TRIS RATING
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THAI POLYCONS PLC

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CORPORATES

Company Rating:	BBB-
Outlook:	Stable

Last Review Date: 30/10/20

Company Rating History:

Date	Rating	Outlook/Alert
09/10/18	BBB	Stable

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RATIONALE

TRIS Rating downgrades the company rating on Thai Polycons PLC (TPOLY) to "BBB-" from "BBB", with a "stable" rating outlook. The downgrade reflects TPOLY's plummeting earnings and materially weakened financial profile, due in large part to the poor performance of its construction business.

The rating continues to mirror the sound operating performance and reliable cash flows of the company's power business, which significantly cushion the impact from the cyclical nature of its construction business. However, the rating is tempered by the feedstock supply risk of the biomass power plants and volatile prices, as well as the heightening challenges in the renewable power industry. The rating also considers TPOLY's mediocre competitive position and intense competition in the construction business.

KEY RATING CONSIDERATIONS

Weak performance of construction

Although the power business has been the centerpiece of TPOLY's earnings, the construction business has contributed about half of its revenue. Hence, the overall performance of TPOLY remains highly influenced by the low-margin construction business. For the first half of 2021, TPOLY experienced an earnings downfall as its construction business performed far below expectations. The gross margin of the construction business plunged into a negative 12%, as opposed to the past record range of 6%-12%. TPOLY suffered from overwhelming cost overruns in some projects, emerging from a litany of problems, including a steep rise in steel prices, the underperformance of sub-contractors used, and operating difficulties caused by the Coronavirus Disease 2019 (COVID-19) outbreak. Meanwhile, TPOLY engaged in competitive bidding in several projects.

Looking forward, we expect the gross margin of the construction business to gradually improve as TPOLY strives to fine-tune works previously undertaken by sub-contractors and expand more into less competitive segments. However, we project the gross margin of construction to remain below 5% in our forecast. The razor-thin margins of the backlog construction work and the fiercely competitive environment will continue to pressure the performance of its construction business. Inclusive of the lucrative power business, TPOLY's gross margin should range from 10%-20% during 2021-2023, down from above 20% in the recent past.

Mediocre competitive position

The rating reflects TPOLY's mediocre competitive position in the domestic construction industry. This business is rather small, compared with other contractors rated by TRIS Rating. A typical contract for TPOLY's construction work has been worth below THB1 billion per contract during the past three years. Revenue from the construction business has held at about THB2 billion per annum. TPOLY engages in a narrow scope of construction work, focusing on the construction of buildings such as hospitals, universities, hotels, and shopping malls.

We maintain a positive view on the domestic construction industry over the medium term, considering the government's continued efforts to improve the country's infrastructure. We hold the view that the government spending and state enterprise outlays will be essential for post-pandemic recovery. Public sector construction appears to have a brighter outlook than private sector construction.

Nevertheless, we have witnessed repeated delays in the bidding and awarding of much-anticipated public projects while severe competition among contractors lingers. Most projects are awarded through competitive bidding, which constrains contractors' profit margins. A new surge in outbreak could also disrupt construction activities. TPOLY aims to expand to public infrastructure construction work. However, the company has a limited track record in this segment and has to compete with a large number of contractors.

Reliability of cash flows from power business

TPOLY's rating is chiefly predicated on the high reliability of cash flows from the power business, which should continue to account for more than 90% of its earnings before interest, taxes, depreciation, and amortization (EBITDA). The stable cash flows, resulting from multi-year power purchase agreements (PPAs) with the state-owned producers and distributors of electricity, largely help cushion the swing in the earnings of the construction business.

