TRIS RATING
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THAI POLYCONS PLC

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CORPORATES

Company Rating:	BBB
Outlook:	Stable

RATIONALE

TRIS Rating assigns the company rating on Thai Polycons PLC (TPOLY) at "BBB". The rating reflects the solid operating performance and the predictable cash flows of the power segment. These factors offset the cyclical nature of the construction segment. However, the rating is weighed down by fluctuations in the supply and prices of biomass feedstock, the execution risks associated with several new power projects, and a looming rise in leverage. The rating also takes into consideration TPOLY's mediocre competitive position and intense competition in the construction segment.

KEY RATING CONSIDERATIONS

Predictable cash flow from power segment

TPOLY's rating is built predominantly on the predictable cash flows of the power segment. The power segment will continue to be the key driver of earnings. In TRIS Rating's view, the power segment is evidence of the success of TPOLY's turnaround.

The power segment is operated by TPC Power Holding PLC (TPCH), a core and profit-making subsidiary of TPOLY. TPCH currently has six biomass power plants which are operating, with a combined contracted capacity of 52.8 megawatts (MW). TPCH is adding more capacity. The power segment contributes about 90% of TPOLY's earnings before interest, taxes, depreciation, and amortization (EBITDA).

The power segment generates stable cash flows because TPCH's power plants have secured multi-year power purchase agreements (PPAs) with the state-owned producers and distributors of electricity. Each PPA contains contractually committed tariff rates.

High-performance power plants

TPCH's power plants which are currently operating have shown solid performances over the past three years. The EBITDA margin (earnings before interest, taxes, depreciation, and amortization as a percentage of revenues) has averaged of about 50%.

TRIS Rating opines that the reliable cash flows from the power-generating assets offset the cyclicality of the construction segment. Our forecast assumes the power plants will continue to show satisfactory performance over the next three years.

Fluctuations in supply and prices of feedstock

Despite operating at high levels of efficiency, the power plants are highly susceptible to fluctuations in the supply and prices of biomass feedstock. TPCH mitigates the supply risk by locating its power plants near sources of biomass feedstock. Operation and maintenance (O&M) contractors are responsible for the supply of the biomass feedstock, in addition to running most of the plants. TPCH cannot pass through the price risk of raw materials to the O&M contractors.

TPCH plans to operate its new power plants itself. The supply risk will rise as a result. TPCH has secured long-term supply agreements with local suppliers to ensure the availability of fuel. However, contract enforcement remains a challenge. TPCH also fends off this risk by taking in suppliers as partners in the

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company's projects. In addition, TPCH is developing its own bio-fuel plantation. In recognition of these efforts, TRIS Rating believes TPCH will manage the supply risk prudently.

Execution risks associated with new power projects

TPCH faces execution risks because it has several new power projects. Construction delays, the choices of project location, and environmental issues could have significant impacts on the new power projects.

In 2016, TPCH won contracts for three biomass power projects in Yala and Narathiwat provinces. The contracts cover a combined contracted capacity of 24.7 MW. TPCH secured a PPA under the Small Power Producer (SPP) scheme to operate a 21-MW biomass power plant in Pattani province. This plant is the largest power project. TPCH is also developing a waste-to-energy project, with a contracted capacity of 8 MW. All projects are currently underway; start dates will come during 2019-2020.

The significant increase in production capacity will also bring new challenges such as feedstock procurement and manpower recruitment. In addition, the new biomass projects are under a competitive bidding system, yielding much lower tariffs. The tariffs for the new plants range between Bt2.8 and Bt3.4 per kilowatt hour (kWh), versus above Bt4 per kWh for the current plants. Production costs must be tightly controlled for these new power projects.

Mediocre competitive position in construction segment

The rating takes into account TPOLY's mediocre competitive position in the construction segment. This segment is rather small, compared with the other contractors rated by TRIS Rating. Revenue in the construction segment has averaged about Bt2 billion during the past several years. Given the small scale, TPOLY cannot undertake large-scale projects, in TRIS Rating's view. A typical contract for construction work has been worth below Bt1 billion per contract during the past three years.

TPOLY has a limit scope of construction work. It focuses on the construction of buildings such as hospitals, universities, hotels, and shopping malls. It has constructed few power plants.

TPOLY is intent on acquiring contracts for public infrastructure construction projects in a bid to reverse the drop in revenue in the segment. However, TPOLY has no track record in this type of construction work, and it has to compete with a large number of contractors.

Revenue rising, bolstered by power segment

TRIS Rating forecasts TPOLY's total operating revenues will increase to Bt5 billion in 2021, from about Bt3.6 billion in 2018. The power segment will drive the growth. Revenue from the sale of electricity should grow steadily to about Bt3 billion in 2021, from about Bt1.6 billion in 2018. Under TRIS Rating's base case projection, production capacity in the power segment will double within the next three years.

