

TMT STEEL PLC

No. 177/2020
26 October 2020

CORPORATES

Company Rating:	BBB
Outlook:	Stable

Last Review Date: 06/11/19

Company Rating History:

Date	Rating	Outlook/Alert
15/02/18	BBB	Stable

RATIONALE

TRIS Rating affirms the company rating on TMT Steel PLC (TMT) at "BBB" with a "stable" outlook. The rating reflects TMT's leading market position in the downstream steel industry, broad product offerings, diverse customer base, and stronger profitability than its peers. However, the rating is constrained by the cyclical nature and price competition in the steel industry as well as volatile margin.

KEY RATING CONSIDERATIONS

Leading steel supplier

TMT's rating continues to reflect its market position as the leading steel solution provider in Thailand. By revenue, TMT is the largest company among listed peers in the downstream steel industry. Its competitive advantages are underpinned by its comparatively large scale of operation and its effective supply chain management. TMT has successively expanded its production capacity over the past several years, aiming at widening its customer base and diversifying its product mix. The expansion includes a new factory for steel pipe production as well as enlarged warehouse space.

The company has successfully differentiated itself from majority of steel traders by offering technical and consultation services that help customers achieve better operational efficiency. Through this business strategy, the company's sales volumes have grown continuously over several years, outpacing the flat industry growth rate. The company's sales volumes elevated to a peak of 0.78 million tons in 2019, an average growth of 8.2% per annum, from approximately 0.57 million tons in 2015.

Broad product offerings and diverse customer base

The assigned credit rating takes into consideration the company's broad range of product offerings that cover flat and long steel products as well as tailor-made products. The company positions itself as a one-stop steel supplier to capture demand in multiple market segments.

We believe that the company's wide coverage across diverse market segments will help alleviate the effect of volatility in steel demand. TMT's customers include wholesalers, construction contractors, steel fabricators, as well as automotive and industrial-part manufacturers. However, the company's revenue tends to increasingly link with construction-related segments, assessed from the rapid growth of sales volume of structural steel tubes. TMT's production capacity of structural steel pipes has expanded over several years with an aim to enlarge its customer base in the construction sector.

Stronger profitability than peers

TMT has continued a streak of profits over the last several years. Despite the fluctuation, its profit margin has been higher than most of its peers listed on The Stock Exchange of Thailand (SET). Some competitors have experienced losses and seen greater earnings volatility.

We see TMT's stronger profitability is derived from the added value TMT gains from consulting services and its ability to manage the effects of price fluctuations of hot rolled coil (HRC), a key raw material. TMT has also placed emphasis on efficient cost management and fast inventory turnover in efforts to stabilize its profit margin.



Exposure to highly cyclical industry and price competition

Steel demand can be changed rapidly as it is closely linked to the construction and manufacturing industries, which are in turn sensitive to changes in economic conditions. During 2015-2019, the growth rate of domestic steel consumption experienced wide swings, in the range of -14% to 15% per year. The average growth was 1.7% a year.

The Coronavirus Disease 2019 (COVID-19) pandemic has led to sharp declines in domestic demand particularly in the construction and automotive sectors. During the lockdown period, construction projects were delayed while automakers were forced to shut down productions. For the first eight months of 2020, domestic consumption of steel fell by 14% year-on-year (y-o-y).

TMT's credit profile is constrained by price competition, given the commodity nature of steel products and threats of imported steels from China. However, the current price competition in the domestic steel market lessens due to the improving demand-supply balance. TMT's profitability also demonstrated its recovery as earnings before interest, taxes, depreciation, and amortization (EBITDA) margin rose from 3.6% in 2019 to 6% in the first six-months of 2020.

Volatile margins

TRIS Rating views that TMT's performance is susceptible to the volatility raw material costs although its operational record has shown that the company is less vulnerable to fluctuations of HRC price than other companies. Precipitous increases or drops in HRC price would significantly impact the company's earnings. During 2015-2019, the fluctuation of TMT's EBITDA was depicted by a rise from THB0.63 billion in 2015 to a peak of THB1.35 billion in 2016, before dropping to THB0.6 billion in 2019. Its EBITDA margin also swung widely in the range 3.6%-10.9%.

Financial profile expected to improve

We forecast TMT's financial leverage will return to a moderate level and be commensurate with the assigned rating. The ongoing fall in steel prices has significantly benefited the company, by greatly reducing the need for working capital. The company's adjusted net debts fell to THB3.8 billion in 2019 and about THB3.5 billion as of June 2020, from THB4.4 billion in 2018. We do not expect significant capital spending. As a result, the company's outstanding debt should not increase substantially over the next three years. We expect the company's debt to capitalization ratio to stay about 55%.

We view TMT to be impacted moderately by the demand contraction from the COVID-19 spread. At the current running rate, we project the company's sales volume to drop by only about 5% in 2020, which is comparatively better than the overall market. Given the recovering construction activities, we expect sales to improve each year starting from 2021. In our base case, we project TMT to arrive at revenue of about THB14 billion in 2020, before increasing to THB15-THB17 billion in the following years.

The EBITDA margin is likely to recover gradually with reviving demand. We forecast EBITDA to be THB0.8-THB1.1 billion a year, and the ratio of net debt to EBITDA to decline to 3-4 times during 2020-2022, from 6.3 times in 2019.

Adequate liquidity

We assess TMT to have adequate liquidity over the next 12 months. The company's sources of funds, including estimated funds from operations (FFO) of THB0.8 billion, cash of THB0.19 billion as of June 2020, and available banking facilities of THB7 billion, are sufficient to address cash outflows totaling THB0.5-THB0.75 billion from its capital spending and expected dividend payments. The bond payment due in April 2021 is expected to be refinanced.

