SAHAKOL EQUIPMENT PLC

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CORPORATES

Company Rating:	BBB-
Outlook:	Stable

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RATIONALE

TRIS Rating assigns the company rating of Sahakol Equipment PLC (SQ) at "BBB-". The rating reflects the strong, well-established core business of the company, as it is a leading mining contractor. The rating also reflects the stable income streams SQ receives from long-term service contracts with creditworthy project owners and a sizable project backlog. These strengths are partially offset by high leverage and business concentration risk, since a few large projects comprise most of SQ's revenue and profits.

KEY RATING CONSIDERATIONS

Long track record

SQ's business risk profile is moderate. The company's strengths are built on a proven track record of running mines, plus the wealth of experience of its mining engineers and a fleet of specialized mining equipment.

SQ was established in 2001 but its roots date back in 1983. In that year, mining operations at the Mae Moh Phase 1 project were undertaken by Sahakol Engineer Co., Ltd., a predecessor company.

SQ has repeatedly won long-term mining service contracts with the Electricity Generating Authority of Thailand (EGAT). In these contracts, SQ typically serves as the main contractor or a joint operator. SQ has conducted mining operations for several phases of the Mae Moh mine over the past thirty-four years. EGAT includes SQ on its short list of technically qualified contractors, reflecting SQ's strong position in mining services.

SQ has sought to grow by expanding to neighboring countries. In 2014, the company entered into a mining service agreement with Hongsa Power Co., Ltd., a leading power producer in the Lao People's Democratic Republic (Lao PDR). In early 2017, SQ was awarded a contract for soil excavation and tin extraction in Myanmar. With these growth opportunities, comes higher country risk. Despite the exposure to greater higher country risk, these two projects would be steppingstones to new growth opportunities outside Thailand.

Stable income streams and sizable backlog

The rating recognizes the stable income streams SQ receives from long-term service contracts and the minimal credit risk of the project owners. EGAT is SQ's principal customer. SQ has a sizeable project backlog. As of March 2018, the backlog stood at Bt34.3 billion, comprising the soil and coal excavation project at the Mae Moh Phase 7 (spanning 2012-2020) worth Bt849 million, the Mae Moh Phase 8 (2016-2025) worth Bt20.2 billion, the Hongsa mine in the Lao PDR (2015-2026) worth Bt9.6 billion, and a tin mining project in Myanmar (2018-2024) worth Bt3.7 billion.

Given the current backlog, TRIS Rating's base case assumes SQ's revenue will be about Bt3.5-Bt4 billion per annum during 2018-2020.

Business concentration risk

SQ has narrow scope of business. As a result, the company carries business concentration risk. For example, projects affiliated with the Mae Moh mine made up around 85% of revenue, on average, over the past five years. The backlog contains only a few, large projects. The largest project in the backlog is the Mae Moh Phase 8 project, which accounts for 59% of the value of the backlog. Should SQ encounter any difficulties or underperform on the Mae

Moh projects, there would be direct repercussions on the company's overall financial profile.

In late 2017, SQ failed to outbid its main competitor in the race for the Mae Moh Phase 9 contract. The contract, spanning a decade, would have been the largest-ever contract for SQ. The contract would have doubled the backlog and would brought in revenue of about Bt4 billion annually. TRIS Rating is of the opinion that the failure to win the Mae Moh Phase 9 contract presents a significant challenge for SQ. There will be very few other large opportunities in the domestic market over the next few years. Despite the initial success of its efforts to expand abroad, SQ must contend with higher country risk and counterparty risk.

Acceptable performance despite landslide incident

SQ grew vigorously over the past few years after it won contracts for the Hongsa mine and the Mae Moh Phase 8 project. The latter is currently the largest project in the backlog. Revenue in 2017 was Bt3.2 billion, up from Bt2.9 billion in 2016, Bt1.9 billion in 2015, and Bt1.6 billion in 2014. The operating margin (operating income before depreciation and amortization as a percentage of revenue) was 37%-41% during 2015-2017. The operating margin improved because SQ earned a higher profit margin from initial stage of the Mae Moh Phase 8 project.