We expect revenue from the construction segment will range from Bt1.4-Bt2.0 billion per annum over the next three years, compared with a three-year average of about Bt2.1 billion. The strengths of the power segment ease pressure to bid for construction contracts. Investment spending by the private sector remains sluggish. TPOLY endeavors to acquire contracts for public infrastructure construction projects to maintain construction revenue. TPOLY had a backlog worth about Bt1.7 billion as of March 2018. The backlog will help partly secure revenue during 2018 and 2019.

TRIS Rating's base-case forecast assumes sales in the residential property segment will stay lower than Bt200 million per annum over the next three years. TPOLY had less than Bt100 million in unsold units as of June 2018. TRIS Rating does not expect the residential property segment will grow aggressively in coming years.

Operating performance on solid course

TRIS Rating expects TPOLY's operating performance will stay strong over the next three years. The contribution from the power segment will rise. The profitability of the power segment is significantly higher than the construction segment. We forecast the operating margin (operating income before depreciation and amortization as a percentage of total operating revenues) will stay above 20% during 2018-2021.

TPOLY suffered from losses in the construction segment during 2012-2015. An increase in the minimum wage and rising raw material prices were the culprits. The substantial losses also came from poor cost estimate. The construction segment has recovered recently. TPOLY has streamlined project management to get greater control over costs. The gross margin of the construction segment improved to 12.2% in the first half of 2018, when it had been below 3% during 2012-2015. We expect earnings in the construction segment will stay positive over the next three years.

Leverage on the rise

TPCH guarantees the debts of the incorporated joint ventures (JVs) in proportion to its stakes in the JVs. In assessing the financial profile and performance of TPOLY, TRIS Rating includes assets, liabilities, and the respective financial performances of the JVs in TPOLY's consolidated accounts, in proportion to the ownership stake of TPCH in each venture.

TPOLY's gearing will increase further in the coming years. TPCH plans to spend about Bt5.5 billion to build new power plants. Moreover, TRIS Rating expects that TPOLY will borrow more to fund its working capital needs if it undertakes public infrastructure construction projects. Despite the rise in leverage, TRIS Rating believes the debt to capitalization ratio will remain below 60% over the next three years, compared with 38.6% as of June 2018.

TPOLY's cash flow in relation to debt will drop as debt will rise. The ratio of funds from operations (FFO) to debt is forecast to fall to about 13% in 2019, before rising to about 17% in 2021. The ratio improved significantly to 32.1% in the first half of 2018. It rose from a negative value before 2015. The power segment boosted earnings. Over the next three years, the EBITDA interest coverage ratio will drop but should remain above 4 times.

Liquidity stays manageable

TRIS Rating believes TPOLY will manage its liquidity prudently. The company has a fairly low debt level and has no funding mismatch. Debts of about Bt460 million will come due during the second half of 2018. Almost Bt280 million are short-term debts TPOLY uses to fund working capital. The remainder or about Bt180 million are long-term project loans TPCH uses to fund power projects.

As of June 2018, TPOLY had undrawn credit facilities, plus cash and marketable securities, of about Bt650 million. This should be sufficient to repay all the debts coming due this year. Over the next three years, we forecast EBITDA will range from Bt800-Bt1,300 million annually. TPOLY must repay long-term debts of Bt400-Bt500 million per annum.

TPOLY has no financial covenants in its bank loans. However, TPCH's subsidiaries and JVs are required to maintain a debt service coverage ratio at above 1.1 times or 1.2 times and keep the debt to equity ratio below 2.5 times. All the subsidiaries and JVs comply with the respective financial covenants. TRIS Rating believes they will stay in compliance for the next 12-18 months.

RATING OUTLOOK

The "stable" outlook reflects TRIS Rating's expectation that the power segment will continue to be the core earner and generate the sizable cash flows as planned. We assume the new power projects will be completed as planned and earn satisfactory returns. In addition, the construction segment will remain profitable. Working capital will be prudently managed.

RATING SENSITIVITIES

A rating upgrade could occur if TPOLY's operating performance and capital structure are significantly stronger than expectations. For example, if EBITDA improves significantly and the leverage level is prudently managed. On the contrary, downward rating pressure would emerge if the performance of the power segment falls significantly short of our estimates, or if the capital structure deteriorates on account of aggressive debt-funded investments.

