

Credit Opinion: Ratchaburi Electricity Generating Holding PCL

Global Credit Research - 24 Apr 2014

Thailand

Ratings

Category	Moody's Rating
Outlook	Stable
Corporate Family Rating	Baa1
Senior Unsecured MTN	(P)Baa2
RH International (Singapore) Corp. Pte Ltd	
Outlook	Stable
Bkd Sr Unsec MTN	(P)Baa2

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Key Indicators

Ratchaburi Electricity Generating Holding PCL[1][2]

	31/12/2013	31/12/2012	31/12/2011	31/12/2010	31/12/2009
(CFO Pre-W/C + Interest) / Interest Expense	6.8	4.8	6.2	11.6	10.3
(CFO Pre-W/C) / Net Debt	63.40%	34.50%	26.40%	134.50%	50.20%
RCF / Net Debt	40.10%	21.70%	16.60%	81.50%	32.40%
FCF / Net Debt	2.30%	18.50%	15.00%	111.50%	34.40%

[1] Ratios for all periods do not include pro-rata share of JV financials. [2] All ratios are calculated using Moody's Standard Adjustments; Source: Moody's Financial Metrics

Note: For definitions of Moody's most common ratio terms please see the accompanying [User's Guide](#).

Opinion

Rating Drivers

Strategic importance to Thailand's power sector, as the country's largest independent power producer (IPP)

Long-term power purchase agreements (PPAs) and secure fuel supply support stable performance

Close links with its parent, Electricity Generating Authority of Thailand (EGAT), a state-owned power generation company, and therefore the associated expected parental support

Weakening credit metrics, owing to sizable capex and joint venture (JV) exposures

Uncertainties associated with expansion strategy outside Thailand

Corporate Profile

Founded in 2000, Ratchaburi Electricity Generating Holding Public Company Limited (RATCH) was established to purchase power plants from its parent, the state-owned power generation company, EGAT.

As of end-2013, RATCH had operations in Thailand, Laos and Australia, with a total installed capacity of 5.2 gigawatts (GW).

Its domestic installed capacity of 4.6 GW accounted for about 13.6% of Thailand's total power generating capacity as of end-2013. About 80% of its capacity comes from its 99.99%-owned subsidiary, Ratchaburi Electricity Generating Company Limited. The remainder is from its JV companies.

RATCH was listed on the Stock Exchange of Thailand in 2000. EGAT, which owns a 45% stake, is its largest shareholder and the sole off-taker of RATCH's power generation capacity.

EGAT is fully owned by the Thai government (Baa1 stable) and is mainly involved in the generation and transmission of energy throughout the country. It is the largest power generation company in Thailand by capacity, accounting for 45% of the country's total capacity as of 31 December 2013.

Rating Rationale

The Baa1 corporate family rating reflects RATCH's: (1) solid and strategic position as the largest independent power producer in Thailand; (2) sound business profile underpinned by the power purchase agreements; and (3) strong relationship with EGAT.

On the other hand, the company's overseas expansion strategy and sizable capex plan could lead to increased execution and development risks and could create pressure on its credit metrics. In particular, RATCH is developing a large scale coal-fired plant in Laos with an integrated coal mine, a first for the company.

Sizable debt exposures at its JVs also pressure RATCH's adjusted credit metrics, after incorporating its pro-rata share in the JVs.

In addition, the rating factors in one-notch uplift, based on our expectation of support from EGAT. The parent's credit profile is stronger than RATCH's.

Recent Developments

RATCH plans to launch a \$1 billion guaranteed medium term note program in 2Q2014. The proposed program will enhance its liquidity and provide diversification to its offshore financing channels. The initial drawdown will be used for refinancing and general corporate purposes.

DETAILED RATING CONSIDERATIONS

(1) STRATEGIC IMPORTANCE TO THAILAND'S POWER SECTOR

RATCH will continue to benefit from its strategic importance to the country's power sector, as the largest IPP with established operations.

RATCH plans to grow its capacity to around 7.2 GW by end-2016. The planned growth is partly driven by the country's Power Development Plan 2010, and will allow the company to benefit from projected growth in electricity demand over the next 3-5 years, along with the likely robust domestic economy.

