TRIS RATING
A Strategic Partner of S&P Global

CreditNews ข่าวเครดิต

M.K. REAL ESTATE DEVELOPMENT PLC

No. 53/2019
12 April 2019

CORPORATES

Company Rating: BBB
Outlook: Negative

Last Review Date: 15/03/18

Company Rating History:

Date	Rating	Outlook/Alert
10/02/16	BBB	Stable
24/06/15	BBB+	Alert Negative
17/06/15	BBB+	Negative
05/03/10	BBB+	Stable
20/03/08	BBB	Stable

Contacts:

Hattayanee Pitakpatapee
hattayanee@trisrating.com

Jutamas Bunyawanichkul
jutamas@trisrating.com

Auyporn Vachirakanjanaporn
auyporn@trisrating.com

Tulyawat Chatkam
tulyawat@trisrating.com

Suchada Pantu, Ph. D.
suchada@trisrating.com

WWW.TRISRATING.COM

RATIONALE

TRIS Rating affirms the company rating on M.K. Real Estate Development PLC (MK) at "BBB" and revises downward the outlook to "negative" from "stable". The "negative" outlook reflects concerns over a weaker financial profile given its expansion into new businesses. The rating continues to reflect MK's acceptable brand recognition in the housing segment and improving residential property sales. However, the rating is constrained by MK's relatively volatile profitability and a looming rise in financial leverage.

The rating also incorporates the concern over the high level of household debt nationwide, which limits the purchasing power of homebuyers. Recent regulatory changes, introduced by the Bank of Thailand (BOT), may also affect the availability of mortgage loans.

KEY RATING CONSIDERATIONS

Weaker financial profile from aggressive expansion into unfamiliar businesses

TRIS Rating forecasts MK's financial leverage to rise further from aggressive expansion into various businesses. According to MK's business diversification strategy, MK aims to raise the contribution from recurring income business. In 2015, the company acquired 100% of the equity of Prospect Development Co., Ltd. (PD), a developer of ready-built factories (RBFs) and warehouses for rent in the Bangkok Free Trade Zone (BFTZ). In addition, the company developed the Park Court, a mixed-use project offering rental apartments and condominiums for sale.

The foray into rental property has required a significant amount of investment. The debt to capitalization ratio has increased, rising from 20% in 2014 to 47% in 2016, 50% in 2017, and 55% in 2018. The returns from its investments remained low. The pretax return on permanent capital dropped to 4.75% in 2018 from 7.21% in 2015.

Going forward, MK plans to operate office space for rent, health and wellness business, and hotel business. The total construction cost of these businesses during 2019 through 2021 will be around Bt3,900 million. However, MK plans to sell some plots of land and ready-built condominium units, worth around Bt2,000 million, to finance the constructions. TRIS Rating raises concerns over this MK's recent move since the management team has a limited track record in these new businesses. However, MK will partner with a hospital group with long experience in wellness business. In addition, the significant amount of investment during investment period will put pressure on its financial profile. TRIS Rating expects MK's debt to capitalization ratio will reach 60% during 2019-2020, and then slightly drop to 57% in 2021.

Small but rising revenue base

MK is smaller than most of the property developers rated by TRIS Rating. Revenue has ranged from Bt3,000-Bt4,500 million per year over the past four years. The largest source of revenue is the sale of residential property. Residential sales have constituted more than 90% of revenue yearly during the last three years. Revenue contribution from rental properties, including RBFs and warehouses for rent in BFTZ and rental apartments on Sukhumvit 77 road, was still minimal. However, revenue from rental assets is expected to rise after the whole project in the BFTZ is complete.

Going forward, TRIS Rating assumes MK's revenue will grow to about Bt4,500 million-Bt5,300 million per annum during 2019-2021, driven by a steady growth in revenue from residential property for sale, and greater contribution from recurring income business after fully operated. The revenue contribution from its rental businesses is expected to increase to around 20% of total operating revenues from 2020 onwards.

Acceptable brand recognition

In TRIS Rating's view, MK's housing products under the "Chuan Chuen" brand are well accepted by customers in the middle- to low-income housing segments. The new management team has also improved product design and quality. Thus, residential property sales have grown satisfactorily over the past three years. Excluding sales of raw land, revenue from the sales of residential property rose steadily from Bt2,296 million in 2016, to Bt2,654 million in 2017 and Bt2,854 million in 2018.

Going forward, revenues from the sales of residential property (excluding sales of raw land) are expected to increase and range between Bt3,200-Bt3,600 million during 2019-2021. The growth in revenue will derive from both existing and new projects. As of December 2018, MK had 25 projects, comprising 24 housing projects and one condominium project, the Park Court project. The value of the unsold units was Bt5,762 million. MK plans to launch four new housing projects in 2019, worth Bt4,560 million. However, the company has an insignificant amount of backlog since its policy is to sell finished or nearly finished housing units. Therefore, meeting the revenue target depends solely on the ability to generate new sales.