The power business is carried out by its core and profit-making subsidiary, TPC Power Holding PLC (TPCH). Currently, TPCH owns and operates ten biomass power plants, with a combined contracted capacity of 98.5 megawatts (MW). TPCH is adding more capacity to enlarge its power portfolio. The core subsidiary will add a total of 13.7 MW in contracted capacity from new power projects in the pipeline, comprising two biomass power plants (5.7 MW) and one waste-to-energy plant (8 MW), all of which have experienced construction delays due to the COVID-19 outbreak. However, the investment budgets remain under control. These new projects are scheduled to commence operations within the year ahead, lifting the aggregate contracted capacity to 112.2 MW. As well as to the current projects in the pipeline, we assume TPCH will add another 6 MW in new capacity over the forecast period.

Sound performance of power plants

The operating power plants consistently stage sound performance. In all, the EBITDA as percentage of revenues (EBITDA margin) of the power plants has remained at high levels of 40%-50%, except in the first half of 2021. TPCH faced unsmooth operations at its new plants during an early stage of operations marred by operating difficulties induced by the COVID-19 outbreak. Over the next three years, we believe TPCH will succeed in fine-tuning the operations of the new plants, resulting in reliable and sizable cash flows to offset the weakened construction business.

Growth driven by power business

We expect the power business will remain the key growth driver of TPOLY over the next three years. In our base-case forecast, the company's total operating revenues should increase steadily, reaching THB5.7 billion in 2023, from THB4.4 billion in 2021. Revenue from the sale of electricity will likely increase to THB3.6 billion in 2023, from THB2.7 billion in 2021. At the same time, we forecast revenue from the construction business to range between THB1.7-THB2.1 billion per annum during 2021-2023. We assume that TPOLY will secure new construction contracts worth THB1-THB1.5 billion per year. As of June 2021, TPOLY had a backlog worth THB2.7 billion, partly helping secure revenue over the forecast period.

We also assume sales in the residential property business will stay below THB50 million a year over the next three years. TPOLY had unsold units worth about THB20 million as of June 2021. We do not expect TPOLY to grow rapidly in the residential property business, given the weak market sentiment. TPOLY plans to launch new housing projects in 2022, but the execution is subject to market conditions. In all, we forecast the company's EBITDA margin will range between 10%-20% during 2021-2023, translating into EBITDA of THB0.5-THB1.1 billion per year and funds from operations (FFO) of THB300-THB800 million per year.

Feedstock supply risk and volatile prices

TPCH remains highly vulnerable to the risk of shortages and the volatile prices of biomass feedstock. The key feedstocks for biomass power generation are derived from agricultural waste, such as woodchip, rice husk, coconut shells, and other fast-growing plants. The availability of feedstock relies on several factors, such as seasonality, the use of biomass in other industries, and the increasing number of biomass power plants. Biomass power producers who do not have their own farm waste need to compete with others in securing feedstock. The prices of biomass fuel could also swing wildly while feedstock varies in terms of humidity and calorific value.

For most of its operating power plants, TPCH engages operation and maintenance (O&M) contractors for plant operation whereas it procures the supply of biomass feedstock itself. This exposed the company to supply risk. Given the lack of its own farm waste, TPCH has secured long-term supply agreements with local suppliers to ensure the availability of feedstock. Nevertheless, contract enforcement remains a significant risk. To mitigate the risk, TPCH takes in suppliers as partners in the company's power plants. Moreover, TPCH is striving to develop its own biofuel plantation.

Increasingly challenging power market

We hold the view that investments for renewable power in the domestic market have become increasingly challenging, considering the cut-off of the incentive tariff and intensified bidding competition. The recent bid on community power projects ended with a fiercely competitive tariff rate of THB2.7972 per kilowatt-hour (kWh), on average, for biomass power. Moreover, the country's high reserve of generation capacity and the pandemic-induced decline of power demand are downside factors to the prospects of the renewable power business. Given the dearth of new opportunities, acquisitions and divestiture of existing power projects are becoming the industry trend.

