TRIS RATING
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EASTERN PRINTING PLC

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CORPORATES

Company Rating:	BBB-
Outlook:	Stable

Last Review Date:

Date	Rating	Outlook/Alert
09/11/17	BBB	Stable

Company Rating History:

Date	Rating	Outlook/Alert
30/11/16	BBB	Stable
01/12/15	BBB	Stable

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RATIONALE

TRIS Rating downgrades the company rating on Eastern Printing PLC (EPCO) to “BBB-“ from “BBB”. The downgrade reflects EPCO’s heightened leverage stemming from its massive investments. The deluge use of debt leads to additional strain on its financial resilience.

The rating continues to reflect EPCO’s solid market position and long-established track record in the printing industry, the profitable printing business despite its dismal outlook for growth, and the more reliable cash flow from its strategic diversification into the power business. Conversely, the rating is weighed down by the gloomy outlook for the printing industry, elevated debt to support growth in the power business, and higher execution risks from overseas expansion.

KEY RATING CONSIDERATIONS

Excessive debt loads slash the rating

The rating downgrade is primarily predicated on EPCO’s heightened leverage, following excessive investments in both the printing and power segments. EPCO vows to spend around Bt420 million in acquiring 84.5% share of WPS (Thailand) Limited (WPS), a move aimed at expanding into the packaging business. In anticipation of fast-growing e-commerce and logistics industries, EPCO will double-down on packaging. The acquisition will bring in extended printing facilities. EPCO also plans to invest about Bt200 million in new packaging machinery.

TRIS Rating expects that the added production capacity could spell Bt300 million more in revenue per year, after the full operation set for mid 2019. On the downside, the acquisition of WPS is entirely financed by bank loans.

Furthermore, EPCO is taking on huge investments in the power business. EPCO will spend Bt5.1 billion in connection with investments in solar farm projects in Vietnam and Japan during 2018-2019. Such massive investments will cause EPCO to remain saddled with debt over the next few years.

Solid market position and long-established track record

The rating is reflective of EPCO’s strong market position as a leading printing service provider due to its size and broad range of products. EPCO maintains long term relationships with its customers on the strength of its long-established track record.

Despite the long-moribund printing and publishing industries, EPCO remains profitable and its gross margin is relatively higher than peers. On a stand-alone basis, EPCO’s operating margin (operating profit before depreciation and amortization as a percentage of revenue) was over 15% for the past five years.

Dismal outlook for printing segment

EPCO’s strengths in the printing segment are partially weighed down by the dismal outlook for the printing industry, due for the most part to dwindling demand for printing services. The industry is at a precipice of significant change. The fast-and-steady growth of internet usage and digital media stand to undercut industry-wide demand for printing materials.

As a result, EPCO’s revenue from the printing segment has consistently tailed off to about Bt400-Bt500 million per year during 2015-2017, a number that has been declining from Bt650 million. For the first nine months of 2018, EPCO's performance in the printing business undershot our expectation, with a 9% drop in revenue year-over-year (y-o-y). Gross margin also declined from 25.4% in 2017, to 22.3% in the first nine months of 2018. The printing business remains mired over the long run.

We view EPCO's foray into packaging is slated to revamp the growth of its printing segment. However, EPCO's monumental challenge is building up a customer base amid a competitive market. Unlike the metal and glass packaging categories which are dominated by a few large companies, the paper and board category is fragmented with a large number of small and medium-scale companies.

Benefits from strategic diversification into the power business

The rating incorporates EPCO's advantageous diversification into the power industry. The company has diversified into the solar power business since 2012, primarily through its main subsidiary, Eastern Power Group PLC (EP; rated "BBB-/Stable"). EPCO currently owns 75% of EP. The power segment has served as a counterweight to the floundering printing business, making EPCO's cash flow more stable and enlarging overall revenue.

The power segment has exhibited tremendous growth. In terms of assets, the power business contributed around 67% as of September 2018. The segment also made up around 65% of total EBITDA (earnings before interest, tax, depreciation, and amortization).

In the absence of opportunities in the domestic market, EPCO plans to grow its power business overseas. EPCO is currently developing and constructing three solar farm projects in Japan, which require the company to spend a total Bt1.8 billion during 2018-2019. In addition, EPCO recently announced its plan to invest in two solar power projects in Vietnam, with installed capacity of 99.6 megawatts (MW). The total cost of the projects is Bt2.8 billion.

