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Credit Opinion: PTT Public Company Limited

Global Credit Research - 07 Apr 2015

Bangkok, Thailand

Ratings

Category	Moody's Rating
Outlook	Stable
Issuer Rating	Baa1
Sr Unsec Bank Credit Facility	Baa1
Senior Unsecured	Baa1
PTT Exploration & Production Public Co. Ltd.	
Outlook	Stable
Issuer Rating	Baa1
Senior Unsecured	Baa1
Subordinate	Baa3
Thai Oil Public Company Ltd	
Outlook	Stable
Senior Unsecured	Baa1
PTTEP Canada International Finance Limited	
Outlook	Stable
Bkd Senior Unsecured	Baa1
PTT Global Chemical Public Company Limited	
Outlook	Stable
Issuer Rating	Baa2
Senior Unsecured	Baa2

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Key Indicators

[1]PTT Public Company Limited

	12/31/2014	12/31/2013	12/31/2012	12/31/2011	12/31/2010
EBIT/Average Book Capitalisation	11.4%	12.9%	15.1%	16.6%	14.7%
EBIT / Interest Expense	6.5x	7.5x	8.6x	8.7x	7.1x
Retained Cash Flow/Net Debt	54.4%	40.6%	45.6%	43.2%	36.2%
Total Debt/Capital	36.1%	36.6%	37.7%	38.3%	41.5%

[1] All ratios are based on 'Adjusted' financial data and incorporate Moody's Global Standard Adjustments for Non-Financial Corporations. Source: Moody's Financial Metrics

Note: For definitions of Moody's most common ratio terms please see the accompanying [User's Guide](#).

Opinion

Rating Drivers

- Natural monopoly status in Thailand's gas transmission and distribution sector drives stable returns
- Subsidiary PTTEP contributes strong operating cash flows but is exposed to oil price cyclicality and has an increased appetite for capital spending and acquisitions
- Growing leverage to fund investments and acquisitions
- Moderate scale and domestic focus, but good profitability compared with similarly-rated global peers
- Expected support from the Thai government (Baa1 stable)

Corporate Profile

PTT Public Company Limited (PTT) is an integrated oil, gas and petrochemical company based in Thailand. Its main operations include domestic procurement, transmission, distribution, processing and marketing of natural gas, and exploration and production of oil and gas through its 65%-owned subsidiary, PTT Exploration and Production Public Company Ltd. (PTTEP, Baa1 stable).

PTT is directly engaged in oil marketing and international trading. It also holds interests in five domestic oil refineries which, together with its six gas separation plants, support the company's petrochemical business with a wide range of liquid and gas-derived petrochemical products.

As at 31 December 2014, the company operated in 30 countries and reported consolidated revenues of THB2.8 trillion. At the end of 2014, its largest shareholder was the Ministry of Finance, which owned 51.1% of its total share capital. A further 14.9% stake in the company was owned through the government-invested Vayupak Mutual Funds.

Rating Rationale

As a government-related issuer (GRI), PTT's final Baa1 issuer rating reflects its baseline credit assessment (BCA) of baa2 and incorporates a one-notch uplift reflecting our expectation of strong support from the government under our Joint Default Analysis approach.

PTT's BCA is underpinned by its relatively stable cash flows derived from its natural monopoly in gas transmission and distribution, and the earnings contribution from its higher-margin major upstream subsidiary, PTTEP. The latter has a solid operating profile supported by less cyclical cash flows compared with its global peers. This is mainly due to its natural gas production which benefits from long-term sales contracts.

PTT's rating remains constrained by the group's: 1) increasing leverage due to a growing appetite for acquisitions and capital investments, 2) its small production base and high domestic concentration compared with other similarly-rated major integrated oil and gas companies; and 3) inherent exposure to the cyclical nature of oil prices and refining/ petrochemical margins.

DETAILED RATING CONSIDERATIONS

1. Natural monopoly status in Thailand's gas transmission and distribution sector drives stable returns

PTT's natural gas business provides a stable source of income and cash flows as the company owns and operates Thailand's 6 gas separation plants as well as the country's 4,171-kilometer gas pipeline network. This network, which has an existing capacity of 4,580 million standard cubic feet per day (mmscfd), links commercial gas fields to gas separation plants, domestic power producers and other industry users.

