SYNTEC CONSTRUCTION PLC

No. 130/2017 12 October 2017

Company Rating:	BBB
Outlook:	Stable

Company Rating History:

Date	Rating	Outlook/Alert
12/10/16	BBB	Stable
27/08/15	BBB-	Positive
06/03/09	BBB-	Stable

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Rating Rationale

TRIS Rating affirms the company rating of Syntec Construction PLC (SYNTEC) at "BBB". The rating reflects the company's strong market position in the construction of high-rise buildings, high operating efficiency, sizable backlog, and ample liquidity. However, the rating is tempered by a high reliance on the end-markets SYNTEC serves and the cyclical nature of the engineering and construction (E&C) industry.

SYNTEC was established in 1988 and listed on the Stock Exchange of Thailand (SET) in 1993. The company is a general contractor but it is best known for the construction of high-rise residential and commercial buildings for private sector clients. As of September 2017, the Phahusutr family remained the company's major shareholder, owning about 28% of the total number of shares outstanding. SYNTEC, through its majority-owned subsidiaries, expanded into the real estate for rent business in 2013. However, the revenue contribution from the real estate for rent segment is currently small.

SYNTEC's core business has been on a solid course over the past few years, which is reflected in a steady increase in revenue. The company has a strong market position in high-rise construction. Most of the construction works it undertakes are residential property projects in the Bangkok Metropolitan Area. The company is well-positioned to serve several large property developers. SYNTEC's cost competitiveness and reliable service helps the company keep acquiring new projects from repeat clients. Most of its clients are SET-listed, top-tier property developers with satisfactory credit profiles. SYNTEC's revenue surged for a fifth straight year to a record high of Bt7.8 billion in 2016. Revenue kept climbing well into 2017, as the company posted a 23.1% year-on-year (y-o-y) increase during the first half. TRIS Rating holds the view that SYNTEC will keep growing. The company recently racked up a large number of new contracts, pushing the backlog to a new high.

SYNTEC has high operating efficiency due to the efficient control of costs and a strategy to focus on building condominiums, an area where it has expertise. The gross margin has grown significantly from single digits to 18.5% in 2016 and 21.5% in the first half of 2017. Robust profitability, plus prudent management of working capital, make SYNTEC more resilient when facing the cyclical nature of the E&C industry.

However, SYNTEC's strengths are somewhat weighed down by the high reliance on condominium projects from a few clients. The major source of revenue remains the construction of residential property buildings. This concentration reflects the narrow end markets served. For the past three years, the biggest client has been Supalai PLC (SPALI). Projects for SPALI comprised about 20% of SYNTEC's annual revenue. However, the customer concentration risk is offset by the fact that SYNTEC's customers are reliable. Thus, the payment risk is acceptable.

SYNTEC, like other E&C companies, is susceptible to the cyclicality of the E&C industry. The industry cycles, which are in large part derived from the property market, remain a rating constraint. A drop-off in the demand for residential property could add to concerns over the sustainability of the company's revenue streams. However, SYNTEC has recently taken on a wider range of construction projects as the condominium segment slowed. As a result, revenue has kept growing during the past five years.

SYNTEC recently expanded into the real estate for rent business in the hope of diversifying its sources of revenue. The company acquired the lease rights of the Duchess Hotel and Residence (previously known as the Natural Ville Residence), a serviced apartment located on Langsuan road in Bangkok, in late 2013. The lease has about 16 years left to run. SYNTEC then developed three serviced apartments on greenfield sites in Chonburi and Prachinburi provinces. The serviced apartment projects are aimed at luring expatriates working in nearby industrial estates. The first project, the Citadines Grand Central Sriracha, located in the Sriracha community, was launched in the first quarter of 2015. The other two projects are under development.

In April 2016, SYNTEC, through the C S M Capital Partners Co., Ltd. (CSM), a subsidiary, acquired the assets of the Eight Thonglor Residences, a mixed-use development project, located at Soi Tonglor. Its largest-ever acquisition cost SYNTEC about Bt2.5 billion. Despite the large investment, SYNTEC's level of leverage was acceptable. The operating performances of the Duchess Hotel and Residence, the Citadines Grand Central Sriracha, and the Eight Thonglor Residences have been satisfactory. In the first half of 2017, revenue from these properties was Bt220 million in total, or about 5% of total revenue. The occupancy rate was 84% on average. TRIS Rating is of the view that there are notable risks from SYNTEC's foray into the real estate for rent business. The company faces the competitive threats and an increased supply of property projects even though its properties for rent are located in prime areas.