We expect TPCH to face lower rates of return from its power business over the long term. Some of TPCH's plants including TPCH 1, TPCH 2, and TPCH 5 are under a competitive bidding system that provides lower tariff rates. This requires the company to double down on production cost control. Investments in additional green-field or brown-field projects could offer inferior returns due to low tariff rates or high acquisition costs.

Weakened financial profile

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, we include the assets, liabilities, and respective financial performances of the JVs in TPOLY's consolidated accounts, in proportion to the ownership stake of TPCH in each venture.

Compared to our previous forecast, TPOLY's financial profile has weakened considerably with higher leverage and lower cash flows against debt obligations. Going forward, we do not expect the company to aggressively expand its power portfolio. Hence, cash flows from the operating power plants should support further growth in the power business. Moreover, we expect TPOLY to manage its working capital for the construction business efficiently to avoid a rise in financial leverage. In our base-case forecast, we expect annual capital spending of THB1-THB1.6 billion during 2021-2023.

Based on our assumptions, we forecast the ratio of debt to EBITDA to peak at about 10 times in 2021, a steep rise from 6.7 times in 2020. The FFO to debt ratio will tumble to 5.5% in 2021, down from 12.5% in the previous year. Looking further ahead, we project the debt to EBITDA ratio to decline to about 6 times and the FFO to debt ratio to improve to 11%-12% during 2022-2023. The debt to capitalization ratio should rise and hover around 60% during 2021-2023, up from 51% as of 2020.

Debt structure

In assessing the level of priority debt in TPOLY's borrowings, we exclude the debt incurred by the JVs which is guaranteed by TPCH. As such, TPOLY's consolidated debt was THB4.6 billion as of June 2021, almost all of which is considered priority debt, comprising its secured debt and all borrowings incurred by its operating subsidiaries. The priority debt to total debt ratio is 99%, suggesting that the company's unsecured creditors are significantly disadvantaged to its priority debt holders with respect to claims against the company's assets.

Manageable liquidity

TPOLY had short-and long-terms loans coming due in the next 12 months totaling about THB1.6 billion as of June 2021. We expect TPOLY to be able to rollover its short-term loans, which are mainly utilized for construction activities. Moreover, the company had undrawn credit facilities, plus cash and marketable securities, of THB468 million. FFO is forecast at about THB500 million. Added to that, TPCH recently issued new debentures worth THB1.5 billion in September 2021. In recognition of this, we believe TPOLY's liquidity remains manageable.

There are no financial covenants imposed on TPOLY's bank loans. However, TPCH's subsidiaries and JVs are required to maintain a debt service coverage ratio above 1.1 times or 1.2 times and keep the debt to equity ratio below 1.2 times, 1.5 times, or 2.5 times. TPCH's new debentures also require it to keep an interest-bearing debt to equity ratio below 2.5 times. We expect TPCH and each of its subsidiaries and JVs to meet the financial covenants set forth under their respective loans for the next 12-18 months.

BASE-CASE ASSUMPTIONS

- Aggregate contracted capacity of TPCH's operating power plants to increase to about 118 MW in the next three years.
- New contracts for construction works will be worth THB1-THB1.5 billion per annum during 2021-2023.
- Gross margin of construction business to remain below 5%.
- EBITDA margin to range between 10%-20%.
- Total capital spending to range between THB1-THB1.6 billion per annum.

RATING OUTLOOK

The "stable" outlook reflects TRIS Rating's expectation that the power business will continue to be the core cash flow generator. We also expect the power business to recover and generate sizable cash flows as planned. In addition, TPOLY should improve the gross margin of the construction business, with efficient working capital management. TPOLY's financial leverage and cash flow against debt obligations are at levels in line with our forecast.

RATING SENSITIVITIES

A rating upgrade could occur if the performance of the construction business and/or the power business improves significantly. Conversely, downward revision to the rating would develop if the performance of the construction business and/or the power business fall significantly short of our estimates, or if the capital structure deteriorates materially due to 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 before switching to the Stock Exchange of Thailand (SET) in 2010. TPOLY expanded into the residential property and the power businesses in 2010. It spun off the power business to TPCH, its subsidiary, in 2012. The Chanpalangsri family remained the major shareholder, holding an approximately 44% interest in TPOLY, as of September 2021.