In addition, the company plans to diversify its geographical coverage and fuel mix through the capacity additions.

(2) LONG-TERM PPAs AND SECURE FUEL SUPPLY SUPPORT STABLE PERFORMANCE

RATCH's long term PPAs and secure fuel supply will remain the key credit strengths to its rating. The PPAs are robustly structured to limit fluctuations in both fuel costs and foreign exchange rates, as well as changes in demand and the company's debt servicing ability.

In particular, the unique characteristics embedded in the PPAs differentiate RATCH from other rated unregulated power companies, which usually have high exposure to wholesale price volatility

As for its fuel supply, the company has secured stable gas supplies to meet its obligations under the PPAs, through gas sales agreements with PTT Public Company Limited (Baa1 stable).

Currently, over 90% of RATCH's capacity is off-taken by EGAT under long term PPAs for 20-25 years. EGAT has a strong track record in meeting its PPA obligations. As a result, demand is assured and market competition is limited for RATCH's existing operations.

Moreover, under energy payment provisions, RATCH is insulated from fluctuations in fuel input prices, allowing the company to pass through any increases in fuel costs as long as RATCH's plants meet the agreed heat rates.

Majority of RATCH's EBITDA comes from availability payments, which cover the fixed operational and maintenance costs and debt services, plus an agreed return on equity. Availability payments are irrespective of the dispatch of electricity, as long as the power plants are available at the agreed capacity.

RATCH has a solid track record in maintaining high levels of availability; often exceeding plant-specific targets. It has also regularly met targeted heat rates, suggesting that the efficiency of its assets is in line with expectations.

As a result, RATCH's operations face limited volatility, as highlighted by its recurring EBITDA of between THB8 billion and THB10 billion over the past six years.

We estimate annual EBITDA including dividend income of around THB11 billion over 2014 - 2016.

However, we expect mild margin compression after the full consolidation of Tri Energy Co Ltd's (unrated) financials, given that Tri Energy's business exhibits lower margins, and the front-end loading nature of its PPAs. Nevertheless, the shortfall will be partially compensated by the increasing dividend income from the new joint ventures.

(3) CLOSE LINKS WITH EGAT RESULT IN EXPECTED PARENTAL SUPPORT

We expect RATCH will maintain its close links with EGAT, its single largest shareholder and the sole off-taker of RATCH's existing domestic capacity as well as its capacity for plants under construction in Laos.

By the same token, we believe EGAT has strong willingness to provide support to RATCH in times of need, given the strategic importance of RATCH to Thailand's power sector.

Importantly, EGAT also provides operating and maintenance services for most of RATCH's plants, and supports RATCH in environmental management. RATCH's power plants maintain high performance standard with minimal forced outages, under the strong operational support of EGAT.

Another indication of the close link between the two companies is the fact that seven of RATCH's fifteen board members, including its chairman and president, are EGAT representatives. A number of RATCH's key management officers have also previously worked for EGAT.

Moreover, the expected support from EGAT to RATCH in times of need, results in an one-notch uplift to RATCH's rating. During the Asian financial crisis of 1997-98, for instance, EGAT and the Thai government ensured the performance stability and debt servicing ability of IPPs by restructuring their PPAs to avoid huge foreign exchange loss.

EGAT also has a strong ability to provide support, given its solid financial profile.

(4) WEAKENING CREDIT METRICS OWING TO JV EXPOSURES AND SIZABLE CAPEX

RATCH's financial metrics -- incorporating the pro-rata shares from its JVs -- are expected to show a weakening trend over 2014-2016, due to the sizeable debt exposures at the JV level as well as the company's plans to develop offshore projects.

RATCH's financial profile -- excluding JV adjustments -- is sound, based on its stable cash flow from established operations and its deleveraging plan during 2012-13 after its acquisition of Transfield Services Infrastructure Fund.

However, the consolidated financial profile does not fully reflect the debt exposure of RATCH as a JV partner. RATCH's debt exposure at JVs was THB37.3 billion at end-2013 and which we estimate will increase to roughly THB58 billion by 2016. Of this total, around 60% will be attributed to the Hongsa project in Laos.

