TTCL PLC

No. 155/2018
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CORPORATES

Company Rating:	BBB-
Outlook:	Stable

Company Rating History:

Date	Rating	Outlook/Alert
29/12/17	BBB	Stable
28/03/14	BBB+	Stable

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RATIONALE

TRIS Rating downgrades the company rating on TTCL PLC (TTCL) to "BBB-" from "BBB". The downgrade reflects TTCL's continued weak operating performance and lingering heavy debt loads. Moreover, the substantial amount of unsettled receivables related to a project in the Lao People's Democratic Republic (Lao PDR) adds further concerns on the rating.

The rating continues to reflect TTCL's strengths in EPC (engineering, procurement, and construction) for the industrial segment, its capability to undertake large projects in Thailand and abroad, as well as its strategic diversification into the power business. However, these strengths are weighed down by heightened leverage, execution risks of projects abroad, cyclicality of the EPC industry, and severe competition.

KEY RATING CONSIDERATIONS

Continued weak operating performance

The rating downgrade is predicated on TTCL's continued weak operating performance, led by a precipitous falloff in new contracts signed in 2016 and 2017. TTCL's revenue totaled Bt10.5 billion in 2017, while three years earlier the company had annual revenues of around Bt20 billion. TTCL is highly susceptible to the cyclicality of the EPC segment. The slowdown in investment of private refining and petrochemical companies has drastically affected its revenue and profits. TTCL could not secure new contracts in 2016, while new contracts in 2017 came in at Bt9.6 billion; however, this was relatively low.

The subdued performance carried on in the first half of 2018 as TTCL racked up only Bt3.2 billion in revenue, a whopping 51% decline year-over-year (y-o-y). TTCL's half-year revenue was far below TRIS Rating's previous forecast of around Bt9-Bt10 billion in expected total revenue for 2018. TTCL's growth has languished as its backlog starts to dissipate.

The company's operating margin (operating profit before depreciation and amortization as a percentage of revenue) in the first half of 2018 fell to 4.91%, down from 7.10% in 2017.

Lingering heavy debt loads

The downward rating pressure has also developed from TTCL's heavy debt loads. TTCL borrowed more to fund its working capital needs for larger projects, undergoing a much longer cash conversion cycle. TTCL also borrowed to fund its additional investment in the power segment. The company engaged in acquiring a series of additional shares of TTCL Power Holdings Pte. Ltd. (TTPHD), which cost TTCL a total of about Bt1.8 billion. TTCL's stake in TTPHD increased from 70% to 100% in 2017.

TTCL's debt to capitalization ratio was 72.1% at the end of June 2018 and 71.2% at the end of 2017, up from 50%-55% during 2014-2016. TTCL's capital structure was also weaker than our previous estimate that the company would keep the leverage ratio below 70%.

Substantial overdue payments for troubled project

TTCL's leverage is likely to remain elevated, due in large part to substantial overdue payments in relation to a troubled project in the Lao PDR. TTCL secured a sizable contract to build a rock salt exploiting and processing plant in the Lao PDR. The project owner is a joint venture with Vietnam National Chemical Group (Vinachem), a Vietnamese state-controlled enterprise. The joint venture receives a long-term concession from the Lao government to mine salt in the area.

TTCL commenced construction in 2016. However, the project owner suspended construction in mid-2017, following orders from the Vietnamese government. The project suspension leaves TTCL with a substantial Bt2.3 billion in accounts receivable and unbilled receivables. TTCL is reportedly under negotiation with the project owner concerning project resumption and overdue payments related to the work delivered. Given this prolonged discussion, we do not expect that both parties will arrive at an agreement any time soon.

The huge unsettled receivables add further concerns on the rating. We highlight that TTCL's financial profile would be worse off should the company need to put aside provisions for such unsettled receivables. This scenario could lead to a precarious financial position and breach of respective financial covenants.

Capability to undertake large projects in Thailand and abroad

The rating continues to reflect TTCL's strengths in the domestic EPC market, particularly in the industrial plant segment. TTCL's track record of project execution is substantiated by a list of large refining and petrochemical companies. TTCL is among the top five Stock Exchange of Thailand (SET)-listed contractors, in terms of revenue base and asset size. The company is capable of undertaking large EPC projects and expanding geographically. TTCL has moved to undertake larger projects and grow its footprint in several countries, including Qatar, Malaysia, Myanmar, Lao PDR, and Vietnam. A proven track record, together with know-how and experience, should help the company retain its market position over the medium term.

