TRIS RATING
A Strategic Partner of S&P Global

CreditNews ข่าวเครดิต

CH. KARNCHANG PLC

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CORPORATES

Company Rating:	A
Issue Rating:	
Senior unsecured	A
Outlook:	Stable

Last Review Date: 19/07/18

Company Rating History:

Date	Rating	Outlook/Alert
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

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RATIONALE

TRIS Rating upgrades the company rating on CH. Karnchang PLC (CK) and the ratings on CK's outstanding senior unsecured debentures to "A" from "A-", with a "stable" outlook. The upgrade reflects CK's enhanced resilience in the event of a construction downturn, led by rewarding investments in affiliates, potential surge in earnings, and lessened financial leverage.

The ratings continue to reflect CK's position as a top-tier contractor, its ability to undertake large-scale and sophisticated construction projects, as well as the synergy and financial flexibility the company gains from its strategic investments. However, the ratings are constrained by the cyclicality of and competitive threats in the engineering and construction (E&C) industry.

KEY RATING CONSIDERATIONS

Strong business profile

CK's strong business profile is predicated on the company's solid competitive position in the domestic E&C industry. CK's construction competence encompasses 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 transit and hydropower plants.

CK is the second largest E&C companies listed on the Stock Exchange of Thailand (SET), based on revenue and assets. Given its long-established track record and large capital base, CK is among a few top-tier contractors capable of bidding and undertaking massive-scale public infrastructure projects.

Strategic investments are paying off

The ratings also recognize CK's management track record in executing its business strategy. In addition to its core construction business, CK has strategically built a strong foundation of recurring income in order to ward off a rampant downturn in construction.

CK invests and holds meaningful stakes in Bangkok Expressway and Metro PLC (BEM), TTW PLC (TTW), and CK Power PLC (CKP). These three companies, all of which are SET-listed, provide products that meet basic needs (i.e., transportation, infrastructure, and utilities) under concession contracts or multi-year utility purchase contracts.

TRIS Rating views that CK has successfully carried through this business approach, which makes the company impervious to the cyclicality of the construction business. As they expand, the affiliates provide sizable construction projects. Further, CK also earns substantial dividends on a recurring basis and capital gains from occasional divestments.

Enhanced resilience in a downturn

The rating upgrade reflects CK's enhanced resilience in the event of a downturn in construction. The strategic investments are paying off. TRIS Rating expects CK to recognize higher income from its investments, given stronger operating performances by its affiliates, i.e. BEM and CKP. In TRIS Rating's forecast, CK would recognize shared profits from both companies of around Bt1.0-Bt1.5 billion per annum over the next three years. TTW, meanwhile, will bring in a stable dividend income of around Bt450-Bt500 million per year. The strategic investments also provide CK with financial flexibility, as they are marketable and their market values have risen over the past years.

The drawback of strategic investments is the commitment for huge capital investments up front. CK needed to provide considerable financial supports for some concession projects as the project sponsor, leaving CK with a debt-heavy capital structure. However, TRIS Rating views that BEM and CKP currently have strong business profiles and heightened abilities to raise funds for their projects. Looking ahead, TRIS Rating does not expect that CK will need to financially support either company to a great extent, which would preclude CK from maintaining its current gearing leverage.

Exposure to cyclicality and competition in E&C

TRIS Rating maintains a positive view for the domestic E&C industry over the next few years. This view takes into consideration the outlays for a number of large-scale public infrastructure projects, in particular, the government's flagship Eastern Economic Corridor (EEC) projects. On the strength of its market presence, CK is poised to replenish its dissipating backlog.

However, the ratings are fundamentally constrained by the cyclicality of the E&C industry. Moreover, severe competition among contractors continues to pressure profitability. Most projects are awarded through competitive bidding, which puts a strain on contractors' profit margins. Delays in the bidding and awarding of government projects also pose a downside risk.

Potential surge of earnings and cash flow

In TRIS Rating's three-year forecast, CK would generate revenue in a range of Bt30-Bt33 billion per annum during 2019-2021. CK's moderate backlog will secure about 90% of the base-case revenue in 2019, 40% in 2020, and 15% in 2021. TRIS Rating expects that CK's gross profit margin for construction will remain at 8%. Gross profit will be sustained at a minimum of Bt2.7 billion per year. In anticipation of higher income from its affiliates, TRIS Rating forecasts CK's earnings before interest, tax, depreciation, and amortization (EBITDA) will increase to around Bt4.0-Bt4.5 billion per year during 2019-2021, compared with Bt3.3-Bt4.0 billion over the past three years. Meanwhile, funds from operations (FFO) would edge up to range around Bt2.6-Bt3.0 billion per annum.

Less debt load expected

The ratings upgrade also includes TRIS Rating's expectation that CK will shoulder less debt load in the years ahead. CK's financial leverage steadily declined over the past three years. The debt to capitalization ratio fell considerably to 57.2% as of 2017, from about 65%-70% three years earlier. The reduction came after CK transferred the project loan for the MRT Purple Line project to BEM. The debt to capitalization ratio remains elevated at 52.9% as of 2018, as CK needs to provide the sponsor loan to the Xayaburi hydropower project for nearly Bt14 billion.

