TRIS RATING
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SAHAKOL EQUIPMENT PLC

No. 64/2024
24 April 2024

CORPORATES

Company Rating:	BBB-
Outlook:	Stable

Last Review Date: 22/05/23

Company Rating History:

Date	Rating	Outlook/Alert
11/06/21	BBB-	Stable
22/06/20	BBB-	Negative
08/06/18	BBB-	Stable

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RATIONALE

TRIS Rating affirms the company rating on Sahakol Equipment PLC (SQ) at "BBB-" with a "stable" rating outlook. The rating reflects SQ's competitive strengths in mining services and the predictable income generated from long-term service contracts with creditworthy clients. However, these strengths are weighed down by the company's narrow scope of business with reliance on a few large projects, depleting backlog, and high financial leverage. The rating also takes into consideration the potential adverse effect of heightened environmental concerns surrounding the coal mining industry and rising construction materials and labor costs, which may exert downward pressure on SQ's profit margins in the short to medium term.

KEY RATING CONSIDERATIONS

Strengths in mining services with predictable income from long-term contracts

SQ provides an extensive range of mining services. The company's competitive edge stems from its wealth of experienced mining engineers and specialized mining equipment. SQ has served as the main contractor or a joint operator for several phases of the Mae Moh mining operations of the Electricity Generating Authority of Thailand (EGAT) over the past three decades.

In addition, SQ has undertaken mining projects in the Lao People's Democratic Republic (Lao PDR) since 2015. The company currently holds a lignite mining service agreement with Hongsa Power Co., Ltd. (HPC), a leading power producer in the Lao PDR. The project is viewed as the start of SQ's overseas expansion. HPC continually feeds work related to the Hongsa mine to the company.

SQ's income streams are quite predictable since they are backed by long-term mining service contracts, which typically have a contract period of 10 years for each phase. In addition, the credit risk of its counterparties, EGAT and HPC, are considered low.

Rating weighed down by high concentration risk, depleting backlog, and heightened environmental concerns

TRIS Rating assesses SQ's business as highly concentrated in terms of scope and clientele. The company focuses narrowly on the coal mining business, which currently has very limited opportunities for growth. Its revenues are derived from only two major clients, EGAT and HPC. Over the last five years, revenues ranged around THB4.8-THB6.2 billion per annum, depending on additional mining-related works. In 2023, the Mae Moh mine generated around 41% of the company's revenue while the remainder came from the Hongsa mine.

As of December 2023, SQ's backlog stood at THB13.2 billion, down from THB16.1 billion at the end of 2022. The remaining backlog comprised THB3.9 billion of the Mae Moh Phase 8 project (MM8), THB4.4 billion of the Hongsa Mine Phase D project (HMD), and projects related to the Hongsa mine including the build-lease-transfer (BLT) project, operation and maintenance (O&M) services, and the North pit wall expansion project. Around 83% of its backlog is scheduled for completion in 2024-2027. However, given the increasing demand for coal at EGAT's power plants, SQ is expected to secure an additional mining production contract valued at approximately THB4-THB5 billion for the Mae Moh mining expansion phase (MM Expansion) by the end of 2024.

Looking forward, given the dearth of new viable mining projects in Thailand due to environmental concerns, SQ is likely to focus solely on bidding for the Mae Moh Phase 10 (MM10) and Hongsa Mine Phase G (HMG) projects, which are expected to be tendered in 2025 and 2027, respectively. The estimated project value of MM10 and HMG are approximately THB35 billion and THB9.7 billion, respectively. Given its established presence in the field and limited number of competitors, we view there is high probability for SQ to win the new contacts. However, a failure to secure these two projects would significantly jeopardize the company's long-term business outlook.

Gross margins continue to face pressure

SQ's operating performance in 2023 was in line with our expectations, with revenues reaching THB6.2 billion. Its gross profit margin stood at 15.2%, down slightly from 16.2% in 2022 and the 20%-22% level in 2020-2021, but still better than our prior forecast of 13.4%. The decline in gross margin was attributed to increased expenses for explosives and fuel, as well as higher repair and maintenance costs, influenced by usage cycles.

Looking forward, given the current backlog and additional work on the Mae Moh mining, we project SQ's revenue to range from THB4-THB5 billion annually during 2024-2026. Its gross profit margin is expected to hover around 16%-18% in 2024-2025, given the expected persistently high fuel prices and construction costs in 2024 and a decline in unit price and production volume of MM8 in 2025. However, we expect the gross profit margin to rebound to around 22% in 2026 assuming the full production of additional work from the MM Expansion.

SQ's earnings before interest, taxes, depreciation, and amortization (EBITDA) are projected to be around THB1.5 billion in 2024, declining to around THB1.2 billion in 2025 due to the reduced production of MM8, before recovering to THB1.4 billion in 2026 upon the full production of MM Expansion. The EBITDA margin is likely to remain in the 30%-32% range over the forecast period.