TMT continues to comply with the financial covenant on its outstanding bond. Its net interest-bearing debt (IBD) to equity ratio was about 1.19 times in June 2020, against the ceiling of 2 times.

BASE-CASE ASSUMPTIONS

- Sales volume to drop around 5% in 2020 before restoring by around 4%-7% per year in 2021-2022.
- EBITDA margin to return to the average of 6%-7%.
- Total capital expenditures of about THB0.83 billion during 2020-2022.
- Dividend payout ratio of 90%.

RATING OUTLOOK

The "stable" outlook embeds our expectation that TMT will maintain its market position and stronger-than-peer profitability. We also believe TMT will maintain its prudent management of working capital and continue its disciplined approach in pricing its products.

RATING SENSITIVITIES

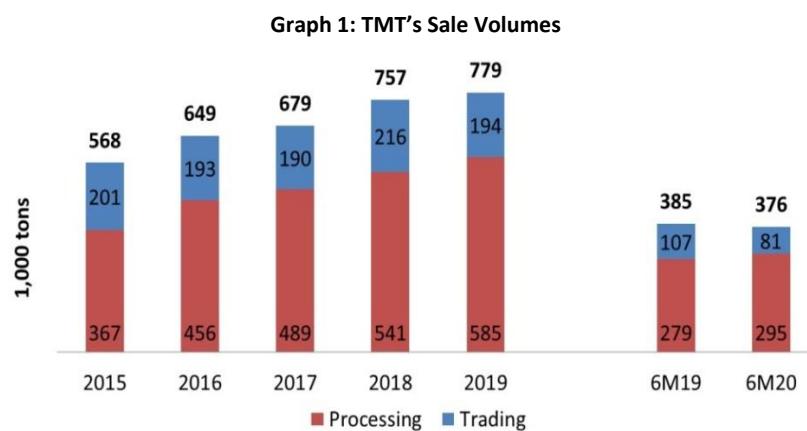
The rating or outlook may be revised upward if the company's business scale improves or if the company's cash flow base materially enlarges from the current level on a sustained basis. The rating or outlook could be revised downward if TMT's operating performance falls short of estimates that materially heightens the ratio of net debt to EBITDA. Downward pressure on the rating could also occur from heavy debt-funded investments or persistently sluggish domestic demand over a long period.

COMPANY OVERVIEW

TMT is a steel solution provider in Thailand. The company's business engages in steel trading, processing, and consulting services. The company was established in 1992 and listed on the SET in 2005. The Tarasansombat family, the founding shareholder, owned a majority of TMT's stake of about 68.8% as of June 2020. The main factory and warehouse are in Ayutthaya province and the company also has a distribution center in Bangkok. TMT's production capacity has expanded continuously to 766,800 tons per annum as of June 2020 from 390,000 tons per annum in 2013. The company primarily offers flat steel products processed from HRC, such as hot rolled sheets, round tubes, and rectangular tubes. The company also sources long steel products such as I-beams, H-beams, and steel bars for customers.

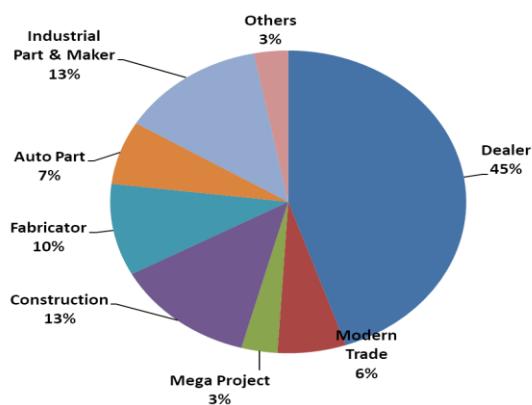
TMT's annual revenue has hovered between THB12-THB17 billion over the past five years, after the company implemented customer-centric strategies, which have resonated with customers. Sales volume was 779,000 tons in 2019. The proportion of steel processing to steel trading was about 75:25.

KEY OPERATING PERFORMANCE



Source: TMT

Graph 2: Sale Volumes Breakdown by Customers*



Source: TMT

* For the first six months of 2020

FINANCIAL STATISTICS AND KEY FINANCIAL RATIOS*

Unit: Mil. THB

	Jan-Jun 2020	Year Ended 31 December			
		2019	2018	2017	2016
Total operating revenues	7,106	16,527	17,418	14,374	12,519
Earnings before interest and taxes (EBIT)	286	392	562	862	1,187
Earnings before interest, taxes, depreciation, and amortization (EBITDA)	424	603	757	1,040	1,358
Funds from operations (FFO)	346	441	601	818	1,083
Adjusted interest expense	44	119	105	67	51
Capital expenditures	65	350	701	473	584
Total assets	6,826	7,149	7,706	7,065	6,079
Adjusted debt	3,456	3,813	4,398	3,612	2,740
Adjusted equity	2,852	2,905	2,704	2,821	2,833
Adjusted Ratios					
EBITDA margin (%)	6.0	3.6	4.3	7.2	10.9
Pretax return on permanent capital (%)	5.7 **	5.5	8.1	14.0	23.4
EBITDA interest coverage (times)	9.6	5.1	7.2	15.6	26.7
Debt to EBITDA (times)	5.3 **	6.3	5.8	3.5	2.0
FFO to debt (%)	14.7 **	11.6	13.7	22.7	39.5
Debt to capitalization (%)	54.8	56.8	61.9	56.1	49.2

* Consolidated financial statements

** Annualized from trailing 12 months

RELATED CRITERIA

- Rating Methodology – Corporate, 26 July 2019
- Key Financial Ratios and Adjustments, 5 September 2018

TMT Steel PLC (TMT)**Company Rating:**

BBB

Rating Outlook:

Stable

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