

EASTERN WATER RESOURCES DEVELOPMENT AND MANAGEMENT PLC

No. 37/2013

17 May 2013

Company Rating: A+

Outlook: Stable

New Issue Rating: -

Rating History:

Date	Company	Issue (Secured/Unsecured)
23/01/08	A+/Sta	-
11/10/07	A+/Alert Dev	-
20/09/07	A+/Alert Dev	-/A+
12/07/04	A+/Sta	-/A+
29/06/04	A+	-/A+

Rating Rationale

TRIS Rating affirms the company rating of Eastern Water Resources Development and Management PLC (EASTW) at “A+”. The rating reflects EASTW’s strengths as the sole raw water provider with a comprehensive pipeline network in the Eastern Seaboard area, high barriers to entry, and low operating risk. The company’s reliable stream of cash flows and strong financial profile also support its credit rating. However, EASTW’s strengths are partially constrained by the large capital investment requirements needed to maintain and expand its business, the unpredictable effects of climate change, and customer concentration risk. In addition, EASTW faces uncertainty surrounding water resource management regulations, which are set by government agencies. This raises a concern over the company’s future ability to service growing demand for raw water.

Established in 1992 following a Cabinet resolution, EASTW was given a mandate to be responsible for the development and management of raw water distribution systems in seven provinces in the Eastern Seaboard. Currently, the raw water provision services offered by EASTW focus on Chonburi, Rayong, and Chachoengsao provinces, as the commercial activities and communities in these areas continue to expand. In addition, the company also provides tap water in 11 service areas. As of December 2012, the major shareholders of the company were the Provincial Waterworks Authority (PWA; 40.2%), The Electricity Generating PLC (EGCO; 18.7%), Norbax Inc., 13 (9.6%), and the Industrial Estate Authority of Thailand (IEAT; 4.6%).

The company’s business fundamentals have remained strong as raw water demand on the Eastern Seaboard has grown consistently. In 2012, EASTW’s total revenue was Bt3,677 million, a 13% increase from the previous year. Raw water sales accounted for 71% of total revenue, while tap water services represented 23% of the total. Revenue from raw water sales was Bt2,612 million in 2012, up by 15.5% from a year earlier. The supportive factors were the continuing growth of industrial activities in the East and increasing demand from consumer groups. Despite steady growth in consumption, raw water demand is quite susceptible to economic conditions. For example, in 2009, raw water sales declined in tandem with an economic downturn. The tap water segment has also grown continuously. In 2012, the revenue from the tap water segment was Bt844 million, or a 9.9% year-on-year (y-o-y) rise. However, EASTW is exposed to customer concentration risk as sales to PWA and IEAT, the major shareholders and key customers, comprised 65%-70% of its total annual sales during the last five years. In addition, PWA had bargaining power when negotiating the raw water tariff. For example, during 2008-2011, EASTW provided some discounts to its domestic consumption customers, including the PWA.

The company has initially leased and operated four water pipeline networks previously overseen by the Ministry of Finance (MOF). EASTW continues to develop

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its distribution network so that it can connect all its service areas. Although water distribution does not require complicated technology, it does require a significant amount of capital to create extensive networks. The distribution networks pose a significant barrier to entry. A fully connected network also enhances EASTW’s ability to efficiently extract and manage water taken from various sources, so as to supply its clients in all service areas. Because of the capital intensive nature of the business and EASTW’s network coverage, EASTW is unlikely to face a threat from any large competitor in the raw water segment during the foreseeable future. One major threat in the raw water segment is the sourcing of the water supplies. Climate change could affect the volume of rainfall and thus the level of water accumulated in reservoirs. In order to cope with increasing demand, EASTW has to continue to find new raw water sources. The new sources are often located farther from EASTW’s service areas. Therefore, EASTW is likely to incur higher costs for its water supply in the future. Moreover, the additional volume of water supply is subject to approval by the Royal Irrigation Department (RID). The RID typically gives priority to the provision of water to the agricultural sector.

To secure its sources of water for the next five years, EASTW has invested in the Tab-Ma Pond project in Rayong. This project carries a total cost of Bt2,728 million. The first phase of the project is expected to finish in 2015. The first phase will add 32.5 million cubic meters (mcm) of new capacity, increasing to 55 mcm once the project is complete in 2017. In addition, the company plans to lay a pipeline to extract water from the Prasae reservoir to Nong Pla Lai reservoir. The Prasea-Nong Pla Lai pipeline project is scheduled to start in the second half of 2013. The new pipeline will be finished in 2014, at a total cost of Bt2,850 million. In the tap water segment, although demand has grown steadily, the prospects for expansion are modest since the PWA does not seem inclined to grant any new concessions or outsource its operations.

EASTW’s financial strength is supported by its solid operating record and reliable sources of income. The company’s operating margin before depreciation and amortization was high at 54%-56% during the past four years. Funds from operations (FFO) increased by 9.6% y-o-y in 2012 to Bt1,500 million. However, EASTW’s debt level also increased in 2012, jumping from Bt2,984 million in 2011 to Bt4,307 million in 2012. The sharp rise in debt was mainly due to the investment in the Tab-Ma Pond project and the Bangphra project to improve system capacity. Leverage is projected to increase further, given the planned capital expenditures of more than Bt6,000 million over the next two years. EASTW’s cash flow protection and liquidity profile are expected to weaken during the next few years, owing to both sizable investment and its dividend payout policy. The company is likely to continue its annual dividend payment. EASTW’s operating stability can bear a weaker balance sheet when it invests in the planned expansion projects. EASTW’s financial profile is expected to strengthen after the projects are complete.

Rating Outlook

The “stable” outlook reflects the expectation that EASTW will sustain its resilient operation and reliable streams of cash. TRIS Rating also expects the company to expand through the conservative use of leverage, while maintaining its well-disciplined monitoring. These efforts will help EASTW maintain its credit quality.

Eastern Water Resources Development and Management PLC (EASTW)

Company Rating:	A+
Rating Outlook:	Stable

Financial Statistics and Key Financial Ratios*

Unit: Bt million

	Year Ended 31 December					
	2012 **	2011 **	2010 **	2009 **	2008	2007
Total sales	3,677	3,250	3,066	2,826	2,379	2,401
Gross interest expense	150	114	90	120	174	253
Net income from operations	1,240	1,008	912	807	568	449
Funds from operations (FFO)	1,500	1,368	1,286	1,085	923	791
Total capital expenditures	1,620	1,176	1,315	394	375	789
Total assets	12,440	10,784	9,885	9,148	9,331	9,822
Total debt	4,307	2,984	2,564	2,289	2,936	4,535
Shareholders' equity	7,317	6,933	6,585	6,341	5,974	4,667
Operating income before depreciation and amortization as % of sales	54.38	55.61	54.92	54.94	50.37	43.36
Pretax return on permanent capital (%)	15.73	15.85	15.53	14.25	9.69	8.42
Earnings before interest, tax, depreciation, and amortization (EBITDA) interest coverage (times)	13.63	16.45	19.88	13.22	7.01	4.22
FFO/total debt (%)	34.81	45.84	50.15	47.40	31.43	17.43
Total debt/capitalization (%)	37.04	30.08	28.01	26.51	32.94	49.06

* Consolidated financial statements

** Starting from October 2009, EASTW has changed the accounting period from October-September to January-December.

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