In view of production capacity, solar power plants in Vietnam will make up around one-fifth of total capacity. The solar farms in Vietnam are scheduled to commence operation by June 2019, while the Japan-based projects are set for 2nd and 3rd quarter of 2019. Such investments will enlarge power production capacity and edge up the proportion of more stable income from the power segment. In our base case, we forecast that EBITDA will rise to Bt550-Bt900 million in 2018-2019, up from around Bt400 million in the past years. EBITDA would then edge up to a range of Bt1.4-Bt1.5 billion from 2020 onwards.

Execution risks of forthcoming projects

In our view, the investments in Vietnam carry relatively higher risks than the projects in Thailand and Japan. Despite benefits from expanding capacity, EPCO, in common with other power producers, is exposed to several risks, such as country risk, regulatory risk, challenging contract enforcement, delay of construction, changes in tariff, etc. Furthermore, the projects carry relatively higher counterparty risk by the state-run Electricity of Vietnam (EVN), which is the only authorized buyer of electricity in the country. Despite high potential, solar power in Vietnam is in its early stages. The track record of solar power of the country is relatively limited, compared with Thailand and Japan.

Currently, construction risk is very challenging. The Vietnamese government has demonstrated support for developing renewable energy by offering a fixed feed-in-tariff (FiT) of US9.35 cent per kilowatt-hour (kWh). However, this initial FiT will apply to projects that achieve commercial operation by June 2019. Delays in construction would jeopardize the viability of the projects. The government's policy on solar prices for projects starting after the deadline is uncertain. However, the construction risk is partially alleviated by the terms of the Engineering Procurement and Construction (EPC) contracts and bonds. In case of delay commissioning caused by the EPC contractors, EPCO is not obliged to make its final EPC payments.

Debt-heavy capital structure

EPCO's leverage is higher than our previous forecast as the company opts to grow overseas at the expense of ever-mounting debt. On a consolidated basis, EPCO will spend around Bt1.3 billion in 2018, followed by a hefty Bt4.3 billion in 2019 for the overseas projects EPCO is developing. We forecast that total debt would increase drastically from Bt6.0 billion as of September 2018 to Bt9.7 billion in 2019. The deluge of debt financing will put additional strain on its resilience against unexpected adverse circumstances. Moreover, we expect EPCO's financial cost would rise in the wake of elevated debt and the potential rise in interest rates.

In our base case, we forecast that the ratio of debt to capitalization would stand at nearly 70% in 2018, before gradually declining to below 60% in 2020. The ratio of funds from operations (FFO) to debt stood at a low 3.7% as of 2017 and would remain low in the range of 4%-5% in 2018-2019. The ratio will improve significantly to 10% and over from 2020 onwards.

Mismatch funding for long-term projects

There is an evidence of mismatch funding is seen. Some of EPCO's Japan-based solar farm projects are funded by bank loans with tenors of up to three and a half years. The company is obliged to make bullet payments at maturity. The tenors of loans do not match the long-term projects as EPCO would need to make a large repayment in 2021. In addition, EPCO has also raised funds to partially finance the power segment in the form of bonds and short-term bills of exchange.

Given the current debt profile, EPCO has repayment obligations of Bt1.2-Bt1.4 billion in 2019-2020 and nearly Bt2.2 billion in 2021. Meanwhile, FFO is expected at Bt0.5-Bt1.0 billion per year during 2019-2021. We expect that the company would prudently manage liquidity during the build-up phase.

RATING OUTLOOK

The "stable" outlook reflects our expectation that the new investments will pay off as expected. The packaging line of production will steer the printing segment out of its revenue slump. At the same time, we expect EPCO will successfully execute the power projects under construction such that the new power plants will commence their operations as planned and perform well in line with expectations. In addition, EPCO's capital expenditure should not deteriorate significantly from the current level. We expect the company to prudently manage liquidity as well.

RATING SENSITIVITIES

A rating upgrade is unlikely in the near term but it could occur if EPCO substantially strengthens its capital structure or its power plants outperform their guidance. Conversely, a rating downgrade could develop if EPCO's operating performance undershoots estimates, if EPCO continues to invest with deluge use of debt, or it fails to execute new power projects as planned.

COMPANY OVERVIEW

EPCO was established in 1990 as a printing service provider. The company was listed on the Stock Exchange of Thailand (SET) in 1993. As of November 2018, Aqua Corporation PLC (AQUA) held approximately 38% of EPCO while the Chinsupakul family, the company's founders, owned 17%. EPCO provides a full range of printing services, serving both domestic customers and customers abroad. EPCO prints newspapers, magazines, product manuals, educational books, calendars, and advertising materials. EPCO has transitioned to focus heavily on the power business to make up for the drop-off in the printing business.

