Research Update:

Ratch Group Public Co. Ltd. Rating Lowered To 'BBB' On Rising Leverage; Outlook Stable

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PRIMARY CREDIT ANALYST

Cheng Jia Ong
Singapore
+ 65 6239 6302
chengjia.ong
@spglobal.com

SECONDARY CONTACT

Abhishek Dangra, FRM
Singapore
+ 65 6216 1121
abhishek.dangra
@spglobal.com

Rating Action Overview

- Ratch Group Public Co. Ltd. will face sustainably higher leverage following continued growth spending and an increase in leverage tolerance.
- While Ratch could benefit from potential equity injection and incremental cash flows from new investments in 2022, its leverage will remain high at 3.5x-4.0x over the next three to four years.
- On Sept. 24, 2021, S&P Global Ratings lowered its long-term issuer credit rating on Ratch and the long-term issue ratings on the company's guaranteed senior unsecured notes and U.S. dollar-denominated medium-term note program to 'BBB' from 'BBB+'.
- The stable outlook reflects our expectation that Ratch's steady operations and growing cash flows will support its higher leverage and growth spending over the next two years.

Rating Action Rationale

Elevated spending will keep Ratch's debt-to-EBITDA ratio above 3.0x over the next few years. We estimate the company's leverage will peak in 2021, with a debt-to-EBITDA ratio of 5.9x, and then decrease to 3.5x-4.1x over the next three years. This long-term level of leverage is more commensurate with a stand-alone credit profile (SACP) of 'bbb'. Moreover, Ratch's debt-to-EBITDA ratio has been steadily increasing over the past few years, to 3.6x in 2020 from 1.3x-2.3x over 2017-2019. The company's adjusted debt also went up significantly to Thai baht (THB) 36 billion in 2020, from about THB14 billion in 2017, while EBITDA remained largely flat. This indicates a structural shift in Ratch's debt tolerance and increased risk appetite for greater debt-funded investments.

Ratch is likely to incur significantly higher capital expenditure (capex) of close to THB18 billion in 2021, compared to our previous estimate of THB8 billion. Most of the capex will be targeted at committed investments across sectors such as power, infrastructure, and healthcare, and will likely be debt-funded. Spending will outpace earnings growth given cash flow generation from these investments (largely minority investments) will not be material over the next few years, with only a few being operational and cash flow accretive. We also view investments in infrastructure-related assets to have a very different cash flow profile to availability-based power assets.

Leverage will remain high despite Ratch's proposed equity issuance in 2022 to support growth investments. Ratch announced a proposed acquisition of 45.5% stake in PT Paiton Energy (Paiton), an Indonesia-based coal power producer with 2,045 megawatt (MW) of operating capacity. The transaction is likely to close by the first quarter of 2022. The cost of the acquisition is about THB26 billion (US$809.6 million), which we expect to be largely funded by a target equity issuance of THB30 billion during the same quarter. We believe the option of a private placement post the preferential public offering increases the likelihood of successful equity raising.

In our opinion, equity funding and immediate cash flow contribution from the proposed Paiton acquisition will help stabilize Ratch's leverage from its peak in 2021. We estimate the company's debt-to-EBITDA ratio to moderate to about 4.1x in 2022 and 3.5x-4.0x over 2023-2025. However, significant deleveraging toward the 3.0x level would be unlikely, based on the company's growth plans and aspirations. We expect Ratch to pursue investments opportunistically as it seeks to achieve a capacity of 10,000 MW by 2025.

In our view, Ratch's acquisition of a stake in a large coal-fired plant will further delay its efforts for energy transition. However, we expect Paiton to provide greater diversity and scale for Ratch with long-term cash flows backed by favorable power purchase agreements (PPAs). The long-term PPAs benefit from availability-based payments with full pass through of operating and fuel costs, protecting the asset from volume and fuel cost risks. The sole offtaker is Perusahaan Perseroan (Persero) PT Perusahaan Listrik Negara (BBB/Negative/--), which we view as a strong counterparty and one that has been timely on payments.

We forecast dividend income from Paiton to be THB2 billion-THB2.5 billion per year, contributing an average of about 20% of Ratch's adjusted EBITDA over 2022-2025. While Ratch is exposed to higher regulatory risks in Indonesia, compared with the stable regulatory environment in Thailand, we believe Paiton's favorable PPAs and contracted nature of cash flows mitigate such risks. In addition, Ratch's equity capacity of 930MW (based on 45.5% shareholding) will partly offset its PPA renewal risk for contracts expiring in 2025 and support cash flows.

We do not consolidate the debt of Paiton and other equity affiliates because these debts are structured as project financing and are nonrecourse to Ratch. Also, these projects are largely de-risked with little likelihood of need for extra support from the sponsor. However, the financing structure across debt and equity is more aggressive for these projects compared with Ratch's balance sheet, and any dip in performance could necessitate unscheduled equity injections from the company.

We recognize that Ratch has increased its undertaking in equity-accounted projects over the past few years, which could expose it to off-balance sheet debt. Should such investments continue, we will assess the effect on the company's financials by reviewing the ownership and standing of co-shareholders, materiality and execution risks, and the reputational impact of an absence of support in the case of financial distress.

