

## Research Update:

# Ratch Group Public Co. Ltd. Downgraded To 'BBB-' On Higher Leverage; Outlook Stable

September 16, 2022

## Rating Action Overview

- Thailand-based power producer Ratch Group Public Co. Ltd. will face sustained higher leverage following its upcoming US\$605 million acquisition in Nexif Energy and US\$809.6 million acquisition of PT Paiton Energy, which Ratch will fund through new debt and cash on hand.
- We believe Ratch's leverage tolerance has increased, as management is comfortable operating at a markedly higher leverage of 6.0x, as measured by debt to EBITDA, compared with less than 4.0x in the past.
- On Sept. 16, 2022, 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 view that Ratch's steady operations and growing cash flow will support higher leverage and growth spending over the next two years. We also expect the company to manage its balance sheet as it expands, such that debt to EBITDA remains between 6.0x and 7.0x for the next 12-18 months.

## Rating Action Rationale

**Debt funded growth and higher leverage tolerance will keep Ratch's debt-to-EBITDA ratio above 6.0x over the next few years.** In our view, Ratch's heightened spending profile indicates an increased risk appetite and a structural shift in its debt tolerance. We believe the company will pursue growth opportunities both domestically and internationally, in line with its plan of achieving capacity of 10,000 megawatts (MW) by 2025, compared with the company's current operational capacity of 7,400 MW.

In August 2022, the company announced a major acquisition in Nexif Energy, which we expect to close in the last quarter of 2022. We believe the company will direct the bulk of its Thai baht (THB) 25 billion equity proceeds from its Preferential Public Offering in June 2022 to fund its upcoming acquisitions, including that of Paiton. That said, given that the recent equity issuance can only accommodate part of the costs of the acquisitions, future spending is likely to be debt-funded.

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Spending in the next two to three years will now amount to about THB72 billion, compared with THB37 billion we previously estimated. This amount includes investments in Paiton's and Nexif's operational assets, construction spending in Nexif's project pipeline, and various small and midsize investments in equity affiliates.

We estimate the higher debt will result in the company's debt-to-EBITDA ratio trending at about 6.0x in 2022 and 2023, increasing to 6.9x in 2024. This contrasts with our previous leverage projection of 3.5x-4.0x for the period. As such, we view Ratch's long-term leverage level to be more commensurate with a weaker stand-alone credit profile (SACP) of 'bb-'. Spending will outpace earnings growth, as these include spending on development assets.

**The acquisition of Nexif Energy will improve Ratch's diversity and support its aspirations to increase its renewables share, though the EBITDA contribution in the next two to three years is relatively modest.** We forecast Nexif Energy's operational portfolio will accrue an incremental annual EBITDA of about THB2.4 billion from 2023 (about 13% of Ratch's EBITDA), which is a relatively modest addition given its aggressive stand-alone leverage, in our view. That said, with the addition of 450MW of operational assets to Ratch's portfolio, the transaction will enhance the company's diversity and support its energy transition goals. Nexif's operational portfolio consists of 60% renewables (wind) and 40% gas capacity, which is mostly contracted under long-term power purchase agreements (PPAs) with utilities (both government-owned as well as private), providing cash flow visibility. However, the company's renewables capacity is exposed to resource risk, which can result in some variability in volumes, and a small portion of overall capacity is sold on a merchant basis into the spot market, which carries some price risk.

**Paiton is a fully operational asset, which can contribute immediate cash flows upon acquisition completion.** In 2021, Ratch announced a proposed acquisition of 45.5% stake in Paiton, an Indonesia-based coal power producer with 2,045MW of operating capacity. The transaction, which carries a consideration amount of THB26 billion (about US\$809.6 million), is likely to close in 2023. In our view, Ratch's acquisition of a stake in a large coal-fired plant will further delay its energy transition efforts. However, we expect Paiton to provide greater diversity and scale for Ratch with long-term cash flow backed by favorable 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/Stable/--), which has been timely on payments.

We forecast dividend income from Paiton to be THB2 billion-THB3 billion per year, contributing an average of about 20% of Ratch's adjusted EBITDA over 2023-2025. While Ratch is exposed to higher regulatory risks in Indonesia, compared with the stable regulatory environment in Thailand, Paiton's favorable PPAs and contracted nature of cash flow mitigate such risks, in our view. 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 flow.