In our base case, TRIS Rating expects that CK will maintain the leverage ratio in the range of 50%-55% in anticipation of abated financial support CK needs to provide to its affiliates. The ratio of debt to EBITDA is expected to drop and stay at around 7 times. TRIS Rating considers CK's leverage level to be higher than those of other companies with the same rating. However, the leverage level is commensurate with CK's 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.

Manageable liquidity

CK's liquidity is deemed manageable. The company had Bt8.5 billion in cash plus current investments of Bt0.4 billion as of December 2018. FFO are forecast at about Bt3.0 billion over the next 12 months while the company is expected to spend approximately Bt1.5 billion in capital expenditures and distribute dividends of around Bt1.0 billion. The company has Bt4.8 billion in long-term debts maturing in the next 12 months, and these are expected to be repaid with revenue from construction projects or refinanced by new debentures. Given its presence in the capital market and its credit profile, refinancing risk is considered low.

The liquidity profile is enhanced by the company's financial flexibility through its investments in the three SET-listed companies. At the end of 2018, the fair market value of CK's investments in those companies was Bt66.6 billion, or about 1.8 times the company's total debt. It is likely that CK will maintain a significant percentage of shareholding in these companies.

During 2019-2021, the ratio of EBITDA interest coverage is expected to stay above 3.5 times. The FFO to total debt ratio is expected to stay above 8%. CK must maintain a net interest-bearing debt to equity ratio below 3 times in order to comply with the financial covenants specified in its outstanding bonds. The ratio was 1.08 times at the end of 2018.

BASE-CASE ASSUMPTIONS

- CK's revenue will be around Bt30-Bt33 billion per annum during 2019-2021.
- Gross profit margin for construction will maintain at least 8%.
- CK will secure new construction contracts worth a total of Bt30-Bt35 billion per year.
- The Xayaburi sponsor loan will hold in several years ahead.
- There are no extensive investments or financial supports granted to related companies.

RATING OUTLOOK

The "stable" outlook reflects TRIS Rating's expectation that CK will remain highly competitive in securing sizable new contracts in connection with the forthcoming infrastructure projects. CK could sustain its gross margin of construction at 8% despite stiff competition. CK's strategic investments remain fruitful and its debt to capitalization ratio is expected to stay around 50%-55% over the next three years.

RATING SENSITIVITIES

A rating upgrade is unlikely in the near term, but it could occur if CK could significantly uplift cash flow protection such that the debt to EBITDA ratio will markedly tail off and stay below 5 times for a sustained period. The debt to capitalization ratio in the meantime stays below 50%.

A negative rating pressure could develop if CK's operating cash flow drops significantly, possibly due to delays and cost overruns in major projects. A plunge in operating performance, or a deluge of investments or extensive financial supports provided to its affiliates, which cause the debt to capitalization ratio to stay above 60% for a sustained period, could also precipitate a rating downgrade.

COMPANY OVERVIEW

CK was established in 1972 by the Trivisvavet family. CK initially focused on public works 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 2019, the Trivisvavet family held approximately 31% 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 magnified.

CK's revenue in 2016 was record-high at nearly Bt46 billion, around half of which was contributed by the Xayaburi hydropower dam project. CK was awarded an additional contract worth Bt19.4 billion to enhance environmental aspects of the project. Despite a significant amount of additional recognized revenue, CK, as a project sponsor, needs to finance the additional construction in the form of a sponsor loan to the project. CK provides sponsor loans to the project company, Xayaburi Power Co., Ltd. (XPCL), for the amount of Bt13.5 billion. XPCL will repay the loan and interest from earnings after the commercial operation date, which is scheduled for 2019. The loan repayment risk, thus, is tied to XPCL's performance.

In 2018, CK's revenue came in at Bt30 billion, down 18% from the previous year. The gross profit margin increased to 9.0%, from a range of 7.5%-8.8% during 2015-2017. CK's backlog at the end of 2018 stood at Bt50 billion. Major projects in the backlog include the MRT Orange Line project contracts worth a combined Bt21.1 billion, the maintenance and engineering (M&E) equipment contract for the MRT Blue Line worth Bt11.4 billion, and the Xayaburi hydropower dam project worth Bt8.5 billion. These three projects account for 82% of the company's total backlog value.