Good cash flow stability should support Ratch through its growth phase over the next three years. The company's adjusted EBITDA is likely to increase to THB13 billion-THB15 billion over 2022-2024, from our estimate of THB9.5 billion in 2021. Its earnings mix will change with Paiton contributing a moderate 20% of adjusted EBITDA, and PPAs with parent Electricity Generating Authority of Thailand (EGAT) contributing about 55% of adjusted EBITDA (declining from 70% previously). Nonetheless, we believe Ratch continues to benefit from good earnings visibility given Paiton's favorable contract terms and healthy operating performance. Any decrease in dividend income from Paiton and other equity investments (possibly due to a change in capex and debt payment schedule), could weigh on the company's cash flows.

Outlook

The stable outlook reflects our expectation that Ratch's steady operations and incremental cash flows will support the company's higher leverage and growth spending over the next 12-24 months. We also expect Ratch to largely fund the Paiton acquisition with equity and manage its balance sheet as it expands.

Downside scenario

We may lower the rating on Ratch if the company's 'bbb' SACP weakens by four notches to 'bb-'. This assumes that EGAT and the Thai government will be incentivized to provide extraordinary financial support to Ratch in the case of its financial distress, and that the relationship between EGAT and Ratch will remain intact.

The SACP could come under pressure if:

- Increasing earnings contribution from new growth investments and infrastructure-related sectors substantially erodes Ratch's earnings quality; or
- Ratch's debt-to-EBITDA ratio stays well above 4.0x for a sustained period. This could happen if: (1) the company continues to pursue aggressive debt-funded expansion without a commensurate increase in earnings; or (2) falling availability payments or lower dividend contributions from equity investments result in weaker cash flows.

Upside scenario

We could raise the rating if we believe Ratch is committed to deleveraging, with its debt-to-EBITDA ratio improving to below 3.0x on a sustainable basis. This could happen if the company prudently manages its growth spending with sizable cash flow generation, and demonstrates a record of maintaining a more conservative capital structure and financial policy.

Company Description

Ratch is Thailand's second-largest power generator after EGAT, with operations mainly in Thailand, Australia, and Laos. The company has total operational capacity of 7,053 MW as of June 30, 2021. Ratch is 45% owned by EGAT.

Our Base-Case Scenario

Assumptions

- Thailand's real GDP to grow 2.8% in 2021 and 4.9% in 2022, after contracting 6.1% in 2020. Ratch's revenue growth over the period is not dependent on GDP growth rates because revenue is largely driven by availability payments and capacity addition.

- Ratch's EBITDA, adjusted for principal repayment on financial leases and dividends from joint ventures (JVs), to be THB9.5 billion in 2021 and THB13 billion-THB15 billion over 2022-2023.
- Dividends received from equity-accounted JVs to be close to THB1.7 billion in 2021 and increase to about THB4.5 billion in 2022 and THB7 billion in 2023.
- Capital spending, including investments in affiliates, to be about THB18 billion in 2021 and increase to THB32 billion in 2022 due to the proposed Paiton acquisition.
- Adjusted debt to be above THB50 billion over 2021-2022 due to higher spending, compared with THB36 billion in 2020.
- Dividend payout to be about THB3.5 billion in 2021 and increase to THB4.5 billion annually thereafter.

Key metrics

- Debt-to-EBITDA ratio of close to 5.9x in 2021, decreasing to about 4.1x in 2022 and 3.5x-4.0x over 2023-2025.
- EBITDA interest coverage of about 4.4x in 2021, increasing to 5.5x thereafter.

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 June 30, 2022. 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 Ratch to maintain sufficient headroom under its covenants even if EBITDA declines by 15%.

Principal liquidity sources include:

- Cash and short-term investments of about THB7.8 billion as of June 30, 2021.
- Undrawn long-term committed facilities of about THB9.6 billion as of June 30, 2021.
- Cash flow from operations of about THB5.3 billion over the 12 months to June 30, 2022.
- Working capital inflow of THB2.4 billion over the period.

Principal liquidity uses include:

- Debt maturities of THB6.9 billion over the 12 months to June 30, 2022.
- Consolidated capital spending, including investments in affiliates, of about THB9.5 billion over the period, which we view as committed spending.
- Dividend payments of about THB4.4 billion over the period.

Issue Ratings - Subordination Risk Analysis

Capital structure

As of June 30, 2021, Ratch's capital structure consists of about THB46.4 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 RH International (Singapore) Corp. Pte. Ltd., a wholly owned subsidiary of Ratch, and are irrevocably and unconditionally guaranteed by Ratch.

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 41.1% as of June 30, 2021, below our threshold of 50% for notching down the issue rating.

Ratings Score Snapshot

Issuer Credit Rating: BBB/Stable/--

Business risk: Satisfactory

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

Financial risk: Significant

- Cash flow/Leverage: Significant

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: Ratings Above The Sovereign--Corporate And Government Ratings: Methodology And Assumptions, Nov. 20, 2013
- Criteria | Corporates | General: Corporate Methodology, Nov. 19, 2013
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- General Criteria: Methodology: Industry Risk, 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

Downgraded

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