**Ratch's increasing reliance on dividend income from associates and joint ventures (JVs) could create additional risks.** We recognize that Ratch has increased its minority investments in several projects over the past few years, which could expose the company to off-balance sheet debt because these investments are accounted for as equity investments. In light of this risk, we will continually 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. For now, we apply a higher cash haircut of 30% for Ratch's unrestricted cash to reflect the need for potential unexpected cash calls from these equity investments.

At this juncture, we consider these projects to be largely de-risked with little likelihood of need for extra support from the sponsor. This is evidenced by Ratch's good track record of largely visible and stable dividends. However, we may re-assess this stance in the future should there be a deterioration in the quality of dividends, or incidences of extraordinary support flowing to these minority investments.

**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 THB11.6 billion in 2022, and reach THB15 billion-THB17 billion over 2023-2024, from THB9.6 billion in 2021. Ratch's earnings mix will change with Nexif and Paiton each contributing close to 20% of long-term adjusted EBITDA, and PPAs with parent Electricity Generating Authority of Thailand (EGAT) contributing about 40% of adjusted EBITDA (declining from 55% in 2021). Nonetheless, we believe Ratch continues to benefit from good earnings visibility, given Paiton's favorable contract terms and healthy operating performance, as well as the largely contracted nature of Nexif's operational portfolio. Any decrease in dividend income from Paiton, Nexif, and other equity investments (possibly due to a change in capex and debt payment schedule), could weigh on Ratch's cash flow.

In our view, Ratch has a healthy interest servicing ability, despite its rising leverage. This is reflected in the company's EBITDA interest coverage trending at 3.5x-4.0x, in contrast to similarly highly leveraged peers with the ratio averaging in the 1.0x-1.5x range. We anticipate that this will preserve the company's credit quality as it embarks on higher growth spending over the next two years.

**We continue to view Ratch as strategically important within the EGAT group.** Amid Ratch's increasing international investments, we believe EGAT will continue to support Ratch in its growth aspirations, as well as provide financial support, if needed. This is evident from the past equity issuance of THB25 billion, of which EGAT has committed its share as a shareholder to fund Ratch's sizable investment plans. We believe Ratch is the preferred subsidiary when it comes to overseas sourcing of power for Thailand on private projects because of its experience and financial strength. The EGAT governor is on Ratch's board of directors, for approval of such investments. Nonetheless, we continue to monitor the importance of Ratch to EGAT, in light of its expanding footprint outside Thailand.

## Outlook

The stable outlook reflects our view that Ratch will maintain stable operations and cash flow, including its dividend income, which will support higher leverage and growth spending over the next two years. We also expect Ratch to manage its balance sheet as the company expands, such that debt-to-EBITDA remains in the 6x-7x range over the next 12-24 months.

## Downside scenario

We may lower the rating on Ratch if:

- The company's debt-to-EBITDA ratio increases to above 7.5x on a sustained basis and if its ability to service debt declines sharply such that its EBITDA interest coverage ratio falls sustainably below 3.0x. This could be a result of continued aggressive debt-funded expansion without a commensurate increase in earnings, falling availability payments or weaker dividend contributions or a need for support from equity investments; or
- Ratch's importance to its parent, EGAT, diminishes, evident through weaker integration or a

reduction in EGAT's shareholding in the company. This could result in a lack of timely and sufficient financial support from EGAT and the Thai government to preserve Ratch's creditworthiness.

## **Upside scenario**

We could raise the rating if we believe Ratch is committed to deleveraging, with its debt-to-EBITDA ratio improving to below 4.5x 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 had total operational capacity of 7,400 MW as of June 30, 2022. Ratch is 45% owned by EGAT.

## **Our Base-Case Scenario**

### **Assumptions**

- Thailand's real GDP to grow by 3.2% in 2022 and 4.2% in 2023, and 3.6%-3.8% annually thereafter. Ratch's revenue growth over the period is not dependent on GDP growth rates because revenue is largely driven by availability payments and capacity additions.
- Ratch's EBITDA, adjusted for principal repayment on financial leases and dividends from JVs, to be THB11.6 billion in 2022 and THB15 billion-THB17 billion over 2023-2024.
- Dividends received from equity-accounted JVs to be close to THB2.4 billion in 2022 and increase to THB5 billion-THB7 billion over 2023-2024.
- Capital spending, including investments in affiliates, to be about THB27 billion in 2022 due to the Nexif Energy acquisition. This will remain elevated in 2023 at THB37.5 billion with the proposed Paiton acquisition and development of under construction assets in the Nexif Energy portfolio.
- Adjusted debt to be about THB71 billion in 2022, increasing to above THB100 billion thereafter due to higher debt-funded spending and consolidation of Nexif Energy's debt.
- Dividend payout to be about THB3.6 billion in 2022 and about THB3 billion-THB3.5 billion annually thereafter.