Financial leverage remains high

SQ's financial leverage remains high but is expected to decrease over the forecast period. The company typically carries a substantial debt burden at the commencement of each project, due to hefty capital expenditure for new heavy-duty machinery and equipment. Therefore, we forecast SQ's debt to capitalization ratio to remain at 62%-63% in 2024, consistent with the 2023 levels, considering the front-end funding needed for the construction of the BLT project during 2023 through the first quarter of 2024. Capital expenditure will be around THB1.1 billion in 2024 and around THB150-THB200 million per year in 2025-2026. Subsequently, the ratio is projected to decline to approximately 50% by 2026. SQ's debt to EBITDA ratio is projected to stay within the range of 3.0-3.5 times, while the funds from operations (FFO) to debt ratio should remain above 20%.

The financial covenants on its bank loan obligations require the maintenance of a debt service coverage ratio above 1.2 times, an interest-bearing debt (IBD) to equity ratio below 2 times, and IBD to EBITDA ratio lower than 4 times. For the covenant in relation to SQ's outstanding debentures, the company is obliged to keep its IBD to equity ratio below 3.5 times. At the end of 2023, barring the debt service coverage ratio, SQ was able to comply with the financial covenants. SQ's debt service coverage ratio at the end of December 2023 stood at 0.9 times, below the required threshold of 1.2 times. However, we expect the company to receive a covenant waiver from its creditors. The bank loan financial covenants are tested at the end of every quarter, while those on the debentures are tested at the end of each year.

Tight liquidity

SQ's liquidity is tight. As of December 2023, the company's liquidity sources comprised cash on hand of THB180 million plus undrawn credit lines of about THB200 million. We forecast SQ will generate FFO of around THB1.1-THB1.2 billion over the next 12 months. SQ's uses of funds over the next 12 months include maturing debts of about THB2.8 billion, capital expenditure of around THB0.8 billion, and dividend payments of around THB0.1 billion. Debts coming due over the next 12 months comprise THB1.9 billion of scheduled project loan repayments and THB0.9 billion of maturing debentures. Typically, project loans will be repaid with cash received from project progress payments. The company plans to refinance maturing debentures with new debenture issuances.

Debt structure

As of December 2023, SQ's consolidated debt, excluding lease liabilities, amounted to THB4.9 billion, with THB2.8 billion of secured debt. The priority debt to total debt ratio was 58%, exceeding our 50% threshold. Thus, we consider SQ's unsecured creditors to be significantly disadvantaged to its priority debt holders with respect to the priority of claims against the company's assets.

BASE-CASE ASSUMPTIONS

- Revenues of THB4-THB5 billion during 2024-2026.
- EBITDA margin to hold in the 30%-32% range.
- Capital expenditure of around THB1.1 billion in 2024 and THB150-THB200 million per year in 2025-2026.

RATING OUTLOOK

The “stable” outlook reflects our expectation that SQ will maintain its competitive strengths in the mining business, and that the company will perform in accordance with the terms of its contracts and generate an acceptable level of cash flow over the course of the undertaken projects. We expect its FFO to debt ratio to stay above 20% over the next three years.

RATING SENSITIVITIES

The rating could be revised downward if SQ’s operating performance falls significantly short of expectations. A negative rating pressure could develop if the FFO to debt ratio falls below 20% for a sustained period. The rating upside is limited given the environmental concerns of this business.

COMPANY OVERVIEW

SQ was established in May 2001 by the Sirison and Areekul families, but its roots date back to 1983. In that year, mining operations at the Mae Moh Phase 1 project were undertaken by Sahakol Engineer Co., Ltd., a predecessor company. SQ is currently the largest mining contractor in Thailand, providing a complete range of mining engineering services, including mine planning, open-pit mining operations, mining consultancy, and heavy-duty mining equipment rental and maintenance.

The company is primarily engaged in overburden and lignite removal services for the Mae Moh mine in Lampang province. The mine supplies lignite to the Mae Moh coal-fired power plants owned and operated by EGAT. SQ has conducted mining operations for several phases of the Mae Moh mine over the past 35 years. Projects at the Mae Moh mine have accounted for 65%-70% of the company’s total annual revenue during 2020-2022. In 2023, the Mae Moh mine generated 41% of the company’s revenue while the remainder came from the Hongsa mine.

SQ went public in 2015 and was listed on the Stock Exchange of Thailand (SET) in October 2016. The Sirison family has been the company’s major shareholder since its inception. As of March 2024, this founding family held a 24% stake in the company. SQ’s revenue has grown continually over the past few years after winning contracts for the Hongsa mine and the Mae Moh Phase 8 project. The latter is currently the largest project in the company’s backlog. Revenue has been in the THB4.8-THB6.2 billion per annum range during 2019-2023, up from THB3.6 billion in 2018. The EBITDA margin had been maintained in the 20%-35% range over the past five years.