In August 2018, Sojitz Corporation (Sojitz) acquired 9.1% of shares of TTCL and became the major shareholder. TTCL expects to gain business synergy and collaboration with Sojitz. In our view, TTCL should benefit in terms of enhanced business opportunities. However, the much-anticipated synergy is yet to be proven.

We expect that TTCL's operating performance will gradually improve over the next three years. The nascent recovery in oil prices has seemingly revived the expansion plans of petrochemical companies. For the first half of 2018, TTCL secured nearly Bt15 billion in new contracts, including the long-awaited petrochemical complex project in Vietnam. As of June 2018, TTCL's backlog stood at Bt21.3 billion.

Strategic diversification into the power business

Following its strategic move into the power business, TTCL has invested in power projects in a bid to secure more reliable sources of income. Its main project is a 120-megawatt (MW) gas-fired power plant in Ahlone, Myanmar, the "Ahlone project". Despite its smaller revenue contribution, the power segment has generated a sizable amount of EBITDA (earnings before interest, taxes, depreciation, and amortization), making up around half of TTCL's EBITDA, or around Bt400 million annually. Although the Ahlone project exhibited faltering operations during 2016-2017, we expect that the plant performance will begin to plateau after a recent refinement in operations.

TTCL vows to invest in and build the Ahlone expansion project, which will edge up production capacity for 356 MW. TTCL plans to sink around Bt11-Bt12 billion in the project. In pursuits of funds for the project, TTCL is seeking project financing from banks, as well as endeavoring to raise funds through an initial public offering (IPO) of TTPHD, which is scheduled for mid-2019. We view the likelihood of projects taking wing in the near term as remote, considering the slow-moving government bureaucracy of Myanmar. However, TTCL's leverage will increase considerably should the deals go through.

Susceptibility to inherent risks of construction business

We view that TTCL is highly vulnerable to the cyclicality of the EPC business, given the scope of its expertise and end market served. TTCL's core business has been markedly hurt by dismal investment sentiments in petrochemical sectors over the past few years. The low level of oil prices slowed capacity expansions of its target customers, which subsequently caused delay in bidding and contract awarding. In addition, TTCL has encountered tough competitive threats, particularly in overseas projects. The severe competition slashed TTCL's overall gross margin to below 10%.

Despite the benefits TTCL receives from geographical diversification, the company is exposed to execution risks associated with projects abroad, including cost overruns, changes in laws and regulations, contract enforcement, exchange rate risk, etc. Failures in project execution could cause significant negative repercussions for TTCL's performance.

Under TRIS Rating's base case, which excludes the investment in the Ahlone expansion project, TTCL's revenue in 2018 will be around Bt6.7 billion, due to fewer new projects to replenish the backlog. Revenue will gradually recover to reach Bt10 billion in 2019 and range between Bt13-Bt18 billion per annum during 2020-2021, given the company's backlog and expected resurgence in private investment. That said, such a performance revival is belated in comparison to our previous estimate. In addition, we slash the forecast operating margin of TTCL to 6%-7% over the next three years.

Heightened leverage

TTCL's weakened capital structure stands to weigh negatively on the rating. Total debt rose to Bt12.2 billion as of 2017 from Bt8.7 billion as of 2016. TTCL's debt remained high at Bt11.2 billion at the end of June 2018. Under our base case, we forecast that TTCL's total debt will stay around Bt10 billion over the next three years, with the debt to capitalization ratio hovering around 65%-70%. This suggests narrower headroom for the respective debentures' financial covenants. In our forecast, the interest-bearing debt to equity ratio could be as high as 2.6 times, against the imposed limit of 3.0 times.

Cash flow protection, as measured by the ratio of funds from operations (FFO) to debt, is considered low. We expect the ratio would decline to around 1% in 2018 and then improve to range between 5%-8% over the next three years. EBITDA interest coverage ratio will be held at 2-3 times.