SQ's performance in the first quarter of 2018 fell short of expectations. Service revenue was lower and operating costs were higher at the Mae Moh Phase 8 project. Revenue was Bt831 million, a drop of 18% from the same period last year. The operating margin was 26%, a steep decline from normal levels of around 35%. SQ's financial performance was also hurt by an unfortunate landslide at a dump site, owned by EGAT, adjacent to the Mae Moh Phase 8 project. The landslide, in March 2018, damaged parts of the conveyor system and related equipment. The landslide also delayed the installation of a conveyor system. Project operating costs climbed afterwards. SQ is seeking compensation from EGAT to cover replacement costs and other losses stemming from the incident.

TRIS Rating holds the view that the landslide is a one-off event. SQ's operating performance is expected to recover in the second half of 2018, once the conveyor system at the Mae Moh Phase 8 project is fully operational. SQ has reported a lower margin on this project during the first half of 2018. Nonetheless, TRIS Rating's base case forecast assumes the company's operating margin will stay above 36%.

High leverage

The rating is constrained by a high level of financial leverage. The company has shouldered a heavier debt load over the past three years. The debt level has increased significantly since 2014 because of an increased need for working capital and greater capital expenditures. SQ typically buys the new machinery and equipment it needs at the beginning of a new project. The leverage level improved after SQ raised Bt1.2 billion from an initial public offering (IPO) in October 2016. The total debt to capitalization ratio fell considerably to 52.8% at the end of 2016, from above 75% during 2014 and 2015. However, this ratio increased to 71.9% at the end of March 2018. Leverage is on the rise due to the new investments needed for the Mae Moh Phase 8 project.

TRIS Rating holds the views that SQ's financial leverage should stay elevated for the next few years. The total debt to capitalization ratio is expected to increase. SQ has to sink about Bt7 billion in aggregate into the Mae Moh Phase 8 project. The debt to capitalization ratio is forecast to range from 68%-74% over the next three years. Given the hefty capital expenditures, the interest-bearing debt to equity ratio will stay above two times over the year ahead.

Moderate liquidity profile

Liquidity is moderate. The company had Bt579 million in cash at the end of March 2018 plus undrawn credit lines of about Bt1.2 billion. Debts due over the next 12 months amount to about Bt1.4 billion. Most of the debts are project finance loans, repaid from the cash SQ earns as project progress payments.

In TRIS Rating's base case forecast, funds from operations (FFO) are forecast at Bt1-Bt1.3 billion per annum. The FFO to total debt ratio is expected to hover around 15%-20% over the next three years, while the earnings before interest, taxes, depreciation, and amortization (EBITDA) interest coverage ratio is expected to stay above four times over the same period.

RATING OUTLOOK

The "stable" outlook reflects the expectation that SQ will maintain its competitive position as a mining contractor, serving both public sector and private sector clients. SQ will perform in accordance with the terms of the contracts and prudently manage its costs throughout the lengths of the projects. If it can accomplish these goals, the operating margin will exceed 36%. The debt to capitalization ratio is expected to rise above 70% but should decline steadily over the course of the projects. The high level of leverage (gearing) is offset by the predictability of the revenue streams from the projects.

RATING SENSITIVITIES

The rating could be revised downward if the operating performance falls short of expectations. In addition, the ratings would be affected if any large capital expenditures cause the debt to capitalization ratio to exceed 70% for a sustained period. The rating upside is limited in the medium term as leverage is expected to remain high. However, the rating or outlook could be revised upward if revenue or cash flow grows and the debt load drops.

COMPANY OVERVIEW

SQ was established in May 2001 by the Sirison family and the Areekul family. The company is the largest mining contractor in Thailand, providing a complete range of mining engineering services, including mine planning, open-pit mining operations, mining consultancy, and heavy-duty mining equipment rental and maintenance.

SQ is primarily engaged in overburden and lignite removal services for the Mae Moh mine in Lampang province. The mine supplies lignite to the Mae Moh coal-fired power plants owned and operated by EGAT.

