

THE UNION MOSAIC INDUSTRY PLC

No. 115/2018

9 August 2018

CORPORATES

Company Rating: BB
Outlook: Stable

Company Rating History:

Date	Rating	Outlook/Alert
08/07/16	BB+	Stable
27/05/14	BBB-	Stable

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RATIONALE

TRIS Rating downgrades the company rating on The Union Mosaic Industry PLC (UMI) to “BB” from “BB+”. The rating downgrade reflects UMI’s weaker-than-expected performance and a significant deterioration in its financial profile.

The rating continues to reflect UMI’s adequate competitive advantage in the tile market. However, the rating is weighed down by prolonged weakness in the domestic demand and intensified competition from imported tiles. The rating also takes into account the rising energy cost as well as heightening liquidity risk and refinancing risk of the bond.

KEY RATING CONSIDERATIONS

Adequate business profile

UMI’s adequate competitive strength is underpinned by its modest market share, well-accepted brand names, and long track record of operation. UMI’s products have been distributed in Thailand for over 30 years. The company covers about 11%-13% of market share by sales. UMI targets at the middle- to high-end market segments. The company can earn some price premium because of the quality of its offered products.

However, we are of the opinion that its business profile has weakened, seen from contraction of sales and reducing capacity. UMI is intent on paring down capacity and operations, in a bid to boost production efficiency and cut costs.

Poor prospects of the tile market

UMI’s operating result continued to suffer from the prolonged downturn in the building material industry. Domestic demand for tiles has continued to tumble over the past several years, due in large part to sluggishness in the residential property sector. Domestic manufacturers continue to struggle with fierce price competition from imported tiles. Large tile producers have expanded into the neighboring countries, despite relatively lower profit margin, to maintain their productions. The industry downtrend has prompted tile producers to implement cost-cutting measures to alleviate depressive impact. The down cycle also led to merger among tile producers. In our view, the prospects for recovery of the tile market remains bleak over the next two or three years.

Weaker-than-expected performance

The rating downgrade is built on UMI’s weaker-than-expected operating performance. UMI’s sales plunged by 11% in 2017 to Bt2.5 billion, down from Bt2.8 billion in 2016. The company continued to underperform in the first half of 2018. Sales fell further by 8.8% year-on-year (y-o-y). The operating margin (operating income before depreciation and amortization as a percentage of sales) fell to 7.7% in 2017 and 5.5% in the first half of 2018. As a result, cash flow protection worsened as the ratio of funds from operations (FFO) to total debt fell to 11.7% in 2017 and 8.2% in the first half of 2018, far below the range of 15%-21% in our previous forecast.

UMI’s sales volume of main products has declined steadily, reflecting its weakened market position. The company remains focused on the medium- to high-end segments, which should have stronger demand and affordability than the lower-end segment. However, these target markets are smaller. Moreover, imported tiles, particularly from China, have increasingly penetrated the high-end segment, with wide ranges of products. This is also a major hindrance to

UMI's effort to recover the sales volume.

Rising energy cost to dampen profitability

Looking ahead, we expect UMI's profit margin to narrow down. In our base case, we forecast sales to range between Bt2.3-Bt2.4 billion during 2018-2020. The profit will suffer due to an escalating price of natural gas, a main energy source for tile production. Natural gas generally comprises 20%-25% of total cost. The price of gas is contractually set to follow the price of fuel oil with a lag of three to four months.

As the oil price increased by about 25% y-o-y in the first half of 2018, we view that UMI's profitability in the second half of 2018 will contract further. We forecast the operating margin to decline and stay below 6.0%, compared with the peak of 11.1% in 2016. As sales slide and profitability erodes, UMI's FFO will diminish gradually.

Rising liquidity risk

TRIS Rating assesses that UMI's liquidity, on consolidated basis, is inadequate, underpinned by waning cash flows and large bond maturity. In our projection, earnings before interest, tax, depreciation, and amortization (EBITDA) interest coverage ratio could decline to below 3 times while the ratio of FFO to total debt could fall below 10%.