We included RATCH's JV debt in our assessment of its rating, even though the debt is non-recourse, to reflect RATCH's potential exposure as a JV partner, particularly in instances where a project is of strategic importance to the company.

In addition, the credit metrics of RATCH are pressured by their sizable capex plan, which is estimated to total THB10-THB20 billion over the next three years, with the majority being uncommitted capex for overseas expansion.

Capex will peak in 2015, as the construction of the Hongsa project nears completion. Also, the company is undergoing feasibility study for a coal fired power project in Myanmar. The project will start construction in 2015 or 2016, if the company decides to go ahead.

Consequently, we expect the company's credit metrics to weaken from levels seen in 2013. Projected funds from operations (FFO) interest coverage should range between 2.0x and 3.0x, and projected FFO/ net debt should stand at 10%-15%, compared to 4.4x and 22.3% in 2013.

Although the credit metrics are expected to improve modestly after 2016 when the Hongsa project starts to make meaningful earning contribution, the projected metrics are weak when compared to the company's peers, rated at the higher end of the Baa rating category.

(5) UNCERTAINTIES ASSOCIATED WITH EXPANSION STRATEGY OUTSIDE THAILAND

RATCH's plan to grow its overseas portfolio will provide diversification benefits, but the increased exposure, especially to developing countries such as Laos and Myanmar, will introduce uncertainties to its credit profile, including execution risks, higher levels of regulatory risk, and rising capital requirements.

We expect the company's business portfolio to exhibit greater geographical diversification by 2018, with 60% of its total capacity from plants in Thailand and 40% from overseas markets, versus the current 86% and 14%. Its Thai operations will continue to be the cornerstone of its business, providing stable cash flows to fund its growing overseas businesses.

However, RATCH's expansion will entail execution risks, including potential cost overruns or construction delays. It will also require large amounts of funding. Such risks are partly mitigated by the stable recurring cash flows from its operating plants.

In particular, Laos will take over Australia as the second largest market of RATCH in 2015, accounting for 15% of the total capacity.

However, the new projects in Laos are exposed to higher regulatory risk than is the case for projects in Thailand and Australia, as the political, regulatory and economic environment in Laos is less developed.

The Hongsa project in Laos is a particularly large project, with a total cost of USD3.7 billion, and in which RATCH holds a 40% ownership. The project involves the development of a large scale coal-fired plant with an integrated coal mine, a first for the company. The power plant is expected to commence operations in 2015.

The project is secured by EGAT's PPA of 25 years, under which, EGAT will offtake 90% of the total capacity and the remaining to be taken by local government.

The supply risk associated with the project will be well managed, as its coal mine is expected to have adequate lignite reserves to meet the power plant's consumption. In addition, execution risks will be somewhat mitigated by the company's partnership with Banpu Power (unrated), a company with extensive experience in the coal industry.

Although the Hongsa project does not have political risk insurance, the political risk of the project is partly alleviated by the terms and condition of the concession agreement. Any changes in the legal system in Laos that adversely affect the project company's operations and ability to service its liability will constitute as a Lao Political Force Majeure event. In such a case, the project company can terminate its contract and is entitled to compensation by the Government of Lao PDR under the concession agreements and the EGAT PPA.

The risk exposure to Laos and the large capex are further mitigated by the fact that RATCH has set up joint ventures with partners and local government. The construction contracts for the Hongsa plants have fixed prices that partly mitigate the risk of cost overruns. The majority of the payments and financing are in either USD or THB, thereby minimizing its forex risk.

Liquidity Profile

RATCH has an adequate liquidity profile. At end-2013, its cash sources comprised sizable cash holdings and short-term investments totaling THB9.4 billion.

We estimate that its operating cash flow and dividend income will total THB11-THB12 billion in 2014.

On the other hand, the company's projected cash outlays for 2014 include scheduled debt repayments of THB5.0 billion, short term debt totaling THB9.8 billion, committed capex of THB3.3 billion, as well as dividend payments.

