TRIS RATING
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NAWARAT PATANAKARN PLC

No. 10/2020
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CORPORATES

Company Rating:	BB+
Issue Rating:	
Senior unsecured	BB+
Outlook:	Stable

Last Review Date: 28/02/19

Company Rating History:

Date	Rating	Outlook/Alert
28/02/19	BBB-	Stable
28/02/18	BBB-	Negative
01/04/14	BBB-	Stable

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RATIONALE

TRIS Rating downgrades the company rating on Nawarat Patanakarn PLC (NWR) and the rating on NWR's outstanding senior unsecured debentures to "BB+" from "BBB-". The rating outlook is "stable". The downgrade reflects NWR's subdued performance and our concern over the company's weakening financial profile.

The ratings continue to reflect the company's track record of undertaking a broad range of construction projects for the public and private sectors, as well as the domestic construction opportunities over the medium term. In contrast, the ratings are tempered by the cyclical nature and competitive threats in the engineering and construction (E&C) industry and NWR's underperforming residential property segment.

KEY RATING CONSIDERATIONS

Acceptable track record and competitiveness

NWR's moderate business profile is underpinned by its acceptable track record of executing and completing construction projects. NWR provides a broad range of civil construction work, including the construction of buildings, factories, transportation infrastructure, ports, irrigation works, tunnels, and pipe jacking projects.

NWR remains focused on public infrastructure projects. However, on its own, the company has a limited ability to bid for large projects. Large projects generally require a contractor with specific expertise, a past record of successful projects, and a substantial amount of funds. As a result, NWR generally submits bids for large projects as a joint venture (JV) partner or as a sub-contractor.

Residential property sales remain mired

NWR, through a wholly-owned subsidiary, has launched two single-detached house (SDH) projects and a low-rise condominium project, with a combined value of around Bt4.6 billion. Given the highly competitive nature of the residential property market and the company's lesser-known brand, the projects have not yet met with success. Sales in the SDH projects are still below expectations. In addition, the negative impacts arising from the introduction of new loan-to-value (LTV) rules by the Bank of Thailand (BOT) in April 2019 should slow down a demand for residential properties in the short term.

As a result, sales of residential properties are inadequate to meaningfully strengthen NWR's overall profitability. The company has a pile of unsold housing units in inventory and must shoulder the financial burden for these projects. In all, TRIS Rating does not expect steady growth in this business segment.

Hefty loss caused by construction delays and narrowing margin

The rating downgrade is built on NWR's weak operating performance. Revenue in the first nine months of 2019 was Bt5.9 billion, a 28% drop year-over-year. Despite a sizable backlog, NWR's revenue undershot our forecast, due in large part to delays in construction work for major projects, including architectural work for the two monorails, and the underground power system project of the Metropolitan Electricity Authority (MEA). The company's revenue was also trimmed by its sputtering residential sales.

The gross margin of the construction segment fell to 4.4% in the first nine months of 2019, in contrast to 6%-7% three years earlier. The narrowing margin was caused by fiercely competitive bidding and cost overruns in some projects. NWR's gross margin for construction is relatively lower than those of its peers.

Moreover, NWR was unable to cut its operating expenses. As a result, the operating margin (operating profit before depreciation and amortization as a percentage of revenue) in the first nine months of 2019 drastically declined to 4.2%, compared with 8%-10% during 2016-2018. In effect, TRIS Rating expects that NWR will incur a hefty loss of nearly Bt500 million in 2019. This would result in negative funds from operations (FFO). We are of the view that with such a sizeable loss, any turnaround is still some way off.

Weak performance likely to continue

Over the past year, NWR mustered Bt4.6 billion in new contracts, lower than our previous forecast of Bt7 billion. As of September 2019, backlog stood at Bt16.5 billion. In the next three years, TRIS Rating expects NWR will arrive at Bt9-Bt12 billion in revenue per year.

We expect NWR's weak profitability will be drawn out, due in large part to several low-margin projects in the backlog. In addition, any further delays in major projects would threaten to undercut overall margin. NWR remains focused on public infrastructure projects and the company is likely to secure new contracts as a sub-contractor. However, such contracts generally render low gross profit margins.

With the backdrop of eroding margins, we expect flat to slightly negative net earnings in the next few years. In our base case for 2020-2022, we expect gross margin for construction to be in the 5.5%-6.0% range. Overall gross margin is expected to stay at around 7%. At the same time, operating margin is likely to remain low at around 6%. Earnings before interest, tax, depreciation, and amortization (EBITDA) will hover in the Bt600-Bt750 million per year range. Funds from operations (FFO) will be Bt300-Bt450 million per year.

Domestic opportunities over the medium term

For the first nine months of 2019, domestic construction grew by 3.9% year-over-year. Public construction rose by 5.7% while private construction marginally increased by 1.8%. The outlook for private construction remains bleak as residential construction represents around half of this market segment. Given the current property glut, private construction will continue to slow in 2020.

We expect the public segment will remain the key driver of domestic construction. Apart from recoveries in exports and tourism, the public investment budget and state enterprise outlays will play a major role in boosting the economy. Therefore, we maintain a positive view on the domestic E&C industry over the medium term. As such, we expect NWR will be able to secure sizable new contracts in the years ahead.

