TRIS RATING
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EAST COAST FURNITECH PLC

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Company Rating: BB

Outlook: Stable

Rating Rationale

TRIS Rating assigns the company rating of East Coast Furnitech PLC (ECF) at "BB". The rating reflects ECF's adequate competitive position in the furniture business, underpinned by strong distribution channels, long customer relationships and record of controlling cost of production. However, the strength of rating is constrained by weak prospects for the furniture industry in Thailand, pressures from rising labor costs and marketing expenses, and high leverage due to a long cash conversion cycle. The rating takes into consideration the risks inherent in the renewable energy projects and ECF's limited track record in the power industry.

Established in 1999, ECF is a manufacturer and distributor of home furnishings in Thailand. The company makes furniture from particle board and rubber wood. Revenue from particle board furniture accounted for 71% of ECF's total sales in 2016, while rubber wood furniture accounted for 22%. The remainder of revenue was derived from selling decorative foil paper, dried rubber wood, and retail shops franchised from Can Do Co., Ltd. in Japan. ECF was listed on the Market for Alternative Investment (MAI) in 2013. The Suksawad family has been a main shareholder, holding approximately 63% of the outstanding shares as of March 2017.

In 2016, ECF has four main distribution channels, including made-to-order (60% of total furniture sales), Thai modern trade (30%), owned showrooms (7%), and dealers (3%). Almost all made-to-order furniture is exported to leading furnishing distributors and large modern trade retailers in Japan. Meanwhile, ECF distributes furniture under its own brands through well-known modern trade retailers in Thailand, such as Home Pro, Big C, Mega Home, Thai Wasadu, and Tesco Lotus. The company has 16 showrooms to sell rubber wood furniture and other types of wood furniture sourced from Thailand and abroad. The company sells its "fighting brand" products through the dealer channel. ECF's revenues from the Japanese and Thai markets account for 50% and 44% of total sales, respectively.

ECF is a medium-sized manufacturer with above 20 years of operation. The company's market position is moderate, measured by size of revenue, range of product offering, and profitability compared with listed peers. ECF's competitive advantages stem from its strong distribution channels and long-term relationships with fast-growing modern trade retailers in both Japan and Thailand. Selling through these clients gives ECF access to retail customers nationwide and contribute the growth of revenue for the past several years. The rating also considers ECF's cost reductions and improvements of production efficiency, leading to stronger gross profit margin.

The strength of the rating is offset by ECF's vulnerability to the weak industry demand in Thailand. ECF's furniture business remains labor intensive, especially, the production of rubber wood furniture. Because it relies mostly on modern trade channel, the operating profit has been pressured by escalation of advertising and marketing expenses, the result of an agreement stuck with modern trade retailers.

The rating is also constrained by the inherent risks of two renewable energy projects that ECF will invest. For the first project, ECF, through Safe Energy Holdings Co., Ltd. (SAFE), a 50:50 joint venture with Fortune Partner Industry PLC (FPI), decided to acquire Prize of Wood Green Energy Co., Ltd. (PWGE), a 7.5-

Contacts:

Pravit Chaichamnapai, CFA
pravit@trisrating.com

Sermwit Sriyotha
sermwit@trisrating.com

Wajee Pitakpaibulkij
wajee@trisrating.com

Wiyada Pratoomsuwan, CFA
wiyada@trisrating.com

WWW.TRISRATING.COM

megawatt (MW) biomass power plant in Narathiwat province. The project obtained 20-year power purchase agreement (PPA) with the Provincial Electricity Authority (PEA) to sell 6.5 MW of the installed capacity. The feed-in-tariff (FiT) is Bt4.24 per kilowatt-hour (kWh), plus a FiT Premium of Bt0.3 per kWh for eight years. After the investment transaction is completed through cash payment and share swap, ECF will own 33.37% of SAFE with approximately Bt142 million for its portion. The project is expected to start commissioning within the second quarter of 2017.

The second project is the Minbu project, a 220-MW solar farm located in the Magway region in Myanmar. The company will acquire the 20% shares of the project. The project obtained a 30-year PPA with Electric Power Generation Enterprise (EPGE) to sell 170 MW of its capacity. The project secured a fixed tariff rate of 12.75 cent per kWh. ECF will spend a total of Bt1,007 million for this project, comprising Bt310 million for share purchases and Bt696 million for project development. The project has four phases and requires four years of construction. The first phase (50 MW) is expected to commence operation by the first quarter of 2018.

