

# EASTERN WATER RESOURCES DEVELOPMENT AND MANAGEMENT PLC

No. 50/2014

30 June 2014

**Company Rating:** A+

**Outlook:** Stable

**Company Rating History:**

| Date     | Rating | Outlook/Alert |
|----------|--------|---------------|
| 23/01/08 | A+     | Sta           |
| 20/09/07 | A+     | Alert Dev     |
| 12/07/04 | A+     | Sta           |
| 29/06/04 | A+     | -             |

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**Rating Rationale**

TRIS Rating affirms the company rating of Eastern Water Resources Development and Management PLC (EASTW) at "A+". The rating reflects EASTW's strength as the sole raw water provider with a comprehensive pipeline network in the Eastern Seaboard area, high barriers to entry, and its low operating risk. The company's strong financial profile and reliable cash flows also support its credit rating. However, EASTW's strengths are partially offset by the large capital investment requirements needed to maintain and expand its business, the unpredictable effects of climate change, and customer concentration risk. The rating also takes into consideration the uncertainty surrounding water resource management regulations. The regulations are set by government agencies and could impact EASTW's ability to meet the growing demand for raw water in the future.

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, EASTW provides raw water in Chonburi, Rayong, and Chachoengsao provinces, as the commercial activities and communities in these areas have continued to expand. EASTW also provides tap water in 11 service areas. As of April 2014, the major shareholders of the company were the Provincial Waterworks Authority (PWA; owing a 40.2% stake), The Electricity Generating PLC (EGCO; 18.7%), Norbax Inc., 13 (8%), and the Industrial Estate Authority of Thailand (IEAT; 4.6%). In 2013, EASTW's total revenue was Bt3,760 million, a 2.3% increase from the previous year. Raw water sales accounted for 71% of total revenue, while tap water services represented 23% of the total.

EASTW's strong business profile is supported by its status as the sole raw water provider in the Eastern Seaboard and its low operating risk. The company leases and operates four water pipeline networks previously overseen by the Ministry of Finance (MOF). EASTW has continued to develop 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 an extensive network. 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 to supply its clients in all its service areas. Because of the capital intensive nature of the business and the coverage of its own distribution network, 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's water supply is likely to cost more 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. EASTW is exposed to customer concentration risk as sales to the PWA and the IEAT, two major

shareholders and two key customers, comprised 65%-70% of its total annual sales during the last five years. In addition, the PWA is able to negotiate the raw water tariff. For example, during 2008-2011, EASTW provided discounts to some of its consumption group customers, including the PWA. In November and December 2013, EASTW discounted the raw water tariff to this customer group from Bt10.5 per cubic meter (cu.m.) to Bt9.4 per cu.m.

In the past, demand for raw water has shown a gradual growth, supported mainly by industrial activity in the East and rising consumption by households. However, growth is susceptible to economic conditions. In 2013, EASTW's raw water sales volume decreased by 2.5% due to the economic slowdown. Industrial activity has slowed since the third quarter of 2013. The high volume of rainfall in the fourth quarter of 2013 cut demand for raw water, as some customers were able to use their own water resources. In addition, some local waterworks are able to source raw water directly. The average raw water tariff increased by 5.7% in 2013 to Bt10.49 per cu.m. As a result, raw water sales grew by 3.1% in 2013 to Bt2,694 million. The unfavorable momentum continued in the first quarter of 2014. Raw water sales volume dropped by 3.5% year-on-year (y-o-y). Revenue from raw water sales decreased by 3% y-o-y to Bt691 million despite a 2.3% increase in the average raw water tariff. Demand for raw water, especially from industrial users, is expected to recover in the second half of the year after the political tension has eased and the economic sentiment continues to improve.

In contrast, the tap water segment has grown steadily. Revenue from the tap water segment grew by 4.1% y-o-y to Bt876 million in 2013 and by 4.9% y-o-y in the first quarter of 2014 to Bt227 million. Although demand for tap water has grown steadily, the prospects for expansion are modest since the PWA is not inclined to grant any new concessions or outsource its operations. EASTW has to seek opportunities to expand by contacting directly with municipalities which are able to grant tap water services concessions. EASTW is exploring investment opportunities in the tap water business in some of the country members of the Association of South East Asian Nations (ASEAN).

