

TIRATHAI PLC

No. 65/2017

19 September 2017

Company Rating: BBB-

Outlook: Stable

Company Rating History:

Date	Rating	Outlook/Alert
29/02/16	BBB	Stable
25/01/11	BBB+	Stable

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Rating Rationale

TRIS Rating downgrades the company rating of Tirathai PLC (TRT) to “BBB-” from “BBB”. The downgrade reflects the company’s softer-than-expected operating performance and weakened financial profile. The rating continues to reflect the company’s leading position in the domestic electrical transformer market and its capability to produce both power and distribution transformers across a diverse range of capacities and system voltages. The rating also incorporates TRT’s opportunities in export markets. However, these strengths are partially offset by a bleak outlook for the domestic transformer market, fierce competition, and TRT’s heightened financial leverage.

Founded in 1987, TRT is a leading manufacturer of made-to-order transformers. TRT also provides related services, such as transformer installation and maintenance. TRT was listed on the Market for Alternative Investment (MAI) in May 2006. Mr. Sumpun Vongphan, the managing director, and the key managers are the company’s major shareholders, with a combined stake of 29% as of March 2017. TRT has diversified into the assembling of hydraulic crane trucks, customized metalwork, and O&M (maintenance and operation) services through its subsidiaries. The diversification effort serves as a counterweight when demand for its core products, transformers, is slack.

The rating downgrade is built on TRT’s weaker-than-expected performance, the result of a precipitous drop-off in sales of cornerstone products and a drop in profitability. TRT’s performance fell notably short of TRIS Rating’s expectation, due in large part to a continued slump in the domestic market. Revenue in the first half of 2017 was dented by 8% year-over-year (y-o-y) to Bt1.06 billion. The contraction reflected a 30% y-o-y plunge in sales of transformers. TRT, as do other transformer producers, continues to suffer from anemic domestic demand, which has exacerbated price-based competition. TRT incurred a net loss of Bt84 million for the first half of 2017.

The downward rating has also developed from TRT’s weakened financial profile as its debt remains elevated while the drop in performance has eroded its ability to repay. The underperformance will persist through the remainder of the year.

The current rating continues to reflect TRT’s long-established and leading position in the domestic market for electrical transformers. TRT is one of a few transformer manufacturers in Thailand which is capable of producing both power and distribution transformers. TRT’s power transformers have capacities of up to 300 megavolt-amperes (MVA), at system voltages of up to 230 kilovolts (kV). The distribution transformers range in capacity from 1 kilovolt-amperes (KVA) to 10 MVA, at system voltages of up to 36 kV. TRT is amongst a few qualified transformer producers to sell power transformers to state enterprises. Moreover, TRT’s competitive edge is strengthened by a license it obtains from Siemens, a world-renowned transformer maker. Under the terms of the license agreement, Siemens provides support for TRT’s product designs and serves as a market reference for Tirathai-branded power transformers.

With its broad range of core products, TRT is well-positioned to capture domestic customers, which cover state enterprises and private companies, as well

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as expand abroad. TRIS Rating maintains a positive view of TRT's opportunities in export markets, which could counterbalance the industry cycles that are common in the domestic market. TRT recently expanded the capacity of the transformer factory as a means to enhance its competitive advantage. In the first quarter of 2017, the production capacity rose to 9,000 MVA from 5,000 MVA. The expansion could propel TRT's growth over the next five to seven years.

TRIS Rating has slashed the outlook for the domestic transformer market, though demand for electricity is rising. The once-robust industry has contracted sharply in recent years. The electricity authorities have frequently delayed bidding and awarding contracts. In addition, private sector investment has remained weak, and demand has flagged. In both the public sector and private sector market segments, fierce competition has presaged aggressive bidding. Many transformer makers have posted dramatic deteriorations in profitability. They took significant markdowns to win purchase orders from clients. TRIS Rating holds the view that the market doldrums will linger and continue to take a toll on the financial performances of transformer producers.

TRT's revenue was Bt1.06 billion for the first half of 2017, far below TRIS Rating's full-year estimate of over Bt3 billion. Delays in bid tenders at state enterprises and lower-than-expected orders from private sector clients in Thailand and abroad meant sales did not rebound as quickly as forecast. Sales of transformers, which comprise the vast majority of total revenue, fell drastically by 30% y-o-y, from Bt868 million to Bt611 million in the first six months of 2017. Private sector clients in Thailand were TRT's worst-performing segment, as this segment posted a staggering 78.4% drop in sales y-o-y. Because of the plunge, sales of transformers made up just 60% of revenue in the first half of 2017, compared with about 70% over the past few years. Conversely, the revenue contribution from its subsidiaries grew to nearly 40% of total sales.

