

# CH. KARNCHANG PLC

No. 52/2021  
9 April 2021

## CORPORATES

<b>Company Rating:</b>	A-
<b>Issue Ratings:</b>	
Senior unsecured	A-
<b>Outlook:</b>	Stable

Last Review Date: 31/07/20

### Company Rating History:

Date	Rating	Outlook/Alert
04/04/19	A	Stable
30/01/15	A-	Stable
24/01/14	BBB+	Positive
26/02/13	BBB+	Stable
21/01/11	BBB	Stable
09/06/09	BBB+	Negative
23/07/07	BBB+	Stable
16/02/07	A-	Alert Negative
07/09/04	A-	Stable

### Contacts:

Auyporn Vachirakanjanaporn  
auyporn@trisrating.com

Rapeepol Mahapant  
rapeepol@trisrating.com

Monthian Chantarklam  
monthian@trisrating.com



WWW.TRISRATING.COM

## RATIONALE

TRIS Rating downgrades the company rating on CH. Karnchang PLC (CK) and the ratings on its outstanding senior unsecured debentures to “A-” from “A” with a “stable” outlook. At the same time, TRIS Rating assigns a rating of “A-” to CK’s proposed issue of up to THB5 billion in senior unsecured debentures and an additional greenshoe portion of up to THB2 billion due within 10 years. The company plans to use the proceeds from the debentures issuance to repay some of its existing loans and fund business expansion.

The downgrade of ratings reflects CK’s continued weaker-than-expected earnings, small backlog relative to its normal revenue base, and weakened financial profile.

The ratings continue to reflect CK’s solid market position as a top-tier construction contractor and its strong competitive strengths in undertaking large and sophisticated construction projects. The ratings also take into account the benefits of its strategic investments. However, these strengths are held back by the severe competition in the engineering and construction (E&C) industry and possible delays in public construction project bidding.

### KEY RATING CONSIDERATIONS

#### Weaker-than-expected earnings

In 2020, CK continued to underperform in absence of new large-scale project contracts for three years in a row. Due to the prolonged delays in public infrastructure project biddings, CK secured only THB22 billion in new contracts during 2018-2020. As a result, CK’s revenue plunged by 27% to THB17 billion in 2020, the lowest level seen in several years. The company incurred an operating loss of nearly THB300 million in 2020. At the same time, dividends received from its affiliates also dropped sharply in 2020, due to the affiliates’ weak operating results. In particular, the performance of Bangkok Expressway and Metro PLC (BEM) was hard hit by the fallout from the Coronavirus Disease 2019 (COVID-19) outbreak. In effect, CK reported THB2.1 billion in earnings before interest, taxes, depreciation, and amortization (EBITDA), a 23% decline from the previous year.

#### Weakening earnings expected to continue

At the end of 2020, CK’s backlog stood at only THB29.1 billion. This amount is about the normal level of CK’s revenue for one year based on its historical performance. As such, we expect CK’s revenue to continue its sluggish mode. We forecast CK will continue to report weak revenue and earnings in 2021, making it a three-year succession of weaker-than-expected operating performance. Yet, we expect CK’s performance to recover from 2022 onward when the large public infrastructure projects in the pipeline start to come on stream.

#### Competitive strengths

Despite its weakened performance, we view CK’s competitive strengths and solid market position in Thailand’s construction industry as remaining unchanged. CK’s construction competency covers a broad array of construction activities, ranging from general civil works, such as roads, expressways, buildings, and bridges, to highly sophisticated mega projects, such as underground mass transits and hydropower plants.

Given its long-established track record and large capital base, CK is among the few top-tier contractors capable of bidding and undertaking massive-scale public infrastructure projects.

CK remains focused on medium-to-large public infrastructure projects. The company aims to tender a number of upcoming public projects, such as the MRT Orange Line (Western extension), MRT Purple Line (Southern extension), dual track railways, and a large hydropower project in the Lao People's Democratic Republic (Lao PDR). These projects, if secured, will add THB300 billion to CK's backlog.

