

29 APR 2021

## Fitch Revises Outlook on KCE to Stable; Affirms at 'A-(tha)'

Fitch Ratings - Bangkok - 29 Apr 2021: Fitch Ratings (Thailand) has revised the Outlook on KCE Electronics Public Company Limited's (KCE) National Long-Term Rating to Stable from Negative, and affirmed the rating at 'A-(tha)'.

The Outlook revision reflects KCE's strong operating performance and the improving industry outlook for printed circuit boards (PCBs) over the next few years. Fitch expects KCE to remain one of the global leading PCB producers for the automotive industry, with a strong financial profile. Funds from operations (FFO) net leverage is likely to stay healthy at below 1.5x over the medium term, despite the resumption of a capex plan for capacity expansion.

### Key Rating Drivers

**Strong Demand Supports Earnings:** Fitch expects KCE's revenue and EBITDA to increase strongly by around 15%-20% a year in 2021-2022, supported by strong global PCB demand. Earnings growth should also be supported by the ramping up of its capacity expansion from 2H21 onwards. Sales of automotive PCBs - the key end-market segment for KCE - have rebounded to above pre-pandemic levels in 4Q20 with a healthy order backlog for 2021.

We expect the robust demand growth to be sustained over the medium term, given increasing penetration of electronic contents in automobiles and increasing market share of electronic vehicles.

**Margin Improvement:** KCE's EBITDA margin is likely to widen to around 19%-20% in 2021-2022, due to higher capacity utilisation and increase in sales contribution from high-margin, multi-layered automotive PCBs. We expect raw material prices to increase significantly in 2021, but strong demand and limitation on supply availability for PCB products should support the company's ability to pass on cost increases to customers.

KCE posted an EBITDA margin better than Fitch had expected of 18.3% in 2020 (2019: 15.9%) amid the pandemic, due to improved product mix toward more advanced PCBs and effective cost saving efforts.

**Headroom for High Capex:** Fitch believes that KCE's high capex plan over the next few years is flexible and can be adjusted if demand is weaker than the company expects. KCE has maintained a sound financial profile, with nearly zero leverage at end-2020. This should provide sufficient headroom for the company's capex plan. KCE plans to spend around THB3 billion over 2021-2022 for capacity expansion and technological enhancement to support the strong demand growth.

**Leading Auto PCB Producer:** KCE's rating reflects its leading position in the automotive PCB business, which has longer product cycles and deeper customer engagement, providing higher barriers to entry and wider margins than those of consumer electronic PCBs. The company is one of the world's top-10 automotive PCB makers, with revenue market share of around 5%.

**Reduced Customer Concentration:** The expansion of KCE's high-density interconnect (HDI) segment, including non-automotive products, is likely to decrease customer concentration gradually over the medium term. The company's five largest customers contributed about 50% of its total PCB revenue in 2020, declining from about 65% in 2010.

**Currency Volatility:** KCE was highly exposed to foreign-exchange fluctuations, which resulted in volatile EBITDA margins over the past six years. KCE is an exporter and its earnings generally hurt when the Thai baht appreciates, as around 80%-90% of its revenue is in US dollars and euros, while around 50%-60% of costs are in baht, and mostly unhedged.

## **Derivation Summary**

KCE's business profile is moderate relative to nationally rated Thai peers, but its financial profile is stronger. KCE's business and financial profiles are comparable with those of Polyplex (Thailand) Public Company Limited (PTL, A-(tha)/Stable), which is one of the top-10 polyester film producers in the world by revenue. PTL operates in a higher-risk industry, with the majority of its products being standard films that are commodities and face high competition. KCE focuses on automotive PCBs, a niche segment with higher barriers to entry. However, PTL has more geographically diversified operations and a broad customer base. Both companies have low financial leverage with net debt/EBITDA of below 1.5x. The ratings are therefore the same.

Eastern Polymer Group Public Company Limited (EPG, A-(tha)/Stable) and KCE both have businesses that supply the automotive industry, but different product offerings. EPG is a manufacturer of polymer and plastic automotive parts and accessories for utility trucks, which accounted for about 50% of its total revenue. EPG has a more diversified customer base across diverse end-user segments than KCE, given its diversified core businesses in thermal insulation and food and beverage plastic packaging. KCE and EPG have comparable operating scale, but KCE generally has better EBITDA and FCF margins. Their ratings are the same, with comparable business profiles and similarly low financial leverage.

## **Key Assumptions**

Fitch's Key Assumptions Within Our Rating Case for the Issuer:

- Revenue to increase strongly by 15%-20% a year in 2021-2022 (2020: -4.7%), due mainly to the recovery of PCB demand for all end-market sectors, including automotive, consumer and industrial, together with increasing capacity. Revenue to expand in the mid-single digits a year after;
- EBITDA margin to improve to 19%-20% in 2021-2023 (2020: 18.3%), given increasing capacity

utilisation and a higher proportion of sales from high-margin special graded PCB products;

- Copper prices to rise in 2021;

- Large capex plan for capacity expansion and technological upgrade of THB2.8 billion in 2021 (2020: THB334 million). Capex plan of about THB500 million-600 million a year in 2022-2023. This is excluding major uncommitted capex for a new factory;

- Maintain high dividend payout ratio of 85%-90% in 2021-2023 (2020: 92%).

## **RATING SENSITIVITIES**

Factors that could, individually or collectively, lead to positive rating action/upgrade:

- We do not expect an upgrade in the medium term unless KCE achieves a substantial increase in size and a more diverse customer mix, while maintaining FFO net leverage below 1.5x over a sustained period.

Factors that could, individually or collectively, lead to negative rating action/downgrade:

- Lower cash flow or higher investments than Fitch expects or acquisitions leading to FFO net leverage above 1.5x on a sustained basis;

- Decline in operating EBITDA margin below 13% over a sustained period;

- A weakening in the company's market position or loss of key customers.

## **Liquidity and Debt Structure**

Manageable Liquidity: KCE had THB2.3 billion at end-2020, of which THB1.7 billion (due within 2021). Most of the short-term debt is packing credits (bank loans for financing export activities). The liquidity is supported by high cash balance of THB2.3 billion, and uncommitted revolving facilities of THB17.4 billion and USD82 million at end-2020. Additional capex for capacity expansion is likely to be supported by internal cash flow generation and a new long-term loan from banks.

## **REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING**

The principal sources of information used in the analysis are described in the Applicable Criteria.

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### Rating Actions

ENTITY/DEBT	RATING	RECOVERY	PRIOR	
KCE Electronics Public Company Limited	Natl LT	A-(tha) 	Affirmed	A-(tha) 

### RATINGS KEY OUTLOOK WATCH

POSITIVE		
NEGATIVE		
EVOLVING		
STABLE		

## Applicable Criteria

[Corporate Rating Criteria \(pub.21 Dec 2020\) \(including rating assumption sensitivity\)](#)

[National Scale Rating Criteria \(pub.22 Dec 2020\)](#)

[Sector Navigators - Addendum to the Corporate Rating Criteria \(pub.21 Dec 2020\)](#)

## Applicable Models

Numbers in parentheses accompanying applicable model(s) contain hyperlinks to criteria providing description of model(s).

Corporate Monitoring & Forecasting Model (COMFORT Model), v7.9.0 (1)

## Additional Disclosures

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