

EAST COAST FURNITECH PLC

No. 130/2023
19 July 2023

CORPORATES

Company Rating: BB-
Outlook: Stable

Last Review Date: 27/07/22

Company Rating History:

Date	Rating	Outlook/Alert
27/07/22	BB	Stable
30/07/21	BB+	Stable
23/07/20	BB+	Negative
25/07/18	BB+	Stable
19/06/17	BB	Stable

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RATIONALE

TRIS Rating downgrades the company rating on East Coast Furnitech PLC (ECF) to “BB-” from “BB”, while maintaining the “stable” rating outlook.

The downgrade reflects the weakened performance of ECF’s furniture business, as a result of a significant drop in export sales and collection problems in the domestic market. The downgrade also takes into consideration a prolonged delay of the Minbu Solar Power Project in Myanmar in securing project financing from financial institutions.

The rating continues to mirror ECF’s high financial leverage and tight liquidity. The rating also incorporates the company’s adequate competitive strength in the furniture market and established distribution channels through modern-trade retailers in Thailand and overseas markets.

KEY RATING CONSIDERATIONS

Significant drop in furniture exports in 2022-2023

We expect ECF to continue facing challenges from sluggish export market after the Coronavirus Disease 2019 (COVID-19) pandemic with many people returning to work in offices. The decline in export is also brought by the economic slowdowns in the major export markets, particularly the USA and Japan. The company’s furniture export sales curtailed by about 26% in 2022 to THB706 million and continued to decline by 42% during the first three months of 2023. The drop in export sales was in line with the decline in wooden furniture exports from Thailand, which decreased by 33% in 2022 and 38% during the first three months of 2023. The company’s overall revenue decreased by around 8% in 2022 and by 23% in the first quarter of 2023.

In our projection, we expect ECF’s revenue to decline to around THB1.3 billion annually during 2023-2025. ECF’s earnings before interest, taxes, depreciation, and amortization (EBITDA) are expected to be around THB200 million per annum. The impact from the drop in sales should be partly compensated by the falling cost of wood particle. The company’s funds from operations (FFO) are expected to fall to THB20 million in 2025 from THB40 million in 2023, mainly due to high interest payments.

We have also taken into consideration the impact of a fire accident the company faced in April 2023 which caused damages of THB108 million. This loss is expected to be partly covered by insurance claims within this year.

Weakened cash flow from overdue accounts receivable and higher inventory

ECF’s furniture operations experienced negative net cash inflows from operations during 2022 and the first quarter of 2023 due to an increase in overdue receivables from dealer customers. At the end of March 2023, ECF’s receivables increased to THB629 million, of which approximately 50% were overdue from these customers.

To alleviate the risk of setting aside bad debt reserves, ECF suspended sales to these customers in March 2023 and entered into agreements that allow for installment payments over the next 12-36 months. Accounts receivable under these agreements came to THB297 million or nearly half of the total as of the end of March 2023.

Additionally, we have observed a higher level of overstocking and cash flow constraints as the company's cash becomes increasingly tied up in inventory. ECF's inventory days increased to 520 days at the end of March 2023, from 400-440 days in 2021-2022.

Further delay in the Minbu Project

Currently, the company's solar power project in Myanmar (Minbu Project) remains under project assessment by a Chinese insurer and lender. Due to the high-country risk and internal conflicts in Myanmar, the lender may impose limitations on its financial support, offering project loans adequate for the construction of Phase 2 and Phase 3 only. The company expects the lender to approve project financing in the second half of 2023. After approval, we estimate the Phase 2 and Phase 3 will commence commercial operations in 2024 and 2025, respectively.

In our view, the prolonged delay and lack of sufficient funds heighten a project completion risk. ECF has held a 20% interest in the Minbu Project since 2017 with total exposure of THB963 million, representing 23.5% of its total assets as of March 2023. Since ECF has financed the project primarily through debt, we view that the company's cash flow and financial position will remain under pressure from rising interest payments and financial leverage until all four phases of the project start generating meaningful dividend income for the project owners.