In 2014, PTT's gas business accounted for 18% of the group's consolidated revenue and 22% of consolidated EBITDA.

The company's gas sales to power producers and gas separation plants accounted for 79% of its total gas sales

in 2014 and is governed by a government-prescribed tariff structure. The gas sale price structure comprises: 1) the average price PTT pays to gas suppliers (including PTTEP), 2) a supply margin of 1.75% for most of its customers, and 3) a pipeline tariff to cover operating costs and a permitted return.

PTT's sales volume of natural gas in 2014 was an average of 4,688 mmscfd, a 2% increase from 2013 average sales volume of 4,589 mmscfd. This was mainly because of higher gas demand from small power producers and industrial customers.

The company's pipeline capacity is also expected to increase to 7,180 mmscfd in 2015 to handle the increasing gas volumes.

Furthermore, the natural gas business carries a low degree of volume risk for PTT, as the take-or-pay contracts it has entered into with off-takers and suppliers are essentially back-to-back. The certainty provided by the contracts distinguishes PTT from other integrated oil and gas companies which are more exposed to the cyclical nature of the oil sector.

2. PTTEP has a sound operating profile despite rising capital spending and appetite for acquisitions

PTT's subsidiary, PTTEP, is the main contributor of the group's earnings, generating 70% of consolidated EBITDA in 2014. PTTEP's final Baa1 issuer rating incorporates a one-notch uplift, which reflects our expectation that PTT will provide credit support to PTTEP in a distress situation. Accordingly, we consider the credit drivers of PTTEP's underlying credit strength as contributing to PTT's own BCA.

PTTEP's underlying credit strength is underpinned by cash flow stability and visibility from its long-term gas sales contracts. These contracts have built-in natural-gas pricing mechanisms that help cushion PTTEP against the volatility in oil prices. PTTEP also has large oil and gas reserves and production bases supported by a solid operating profile.

PTTEP has an ambitious target to achieve a total production volume of 600 thousand barrels of oil equivalent per day (mboepd) by 2020 from the reported production volume of 359 mboepd in 2014. This target, however, is currently under review given the low oil price environment. PTTEP has made several large acquisitions over the last 2 years. In August 2012, it acquired 100% of Cove Energy Plc. (unrated) for \$1.9 billion, which amongst other assets, gave PTTEP an 8.5% stake in the Mozambique Rovuma offshore basin Area 1 which is estimated to have large recoverable gas reserves of up to 70 trillion cubic feet. The project operator expects the first two liquefied natural gas (LNG) trains will produce 10 million ton per annum and begin exporting LNG in 2019. In addition, PTTEP also acquired a 40% interest in Canada's Kai Kos Dehseh Oil Sands project (KKD) in January 2011 for \$2.28 billion, after which, in January 2014, PTTEP entered into an agreement to restructure ownership rights in the project to make PTTEP the sole owner and operator of the Thornbury, Hangingstone and South Leismer assets. The first phase of production from this project is expected in 2021.

PTTEP expects to invest \$15.9 billion of capex in 2015-19 to explore and develop its new and existing fields, of which \$3.1 billion and \$3.4 billion are estimated to be spent in 2015 and 2016 respectively. These amounts include the further capex required for the LNG development of Mozambique Rovuma Offshore Area1, which is pending a final investment decision, expected at the end of 2015. The capex budget excludes potential acquisitions.

At the same time, PTTEP's successful \$3 billion equity issuance in 2012 improved its credit metrics and financial flexibility. We expect the company to maintain its prudent financial discipline and an appropriate debt capital structure to fund its aggressive capex plan and its appetite for acquisitions.

As an upstream producer, PTTEP is exposed to the cyclical nature of crude oil prices which has declined in the second half of 2014. We believe there is sufficient rating headroom for PTTEP to withstand the impact on its earnings and cash flows because (1) natural gas production constitutes 67% of total sales volumes; (2) 30%-50% of natural gas sales price is indexed to oil prices with a time lag of up to 1 year; and (3) PTTEP has hedged about 70% of its crude oil and condensates volumes in 2014. We will closely monitor the oil prices and impact on PTTEP going into 2015 with particular focus on its hedging policies.