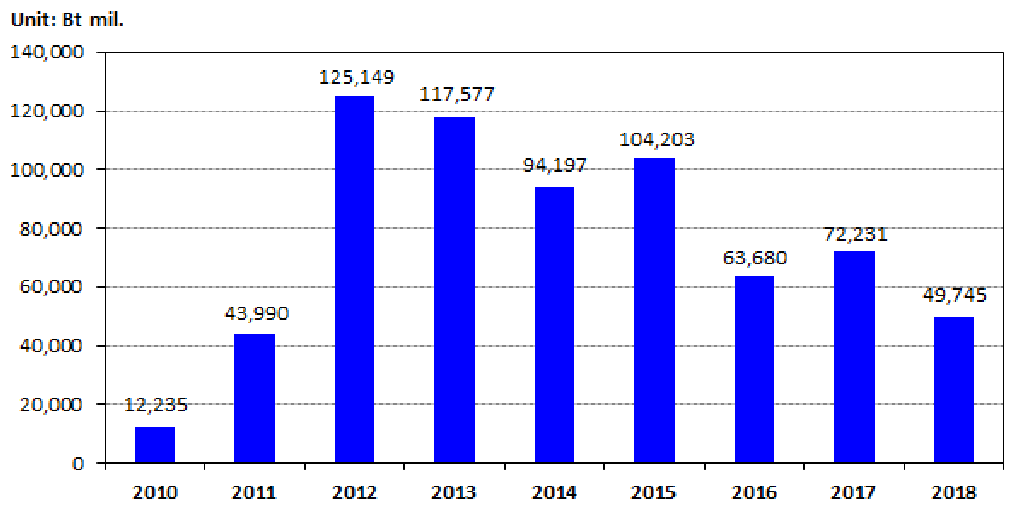
KEY OPERATING PERFORMANCE

Table 1: CK's Investments (As of Dec 2018)

Company Name	CK Holding (%)	Consolidate Investment Cost (Bt mil.)	Fair Value (Bt mil.)	Type of Investment	Customer(s)
BEM	31.78	20,025	47,130	BTO concession AOT concession PPP Gross Cost	Public Public Public
TTW	19.40	5,810	9,521	BOO water purchase agreement	PWA
CKP	27.22	4,541	9,951	Holding company of six power plants	EGAT, PEA, EDL-Gen
Total Investment		**30,376**	**66,602**		

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



Source: CK

FINANCIAL STATISTICS AND KEY FINANCIAL RATIOS*

Unit: Bt million

	-----------------------Year Ended 31 December -------------------				
	2018	**2017**	**2016**	**2015**	**2014**
Total operating revenues	29,634	36,225	45,929	35,059	33,353
Operating income	1,414	2,024	2,584	2,315	3,058
Earnings before interest and taxes (EBIT)	3,632	3,049	3,029	2,270	2,914
Earnings before interest, taxes, depreciation, and amortization (EBITDA)	3,362	3,920	3,999	3,305	3,880
Funds from operations (FFO)	1,957	2,419	2,742	1,285	2,055
Adjusted interest expense	1,266	1,410	1,179	1,562	1,483
Capital expenditures	2,555	913	1,886	1,668	1,415
Total assets	83,501	79,274	94,928	93,066	80,872
Adjusted debt	28,975	31,882	45,819	49,834	37,183
Adjusted equity	25,829	23,873	21,854	20,856	19,471
Adjusted Ratios					
Operating income as % of total operating revenues (%)	4.77	5.59	5.63	6.60	9.17
Pretax return on permanent capital (%)	5.68	4.23	3.90	3.29	4.98
EBITDA interest coverage (times)	2.65	2.78	3.39	2.12	2.62
Debt to EBITDA (times)	8.62	8.13	11.46	15.08	9.58
FFO to debt (%)	6.75	7.59	5.98	2.58	5.53
Debt to capitalization (%)	52.87	57.18	67.71	70.50	65.63

* *Consolidated financial statements*

RELATED CRITERIA

- Key Financial Ratios and Adjustments, 5 September 2018
- Rating Methodology – Corporate, 31 October 2007

CH. Karnchang PLC (CK)

Company Rating:	A
Issue Ratings:	
CK197A: Bt2,500 million senior unsecured debentures due 2019	A
CK198A: Bt500 million senior unsecured debentures due 2019	A
CK20NA: Bt1,000 million senior unsecured debentures due 2020	A
CK215A: Bt2,250 million senior unsecured debentures due 2021	A
CK217A: Bt820 million senior unsecured debentures due 2021	A
CK225A: Bt1,600 million senior unsecured debentures due 2022	A
CK227A: Bt910 million senior unsecured debentures due 2022	A
CK235B: Bt2,700 million senior unsecured debentures due 2023	A
CK245A: Bt1,600 million senior unsecured debentures due 2024	A
CK247A: Bt1,500 million senior unsecured debentures due 2024	A
CK25NA: Bt1,000 million senior unsecured debentures due 2025	A
CK267A: Bt2,700 million senior unsecured debentures due 2026	A
CK275A: Bt1,150 million senior unsecured debentures due 2027	A
CK283A: Bt800 million senior unsecured debentures due 2028	A
CK287A: Bt1,020 million senior unsecured debentures due 2028	A
CK295A: Bt1,000 million senior unsecured debentures due 2029	A
Rating Outlook:	Stable

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