EPCO has diversified into the solar power business since 2012, primarily through its main subsidiary, Eastern Power Group PLC (EP). EPCO currently owns 75% of EP. EP launched two pilot solar farm projects in Kanchanaburi Province in 2012. The contracted capacity of the two farms is 10 megawatts (MW). In 2013, EP added a 5-MW solar farm project in Lopburi Province. During 2014-2015, EP developed eight solar rooftop projects in Bangkok and Samutprakan Province, with a contracted aggregate capacity of 1.5 MW. EP later expanded to solar power projects outside Thailand, as well as cogeneration power.

Table 1: Revenue Breakdown

	2013	2014	2015	2016	2017	9M'17	9M'18
Printing business	71%	61%	57%	58%	46%	45%	42%
Power business	26%	36%	40%	39%	50%	51%	54%
Others	3%	3%	3%	3%	3%	4%	4%
Total	100%	100%	100%	100%	100%	100%	100%
Total Revenue (Bt million)	**783**	**896**	**890**	**881**	**963**	**729**	**710**

Source: EPCO

Table 2: Power Project Portfolio of Eastern Power Group PLC (EP)

Project	Plant Type	Held by EP (%)	Installed (MW)	Equity [(2)] (MWe)	SCOD
OPERATING			**412.6**	**204.9**	
JKR	Solar Farm	100	5.5	5.5	Oct-13
RVP	Solar Farm	100	5.5	5.5	Oct-13
LOPBURI	Solar Farm	100	6.0	6.0	Feb-14
PS	Solar Farm	48	5.0	2.4	Dec-16
Solar rooftop	Solar Rooftop	100	1.5	1.5	Sep-14
KYOTEMBA	Solar Farm	98	12.0	11.8	Nov-16
KURIHARA1	Solar Farm	98	11.7	11.4	Oct-18
Commercial rooftop	Solar Rooftop	100	5.4	5.4	2018-2019
PPTC	CCGT [(1)]	50	120.0	59.4	Mar-16
SSUT	CCGT [(1)]	40	240.0	96.0	Dec-16
CONSTRUCTING & DEVELOPING			**121.2**	**86.0**	
XUAN THO1, 2 (Vietnam)	Solar Farm	65	99.2	64.5	Jun-19
KURIHARA2	Solar Farm	98	17.6	17.2	2019
SHICHI KACHUKU1, 2	Solar Farm	98	4.4	4.3	2019
Total Portfolio			**533.8**	**290.9**	

Remarks: [(1)] Combined cycle gas turbine
[(2)] Capacity based on EP's ownership

Source: EP

FINANCIAL STATISTICS AND KEY FINANCIAL RATIOS

Unit: Bt million

	Jan-Sep 2018	--------------Year Ended 31 December 2017	2016	2015	2014 ----------
Total operating revenues	708	955	880	890	896
Operating income	315	427	370	416	401
Earnings before interest and taxes (EBIT)	430	466	264	311	302
Earnings before interest, taxes, depreciation, and amortization (EBITDA)	316	434	371	416	401
Funds from operations (FFO)	130	202	240	352	325
Adjusted interest expense	179	209	115	52	60
Capital expenditures	530	906	1,092	256	322
Total assets	8,916	8,479	6,930	2,579	2,680
Adjusted debt	5,746	5,442	2,608	1,014	911
Adjusted equity	2,628	2,474	2,191	1,381	1,383
Adjusted Ratios					
Operating income as % of total operating revenues (%)	44.41	44.71	42.01	46.75	44.77
Pretax return on permanent capital (%)	6.56	6.23	5.73	12.28	13.07
EBITDA interest coverage (times)	1.77	2.07	3.24	8.06	6.68
Debt to EBITDA (times)	17.44	12.53	7.03	2.44	2.27
FFO to debt (%)	1.35	3.71	9.19	34.75	35.62
Debt to capitalization (%)	68.62	68.75	54.35	42.33	39.72

RELATED CRITERIA

- Key Financial Ratios and Adjustments, 5 September 2018
- Rating Methodology – Corporate, 31 October 2007

Eastern Printing PLC (EPCO)

Company Rating:	BBB-
Rating Outlook:	Stable

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