3. Growing leverage to fund investments and acquisitions

PTT is set to continue investing in mainstream gas activities, including pipeline extensions, LNG terminals, natural gas vehicle stations, and offshore spur lines. The company is also keen to explore new businesses both locally and overseas, in power, coal, and floating liquefied natural gas (FLNG).

PTT and its wholly owned subsidiaries have budgeted capex of THB299 billion in 2015-2019. In 2015, THB77

billion will be spent, with 45% in its gas business to enhance its LNG import capacity as gas demand grows and 32% to be invested in joint ventures and subsidiaries to accommodate international energy business expansion.

PTT's increasing appetite for acquisitions is evident in its purchase of coal mining assets, which is a new area of business for the company. Its various debt-funded investments have resulted in pressure on the ratings of both PTT and PTTEP. Nevertheless, PTTEP's successful \$3 billion rights issuance in late 2012 to finance the acquisition of Cove Energy was credit positive, as it reduced the company's reliance on debt to fund organic and inorganic growth.

4. Moderate scale and domestic focus, but good profitability compared with similarly-rated global peers

PTT owns its oil and gas reserves through PTTEP, whose reserves and production size are in line with its Baa-rated peers. As of 31 December 2014, it had proved reserves of 777 million barrels oil equivalent (mboe). The company reported an average daily production of 359 mboepd in 2014.

PTT benefits from its well-established infrastructure and production facilities. Its upstream cost structure and capital efficiency have weakened, with its leveraged full-cycle ratio falling below 1x in 2014, from 2.5x in 2010. This resulted from the company's higher finding and development costs through acquisitions of projects with a long exploration and development lead time, such as the Mozambique Rovuma Offshore Area 1 LNG and the Canada Mariana Oil Sands Project (formerly called "KKD Project" before restructuring). As these projects will only be reserve-accretive from 2016, PTT's reserve replacement ratio has also fallen below 1x since 2012.

Given the company's domestically-focused business, any macroeconomic weakness in Thailand could materially affect the domestic gas consumption and in turn, adversely and materially affect PTT's earnings and cash flows.

One of its major gas off-takers is the EGAT, which purchased 26% of PTT's total gas volume in 2014. While this situation may represent a customer concentration risk, it is mitigated by the strategic importance of the EGAT to the government, which is its majority shareholder.

5. Expected support from the government

We have incorporated a high level of government support in PTT's final rating, such that even if PTT's BCA of baa2 falls to baa3, its final issuer rating may still be maintained at Baa1, which is at par with the sovereign rating.

PTT is 51.1% owned by the Ministry of Finance and 14.9% owned by government established fund. Consequently, we have overlaid the company's underlying credit strength with a joint-default analysis for government related issuers (GRI). This involves estimating the likelihood that in the event of impending failure by the company, the government would step in with assistance sufficient to prevent a default. The government's ability to provide such support is reflected by its Baa1 rating.

We consider the government's willingness to support PTT as high, given the Ministry of Finance's explicit ownership maintenance policy and the company's national importance with respect to gas distribution and ultimately to the power generation sector. In addition, THB4.5 billion of PTT's total debt of THB476 billion as at 31 December 2014, was secured by the Ministry of Finance.

There is a strong correlation between the performance of the Thai economy and PTT's own prospects because most of PTT's cash flows are from domestic sources. There is therefore a high possibility that the credit profiles of PTT and the government may weaken simultaneously.

Liquidity Profile

PTT's debt maturity profile is well-laddered; 59% of its total debt has maturity in year 2015-2019, while the remaining 41% has maturity beyond the next five years. PTT generally operates with sufficient cash on hand to service maturing debt, buffer its working capital requirements, and extend credit to group entities when appropriate.

As of 31 December 2014, the company had consolidated cash and cash equivalents of THB203.8 billion, compared to debt maturing in the next 12 months of THB85.0 billion.