However, the downside risks comprise the long-delayed disbursements of budget and stiff competition. The fiscal budget legislative process has been long-delayed and the passing of the bill is now impeded by questionable parliamentary votes. This would disrupt budget disbursements and cause delays in the initiation of large-scale projects. We expect competition in the industry will be heightened in the wake of delays in project bidding and awarding.

Financial leverage to stay elevated

NWR incurred a major loss in 2019 that hurt its capital structure. The debt to capitalization ratio was 51.9% at the end of September 2019, up from 46.1% at the end of 2018. We forecast NWR's debt will stay elevated as delays of work in progress in some projects may be prolonged. In addition, we do not expect NWR will be able to sell its remaining residential units and bring in meaningful amounts of net cash.

Under our base case, we forecast that NWR's total debt will stay at Bt4.5-Bt5 billion over the next three years. The debt to capitalization ratio will rise to 55%-60%. Cash flow protection, as measured by the ratio of FFO to debt, is considered low. We expect the ratio would drop to negative 2% in 2019 and then improve to stay at around 10% over the next three years. The EBITDA interest coverage ratio will be held at around 2.5 times.

Potential breach of financial covenant

NWR is on the verge of a financial covenant breach. The company has to maintain its ratio of net total liabilities to equity below 2.5 times, according to the key financial covenants of its bonds and bank loans. The ratio at the end of September 2019 was 2.3 times. We view that the risk of a financial ratio covenant breach for the period thereafter is high. Given the tight covenant headroom, the ratio could exceed the threshold in our forecast unless NWR manages working capital more efficiently, in particular, by collecting overdue receivables. We emphasize that non-compliance with the covenant or failure to obtain waivers, if needed, could trigger a negative rating action.

Tightening liquidity

NWR's liquidity profile is tight. At the end of September 2019, NWR's source of funds comprised Bt766 million in cash and Bt452 million in undrawn credit facilities. We forecast NWR's FFO over the next 12 months will be in the Bt300-Bt450 million range.

NWR has a substantial amount of debts coming due over the next 12 months totaling Bt3.9 billion, largely comprising bank loans of Bt2.1 billion and bonds of Bt1.7 billion. Most of the bank loans are for working capital, which NWR repays by using progress payments. We expect that NWR will be able to roll over most of its bank loans. The company plans to refinance bond coming due with new bond issues. Considering the large sum of maturing bonds, refinancing risk adds further concern.

BASE-CASE ASSUMPTIONS

- During 2020-2022, total revenue will be in the Bt9-Bt12 billion per year range.
- Overall gross profit margin will stay at around 7%.
- Operating margin will be at around 6%.
- New signed construction contracts will total Bt10 billion in 2020, and Bt7 billion per year in 2021 and 2022.
- Residential property sales will be in the range of Bt350-Bt500 million per year.
- Capital expenditures are expected at around Bt400 million per year.

RATING OUTLOOK

The "stable" outlook embeds our expectation that NWR will sustain its competitive edge in its core business and be able to secure sizeable contracts, given the promising public infrastructure projects on the horizon. Cash flow protection should be in line with our expectation. The FFO to debt ratio should stay at around 10%. The debt to capitalization ratio is expected to stay around 55%-60%.

RATING SENSITIVITIES

The ratings are unlikely to be upgraded in the near term. Leverage is expected to remain high, while the revenue contribution from the property development segment will remain small. However, an upgrade of ratings and/or outlook could occur if NWR demonstrates a significant improvement in operating performance and substantially lowers its debts. As such, the company needs to sustain the debt to capitalization ratio at around 50% and the FFO to debt ratio above 15%.

In contrast, the ratings and/or outlook could be lowered if operating performance declines further. Non-compliance with the financial covenants without obtaining waivers could also trigger a rating downgrade.

COMPANY OVERVIEW

NWR, a general contractor, was established in 1976 by Mr. Mana Karnasuta. The company was listed on the Stock Exchange of Thailand (SET) in 1995. As of May 2019, NWR's major shareholder was Mr. Polpat Karnasuta (son of Mr. Mana Karnasuta), holding 10.1% of the total shares outstanding.

NWR provides a broad range of civil construction work, including the construction of buildings, factories, transportation infrastructure, ports, irrigation works, tunnels, and pipe jacking projects. The company undertakes construction projects for both public and private sector clients, engaging in civil construction work in Thailand and in neighboring countries such as Myanmar and Cambodia. NWR is the sixth-largest of the contractors listed on the SET, as judged by annual revenue and assets.

In 2001, NWR acquired a 60% stake in Utility Business Alliance Co., Ltd., which manages wastewater treatment plants. In addition, NWR secured a significant revenue stream from a nine-year contract to remove soil and excavate coal at the Mae Moh mine. The contract covered the period of 2009-2018. The Mae Moh project was undertaken by the NWR-SBCC Joint Venture, in which NWR held a 50% stake.