Revenue has ranged from Bt7-Bt8 billion annually over the past three years. The construction segment is still the dominant source of revenue, of which 70%-80% is from condominium projects. TRIS Rating's base-case forecast assumes revenue will edge up to Bt8-Bt9 billion annually over the next three years, propelled by a sizable backlog. As of June 2017, the backlog stood at approximately Bt14 billion, far above the past levels of Bt6-Bt8 billion. The sizable backlog, boosted by condominium projects targeting the medium- to high-end customer segments, will secure about half of the projected revenue over the next three years. However, the record high backlog will challenge SYNTEC to sustain the level of operating efficacy over the long run.

SYNTEC has demonstrated its ability to earn profit margins higher than most SET-listed contractors. Profitability has improved significantly and steadily over the past few years due to better cost control measures. The operating margin (operating profit before depreciation and amortization as a percentage of revenue) increased to 18.8% in the first half of 2017. However, the operating margin will likely to decline in the coming years due to more intense competition. During the next three years, the operating margin is assumed to range between 10%-15%, driving funds from operations (FFO) to Bt600-Bt1,000 million per annum under TRIS Rating's base-case projection.

SYNTEC has a fairly conservative financial policy, as evidenced by its moderate level of leverage and ample liquidity. The debt to capitalization ratio stood at 25.5% at the end of June 2017. The ratio fell from 28.6% in 2016, when the company took on more debt to fund the purchase of the Eight Thonglor Residences. In essence, SYNTEC's core E&C business requires a small amount of debt. The strategy to tap clients with satisfactory credit profiles helps reduce SYNTEC's need for working capital and reduce the attendant need for external funding. As a result, most of the funds SYNTEC borrowed were used to fund the investments in real estate for rent. TRIS Rating forecasts the debt to total capitalization ratio will increase, but stay below 40%, over the next three years. SYNTEC has been renovating the Eight Thonglor Residences and developing the remaining serviced apartments. It is also looking to make more investments in real estate for rent. TRIS Rating does not expect the company to make an excessive number of investments, funded with a deluge of new debt, taking considerations its prudent financial policies.

Cash flow protection increased recently, as profits rose and the amount of outstanding debt fell. The FFO to total debt ratio increased to 82.3% in the first half of 2017, from 55.8% in 2016. The EBITDA (earnings before interest, taxes, depreciation, and amortization) interest coverage ratio increased to 26 times, from 20.2 times in 2016. TRIS Rating projects cash flow protection will decline in the years ahead, as profit margins slip and gearing rises. However, cash flow protection is forecast to remain at an acceptable level. TRIS Rating's base-case forecast assumes the FFO to total debt ratio will stay above 20%, while the EBITDA interest coverage ratio will stay above 5 times for the next three years.

SYNTEC maintains a sizable amount of liquid assets. Cash and marketable securities stood at about Bt1.7 billion as of June 2017. This high level not only increases the company's financial flexibility, but also gives the company an edge in the sourcing of raw materials. The company can use its high cash balance to source raw materials before prices start to rise.

Rating Outlook

The "stable" outlook reflects TRIS Rating's expectation that SYNTEC will maintain its strong market position in the construction segment, its core business. The company is also expected to keep its profitability and financial profile in line with expectations. More investments in the real estate for rent should not substantially weaken liquidity and leverage.

A credit rating upgrade could arise if cash flow from operations rise substantially and the financial profile remains strong. Downward rating pressure would emerge if the financial profile deteriorates significantly, which could arise from a slip in competitive position, cost overruns, or excessive investments.

Syntec Construction PLC (SYNTEC)

Company Rating:	BBB
Rating Outlook:	Stable

Financial Statistics and Key Financial Ratios*

Unit: Bt million

		--------------Year Ended 31 December ---------			
	Jan-Jun 2017	2016	2015	2014	2013
Revenue	4,378	7,843	7,190	6,994	6,199
Finance cost	33	65	45	47	49
Net income from operations	514	812	640	334	198
Funds from operations (FFO)	948	1,074	721	711	288
Capital expenditures	143	2,748	257	589	824
Total assets	9,182	9,523	6,722	6,106	5,449
Total debt	1,731	1,925	809	827	1,108
Total liabilities	4,112	4,721	3,110	3,100	2,884
Shareholders' equity	5,070	4,802	3,612	3,006	2,565
Depreciation & amortization	184	295	210	179	119
Dividends	176	192	128	112	-
Operating income before depreciation and amortization as % of sales	18.84	16.22	10.79	9.36	5.78
Pretax return on permanent capital (%)	17.65 **	18.11	16.74	11.90	7.11
Earnings before interest, tax, depreciation, and amortization (EBITDA) interest coverage (times)	25.96	20.20	20.07	13.17	7.33
FFO/total debt (%)	82.34 **	55.79	89.13	86.05	26.05
Total debt to capitalization (%)	25.46	28.61	18.29	21.57	30.16

* *Consolidated financial statements*
** *Annualized with trailing 12 months*

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