### **Operating performance expected to recover**

The prospects of CK's performance recovery are predicated on our expectation that the government will accelerate the much-needed infrastructure projects to revive the domestic economy. We maintain a positive view on the domestic E&C industry over the medium term, considering the government's continued efforts to elevate the country's infrastructure. In stark contrast to private sector construction, public construction holds a much more promising outlook. In our view, government spending and state enterprise outlays will continue to be the key driver for the recovery of the pandemic-hit economy. Hence, we consider CK's performance as poised to bounce back. In our base-case scenario, we forecast CK will secure new construction contracts worth around THB30 billion per year on average over the next three years, with its earnings to recover from 2022 onwards.

### **Benefits from strategic investments**

CK holds meaningful stakes in BEM, TTW PLC (TTW), and CK Power PLC (CKP), which are all listed on the Stock Exchange of Thailand (SET). We view CK's strategic investments as helping reduce the impact from the cyclicity of the construction business. These three companies are expected to render stable dividends as they provide products that serve the country's essential infrastructure needs (i.e., transportation, power, and water supply) under concession contracts or multi-year utility purchase contracts. We forecast CK will receive dividends of around THB1-THB1.2 billion per year from these strategic investments over the next three years.

Moreover, these three companies bring in construction business opportunities to CK when they expand. The investments also provide CK with financial flexibility as the shares of the three affiliated companies are traded on the SET. CK earns substantial capital gains from occasional divestments. As of 2020, their market value totaled THB61.5 billion.

### **Downside risks impeding turnaround**

The delayed launches of several large public projects had considerable impact on CK's performance over the past three years. Despite the recovery prospects, the prolonged delays in project biddings and intense competition remain the key downside risks. We expect upcoming public infrastructure projects will be mainly in the transport sector and the Eastern Economic Corridor (EEC) initiative. Infrastructure development is much needed to boost post-pandemic recovery.

Despite the government's intention to push ahead several infrastructure projects, we have witnessed repeated delays in the biddings and awarding of much-anticipated public projects for a range of reasons. These include certain changes in project master plan, disputes over contract bidding process, prolonged government decision-making process, delays in contract negotiation, etc.

### **Weakened financial profile**

Given the small backlog, we project CK's revenue will remain low at THB18 billion in 2021. In our base-case forecast, we project the revenue to revive to THB34-THB37 billion per year in 2022-2023. Gross profit margin for construction is projected at 8% on average. Given the expected dividends received, we expect EBITDA will remain at about THB2 billion in 2021, the same level as the previous year. We project EBITDA to increase to THB3.5-THB4 billion per year in 2022-2023, and funds from operations (FFO) to total THB700 million in 2021, before bouncing back to THB2.1-THB2.4 billion per year in 2022-2023.

At the end of 2020, CK's total debt stood at THB42.5 billion, most of which was incurred for financing its strategic investments, as well as the sponsor loan to the Xayaburi hydropower project in the Lao PDR. The debt to capitalization ratio was at 57.7% at the end of 2020, up from 51.2% in 2019. In our base-case forecast, we project CK will maintain its leverage ratio at 55%-60%, reflecting our expectation that CK will no longer need to financially support its affiliates.

CK's ratio of debt to EBITDA was 17 times in 2020, far above our previous forecast. We project the ratio to remain at about the same level in 2021, before declining to around 10 times in 2022 and 2023. We view CK's leverage level as commensurate with its ratings, in light of the company's business model as a contractor and an investment company. CK's gearing could decrease further if the Xayaburi sponsor loan is repaid by way of refinancing.

## Adequate liquidity

We assess CK as having adequate liquidity over the next 12 months. The company had THB7.8 billion in cash plus current investments as of December 2020. Debts maturing in the next 12 months comprise THB147 million in short-term loans, THB672 million in long-term loans, and THB3 billion in debentures.

In addition, the liquidity profile is enhanced by the company's financial flexibility from its investments in the three affiliated listed companies. At the end of 2020, the fair market value of CK's investments in these companies was THB61.5 billion, or about 1.4 times the company's total debt. It is likely that CK will maintain a significant percentage of shareholding in these companies.

According to the key financial covenant on its debentures, CK is required to maintain its net interest-bearing debt to equity ratio below 3 times. The ratio stood at 1.3 times as of December 2020. Given the large covenant headroom, we expect that the company will continue to comply with the financial covenant over the next 12 to 18 months.