### **Key metrics**

- Debt-to-EBITDA ratio of about 6.0x over 2022 and 2023, increasing to 6.9x in 2024.
- EBITDA interest coverage of 3.6x in 2022, increasing to 4.5x in 2023, and 3.5x-4.0x 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, 2023. 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 THB34.3 billion as of June 30, 2022.
- Undrawn long-term committed facilities of about THB16.5 billion as of June 30, 2022.
- Cash flow from operations of about THB7.2 billion over the 12 months to June 30, 2023.
- Working capital inflow of THB1.5 billion over the period.

Principal liquidity uses include:

- Debt maturities of THB6.2 billion over the 12 months to June 30, 2023.
- Consolidated capital spending, including investments in affiliates, of about THB23.9 billion over the period, which we view as committed spending.
- Dividend payments of about THB2.7 billion over the period.

## **Environmental, Social, And Governance**

### **ESG credit indicators: E-3, S-2, G-2**

Environmental factors are a moderately negative consideration in our credit rating analysis of Ratch. The company uses natural gas as the source for around 60% of its fuel. This is a bridge fuel as the company transitions from fossil fuels to renewables. However, Ratch's proposed acquisition of a 45.5% stake in PT Paiton Energy (930MW equity capacity in a coal-fired plant in Indonesia) would increase its exposure to coal to about 20% of overall capacity, delaying its energy transition efforts. Close to 20% of Ratch's capacity is renewables and its target of 25% renewables by 2025 could potentially improve carbon exposure and fuel diversity. Earnings are supported by robust long-term contracts without volume and fuel price risks.

## **Issue Ratings - Subordination Risk Analysis**

### **Capital structure**

As of June 30, 2022, Ratch's capital structure consists of about THB60.4 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 unsecured notes and bonds with the issuer credit rating on the company because the ratio of priority debt to total debt was 45% as of June 30, 2022, which is below our threshold of 50% for notching down the issue rating. As Ratch's capital structure continues to evolve with its business growth, we will monitor for any subordination risks in its unsecured debt relative to other debt in Ratch's consolidated capital structure.

We do not include RH International (Singapore) Corp. Pte. Ltd.'s unsecured debt as part of priority debt, as we consider the debt to rank pari passu to that of the parent company Ratch Group, which guarantees these notes.

## Ratings Score Snapshot

| Issuer Credit Rating             | BBB-/Stable/--                       |
|----------------------------------|--------------------------------------|
| Business risk:                   | Satisfactory                         |
| Country risk                     | Intermediate                         |
| Industry risk                    | Moderately High                      |
| Competitive position             | Satisfactory                         |
| Financial risk:                  | Highly leveraged                     |
| Cash flow/leverage               | Highly leveraged                     |
| Anchor                           | b+                                   |
| Modifiers:                       |                                      |
| Diversification/Portfolio effect | Neutral (No impact)                  |
| Capital structure                | Neutral (No impact)                  |
| Financial policy                 | Neutral (No impact)                  |
| Liquidity                        | Adequate (No impact)                 |
| Management and governance        | Satisfactory (No impact)             |
| Comparable rating analysis       | Positive (+1 notch)                  |
| Stand-alone credit profile:      | bb-                                  |
| Group credit profile             | bbb+                                 |
| Entity status within group       | Strategically important (+3 notches) |

## Related Criteria

- General Criteria: Environmental, Social, And Governance Principles In Credit Ratings, Oct. 10, 2021
- 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
- Criteria | Corporates | General: Corporate Methodology, Nov. 19, 2013
- General Criteria: Methodology: Industry Risk, 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

### Downgraded

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

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at [www.standardandpoors.com](http://www.standardandpoors.com) for further information. Complete ratings information is available to subscribers of RatingsDirect at [www.capitaliq.com](http://www.capitaliq.com). All ratings affected by this rating action can be found on S&P Global Ratings' public website at [www.standardandpoors.com](http://www.standardandpoors.com). Use the Ratings search box located in the left column.

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