Press Release

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TRIS Rating Assigns Company Rating of "GUNKUL" at "BBB" with "Stable" Outlook

TRIS Rating has assigned the company rating of Gunkul Engineering PLC (GUNKUL) at "BBB" with "stable" outlook. The rating reflects the company's long track record of providing electrical equipment to both public sector and private sector clients, experience in developing and operating power projects, and vertical integration. The rating also recognizes the predictable cash flows GUNKUL receives from the power segment and the encouraging prospects for the rewnewable energy sector. However, the rating is constrained by the execution risks associated with the power projects and a looming rise in leverage, as the company plans significant investments in the years ahead.

The "stable" outlook reflects TRIS Rating's expectation that GUNKUL's solar and wind plants will perform satisfactorily and generate the sizable cash flows as planned. GUNKUL is also expected to successfully execute the projects under construction and earn satisfactory returns. GUNKUL's primary business as a supplier of electrical equipment is expected to remain on solid ground.

A rating upgrade could occur if GUNKUL's operating performance and capital structure are significantly stronger than expectations. On the contrary, the rating could be lower if the performances of the power projects fall short of the initial estimates, respective guidances, or the capital structure deteriorates due to the failure to generate sufficient cash flows or aggressively debt-funded investments or cost overruns.

GUNKUL was founded in 1982 by Mr. Gunkul Dhumrongpiyawut as a provider of electrical equipment. The company expanded into the engineering, procurement, and construction (EPC) business and the power business in 2010. GUNKUL was listed on the Stock Exchange of Thailand (SET) in 2010. As of March 2017, the Dhumrongpiyawut family remained the major shareholder, holding approximately 54% interest in GUNKUL. The electrical equipment segment has accounted for the majority of revenue, or nearly 60% of total revenue over the past five years, followed by the EPC segment (34%) and the power segment (6%). However, the power segment will soon become the centerpiece of GUNKUL's revenue, accounting for more than half of total revenue within the next three years.

The rating reflects the company's long track record in its primary business of the trading and manufacture of electrical equipment. GUNKUL has an established market presence since it has been in the business for more than 30 years. The company provides both public sector and private sector clients with an extensive range of products covering all stages of the transmission and distribution of electricity. The long track record and wide range of products have created a competitive edge, which results in fairly stable profitability in the electrical equipment segment. On the strengths of its core business, GUNKUL expanded into the EPC business in 2010. The move put the company in a better competitive position in the electrical equipment segment as both businesses are complementary in nature. However, GUNKUL's scope of work is limited as most of its construction contracts are turnkey projects for solar power plants in Thailand.

The rating also considers GUNKUL's experience in developing and operating several renewable power projects. GUNKUL entered this segment through two subsidiaries in 2010 when it developed 10 solar power projects, with a combined contracted capacity of about 57 megawatts (MW). These solar projects commenced operations during 2011-2013. TRIS Rating is of the view that GUNKUL is better positioned, as it has become vertically integrated to some extent. GUNKUL later sold majority stakes in the two subsidiaries, in pursuit of funds for further expansion in the power segment since 2012.

GUNKUL has recently started placing a greater emphasis on rebuilding its power plant portfolio. It has invested in many more solar power projects and embarked on the wind power projects during the past three years. GUNKUL's aggregate equity capacity (or contracted capacity in proportion to its ownership stakes in the power plants) is currently about 468 megawatts equity (MWe), spreading across 36 solar power projects (298 MWe), and five wind power projects (170 MWe). The power plants which are operational consist of 32 solar power projects (91 MWe) and three wind power projects (60 MWe). The remainder, or 317 MWe, comprises four solar projects and two wind projects, which are in the construction and development phases.

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The rating is supported by the acceptable risks of the power segment, aided by predictable cash flows and the encouraging prospects for the rewnewable energy sector. GUNKUL's operational power plants have secured multi-year power purchase agreements (PPAs) with state-owned electricity distributors, and each PPA contains a committed tariff. The payment risk of the power buyers is minimal. The performances of GUNKUL's solar projects have been satisfactory. Since inception, the actual annual output of most solar plants has reached their initial estimates based on a 50% probability (P50 level) of energy production. The first three wind power plants outperformed their initial estimates based on the P90 level of energy production.

Conversely, the rating is constrained by the execution risks of GUNKUL's wind and solar power projects. The company is developing two wind power projects in Nakorn Ratchasrima province, with a combined contracted capacity of 110 MWe. One project is scheduled to commence operations in late 2017, and the other in the second quarter of 2018. Compared with a solar power project, a wind power project carries higher execution risks. Installation risk with the key components and construction difficulties can lead to cost overruns or project delays. In addition, the operational risks of a wind farm project are higher. Actual wind speeds may deviate significantly from expectations, reducing power output and the project cash flows. Despite satisfactory results from the wind power projects, the performances over the long haul have yet to be proven. In addition, GUNKUL is developing four large-scale solar power projects in Japan, with a combined contracted capacity of 207 MWe. Two projects of these are scheduled to start producing electricity during 2018 and 2019, while the other two projects are still in the stage of development. GUNKUL is exposed to construction risk as the long periods of development can lead to cost overruns, which will hurt the returns on the investments.

The rating is also weighed down by a debt-heavy structure. GUNKUL's assets have risen more than three fold since 2014. The company has transitioned from a trading and manufacturing oriented business toward a business centered on power generation at the expense of ever-mounting debt. GUNKUL is forging ahead with plans to spend heavily on renewable power projects over the next five years. The two wind projects will cost around Bt8.8 billion, while the four solar power projects in Japan will cost about Bt24 billion and take longer to come to fruition. The growth of investments ostensibly outpaces cash flow generated by GUNKUL's current portfolio of power plants. As a result, the company needs external source of cash to fund the new projects. The company plans to finance the projects with long-term loans, keeping leverage high. The successful execution of each project will be a positive factor for the rating. Looking further ahead, GUNKUL is likely to develop additional projects in light of its power segment-focused strategy. GUNKUL's heavy debt load puts a lid on the rating.

GUNKUL's revenue has ranged from Bt2-Bt4.5 billion during the past five years. TRIS Rating expects the company's revenue will increase to Bt5-Bt6 billion over the next three years, propelled by the power segment. The operating margin (operating income before depreciation and amortization as a percentage of sales) increased remarkably to 26.4% in 2016, compared with a five-year average of approximately 15%. The power segment, which carries higher returns, boosted profitability. The operating margin is expected to rise, ranging between 30%-50% over the next three years, as the contribution from the power segment rises. The earnings before interest, tax, depreciation, and amortization (EBITDA) are projected to reach Bt3 billion by 2019. Leverage will rise significantly in the coming years in the wake of the massive investments. TRIS Rating's base case forecast assumes the total debt to capitalization ratio will soar from 57.9% in 2016 to around 70% over the next three years. Cash flow protection will drop from the current level during the periods of investments. EBITDA interest coverage ratio is expected to slide to 2.5-3 times, from 3.9 times in 2016. The ratio of funds from opeartions (FFO) to total debt will range from 4%-7%, compared with 5.6% in 2016.

GunkulEngineering PLC (GUNKUL)

Company Rating:	BBB
Rating Outlook:	Stable

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