

EASTERN WATER RESOURCES DEVELOPMENT AND MANAGEMENT PLC

No. 30/2015

21 April 2015

Company Rating: A+

Outlook: Stable

Company Rating History:

Date	Rating	Outlook/Alert
23/01/08	A+	Stable
20/09/07	A+	Alert Developing
12/07/04	A+	Stable
29/06/04	A+	-

Contacts:

Chanaporn Pinphithak
chanaporn@trisrating.com

Pramuansap Phonprasert
pramuansap@trisrating.com

Parat Mahuttano
parat@trisrating.com

Rungtip Charoenvisuthiwong
rungtip@trisrating.com

WWW.TRISRATING.COM

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, its low operating risk, and the high barriers to entry. The company’s reliable cash flows also support its credit rating. However, EASTW’s strengths are partially offset by the large capital investment requirements needed to source additional raw water supplies, the unpredictable effects of climate change, and customer concentration risk. The rating also takes into consideration the uncertainty surrounding water resource management regulations that could affect EASTW’s operations.

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 residential communities in these areas have continued to expand. EASTW also provides tap water services in 10 service areas with a total production capacity of 308,460 cubic meters (cu.m.) per day. As of March 2015, the major shareholders of the company were the Provincial Waterworks Authority (PWA; owning a 40.2% stake), The Electricity Generating PLC (EGCO; 18.7%), Norbax Inc., 13 (6.9%), and the Industrial Estate Authority of Thailand (IEAT; 4.6%). In 2014, raw water sales accounted for 65% 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 and regulatory approvals 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 the water it takes 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, raising the cost of EASTW’s water supply. Moreover, the additional volumes of water supply are subject to the approval from 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 and gets discounts from EASTW.

In general, the factors that drive demand for raw water are industrial activities in the East and rising consumption by households which are susceptible to economic conditions. High levels of rainfall and the ability of some of EASTW's customers to source raw water directly also affect the demand. In 2014, EASTW sold 257 million cu.m. of raw water. The volume sold in 2014 was just about the same as in 2013. Despite a 3% increase in the volume sold to industrial users, the volume of raw water sold to the consumer group dropped by 7.5% in 2014 as PWA was able to source raw water itself. If the PWA continues to increase its ability to source raw water, raw water sales volume of EASTW will be affected and limit growth prospects of its raw water sales. However, due to a 2.6% increase in average raw water tariff to Bt10.77 per cu.m. in 2014, EASTW reported raw water sales of Bt2,768 million, a 2.75% increase from a year earlier.

In contrast, the tap water segment has grown continuously. Revenue from the tap water segment grew by 12.8% y-o-y to Bt989 million in 2014. 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 get a contact directly from municipalities which are responsible for providing tap water services in their localities.

EASTW's financial strength is supported by its proven operating performance and the reliability of its cash flows. In 2014, the company reported revenue of Bt4,242 million. The revenue included Bt269 million of revenue from construction under concession agreements which was also charged as cost of goods sold. Excluding this item, EASTW's revenue from normal operation would grow by 5.7% from a year earlier. The operating margin (operating profit before depreciation and amortization, as a percentage of sales), excluding the extra item, has stayed above 54% during the past five years.

EASTW's 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. The main projects invested are the Tab-Ma pond project and the Prasae-Nong Pla Lai pipeline project. At the end of 2014, EASTW's total debt increased to Bt5,450 million. However, the ratio of debt to capitalization remained fair at 39.02%. Liquidity remained sound. The ratio of funds from operations (FFO) to total debt was 31.58% while the earnings before interest, tax, depreciation and amortization (EBITDA) interest coverage ratio stood at 10.18 times.

Under TRIS Rating's base case scenario, during 2015-2017, EASTW's operating margin will stay above 54% and it will generate reliable streams of cash. EASTW's FFO is expected to be at least Bt1,700 million annually. The cash flow will be used to service its financial obligations of Bt800-Bt1,000 million per annum during 2016-2017 and serve the continuous dividend payment policy.

EASTW plans capital expenditures of approximately Bt2,500 million in 2015 and Bt1,300 million in 2016 mainly for the continuous projects of Tab-Ma pond and the Prasae-Nong Pla Lai pipeline. As these amounts of investment will be funded primarily with new debts, EASTW's debt to capitalization ratio is expected to stay over 40% over the next three years. EASTW's financial profile is expected to strengthen after the projects are complete.

Rating Outlook

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

EASTW's credit upside is alleviated over the next 12 months because the company is making substantial investments which resulted in weakened capital structure and cash flow protection. EASTW's downside risk may be materialized if its operating cash flow is negatively affected by a significant drop in raw water sales volume or a large increase in the cost of raw water. In addition, an aggressive use of debt-funded investments could reduce EASTW's 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 -----				
	2014	2013	2012	2011	2010
Total sales	4,242	3,900	3,677	3,250	3,066
Gross interest expense	224	191	150	114	90
Net income from operations	1,334	1,312	1,240	1,008	912
Funds from operations (FFO)	1,721	1,629	1,500	1,368	1,286
Total capital expenditures	2,097	1,140	1,620	1,176	1,315
Total assets	15,243	13,480	12,440	10,784	9,885
Total debt	5,450	4,567	4,307	2,984	2,564
Shareholders' equity including minority interest	8,517	7,902	7,320	6,936	6,588
Operating income before depreciation and amortization as % of sales	52.40	54.66	54.38	55.61	54.92
Pretax return on permanent capital (%)	13.58	14.76	15.73	15.85	15.53
Earnings before interest, tax, depreciation, and amortization (EBITDA) interest coverage (times)	10.18	11.43	13.63	16.45	19.88
FFO/total debt (%)	31.58	35.67	34.81	45.84	50.15
Total debt/capitalization (%)	39.02	36.63	37.04	30.08	28.01

* Consolidated financial statements

TRIS Rating Co., Ltd.

Tel: 0-2231-3011 ext 500 / Silom Complex Building, 24th Floor, 191 Silom Road, Bangkok 10500, Thailand www.trisrating.com

© Copyright 2015, TRIS Rating Co., Ltd. All rights reserved. Any unauthorized use, disclosure, copying, republication, further transmission, dissemination, redistribution or storing for subsequent use for any purpose, in whole or in part, in any form or manner or by any means whatsoever, by any person, of the credit rating reports or information is prohibited. The credit rating is not a statement of fact or a recommendation to buy, sell or hold any debt instruments. It is an expression of opinion regarding credit risks for that instrument or particular company. The opinion expressed in the credit rating does not represent investment or other advice and should therefore not be construed as such. Any rating and information contained in any report written or published by TRIS Rating has been prepared without taking into account any recipient's particular financial needs, circumstances, knowledge and objectives. Therefore, a recipient should assess the appropriateness of such information before making an investment decision based on this information. Information used for the rating has been obtained by TRIS Rating from the company and other sources believed to be reliable. Therefore, TRIS Rating does not guarantee the accuracy, adequacy, or completeness of any such information and will accept no liability for any loss or damage arising from any inaccuracy, inadequacy or incompleteness. Also, TRIS Rating is not responsible for any errors or omissions, the result obtained from, or any actions taken in reliance upon such information. All methodologies used can be found at <http://www.trisrating.com/en/rating-information/rating-criteria.html>.