UMI has a bond worth about Bt450 million due in July 2019. The company plans to make some prepayments and refinance the remainder to manage refinancing risk. In our opinion, UMI's weakened financial profile could raise the challenges for the company to access financial markets, and thus exposing the company to rising refinancing risk.

We also incorporate the debt trouble of T.T Ceramic PLC (TTC) as a sign of inadequate liquidity. TTC, a main subsidiary of UMI, had about Bt741 million in restructured debt (59.5% of consolidated outstanding debt) as of June 2018. During the second quarter of 2018, TTC requested its lenders to relax on interest payments and principal payments. The parties have agreed on interest rate reduction and smaller amounts of principal repayments in 2018. That was just a temporary relief for TTC. We see a more extensive debt restructuring for TTC is likely to continue.

RATING OUTLOOK

The "stable" outlook reflects our view that the "BB" rating has already taken into consideration the prospect of further deterioration in UMI's financial performance over the next three years. In our base-case forecast, the FFO to total debt ratio will decline to below 10% and the EBITDA interest coverage ratio could drop rapidly to below 3 times over the next three years.

RATING SENSITIVITIES

UMI's rating or outlook could be revised upward if the company can recover its profitability and operating cash flows, through a turnaround of sales and successful implementation of cost reduction measures. The rating upgrade could emerge if the EBITDA interest coverage ratio exceeds 3 times and the FFO to total debt ratio stays above 10% over a sustained period. The rating could be revised downward if UMI's financial profile undershoots our forecast, meaning that the EBITDA interest coverage ratio falls below 2 times for an extended period.

COMPANY OVERVIEW

UMI is a medium-sized manufacturer and distributor of ceramic tiles in Thailand. The company was established in 1973 and was listed on the Stock Exchange of Thailand (SET) in 1989. As of March 2018, major shareholders comprised the Penchart family (about 21% stake), and the Laowiwatwong family (about 26% stake). UMI offers ceramic floors and wall tiles. In efforts to boost its competitiveness and broaden its products line, UMI acquired The Royal Ceramic Industry PLC (RCI) and TTC in 2012. RCI is a manufacturer of ceramic floor and wall tiles while TTC offers porcelain tiles.

Market conditions changed significantly after the two acquisitions. In the wake of a continued decline in demand, UMI later opted to divest its entire stakes of RCI in 2016 but maintain its stake in TTC. TTC produces and sells porcelain tiles under its own "Cergres" brand. In addition, TTC produces porcelain tiles for UMI to sell under "Duragres" brand. UMI currently holds 66.6% of TTC's outstanding share.

FINANCIAL STATISTICS AND KEY FINANCIAL RATIOS*

Unit: BT million

	Jan-June 2018	----- Year Ended 31 December -----			
		2017	2016	2015	2014
Revenue	1,171	2,486	2,793	3,739	4,213
Gross interest expense	21	45	41	69	93
Net income from operations	(52)	(25)	115	(77)	(70)
Funds from operations (FFO)	35	156	267	180	154
Earnings before interest, tax, depreciation, and amortization	90	233	393	267	285
Capital expenditures	17	38	52	58	176
Total assets	3,409	3,409	3,755	3,917	5,509
Total debts	1,245	1,333	1,480	1,545	2,198
Total liabilities	1,834	1,796	2,009	2,103	3,085
Shareholders' equity	1,575	1,613	1,746	1,814	2,424
Depreciation & amortization	111	224	227	362	331
Dividends	2	73	134	92	108
Operating income before depreciation and amortization as % of sales	5.5	7.7	11.1	4.9	5.4
Pretax return on permanent capital (%)	(1.0) **	0.3	5.0	(2.4)	(1.1)
EBITDA interest coverage (times)	4.3	5.1	9.5	3.9	3.1
FFO/total debt (%)	8.2 **	11.7	18.0	11.7	7.0
Total debt/capitalization (%)	44.1	45.3	45.9	46.0	47.6

* Consolidated financial statements

** Trailing with the last 12 months

The Union Mosaic Industry (UMI)
Company Rating:

BB

Rating Outlook:

Stable

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