NWR has expanded into the property development sector, a strategic shift designed to ramp up its revenue base. In 2013, NWR set up a wholly-owned property developer, Mana Patanakarn Co., Ltd. (MANA). MANA develops residential property projects under the "Baranee" brand. In November 2014, MANA launched an SDH project, "Baranee Park Romklao", valued at Bt1 billion. In August 2015, MANA launched "Aspen Condo", its first low-rise condominium project, targeting the middle- to low-end market segments. The Aspen Condo has four phases, consisting of 1,448 units. The project value is Bt2.8 billion. The average selling price is Bt2 million per unit. In October 2015, MANA launched another housing project, "Baranee Residence", worth around Bt800 million.

The company expanded into the production and distribution of construction materials in December 2013 when NWR established Advance Prefab Co., Ltd. Advance Prefab manufactures concrete products for use in NWR's construction projects as well as for sale to the public.

The construction segment generates most (85%-90%) of the company's total revenue. During the past five years, the building and transportation infrastructure segments contributed the majority of the revenue, accounting for 70%-80% of revenue each year.

KEY OPERATING PERFORMANCE

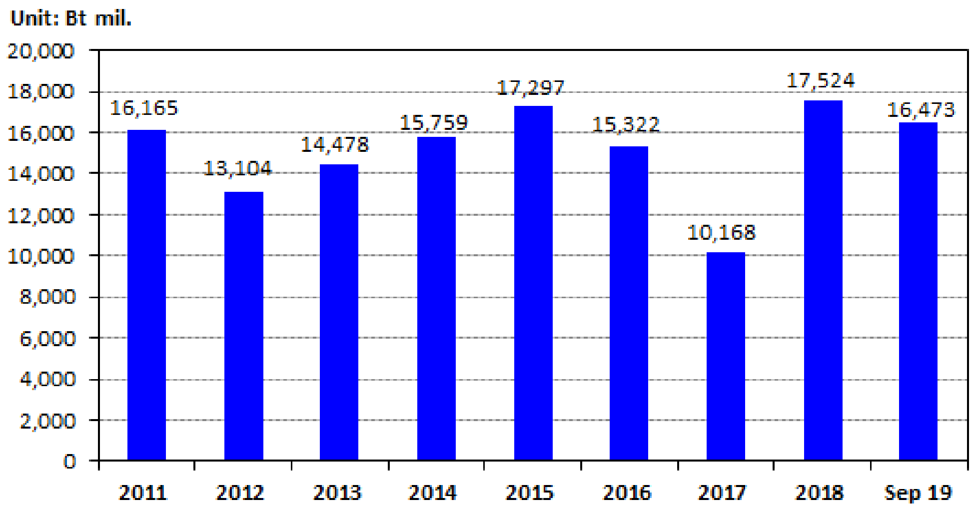
Table 1: Construction Revenue Breakdown by Type of Project

Unit: %

Type of Project	2012	2013	2014	2015	2016	2017	2018	Jan-Sep 2019
Buildings, factories, plants	53	54	51	32	21	26	38	19
Transportation infrastructure	33	29	28	40	48	45	52	67
Coal excavation	12	15	12	12	11	13	0	0
Tunnels & pipe jacking	0	1	7	11	15	10	9	14
Marine work	2	0	2	6	5	6	1	0
Total	**100**	**100**	**100**	**100**	**100**	**100**	**100**	**100**

Source: NWR

Chart 1: Backlog as of Sep 2019



Source: NWR

FINANCIAL STATISTICS AND KEY FINANCIAL RATIOS*

Unit: Bt million

	Jan-Sep 2019	---------------Year Ended 31 December ---------- 2018	2017	2016	2015
Total operating revenues	5,926	10,536	10,611	9,372	8,729
Earnings before interest and taxes (EBIT)	(63)	630	106	317	66
Earnings before interest, taxes, depreciation, and amortization (EBITDA)	264	1,202	901	984	621
Funds from operations (FFO)	94	946	648	726	383
Adjusted interest expense	170	231	246	234	228
Capital expenditures	208	160	362	921	753
Total assets	12,686	13,043	13,206	13,869	12,865
Adjusted debt	3,906	3,389	4,225	3,750	3,908
Adjusted equity	3,625	3,957	3,531	3,746	3,683
Adjusted Ratios					
EBITDA margin (%)	4.45	11.41	8.49	10.50	7.11
Pretax return on permanent capital (%)	0.06 **	7.12	1.20	3.56	0.78
EBITDA interest coverage (times)	1.55	5.19	3.66	4.21	2.72
Debt to EBITDA (times)	8.48 **	2.82	4.69	3.81	6.30
FFO to debt (%)	5.75 **	27.92	15.35	19.37	9.79
Debt to capitalization (%)	51.87	46.14	54.47	50.03	51.48

* *Consolidated financial statements*
** *Annualized with trailing 12 months*
Note: *All ratios have been adjusted by including JV's financial performance (NWR-SBCC JV) on pro-rata basis.*

RELATED CRITERIA

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

Nawarat Patanakarn PLC (NWR)

Company Rating:	BB+
Issue Rating:	
NWR208A: Bt1,720.1 million senior unsecured debentures due 2020	BB+
Rating Outlook:	Stable

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