## BASE-CASE ASSUMPTIONS

These are the key assumptions in TRIS Rating's base-case forecast for CK's operations during 2021-2023:

- Revenue is projected to be around THB18 billion in 2021, THB34 billion in 2022, and THB37 billion in 2023.
- Gross profit margin for construction to be maintained at around 8%.
- On average, CK to secure new construction contracts worth a total of THB30 billion per year.
- The Xayaburi sponsor loan to hold in several years ahead.
- There will be no extensive investments or financial supports granted to related companies.

## RATING OUTLOOK

The "stable" outlook reflects our expectation that CK will remain highly competitive in the E&C industry, with the ability to secure new contracts in connection with the prospective infrastructure projects, enabling the company to restore its backlog, and attain operating performance in line with our forecast. We expect CK will be able to manage its debt to EBITDA ratio at 8-10 times in the long term.

## RATING SENSITIVITIES

A rating upgrade will depend on CK accumulating sizable backlog to secure future revenue and generate stronger-than-expected earnings, resulting in a debt to EBITDA ratio below 8 times for a sustained period.

A downward revision to the ratings could occur if CK fails to win new contracts that are sufficient to reinvigorate its revenue and earnings. Downward pressures on the ratings could also emerge from significant cost overruns in major projects or unanticipated, extensive financial support provided to its affiliates, resulting in the debt to EBITDA ratio to stay above 13 times for a sustained period.

## COMPANY OVERVIEW

CK was established in 1972 by the Trivisvavet family. CK initially focused on public work projects for government agencies. The company later greatly expanded its business scope and became a listed company on the SET in 1995. As of March 2021, the Trivisvavet family held approximately 30% of CK's shares outstanding. The family plays an important role in formulating and executing the company's strategies and overall business directions.

CK's business is divided into two segments: construction and investment. In the construction segment, CK has a long-established presence in the E&C sector, with experience and expertise in all kinds of construction ranging from general civil works to highly sophisticated projects. This diverse construction background, spanning several complex projects, enhances the company's competitive position. Furthermore, CK's large capital base helps support the company in bidding on large-scale government infrastructure projects.

The investment segment includes significant holdings in the three SET-listed companies (BEM, TTW, and CKP). These strategic investments help strengthen CK's business profile and provide the company with financial flexibility. The market values of these investments have risen.

CK, as a project sponsor, needs to finance the additional construction in the form of a sponsor loan to the project. CK is providing sponsor loans to the project's operating company, Xayaburi Power Co., Ltd. (XPCL), in the amount of THB13.5 billion. XPCL will repay the loan and interest from earnings after the commercial operation date. The loan repayment risk, thus, is tied to XPCL's performance.

**KEY OPERATING PERFORMANCE**

**Table 1: CK's Investments (As of Dec 2020)**

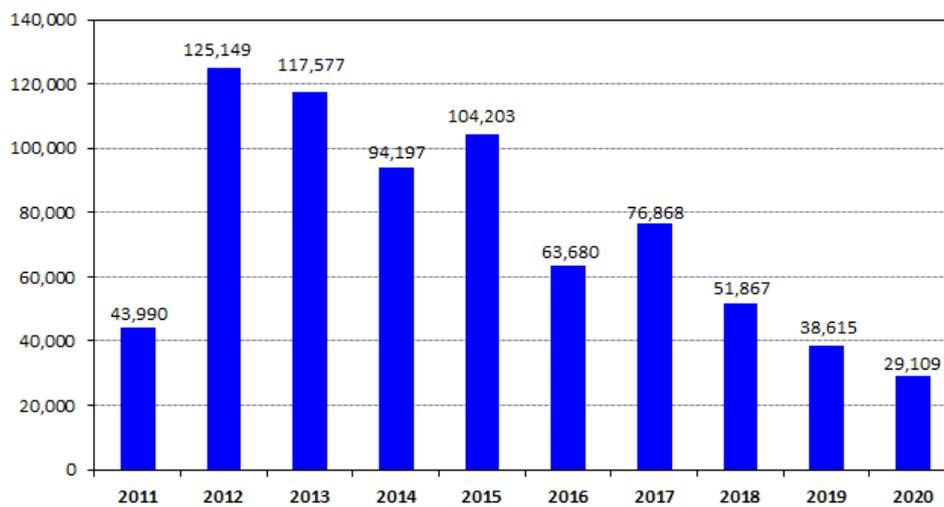
Company Name	CK Holding (%)	Consolidate Investment Cost (Mil. THB)	Fair Value (Mil. THB)	Type of Investment	Customer(s)
BEM	32.21	20,771	40,867	BTO concession AOT concession PPP gross cost	Public Public Public
TTW	19.40	5,810	9,521	BOO water purchase agreement	PWA
CKP	30.67	7,750	11,119	Holding company of power plants	EGAT, PEA, EDL-Gen
<b>Total Investment</b>		<b>34,331</b>	<b>61,507</b>		