KEY OPERATING PERFORMANCE

Table 1: SQ's Projects in the Backlog as of Dec 2023

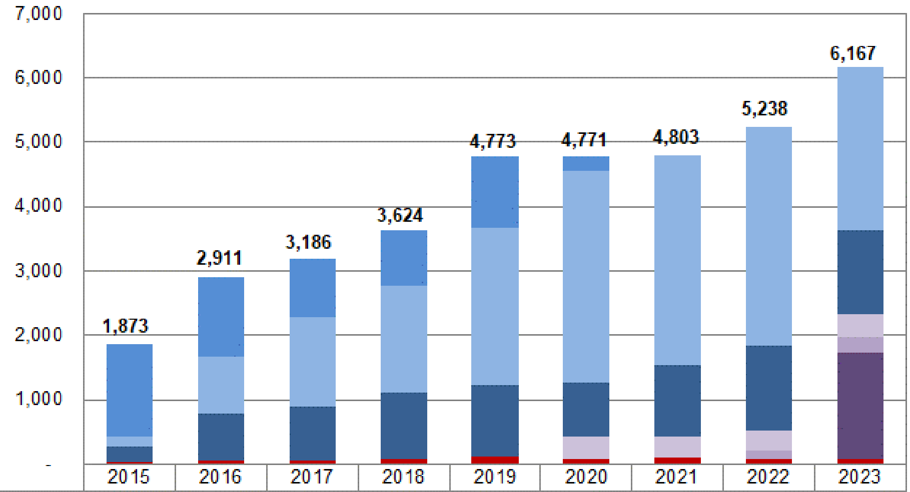
Unit: Mil. THB

Projects	Duration	Project Value (Mil. THB)	Backlog Value (Mil. THB)	Total Backlog (%)
Mae Moh Phase 8	2016-2025	22,871	3,940	30
Hongsa Mine Phase D	2015-2026	12,779	4,353	33
O&M Hongsa	2020-2026	2,265	1,163	9
North pit wall expansion	2022-2027	837	475	3
Build lease & transfer (BLT)	2021-2024	2,245	1,005	8
O&M Hongsa expansion	2027-2033	2,275	2,275	17
Total		**43,272**	**13,211**	**100**

Source: SQ

Chart 1: Revenue Breakdown

Unit: Mil. THB



	2015	2016	2017	2018	2019	2020	2021	2022	2023
Mae Moh Phase 7	1,445	1,238	905	848	1,090	223			
Mae Moh Phase 8	146	897	1,376	1,673	2,461	3,277	3,269	3,402	2,544
Hongsa	247	731	857	1,027	1,107	850	1,104	1,314	1,291
Hongsa O&M	-	-	-	-	-	353	340	317	365
North Pit Wall Expansion	-	-	-	-	-	-	-	122	240
Build Lease & Transfer	-	-	-	-	-	-	-	2	1,656
Others	35	46	47	77	116	68	91	80	71

Source: SQ

FINANCIAL STATISTICS AND KEY FINANCIAL RATIOS*

Unit: Mil. THB

	-------------------Year Ended 31 December -----------------				
	2023	**2022**	**2021**	**2020**	**2019**
Total operating revenues	6,167	5,238	4,803	4,771	4,773
Earnings before interest and taxes (EBIT)	435	554	595	547	386
Earnings before interest, taxes, depreciation, and amortization (EBITDA)	1,287	1,495	1,605	1,650	1,564
Funds from operations (FFO)	1,019	1,257	1,343	1,333	1,163
Adjusted interest expense	268	238	265	317	391
Capital expenditures	299	511	152	310	463
Total assets	9,556	8,870	9,210	10,009	11,106
Adjusted debt	4,804	4,652	5,676	6,669	7,544
Adjusted equity	2,879	2,874	2,658	2,412	2,165
Adjusted Ratios					
EBITDA margin (%)	20.9	28.5	33.4	34.6	32.8
Pretax return on permanent capital (%)	5.5	6.8	6.7	5. 7	3.8
EBITDA interest coverage (times)	4.8	6.3	6.1	5.2	4.0
Debt to EBITDA (times)	3.7	3.1	3.5	4.0	4.8
FFO to debt (%)	21.2	27.0	23.7	20.0	15.4
Debt to capitalization (%)	62.5	61.8	68.1	73.4	77.7

* *Consolidated financial statements*

RELATED CRITERIA

- Corporate Rating Methodology, 15 July 2022
- Key Financial Ratios and Adjustments for Corporate Issuers, 11 January 2022
- Issue Rating Criteria, 15 June 2021

Sahakol Equipment PLC (SQ)

Company Rating:	BBB-
Rating Outlook:	Stable

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