Tightening liquidity

We view that TTCL's liquidity is tight. At the end of June 2018, TTCL had Bt4.0 billion in debt coming due over the next 12 months, comprising Bt3.2 billion in short-term promissory notes (P/N), Bt371 million in project loans, and Bt397 million in loans from related parties. TTCL's liquidity source was Bt890 million in cash and short-term investments. We forecast TTCL's FFO over the next 12 months will be around Bt300-Bt400 million. TTCL would need to roll over their short-term loans. In recognition of this, the company should manage its liquidity more rigidly.

RATING OUTLOOK

The "stable" outlook reflects TRIS Rating's expectation that TTCL will maintain its strong market position in the EPC sector. TTCL could secure sizable new contracts to replenish its backlog. Under TRIS Rating's base-case forecast during 2018-2021, we expect TTCL's revenue will be around Bt6.7 billion in 2018, Bt10.7 billion in 2019, Bt12.8 billion in 2020, and Bt18.0 billion in 2021. The operating margin is expected to stay between 6%-7% and the debt to capitalization ratio will stay between 65%-70% over the next three years.

RATING SENSITIVITIES

A rating upgrade is unlikely in the near term but could occur if TTCL could deliver better-than-expected operating performance and its leverage falls significantly. The rating and/or outlook could be revised downward if TTCL's profitability deteriorates further or the debt to capitalization ratio rises above 70% for a sustained period, which could occur from cost overruns or failure to secure sizable project contracts.

In addition, if TTCL would need to put aside provisions for receivables in connection with the rock salt project and such provisions lead to a precarious financial position, this scenario would also trigger a rating action.

COMPANY OVERVIEW

TTCL is an EPC contractor based in Thailand. TTCL was established in 1985 as a joint venture between Italian-Thai Development PLC (ITD) and Toyo Engineering Corporation (TEC), a Japanese EPC firm. TTCL went public in 2008 and was listed on the SET a year later.

TEC gradually reduced its stakes in TTCL from 22% to 10% during 2015-2017. In February 2018, TEC sold off its shares in the company.

In August 2018, Sojitz, the seventh-largest general trading and investment company in Japan, acquired shares of TTCL and became the company's major shareholder. As of August 2018, Sojitz held approximately 9.1% of TTCL's shares outstanding. TTCL expects to gain synergy in business and collaboration from its major shareholder.

TTCL is positioned as an integrated EPC contractor for industrial plants including refineries and plants which produce petrochemicals, chemicals, fertilizer, oil and gas, and electrical power. In 2010, TTCL expanded into the power business, a move aimed at investing in propitious power projects, which helps reduce its susceptibility to cyclicality and the stiff competition in the EPC business.

As of June 2018, TTCL's backlog stood at Bt21.3 billion. The total value of the current projects in the backlog will be realized at around Bt3.6 billion in the second half of 2018, Bt8.4 billion in 2019, Bt5.8 billion in 2020, and the rest in 2021, according to TRIS Rating's base case.

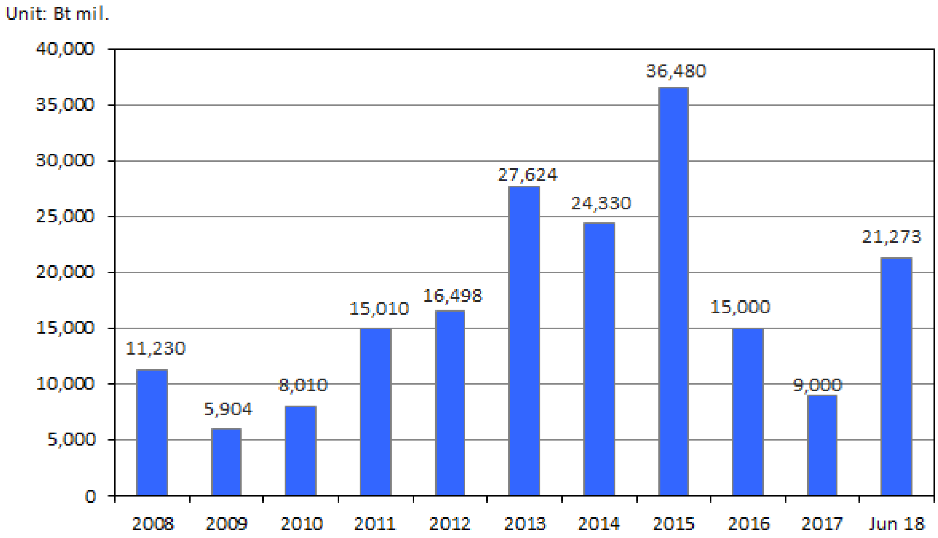
TTCL has a strategy to expand into the power business, a move that helps TTCL secure EPC contracts and earn a steady revenue stream. TTCL has invested in power projects in order to have steady sources of income from multi-year power purchase agreements. Moreover, TTCL undertook all the EPC work for the power projects. The company has invested in natural gas-fired, biogas, and solar power plants.