Following robust growth in operations, SQ went public in 2015 and was listed on the Stock Exchange of Thailand (SET) in October 2016. The Sirison family has been the company's major shareholder since its inception. As of March 2018, this founding family held a 27% stake in the company.

SQ serves open pit mine operators, removing overburden in order to obtain the coal underneath. The company uses heavy machinery and conveyors to transport the overburden (soil) and coal.

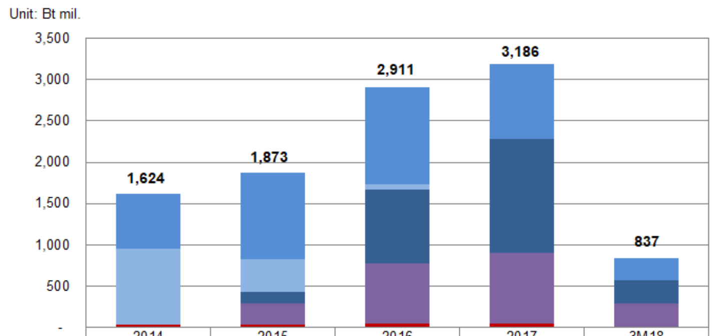
SQ expanded its scope of business to the power segment in order to reduce its susceptibility to fluctuations in the mining industry and develop a stream of recurring income in form of dividends from its investments.

In 2004, SQ set up Sahakol Power Co., Ltd. as an investment holding company. Sahakol Power bought 15% of Triple S Eco Co., Ltd. in 2015. Triple S Eco focuses on renewable energy projects, especially wind power, but currently does not have any projects in its portfolio.

Most of SQ's revenue generated from the projects at the Mae Moh mine. The projects at the Mae Moh mine accounted for more than 75% of its total revenue annually over the past three years. In the first quarter of 2018, revenue came in at Bt831 million, with the Mae Moh mine projects making up about 66%.

KEY OPERTING PERFORMANCE

Chart 1: Revenue Breakdown



	2014	2015	2016	2017	3M18
Mae Moh phase 7	671	1,052	1,173	905	267
Mae Moh phase 7/1	914	392	65	-	-
Mae Moh phase 8	-	146	897	1,376	287
Hongsa	-	247	731	857	273
Others	39	35	46	47	10

Source: SQ

Table 1: SQ's Projects in the Backlog as of Mar 2018

Unit: Bt million

Projects	Duration	Backlog Value	Total (%)
Mae Moh phase 8	2016-2025	20,165	59
Hongsa mine	2015-2026	9,635	28
Tin mine	2018-2024	3,672	11
Mae Moh phase 7	2012-2020	849	2
Total		**34,320**	**100**

Source: SQ

FINANCIAL STATISTICS AND KEY FINANCIAL RATIOS*

Unit: Bt million

		------------- Year Ended 31 December ------------			
	Jan-Mar 2018	2017	2016	2015	2014
Revenue	831	3,154	2,891	1,868	1,614
Gross interest expense	37	137	135	90	106
Net income from operations	(39)	363	349	113	49
Funds from operations (FFO)	157	941	995	653	447
Total assets	11,200	10,241	6,004	4,489	2,749
Total debts	6,516	5,145	2,513	2,221	1,446
Shareholders' equity	2,542	2,578	2,251	740	389
Operating income before depreciation and amortization as % of sales	25.88	36.58	40.62	37.55	33.88
Pretax return on permanent capital (%)	3.63 **	9.21	15.11	9.81	9.93
Earnings before interest, tax, depreciation, and amortization (EBITDA) interest coverage (times)	6.02	8.66	8.84	7.85	5.23
FFO/total debt (%)	10.89 **	18.28	39.58	29.38	30.94
Total debt/capitalization (%)	71.94	66.62	52.75	75.02	78.80

* *Consolidated financial statements*
** *Annualized with trailing 12 months*

Sahakol Equipment PLC (SQ)

Company Rating:	BBB-
Rating Outlook:	Stable

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