Despite its strong market presence amongst domestic transformer producers, TRT's operating performance faltered, following a deluge of price competition. TRT also remains susceptible to the competitive threat of imported products made by Chinese manufacturers. TRT's gross margin softened to 18% in the first half of 2017, compared with 26% in 2016. In particular, the gross margin of transformers fell to merely 7%, from 23% a year ago. The state enterprise clients have remained the most troubled segment since last year, with a thin margin. Gross profit dropped by 41% y-o-y to Bt192 million.

In contrast to the falloff in revenue, TRT's operating expenses continued to rise, in large part because of substantial costs incurred at its subsidiaries. TRT is striving to keep earnings growing by adding other sources of revenue. A rise in costs appears inevitable. The subsidiaries are investing resources to develop the expertise needed to offer more services, such as EPC (engineering, procurement, and construction) and O&M services. As a result, TRT reported an operating loss of Bt80 million and earnings before interest, tax, depreciation and amortization (EBITDA) fell to negative Bt31 million for the first half of 2017. In all, the subdued performance has eroded TRT's ability to repay its debts.

The rating also considers a rise in financial leverage. Total debt has risen sharply since 2015 and has remained elevated. As of June 2017, TRT's debt totaled Bt1.49 billion. The debt-heavy capital structure was caused by escalating working capital needs and additional capital expenditures needed to finish building the new factory. The sharp increase in accounts receivable over the past three years has put pressure on liquidity and leverage. TRIS Rating highlights the fact that the current level of leverage remains a rating concern because TRT is on the cusp of breaching a financial covenant in its debentures. Interest-bearing debt to equity stood at 1.48 times as of June 2017, against the imposed limit of 1.5 times. Total debt to capitalization ratio stood at 59.8%.

Looking ahead, TRIS Rating holds the view that revenue and profitability will rebound once the state enterprises resume a normal bidding schedule and private sector investment rebounds. TRT had a backlog worth Bt0.98 billion as of June 2017. About 85% of the backlog is scheduled to be delivered throughout the remainder of 2017. Under TRIS Rating's base case, TRT's annual revenue would range from Bt2.5-Bt3 billion over the next three years. EBITDA is expected to improve to Bt200-Bt300 million per year. The debt to capitalization ratio is expected to decline gradually to around 50%.

Rating Outlook

The "stable" outlook embeds the expectation that revenue and profitability will revive on the strengths of its competitive edge. Moreover, TRT will be able to manage its working capital needs more prudently and pare down outstanding debts such that the company remains compliant with the respective financial covenants.

TRT's rating or outlook could be upgraded if its operating performance improves significantly, meaning the total debt to capitalization ratio stays below 50%, and the operating margin improves to 10%-15% on a sustained basis. In contrast, the rating and/or outlook could be revised downward should TRT's operating performance and financial leverage deteriorate further.

Tirathai PLC (TRT)
Company Rating:
BBB-
Rating Outlook:
Stable
Financial Statistics and Key Financial Ratios*
Unit: Bt million

	----- Year Ended 31 December -----					
	Jan-Jun 2017	2016	2015	2014	2013	2012
Sales	1,065	2,537	2,224	2,132	2,518	1,921
Gross interest expense	31	42	53	46	46	39
Net income from operations	(78)	48	(47)	48	188	22
Funds from operations (FFO)	(48)	118	(21)	133	274	59
Capital expenditures	56	301	254	156	45	176
Total assets	3,080	3,304	3,025	2,653	2,576	2,528
Total debt	1,494	1,648	1,350	961	880	978
Shareholders' equity	1,004	1,127	1,077	1,174	1,184	1,044
Operating income before depreciation and amortization as % of sales	(3.99)	6.51	0.48	6.66	12.50	4.99
Pretax return on permanent capital (%)	(1.07) **	4.33	(0.77)	5.35	13.69	4.10
Earnings before interest, tax, depreciation, and amortization (EBITDA) interest coverage (times)	(1.02)	4.24	0.83	3.72	7.28	3.14
FFO/total debt (%)	(0.69) **	7.14	(1.55)	13.81	31.07	6.03
Total debt/capitalization (%)	59.82	59.39	55.63	45.00	42.64	48.36

* Consolidated financial statements

** Annualized from trailing 12 months

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