KCE Electronics Public Company Limited (/gws/en/esp/issr/96494795)

FitchRatings

Fitch Assigns First-Time 'A-(tha)' Rating to Thailand's KCE

Fitch Ratings-Bangkok-09 April 2017: Fitch Ratings (Thailand) Limited has assigned KCE Electronics Public Company Limited (KCE) a first-time National Long-Term Rating of 'A-(tha)'. The Outlook is Stable.

KEY RATING DRIVERS

High-Margin Auto PCBs: KCE focuses on the expanding automotive printed circuit board (PCB) segment, which offers higher margins and barriers to entry than PCBs for consumer electronics products. This has helped KCE boost its operations and business profile over the past few years, notwithstanding the challenging global operating environment.

Leading Position in Auto PCBs: KCE is one of the world's top-ten automotive PCB operators by revenue. Its revenue has increased strongly over the previous few years, exceeding overall industry growth. The company also has a strong profit margin, supported by a competitive cost structure from an efficient manufacturing process and Thailand's low labour costs.

Expansion Opportunities: KCE benefits from long-term growth prospects in the automotive PCB market. This is supported by positive global vehicle production growth, particularly in electric vehicles, and more automobile electronic content. KCE's revenue increased at compound annual growth rate of 14%, to THB13.8 billion, over the three years to end-2016, from THB9.3 billion in 2013.Its funds flow from operations (FFO) also increased strongly to THB4.0 billion in 2016, from THB1.6 billion in 2013.

Strong Financial Profile: Fitch expects that, in spite of high capex, KCE should continue to generate strong cash flow and maintain moderate financial leverage in the medium term. Its strong FFO of around THB3.7 billion-4.4 billion per annum over the next three years should cover capex and dividend payments, leading to positive free cash flow (FCF). Fitch forecasts KCE's FFO-adjusted net leverage to remain below 1.0x over the next three years (2016: 0.9x).

Copper Price Exposure: KCE is exposed to changes in raw material costs, particularly copper, which accounted for around 8% of cost of goods sold in 2016. Fitch estimates that every 10% increase in copper cost above the company's expectation could narrow KCE's EBITDA margin by around 80bp. Fitch expects the copper price to increase in 2017 and for KCE's EBITDA margin to weaken to around 28% (2016: 29%) as a result. This is despite the ongoing benefit from a continued improvement in efficiency and economy of scale of new facilities. Prices are agreed with customers annually, allowing KCE to propose price rises at the next negotiation round if the medium-term outlook for copper prices increases. However, the extent to which it can pass on higher copper costs is down to the market-power dynamics between it and its customers.

Concentration; Foreign-Exchange Risks: KCE has a concentrated customer mix and faces ongoing price competition and technology risks associated with the electronics segment. In addition, the appreciation of the Thai baht against the US dollar during the manufacturing cycle could lower baht revenue.

DERIVATION SUMMARY

KCE's business profile is supported by its focus on the expanding automotive PCB segment, which offers better margins and higher barriers to entry than the PCB for consumer electronic products. Nevertheless, the sector's risk profile is above average. KCE operates in the component electronics industry with a similar risk profile to SVI Public Company Limited (BBB+(tha)/Stable). Both focus on the niche segment of their respective industries and benefit from the lower competition and demand volatility, helping stabilise revenue and earnings. However, KCE has a higher profit margin than SVI, which implies a lower competitive intensity and better cost structure. KCE is also significantly larger by revenue and EBITDA. These aspects warrant a rating one notch higher than that of SVI.

KEY ASSUMPTIONS

Fitch's key assumptions within our rating case for the issuer include:
- Single-digit revenue growth over 2017-2019.
- Copper price to increase in 2017 and 2018.
- EBITDA margin of 28%-29% during 2017-2019.
- High capex for capacity expansion in 2017 and 2019.
- 40% dividend payout ratio.
- No major acquisitions.

RATING SENSITIVITIES

Developments that May, Individually or Collectively, Lead to Positive Rating Action
- A substantial increase in size and a broader customer mix, while maintaining FFO-adjusted net leverage below 1.5x and EBITDAR margin above 25% on a sustained basis.
Developments that May, Individually or Collectively, Lead to Negative Rating Action
- Lower cash flows or higher investments than Fitch expects, or acquisitions leading to FFO-adjusted net leverage above 1.5x on a sustained basis.
- Decline in operating EBITDAR margin below 20% on a sustained basis
- A weakening in the company's market position or loss of key customers.

LIQUIDITY

Sufficient Liquidity: KCE has adequate liquidity with THB2.4 billion of debt due within one year at end-2016. Most of its short-term debt is packing credits, while the long-term loan due in 2017 is for THB550 million. This will be supported by a cash balance of THB892 million, while its liquidity needs are fully supported by the committed revolving facility of THB15.7 billion at end-2016.

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Applicable Criteria
Criteria for Rating Non-Financial Corporates (pub. 10 Mar 2017) (https://www.fitchratings.com/site/re/895493)
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