As a major government-related corporate in Thailand, PTT enjoys strong access to the local banking and capital markets. PTT had committed credit facility of THB5.3 billion as at 31 December 2014.

Rating Outlook

The stable ratings outlook is in line with the outlook for Thailand's sovereign rating, and assumes that PTT will maintain a prudent financial profile even as it pursues growth.

What Could Change the Rating - Up

Near-term upward rating pressure is limited, given PTT's relatively high debt to proved reserve ratio and the negative free cash flows expected in 2015.

Nonetheless, we will consider upgrading PTT's rating if it lowers its debt leverage through: 1) PTTEP's successful project developments, which in turn would lead to growth in reserves and production, 2) strengthening its cash flows from its gas business, or 3) significant growth in contributions from its non-conventional investments.

What Could Change the Rating - Down

Downward rating pressure could emerge if PTT's financial leverage continues to deteriorate as a result of: 1) a reduction in the cash flow contribution from PTT's own gas business; 2) major hurdles faced by PTT or PTTEP in implementing their expansion plans; 3) PTT or PTTEP funding their expansions with debt more aggressively than expected; 4) PTT providing financial support to its associates beyond levels determined by its pro-rata ownership stakes; or 5) the company engaging in aggressive initiatives to earn shareholder returns.

Specific credit metrics that would indicate a rating downgrade include: 1) adjusted consolidated EBIT/interest expense below 5x-6x, 2) adjusted consolidated debt/capital above 45% on a sustained basis, or 3) retained cash flow (RCF)/adjusted consolidated net debt below 25-30%.

PTT's rating may also be under pressure if Thailand's sovereign rating is downgraded, or if support from the government declines.

Other Considerations

Downstream operations - PTT's downstream operations are conducted primarily through its associates, which are highly integrated within the group's hydrocarbon value chain. With the exception of its retail fuel marketing and gas business, PTT's downstream activities are not wholly owned by the company. This ownership situation gives PTT far greater market reach for relatively less investment. Nevertheless, we factor in PTT's pro-rated share of indebtedness at its associates, in assessing the company's gearing and leverage.

PTT has taken steps to consolidate its downstream operations and create more integrated businesses within the downstream energy value chain. PTT Global Chemical was formed through the merger of PTT Aromatics and Refining and PTT Chemical.

Methodology - Mapping PTT to Moody's Global Integrated Oil & Gas Industry rating methodology published in April 2014 results in a Baa rating category. Factors considered outside the methodology in assigning the BCA of Baa2 to PTT include the strategic importance of PTT to the Thai economy, as well as the inherently more stable business profile of PTT's gas business, which accounts for the majority of its unconsolidated cash flows from operations.

Rating Factors

PTT Public Company Limited

Integrated Oil & Gas Industry Grid [1][2]	Aaa	Aa	A	Baa	Ba	B	Caa
Factor 1 : Scale (25%)							
a) Average Daily Production (Mboe/d)				X			
b) Proved Reserves (Million boe)				X			
c) Total Crude Distillation Capacity (mmbbl/day)					X		
Factor 2 : Business Position (20%)							
a) Business Position				X			
Factor 3 : Profitability and Returns (10%)							
a) EBIT/Average Book Capitalisation				X			
b) Downstream EBIT/Total Throughput Barrels (\$/bbl)						X	

Factor 4 : Financial Policy (20%)							
a) Financial Policy				X			
Factor 5 : Leverage and Coverage(25%)							
a) EBIT / Interest Expense				X			
b) Retained Cash Flow/Net Debt		X					
c) Total Debt/Capital			X				
Rating:							
Indicated Rating from Grid Factor 1-5				X			
Rating Drag				0			
a) Indicated Rating from Grid				X			
b) Actual Rating Assigned				Baa1			

Government-Related Issuer	Factor
a) Baseline Credit Assessment	baa2
b) Government Local Currency Rating	Baa1
c) Default Dependence	High
d) Support	High
e) Final Rating Outcome	Baa1

[1] All ratios are based on 'Adjusted' financial data and incorporate Moody's Global Standard Adjustments for Non-Financial Corporations. [2] As of 12/31/2014; Source: Moody's Financial Metrics

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