Adequate competitive strength in furniture market

ECF's business strength is underpinned by its established market position as a medium-sized furniture manufacturer in Thailand. The company is considered an original equipment manufacturer (OEM) since the majority of its furniture sales are made-to-order products. We view ECF's competitive strength as adequate to maintain its market position. The company benefits from own production facilities and economies of scale, compared with most furniture manufacturers.

Nevertheless, its business profile is constrained by price-driven competition and limited pricing power in the furniture market as its products are mostly simple knockdown furniture targeted at the low- to medium-priced segments.

Established distribution channels and some benefits from geographical diversification

ECF has two core distribution channels, comprising exports and Thai modern-trade retailers. Most of ECF's export customers are leading furniture and modern trade retailers in Japan. The company has distributed through these two channels for long periods, and we consider them to be an essential factor supporting sales performance over the past several years. In 2022, the export market accounted for 51% of ECF's total furniture sales, while Thai modern trade made up about 43% of the total.

ECF's business profile to some extent benefits from geographical diversity with less reliance on the Japanese market than in the past. In 2022, the company's sales in Thailand and Japan accounted for 50% and 32% of total revenue, respectively. Exports to India contributed about 10% of the total, thanks to growing online orders. Sales to the USA accounted for about 5% of the total.

High financial leverage

We anticipate that ECF's financial leverage will remain high over the next three years. The company plans capital expenditures of approximately THB200 million per year during 2023-2024, primarily for new warehouses and production machinery, as well as replacement of equipment damaged in the fire accident. We expect ECF's net debt to EBITDA ratio to stay above 10 times during 2023-2025. The ratio of funds from operations (FFO) to net debt will likely stay below 5%.

Debt repayment relies on refinancing

We expect ECF's liquidity to remain under pressure due to the company's negative cash inflows and a significant debt repayment due within this year. The company will need to roll over or refinance maturing debt obligations totaling THB503 million coming due over the next nine months, including debentures of THB340 million coming due on 8 December 2023, as well as bills of exchange and bank loans totaling THB163 million. The company plans to issue new debentures in August 2023 to repay the debentures coming due in December.

Capital structure

At the end of March 2023, ECF had THB2.23 billion of debt, including around THB1.23 billion of priority debt. As its priority debt ratio is about 55.2%, higher than our threshold of 50%, we view that ECF's unsecured creditors are significantly disadvantaged with respect to the priority of claims against ECF's assets.

BASE-CASE ASSUMPTIONS

- Revenue of around THB1.3 billion per annum during 2023-2025.
- Shared profits from the Minbu Project of THB30 million in 2023, THB45 million in 2024, and THB75 million in 2025 with no dividend payments from the project.
- EBITDA margin of 16% on average.
- Capital expenditure of THB200 million per annum during 2023-2024 and about THB80 million in 2025.
- Dividend payout ratio of 30% during 2023-2025.

RATING OUTLOOK

The “stable” outlook reflects our expectation that the company’s furniture business will perform in line with our forecast. The company is expected to prudently manage its accounts receivable and inventory to avoid any further deterioration of its cash flow from operations. Phases 2 and 3 of the Minbu Project are anticipated to be up and running in 2024 and 2025, respectively, but no dividend receipts are expected until the project is fully completed.

RATING SENSITIVITIES

A rating downgrade could occur if ECF’s cash flow generation deteriorates further. This could result from rising working capital needs and/or weakened performance in the furniture business. A failure to secure adequate sources of funds to repay its maturing debts would also trigger a negative rating action.

A rating upgrade is unlikely in the near term. However, an upgrade could occur if there are significant improvements in the company’s furniture business and operating cash inflow. A reduction of its debt obligations as a result of substantial dividend receipts from the Minbu Project would be positive for the rating.

