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Research Update:

Ratch Group Public Co. Ltd. Outlook Revised To Negative On Higher Growth Investments; 'BBB+' Ratings Affirmed

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Rating Action Overview

- Ratch Group Public Co. Ltd.'s leverage could stay high over the next two years as the company continues to pursue debt-funded growth investments.
- However, we note that the Thailand-based power producer has some flexibility to control leverage, depending on the cash flow profile of its new investments, the pace of capital spending, and its financial policy.
- On Dec. 14, 2020, S&P Global Ratings revised its outlook on Ratch to negative from stable. At the same time, we affirmed our 'BBB+' long-term issuer credit rating on the company and the 'BBB+' long-term issue ratings on the senior unsecured notes and U.S. dollar-denominated medium-term note program that RH International (Singapore) Corp. Pte. Ltd. (RHIS), a wholly owned subsidiary of Ratch, issued. Ratch guarantees the notes.
- The negative outlook reflects the risk that Ratch's debt-to-EBITDA ratio could stay above 3.0x over the next 12-18 months, owing to the company's elevated spending plans and growth aspirations.

Rating Action Rationale

Ratch's leverage will likely increase over the next two years as it continues to pursue debt-funded growth spending. We believe Ratch will actively pursue growth opportunities. This is in line with its plan of achieving a capacity of 10,000 megawatts (MW) over the next three to five years, compared with the company's current committed capacity of 8,178 MW. As such, we expect higher leverage and forecast the company's debt-to-EBITDA ratio will increase to 3.5x in 2021 and 3.1x in 2022, from our estimate of about 3.0x at end-2020. This is higher than our previous expectation of a debt-to-EBITDA ratio of 2.5x-2.7x over the period.

Ratch will likely incur peak capital expenditure (capex) of close to Thai baht (THB) 12.5 billion this year as it invests heavily in committed and growth projects. We anticipate total capex will stay elevated at about THB8 billion in 2021 and moderate to THB3 billion-THB4 billion over 2022 and 2023. In our view, Ratch has demonstrated an appetite for higher spending and a track record of investing opportunistically in both domestic and offshore projects over the past two years. Moreover, the company is willing to look at minority investments in infrastructure assets, which may have a very different cash flow profile to availability-based power assets. Higher-than-anticipated capital spending beyond 2021 will likely add to the strain on Ratch's balance sheet.

However, we believe Ratch has some flexibility in growth spending as such spending is dependent on suitable market opportunities. We have not incorporated potential earnings from new growth projects given limited visibility on the nature of those investments and their earnings profile. We will require clarity and visibility on the spending and associated earnings contribution of new projects to assess Ratch's long-term leverage and capital structure.

We believe the increase in Ratch's leverage tolerance will weigh on the rating. In our opinion, the company could be comfortable operating at a debt-to-EBITDA ratio of above 3.0x, as it scales up and executes its growth aspirations. Ratch's appetite for higher investments and rising leverage reflect an increase in leverage tolerance—-a departure from its previous debt-to-EBITDA target of 2.0x-2.5x.

We recognize that the company has been prudent in exercising financial discipline and managing a conservative balance sheet. Ratch's decisions on spending and capital management over the next three years, which are within the company's direct control, will underpin its risk appetite. The rating on the company may face downside risks if management prioritizes growth opportunities and higher long-term investment returns for shareholders over deleveraging prospects.

We expect Ratch to maintain good cash flow stability, backed by favorable power purchase agreements (PPAs). Robust long-term PPAs with the Electricity Generating Authority of Thailand (EGAT), which we view as a strong counterparty, will contribute about 70% of Ratch's adjusted EBITDA over the next two years--this includes dividend income from equity affiliates that have PPAs with EGAT. These PPAs protect Ratch from demand-volume and fuel-cost risks, supporting cash flow stability amid the COVID-19 pandemic. Uncertainty over the renewal of PPAs, including those expiring in 2025, could weigh on the company's cash flows.

Ratch also benefits from good earnings visibility for its growing Australia operations due to favorable contract terms such as fixed tariffs and offtake volumes (only about 10% of the company's Australia capacity is exposed to the merchant market). We expect stable and resilient cash flows to support Ratch through its growth phase over the next three years.

Steady dividend contributions from equity affiliates will be key to Ratch's earnings quality. We expect dividend income from equity affiliates to be about THB2 billion over 2020-2021, contributing about 20% of Ratch's total EBITDA over the period. The contribution is lower than our previous expectation of THB2.7 billion-THB3 billion, owing to weaker dividend income from the Hongsa thermal plant in Laos (attributable capacity of 751 MW based on Ratch's 40% shareholding). This is largely due to a change in capex and debt payment schedule, rather than lower earnings caused by operational challenges. Nonetheless, we believe Ratch has good diversity given its portfolio of equity investments spread across various countries, which should continue to support its dividend stream and earnings profile as the investments ramp up.

Outlook

The negative outlook reflects the risk that Ratch's debt-to-EBITDA ratio could stay above 3.0x over the next 12-18 months, owing to the company's elevated spending plans and growth aspirations.

Downside scenario

We may lower the rating on Ratch if the company's debt-to-EBITDA ratio remains above 3.0x and persistently negative free operating cash flows prevents meaningful deleveraging. This could happen if:

- Ratch continues to pursue aggressive debt-funded expansion without a commensurate increase in earnings, or
- Falling availability payments or lower dividend contributions from equity investments result in weaker cash flows.