Notes: PWA = Provincial Water Works Authority of Thailand  
 EGAT = Electricity Generating Authority of Thailand  
 PEA = Provincial Electricity Authority  
 EDL-Gen = EDL-Generation Public Company

Source: CK

**Chart 1: Backlog at Year End**

Unit: Mil. THB



Source: CK

**FINANCIAL STATISTICS AND KEY FINANCIAL RATIOS\***

Unit: Mil. THB

	-----Year Ended 31 December -----				
	2020	2019	2018	2017	2016
Total operating revenues	17,060	23,408	29,634	36,225	45,929
Earnings before interest and taxes (EBIT)	1,670	3,123	3,632	3,049	3,029
Earnings before interest, taxes, depreciation, and amortization (EBITDA)	2,060	2,685	3,362	3,920	3,999
Funds from operations (FFO)	742	1,307	1,956	2,419	2,742
Adjusted interest expense	1,290	1,251	1,267	1,410	1,179
Capital expenditures	592	2,245	2,555	913	1,886
Total assets	82,774	82,586	83,501	79,274	94,928
Adjusted debt	35,890	29,117	28,999	31,882	45,819
Adjusted equity	26,271	27,813	25,829	23,873	21,854
<b>Adjusted Ratios</b>					
EBITDA margin (%)	12.08	11.47	11.34	10.82	8.71
Pretax return on permanent capital (%)	2.46	4.82	5.68	4.23	3.90
EBITDA interest coverage (times)	1.60	2.15	2.65	2.78	3.39
Debt to EBITDA (times)	17.42	10.84	8.63	8.13	11.46
FFO to debt (%)	2.07	4.49	6.74	7.59	5.98
Debt to capitalization (%)	57.74	51.15	52.89	57.18	67.71

\* Consolidated financial statements

**RELATED CRITERIA**

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

## CH. Karnchang PLC (CK)

<b>Company Rating:</b>	A-
<b>Issue Ratings:</b>	
CK215A: THB2,250 million senior unsecured debentures due 2021	A-
CK217A: THB820 million senior unsecured debentures due 2021	A-
CK225A: THB1,600 million senior unsecured debentures due 2022	A-
CK226A: THB3,000 million senior unsecured debentures due 2022	A-
CK227A: THB910 million senior unsecured debentures due 2022	A-
CK235B: THB2,700 million senior unsecured debentures due 2023	A-
CK238A: THB500 million senior unsecured debentures due 2023	A-
CK245A: THB1,600 million senior unsecured debentures due 2024	A-
CK246B: THB3,500 million senior unsecured debentures due 2024	A-
CK247A: THB1,500 million senior unsecured debentures due 2024	A-
CK258A: THB3,000 million senior unsecured debentures due 2025	A-
CK25NA: THB1,000 million senior unsecured debentures due 2025	A-
CK267A: THB2,700 million senior unsecured debentures due 2026	A-
CK283A: THB800 million senior unsecured debentures due 2028	A-
CK287A: THB1,020 million senior unsecured debentures due 2028	A-
CK296A: THB3,500 million senior unsecured debentures due 2029	A-
CK308A: THB1,500 million senior unsecured debentures due 2030	A-
Up to THB5,000 million senior unsecured debentures and additional greenshoe portion of up to THB2,000 million due within 10 years	A-
<b>Rating Outlook:</b>	Stable

### TRIS Rating Co., Ltd.

Silom Complex Building, 24th Floor, 191 Silom Road, Bangkok 10500, Thailand Tel: 02-098-3000

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