As a result, there will be shortfall in cash sources of around THB900 million.

The shortfall can be covered by the company's uncommitted credit facilities totaling THB10 billion (at end-2013), and \$1 billion guaranteed medium term note program to be issued in 2Q2014. It has also demonstrated the ability to access the local debt and capital markets.

Rating Outlook

The stable rating outlook reflects our expectation that there will be no material adverse changes to the regulatory environment for Thailand's electricity market over the next 12-18 months. The stable outlook is also consistent with the rating of the sovereign, which is the 100% owner of EGAT, Ratch's parent.

What Could Change the Rating - Up

RATCH's financial metrics are expected to remain weak when compared to its peers positioned in the high end of the Baa rating category. Consequently, the possibility of a rating upgrade is remote in the near term.

Nevertheless, because its operations and credit profile are closely linked to those of EGAT and therefore to Thailand's sovereign rating, a sovereign upgrade could trigger a review of RATCH's rating.

What Could Change the Rating - Down

The rating could be downgraded if RATCH's credit strength deteriorates substantially due to aggressive debt-funded investments or material increase in its business risk profile due to overseas expansion. The key metrics that Moody's would consider for a downgrade include adjusted FFO/interest coverage falls below 2.5x and adjusted FFO/ net debt falls below 10%-15% on a sustained basis.

Such credit metrics are adjusted for joint-venture exposures.

In addition, a downgrade of Thailand's sovereign rating or a material reduction of EGAT's stake in the company would also be negative for RATCH's rating.

Other Considerations

(1) Structural subordination risk

RATCH generally finances its power projects at the subsidiary level. This funding arrangement is often used than holdco debt mainly because the subsidiaries with direct holding of power plant/ project are capable to arrange financing of their own.

At end-2013, the ratio of subsidiary debt to total assets was 23%, which was higher than the 15% threshold set for notching due to structural subordination. We expect the ratio to remain in excess of 15% over the next three years.

(2) Mapping to Moody's Unregulated Utilities and Power Companies Methodology

We applied the Regulated Electric and Gas Utilities methodology in the credit assessment of RATCH prior to the affirmation of the company's Baa1 corporate family rating and stable rating outlook on 22 April 2014. The principal methodology was changed to the Unregulated Utilities and Power Companies methodology due to the update of the former methodology with a more specific definition on regulated generation companies. RATCH's business profile is more akin to an unregulated power company, given its business is governed by power purchase agreements under bilateral negotiation with off-taker.

RATCH maps to Baa2 under the methodology, according to the projected credit metrics with pro-rata JV adjustments in 2014-16. The difference between the indicated grid outcome and the corporate family rating is

explained by RATCH's: (1) robust PPA structure, with EGAT as a strong offtaker; and (2) close linkage with EGAT and therefore our expectation of parental support to RATCH from EGAT.

Rating Factors

Ratchaburi Electricity Generating Holding PCL

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Power Companies [1][2]	Aaa	Aa	A	Baa	Ba	B
Factor 1: Market Assessment, Scale and Competitive Position (20%)						
a) Market and Competitive Position		X				
b) Geographic Diversity					X	
Factor 2: Cash Flow Predictability of Business Model (20%)						
a) Effectiveness of Hedging Strategy		X				
b) Fuel Strategy and Mix						X
c) Capital Requirements & Operational Performance		X				
Factor 3: Financial Policy (10%)						
a) Financial Policy				X		
Factor 4: Financial Strength Metrics (50%)						
a) (CFO Pre-W/C + Interest) / Interest Expense (3 year Avg)					X	
b) (CFO Pre-W/C) / Net Debt (3 year Avg)					X	
c) RCF / Net Debt (3 year Avg)						X
d) FCF / Net Debt (3 year Avg)					X	
Rating:						
a) Indicated Rating from Grid				Baa2		
b) Actual Rating Assigned				Baa1		

[1] All ratios are based on 'Adjusted' financial data and incorporate Moody's Global Standard Adjustments for Non-Financial Corporations and include pro-rata share of JV financials [2] As of 12/31/2013; Source: Moody's Financial Metrics TM

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