Upside scenario

We may revise the outlook to stable if:

- Ratch demonstrates a clearly articulated financial policy as it executes its growth plans, and
- The company is committed to restoring its debt-to-EBITDA ratio to below 3.0x on a sustainable basis.

Company Description

Ratch is Thailand's second-largest power generator, with operations mainly in Thailand, Australia, and Laos. We expect the company's total operational capacity to reach 6,750 MW by end-2020. It is 45% owned by EGAT.

Our Base-Case Scenario

- Thailand's real GDP to contract 6.4% in 2020 and grow 5.0% in 2021.
- Ratch's EBITDA, adjusted for principal repayment on financial leases and dividends from joint ventures (JVs), to be THB10.5 billion in 2020 and THB10 billion-THB10.5 billion over 2021-2022.
- Dividends received from equity-accounted JVs to be close to THB2 billion over 2020-2021 and increase to about THB3 billion in 2022.
- Capital spending, including investments in affiliates, to be about THB8 billion in 2021 and THB3 billion-THB4 billion over 2022-2023.
- Adjusted debt of THB33 billion-THB35 billion over 2021-2022 due to higher spending, compared with our estimate of THB31 billion in 2020.
- Stable dividend payout of approximately THB3.5 billion annually over 2020-2022.

Based on these assumptions, we arrive at the following credit measures:

- Debt-to-EBITDA ratio of close to 3.0x in 2020, increasing to about 3.5x in 2021 and 3.1x in 2022.
- Ratio of funds from operations to debt of about 27% in 2020, decreasing to 22%-25% over 2021 and 2022.

Liquidity

We assess Ratch's liquidity as adequate because we anticipate that the company's funding sources will cover uses by more than 1.2x over the 12 months ending Sept. 30, 2021. Ratch has supportive banking relationships and good access to domestic and international debt markets, given its market position and indirect connection to the government through EGAT. We expect the company to maintain sufficient headroom under its covenants even if EBITDA declines by 15%.

Principal liquidity sources include:

- Cash and short-term investments of about THB6.6 billion as of Sept. 30, 2020.
- Cash flow from operations of about THB6 billion over the 12 months to Sept. 30, 2021.
- Working capital inflow of THB2 billion over the period.
- Proceeds from issuance of green debentures of THB8 billion in November 2020.

Principal liquidity uses include:

- Debt maturities of THB8.4 billion over the 12 months to Sept. 30, 2021.
- Consolidated capital spending, including investments in affiliates, of about THB6.7 billion over the period, which we view as committed spending.
- Dividend payments of up to THB3.5 billion over the period.

Issue Ratings - Subordination Risk Analysis

Capital structure

As of Sept. 30, 2020, Ratch's capital structure consists of about THB41.3 billion of total debt. The company has US$300 million of 4.5% senior unsecured notes due on March 27, 2028, and ¥15 billion of 2.72% senior unsecured bonds due on Aug. 24, 2026. Both are issued by RHIS, a wholly owned subsidiary of Ratch, and are irrevocably and unconditionally guaranteed by the rated parent.

Analytical conclusions

We equalize the issue ratings on Ratch's guaranteed notes and bonds with the issuer credit rating on the company because of the absence of subordination risks. Ratch's ratio of priority debt to total debt was 44.6% as of Sept. 30, 2020, below our threshold of 50% for notching down the issue rating.

Ratings Score Snapshot

Issuer Credit Rating: BBB+/Negative/--

Business risk: Satisfactory

- Country risk: Moderately high
- Industry risk: Moderately high
- Competitive position: Satisfactory

Financial risk: Intermediate

- Cash flow/Leverage: Intermediate

Anchor: bbb

Modifiers

- Diversification/Portfolio effect: Neutral (no impact)
- Capital structure: Neutral (no impact)
- Liquidity: Adequate (no impact)
- Financial policy: Neutral (no impact)
- Management and governance: Satisfactory (no impact)
- Comparable rating analysis: Positive (+1 notch)

Stand-alone credit profile: bbb+

- Group credit profile: bbb+
- Entity status within group: Strategically important (no impact)

Related Criteria

- General Criteria: Group Rating Methodology, July 1, 2019
- Criteria | Corporates | General: Corporate Methodology: Ratios And Adjustments, April 1, 2019
- Criteria | Corporates | General: Reflecting Subordination Risk In Corporate Issue Ratings, March 28, 2018
- General Criteria: Guarantee Criteria, Oct. 21, 2016
- General Criteria: Rating Government-Related Entities: Methodology And Assumptions, March 25, 2015
- Criteria | Corporates | General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- Criteria | Corporates | Industrials: Key Credit Factors For The Unregulated Power And Gas Industry, March 28, 2014
- General Criteria: Methodology: Industry Risk, Nov. 19, 2013

- Criteria | Corporates | General: Corporate Methodology, Nov. 19, 2013
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities, Nov. 13, 2012
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011
- General Criteria: Stand-Alone Credit Profiles: One Component Of A Rating, Oct. 1, 2010

Ratings List

Ratings Affirmed; Outlook Action

	To	From
Ratch Group Public Co. Ltd.		
Issuer Credit Rating	BBB+/Negative/--	BBB+/Stable/--
RH International (Singapore) Corp. Pte. Ltd.		
Senior Unsecured	BBB+	