
TPIPL251A: Bt3,000 million senior unsecured debentures due 2025	BBB+
Rating Outlook:	Stable

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