The construction business made up about a half of total revenue. However, the power business accounted for the majority of TPOLY's earnings. EBITDA of the power business made up more than 90% of TPOLY's EBITDA during the past three years.

KEY OPERATING PERFORMANCE

Table 1: Revenue Breakdown

Unit: %

Segment	2017	2018	2019	2020	Jan-Jun 2021
Construction	60	49	55	55	43
Property	8	3	1	1	0
Power	32	46	43	45	56
Trading	1	1	0	0	0
Total	**100**	**100**	**100**	**100**	**100**
Total revenue (Mil. THB)	**3,432**	**3,367**	**3,798**	**3,974**	**2,140**

Source: TPOLY

Table 2: 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	95	Operating	23.0	21.0	Adder
TPCH1	99	Operating	9.9	9.2	FiT
TPCH2	99	Operating	9.9	9.2	FiT
TPCH5	99	Operating	6.3	6.3	FiT
PBM	59	Constructing	3.0	2.9	FiT
PBB	59	Constructing	3.0	2.9	FiT
Sub total - Biomass			**112.4**	**104.2**	
Waste Projects					
SP	50	Constructing	9.5	8.0	FiT
Sub total - Waste			**9.5**	**8.0**	
Grand total			**121.9**	**112.2**	

Source: TPCH

CRB = Chang Raek Bio Power
MWE = Maewong Energy
MGP = Mahachai Green Power
TSG = Thungsung Green
PGP = Phathalung Green Power
SGP = Satun Green Power
PTG = Pattani Green
TPCH1 = TPCH Power 1
TPCH2 = TPCH Power 2
TPCH5 = TPCH Power 5
PBM = Pracharat Biomass Mae Lan
PBB = Pracharat Biomass Bannang Sata
SP = Siam Power

FINANCIAL STATISTICS AND KEY FINANCIAL RATIOS*

Unit: Mil. THB

		-------------- Year Ended 31 December		-----------	
	Jan-Jun 2021	2020	2019	2018	2017
Total operating revenues	2,162	3,906	3,827	3,564	3,599
Earnings before interest and taxes (EBIT)	43	448	606	690	574
Earnings before interest, taxes, depreciation, and amortization (EBITDA)	232	703	797	863	702
Funds from operations (FFO)	183	584	710	746	592
Adjusted interest expense	83	123	101	108	91
Capital expenditures	306	1,428	1,704	731	872
Total assets	11,400	10,937	9,981	7,496	6,993
Adjusted debt	5,132	4,671	3,831	2,097	1,995
Adjusted equity	4,264	4,448	4,197	3,785	3,262
Adjusted Ratios					
EBITDA Margin (%)	10.75	17.99	20.83	24.21	19.50
Pretax return on permanent capital (%)	2.46 **	5.05	8.27	11.39	10.50
EBITDA interest coverage (times)	2.79	5.73	7.86	7.97	7.73
Debt to EBITDA (times)	8.92 **	6.65	4.81	2.43	2.84
FFO to debt (%)	8.74 **	12.51	18.53	35.59	29.69
Debt to capitalization (%)	54.62	51.22	47.72	35.65	37.95

Note: The figures include assets, liabilities, and the respective financial performances of MGP and SP, in proportion to the ownership stake in these JVs.
** Consolidated financial statements*
*** Adjusted with trailing 12 months*

RELATED CRITERIA

- Group Rating Methodology, 13 January 2021
- Rating Methodology – Corporate, 26 July 2019
- Key Financial Ratios and Adjustments, 5 September 2018

Thai Polycons PLC (TPOLY)

Company Rating:	BBB-
Rating Outlook:	Stable

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