EASTW's financial strength is supported by its proven operating performance and the reliability of its cash flows. The operating margin before depreciation and amortization stayed above 54% during the past five years. Its financial profile remains strong, despite a considerable rise in debt during the past two years due to its investment to improve raw water distribution system capacity and to secure its water supply sourcing. At the end of March 2014, the ratio of debt to capitalization was 35.5%. Liquidity remains sound. The ratio of funds from operations (FFO) to total debt was 37.2% (annualized, from the trailing 12 months) in the first quarter of 2014.

Under TRIS Rating's base case scenario, EASTW's leverage is expected to increase over the next three years. EASTW plans capital expenditures of more than Bt4,000 million during the next three years. The bulk of the capital expenditures will go to support its water supply sources namely the Tab-Ma Pond project and the Prasae-Nong Pla Lai pipeline project. The ratio of debt to capitalization is expected to stay over 45% over the next three years. The ratio may be higher if EASTW invests in any tap water projects abroad. TRIS Rating expects that the company will be able to maintain its reliability streams of cash. The company is expected to generate FFO of at least Bt1,500 million annually over the next three years in order to meet its financial obligations and pay dividends. EASTW's financial profile is expected to strengthen after the projects are complete.

#### Rating Outlook

The "stable" outlook reflects the expectation that EASTW's operation will remain resilient and continue to generate reliable streams of cash. TRIS Rating also expects the company to expand through the conservative use of leverage and maintain its well-disciplined monitoring so as to sustain its credit quality.

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### Eastern Water Resources Development and Management PLC (EASTW)

**Company Rating:**

A+

**Rating Outlook:**

Stable

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### Financial Statistics and Key Financial Ratios\*

Unit: Bt million

|  | Jan-Mar<br>2014 | ----- Year Ended 31 December ----- |        |        |       |       |
|--|-----------------|------------------------------------|--------|--------|-------|-------|
|  |                 | 2013                               | 2012   | 2011   | 2010  | 2009  |
| Total sales  | 973             | 3,760                              | 3,677  | 3,250  | 3,066 | 2,826 |
| Gross interest expense   | 51              | 189                                | 150    | 114    | 90    | 120   |
| Net income from operations   | 372             | 1,316                              | 1,240  | 1,008  | 912   | 807   |
| Funds from operations (FFO)  | 552             | 1,680                              | 1,500  | 1,368  | 1,286 | 1,085 |
| Total capital expenditures   | 509             | 1,148                              | 1,620  | 1,176  | 1,315 | 394   |
| Total assets   | 13,678          | 13,485                             | 12,440 | 10,784 | 9,885 | 9,148 |
| Total debt   | 4,570           | 4,567                              | 4,307  | 2,984  | 2,564 | 2,289 |
| Shareholders' equity including minority interest   | 8,272           | 7,927                              | 7,320  | 6,936  | 6,588 | 6,344 |
| Operating income before depreciation and amortization as % of sales                              | 60.43           | 56.52                              | 54.38  | 55.61  | 54.92 | 54.94 |
| Pretax return on permanent capital (%)   | 14.26 **        | 14.76                              | 15.73  | 15.85  | 15.53 | 14.25 |
| Earnings before interest, tax, depreciation, and amortization (EBITDA) interest coverage (times) | 11.61           | 11.53                              | 13.63  | 16.45  | 19.88 | 13.22 |
| FFO/total debt (%)   | 37.22 **        | 36.80                              | 34.81  | 45.84  | 50.15 | 47.40 |
| Total debt/capitalization (%)  | 35.59           | 36.55                              | 37.04  | 30.08  | 28.01 | 26.51 |

\* Consolidated financial statements

\*\* Annualized, from the trailing 12 months

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