COMPANY OVERVIEW

Established in 1988, TPOLY is a construction contractor, providing engineering and construction (E&C) services to the public and private sectors. The company focuses on constructing buildings and civil works. The company was listed on the Market for Alternative Investment (MAI) in 2009 and moved to the Stock Exchange of Thailand (SET) in 2010. TPOLY expanded into the residential property segment and the power segment in 2010. It spun off the power segment to TPCH, its subsidiary, in 2012. The Chanpalangsri family remained the major shareholder, holding approximately 44% of TPOLY's interest, as of June 2018.

The construction segment currently accounts for the majority of revenue. In the first half of 2018, the segment made up nearly half of total revenue, followed by the power segment (45%), the residential property segment (4%), and the trading segment (1%). However, the power segment is now the major source of earnings. EBITDA of this segment make up about 90% of TPOLY's EBITDA.

KEY OPERTING PERFORMANCES

Table 1: Revenue Breakdown

	2014	2015	2016	2017	6M18
Construction	81%	85%	71%	60%	49%
Property	8%	4%	4%	8%	4%
Power	12%	11%	25%	32%	45%
Trading	-	-	-	1%	1%
Total	**100%**	**100%**	**100%**	**100%**	**100%**
Total revenue (Bt million)	**2,180**	**2,654**	**2,708**	**3,432**	**1,626**

Source: TPOLY

Table 2: Backlog of Construction Work as of Mar 2018

Project	Project Owner	Backlog (Bt Mil.)	% of Total
Medical research building	Intrarat Hospital Co., Ltd.	443	50
Inpatient building	Phatthalung Hospital Co., Ltd.	271	16
Office building	Airports of Thailand PLC	231	14
Novotel Sriracha Marina Bay Hotel	RCK Hotel and Residence Co., Ltd.	223	13
Others	-	540	32
Total		**1,708**	**100**

Source: TPOLY

Table 3: Power Project Portfolio

Company/Country	Held by TPCH	Status	Installed Capacity (MW)	Contracted Capacity (MW)	Tariff
Biomass Projects					
CRB	73%	Operating	9.5	9.2	Fit
MWE	85%	Operating	9.0	8.0	Fit
MGP	46%	Operating	9.5	8.0	Fit
TSG	65%	Operating	9.5	9.2	Fit
PGP	60%	Operating	9.9	9.2	Fit
SGP	51%	Operating	9.9	9.2	Fit
PTG	65%	Developing	23.0	21.0	Adder
TPCH1	65%	Developing	9.9	9.2	Fit
TPCH2	65%	Developing	9.9	9.2	Fit
TPCH5	65%	Developing	6.3	6.3	Fit
Sub total - Biomass			**106.4**	**98.5**	
Waste Projects					
SP	50%	Dealing PPA	9.5	8.0	-
Sub total - Waste			**9.5**	**8.0**	
Grand total			**115.9**	**106.5**	

Source: TPCH

CRB : Chang Raek Bio Power
MGP : Mahachai Green Power
PGP : Phathalung Green Power
PTG : Pattani Green
TPCH2 : TPCH Power 2
SP : Siam Power
MWE : Maewong Energy
TSG : Thungsung Green
SGP : Satun Green Power
TPCH1 : TPCH Power 1
TPCH5 : TPCH Power 5

FINANCIAL STATISTICS AND KEY FINANCIAL RATIOS*

Unit: Bt million

		--------------Year Ended 31 December -----------			
	Jan-Jun 2018	2017	2016	2015	2014
Total operating revenues	1,701	3,594	2,841	2,690	2,213
Operating income	431	716	423	(3)	(117)
Earnings before interest and taxes (EBIT)	335	573	334	(69)	(174)
Earnings before interest, taxes, depreciation, and amortization (EBITDA)	431	712	423	(3)	(117)
Funds from operations (FFO)	373	603	364	(164)	(210)
Adjusted interest expense	54	90	71	88	81
Capital expenditures	163	808	1,028	603	673
Total assets	7,126	6,936	6,547	5,429	4,948
Adjusted debt	2,209	1,989	1,423	717	513
Adjusted equity	3,512	3,262	2,854	2,514	1,669
Adjusted Ratios					
Operating income as % of total operating revenues (%)	25.34	19.92	14.87	(0.11)	(5.29)
Pretax return on permanent capital (%)	11.55 **	10.55	7.23	(1.77)	(5.66)
EBITDA interest coverage (times)	8.03	7.94	5.99	(0.03)	(1.44)
Debt to EBITDA (times)	2.67 **	2.80	3.37	(240.54)	(4.39)
FFO to debt (%)	32.13 **	30.34	25.60	(22.88)	(40.92)
Debt to capitalization (%)	38.61	37.88	33.27	22.20	23.52

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

Thai Polycons PLC (TPOLY)

Company Rating:	BBB
Rating Outlook:	Stable

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