COMPANY OVERVIEW

ECF engages in the manufacture and distribution of home furniture in Thailand. The company owns two factories in Rayong Province, focusing on producing knockdown furniture and rubber wood furniture. Revenue from selling furniture contributes over 90% of its total revenue; the remainder is derived from selling decorative foil paper and dried rubber wood. ECF has been listed on the Market for Alternative Investment (MAI) since 2013. The Suksawad Family is the main shareholder, holding approximately 50% of the company’s outstanding shares at the end of March 2023.

ECF distributes its furniture products through two main channels, including made-to-order for export and Thai modern trade. Almost all made-to-order furniture is exported to leading furnishing distributors and large modern trade retailers in Japan. In Thailand, the company distributes furniture through well-known modern trade retailers, such as Home Pro, Big C, Mega Home, Thai Wasadu, Lotus’s, and Global House.

The company, through ECF Power Co., Ltd., has invested in power business in the Minbu Project, a 220-megawatt (MW) solar power plant in Myanmar. The project consists of four phases. The first phase with 50 MW has already achieved the commercial operating date since September 2019.

KEY OPERATING PERFORMANCE

Table 1: ECF's Revenue Breakdown by Distribution Channel

Revenue (Mil THB)	2018	2019	2020	2021	2022	1Q22	1Q23
Made to order (export)	690	706	869	950	706	225	130
Modern trade	371	372	386	472	586	153	137
Showroom	62	27	48	25	12	3	5
Warehouse and dealer	175	90	28	49	68	15	31
Total revenue	1,297	1,195	1,331	1,495	1,372	395	303
% change	(2.6%)	(7.9%)	11.3%	12.4%	(8.2%)		(23.3%)

Source: ECF

Table 2: ECF's Power Project Portfolio as of 30 Mar 2023

Project/Country	Type	Held by ECF (%)	Installed Capacity (MW)	Contracted Capacity (MW)	COD
Myanmar					
Minbu Project					
- Phase 1	Solar	20	50	40	Sep 2019
- Phase 2	Solar	20	50	40	within 2024
- Phase 3	Solar	20	50	40	within 2025
- Phase 4	Solar	20	70	50	-
Total			220	170	

Source: ECF

FINANCIAL STATISTICS AND KEY FINANCIAL RATIOS*

Unit: Mil. THB

	Jan-Mar 2023	-----Year Ended 31 December -----			
		2022	2021	2020	2019
Total operating revenues	320	1,450	1,585	1,401	1,273
Earnings before interest and taxes (EBIT)	51	197	188	172	186
Earnings before interest, taxes, depreciation, and amortization (EBITDA)	57	217	200	192	228
Funds from operations (FFO)	15	54	61	49	98
Adjusted interest expense	41	159	135	133	118
Capital expenditures	14	189	150	100	57
Total assets	4,091	3,988	3,756	3,545	3,348
Account receivables	629	596	454	331	283
Inventory	1,337	1,277	1,314	1,370	1,379
Adjusted debt	2,204	2,219	1,996	1,684	1,608
Adjusted equity	1,369	1,367	1,327	1,240	1,242
Adjusted Ratios					
EBITDA margin (%)	17.7	14.9	12.6	13.7	17.9
Pretax return on permanent capital (%)	5.6 **	5.6	5.7	5.5	6.2
EBITDA interest coverage (times)	1.4	1.4	1.5	1.4	1.9
Debt to EBITDA (times)	9.9 **	10.2	10.0	8.8	7.0
FFO to debt (%)	2.5 **	2.4	3.0	2.9	6.1
Debt to capitalization (%)	61.7	61.9	60.1	57.6	56.4

* Consolidated financial statements

** Annualized with the trailing 12 months

RELATED CRITERIA

- Corporate Rating Methodology, 15 July 2022
- Key Financial Ratios and Adjustments for Corporate Issuers, 11 January 2022
- Issue Rating Criteria, 15 June 2021

East Coast Furnitech PLC (ECF)

Company Rating:	BB-
Rating Outlook:	Stable

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