TTCL entered the power business in 2010 when it invested in Nava Nakorn Electricity Co., Ltd. (NNE). NNE operates a 110-MW combined cycle gas turbine power plant. TTCL currently holds 44% of the preferred shares of NNE. The company invested in and built a 120-MW gas-fired power plant in Ahlone, Myanmar, the "Ahlone project". TTCL, through its Myanmar-based subsidiary, owns 100% of the Ahlone project, which carries a total investment cost of about Bt5.5 billion.

TTCL also developed a 25-MW solar farm in Miyazaki, Japan, at a cost of Bt3 billion. This plant plans to commence operations in the first half of 2020. In addition, TTCL has signed a letter of notice to proceed to develop the Ahlone expansion 356-MW project in January 2018. TTCL plans to invest in and build the Ahlone expansion, with total project cost of around Bt11-Bt12 billion. Given the current group structure, power-producing companies are under Singapore-based TTPHD, its wholly-owned holding company. TTCL endeavors to list TTPHD on the stock market in pursuit of funds for further expansion.

KEY OPERTING PERFORMANCE

Table 1: Backlog at Year End



Source: TTCL

Table 2: Construction Revenue Breakdown by Location

Unit: %

Location	2011	2012	2013	2014	2015	2016	2017	Jan-Jun 2018
Domestic	54.4	53.7	58.2	49.2	44.0	34.0	38.5	57.0
Overseas	45.6	46.3	41.8	50.8	56.0	66.0	61.5	43.0
Total	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**
Revenue (Bt mil.)	**8,896**	**11,358**	**17,865**	**19,575**	**21,524**	**20,024**	**10,447**	**2,987**

Source: TTCL

FINANCIAL STATISTICS AND KEY FINANCIAL RATIOS*

Unit: Bt million

		--------------Year Ended 31 December			-------------
	Jan-Jun 2018	2017	2016	2015	2014
Total operating revenues	3,195	10,474	20,028	21,534	19,581
Operating income	157	795	1,016	912	605
Earnings before interest and taxes (EBIT)	78	225	895	1,094	593
Earnings before interest, taxes, depreciation, and amortization (EBITDA)	124	1,058	1,240	1,372	738
Funds from operations (FFO)	(58)	690	701	844	554
Adjusted interest expense	236	437	445	370	124
Capital expenditures	422	117	90	108	64
Total assets	21,990	23,865	25,812	25,897	22,652
Adjusted debt	10,416	10,118	6,710	8,242	5,903
Adjusted equity	4,030	4,095	6,341	6,289	6,415
Adjusted Ratios					
Operating income as % of total operating revenues (%)	4.91	7.10	5.01	4.23	3.09
Pretax return on permanent capital (%)	(0.04) **	1.41	5.65	7.22	5.57
EBITDA interest coverage (times)	0.53	2.42	2.79	3.71	5.93
Debt to EBITDA (times)	24.37 **	9.56	5.41	6.01	8.00
FFO to debt (%)	0.94 **	6.82	10.45	10.24	9.39
Debt to capitalization (%)	72.10	71.19	51.41	56.72	47.92

Note: EBITDA and FFO are adjusted by financial assets under concession arrangement of Ahlone power plant project, thus all financial ratios from 2016 onward are adjusted.

* *Consolidated financial statements*

** *Annualized with trailing 12 months*

TTCL PLC (TTCL)

Company Rating:	BBB-
Rating Outlook:	Stable

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