TRIS Rating holds the view that the investments in the power projects will deliver recurring income and diversify ECF's revenue base. However, the company faces several types of execution risk, such as construction, operation, and especially country risk and political risk in Myanmar. The combined investment in the power projects is sizable, compared with ECF's current equity base. The company plans to finance the investments with a combination of new debentures, exercised warrants, and newly issued shares in order to balance its financial leverage.

During 2012-2016, ECF's revenue grew at an average rate of 6.5% per annum. Thanks to ongoing improvements in the production process, the gross profit margin increased continuously and was adequate to offset the rise in selling, general, and administrative costs (SG&A). The average operating margin (before depreciation and amortization) was 12.1% over the last five year. The operating margin in 2016 dropped to 10.6% due to expenses related to feasibility studies of the power projects, advertising and sales promotions for the furniture business, and the opening of the Can Do shops. Funds from operations (FFO) in 2016 were Bt94 million, below the five-year average of Bt118 million. In the first quarter of 2017, the operating performance improved, thanks to better sales. The operating margin rebounded to 12.9%. FFO was Bt42 million, close to the same period figure in the previous year.

ECF's financial leverage is weak. Due to a long cash conversion cycle, the company needed more short-term credit facilities to support sales growth. After the initial public offering (IPO) in 2013, the debt to capitalization ratio increased from 58% as of December 2013 to 63.9% as of March 2017. Outstanding debt increased from Bt476 million in 2013 to Bt751 million in 2015 and surged to Bt1,195 million in the first quarter of 2017. At the same time, the cash flow protection also weakened, the annualized FFO to total debt fell to 8% in the first three months of 2017, compared with the ratio of more than 15% prior 2015.

Looking forward, TRIS Rating's base case scenario forecasts that ECF's furniture business will grow moderately by 5%-7% per annum and the operating margin will hold within a range of 10%-13%. However, new investments are likely to impair financial leverage over the next three years. Capital expenditures are forecast at approximately Bt750 million in 2017 and Bt200-Bt250 million per annum during 2018 and 2019. Although ECF may consider raising new equity, the timing and size of any boost in equity capital remains uncertain. TRIS Rating takes a conservative approach by including only the new equity raised from the exercise of ECF's warrants of about Bt105 million. Therefore, the debt to capitalization ratio will weaken further as the ratio will stay above 70%. The FFO to total debt ratio is expected to stay at about 5% during 2017-2019. TRIS Rating notes that a successful injection of new equity capital will be a plus for the credit strength.

Rating Outlook

The "stable" outlook reflects the expectation that ECF's furniture business will continue to grow moderately and the company will be able to maintain its operating margin within a range of 10%-13%. The modern trade channel from Japan and Thailand will remain the core distribution channel. The rating or outlook could be upgraded if the power projects execute successfully as expected while the company can maintain its capital structure at an acceptable level.

The rating could be downgraded if the operating performance of the furniture business is significantly weaker than expected for an extended period and/or if the power projects are unsuccessful, and cause material losses for an extended period.

East Coast Furnitech PLC (ECF)

Company Rating:	BB
Rating Outlook:	Stable

Financial Statistics and Key Financial Ratios*

Unit: Bt million

	Jan-Mar 2017	------------- Year Ended 31 December 2016	2015	2014	---------- 2013
Revenues	402	1,371	1,334	1,209	1,173
Finance costs	16	54	39	31	33
Net income from operations	20	27	70	68	47
Funds from operations (FFO)	42	94	127	141	124
Capital expenditures	1	35	27	28	33
Total assets	2,246	2,357	1,506	1,239	1,092
Total debts	1,195	1,339	751	593	476
Total liabilities	1,570	1,698	1,053	840	747
Shareholders' equity	676	659	454	399	345
Depreciation & amortization	22	71	69	69	71
Dividends	0	32	36	16	31
Operating income before depreciation and amortization as % of sales	12.9	10.6	12.7	13.6	12.1
Pretax return on permanent capital (%)	4.9 **	5.9	10.7	12.4	11.0
Earnings before interest, tax, depreciation, and amortization (EBITDA) interest coverage (times)	3.6	3.1	4.8	5.9	4.7
FFO/total debt (%)	8.0 **	7.0	16.9	23.8	25.9
Total debt/capitalization (%)	63.9	67.0	62.3	59.8	58.0

* *Consolidated financial statements*

** *Annualized with trailing 12 months*

TRIS Rating Co., Ltd.
Tel: 0-2231-3011 ext 500 / SilomComplexBuilding, 24th Floor, 191 Silom Road, Bangkok10500, Thailand www.trisrating.com