Volatile profit margins but should gradually improve in the next couple years

MK's profitability has fluctuated due to extra spending in selling, general, and administrative expenses (SG&A) after the new management team stepped in. During the first few years, the new management team focused on improving the existing projects and clearing aged housing stock. The additional expenditures, such as the improvements in the landscape and common facilities, the impairment loss of assets, and selling land-related expense, pushed SG&A higher and the operating margin lower. The operating margin (operating income before depreciation and amortization as a percentage of revenue) dropped to 16% in 2017 and 2018, down from 19% in 2016.

TRIS Rating expects the operating margin will recover over the next three years because the additional expenditures during in the last few years are not recurring expenses. In addition, the more contribution from rental properties should help increase profitability given higher gross margin than housing projects. The operating margin is forecast to range between 17%-23% over the next three years, in TRIS Rating's base-case forecast.

High level of household debt remains a concern

Demand for residential property is cyclical and is affected greatly by the domestic economy. The slow growth of the domestic economy has kept the demand for residential property low. In addition, the high level of household debt nationwide limits the purchasing power of home buyers. As a result, banks retain stringent lending policies, especially for buyers in the middle- to low-income segment. MK's main customers are homebuyers in the middle- to low-income segment. However, most of MK's housing units are ready to move in, plus the company has a stringent credit screening process. As a result, the bank rejection rate for MK's customers dropped to 1% in 2018, from around 5% in 2017.

Slight impact of regulatory changes

TRIS Rating expects the impact from the new loan-to-value (LTV) rules on MK is not so significant. The BOT will implement a new macro prudential policy in April 2019. Under the new rules, homebuyers can borrow up to 70%-80% of the collateral value or LTV ratio for a second and subsequent mortgage loan. The LTV ratio had been 90%-100% previously. We believe that the new LTV rules should affect demand for condominiums more than demand for landed properties. This is because people usually buy condominium units as a second or third home. The majority of MK's products are landed residential properties, plus most of MK's customers are first-time homebuyers. As a result, the stricter LTV rules should not have a significant impact on MK's sales. However, there is a portion of homebuyers that may need loans for more than 100% of the collateral value in order to cover all the transfer expenses. These buyers may need more time to save their money. However, MK should be able to lengthen the down payment period for these homebuyers to match with their timing need for saving money.

Liquidity is tight

MK's liquidity remains tight. Cash flow protection has declined over the past three years as profitability fell and leverage increased. The ratio of funds from operations (FFO) to adjusted debt declined from 35.2% in 2014 to 8.7% in 2016 and 5.8% in 2017 and 2018.

As of December 2018, the company had Bt2,860 million in debt due in the next 12 months. The amounts due comprise debentures of Bt1,346 million, bills of exchange (B/Es) of Bt987 million, and other loans of Bt527 million. Capital expenditures are expected to be around Bt2,700 million in 2019, and will range between Bt600-Bt700 million in 2020-2021. Dividend payment will be around Bt110 million, comprising Bt11 million as a cash dividend and Bt99 million as a share dividend. Sources of funds include cash of Bt88 million, FFO of around Bt500 million, and undrawn committed credit facilities of around Bt771 million. In addition, the company plans to sell some land plots, worth around Bt1,100 million, in order to support liquidity. However, due to investment plans, the company has to incur more debts to finance its investments. TRIS Rating expects MK's debt to capitalization ratio will reach 60% during 2019-2020, and then slightly drop to 57% in 2021.

The financial covenants require the net interest-bearing debt to equity ratio to stay below 2 times and the total liabilities to total equity (D/E) ratio to stay below 1.5 times. The ratios at the end of December 2018 were 1.2 times and 1.4 times, respectively. Thus, MK has to manage its capital structure carefully as it expands in order to comply with these covenants.

BASE-CASE ASSUMPTIONS

- Revenue will grow to around Bt4,500-Bt5,300 million per annum during 2019-2021.
- The gross profit margin will range between 31%-37% and the operating margin will hover around 17%-22% over the next three years.
- The budget for land acquisition is forecast at Bt800 million per annum in 2019-2021.
- Capital expenditures are expected to be around Bt2,700 million in 2019, and will range between Bt600-Bt700 million in 2020-2021

RATING OUTLOOK

The "negative" outlook reflects the concerns over MK's aggressive expansion into various businesses. MK's debt to total capitalization ratio is expected to rise, but should stay below 60%. The FFO to total debt ratio should not lower than 5%. The earnings before interest, tax, depreciation, and amortization (EBITDA) interest coverage ratio is expected to stay at 2-3 times.

RATING SENSITIVITIES

The rating and/or outlook of MK could be under downward pressure if the operating performance and/or financial position fall significantly below expectations. A further rise in leverage, without the commensurate returns, will affect the rating negatively. The rating and/or outlook could be revised upward if the company successfully diversifies into the recurring income business and/or improves the financial leverage.

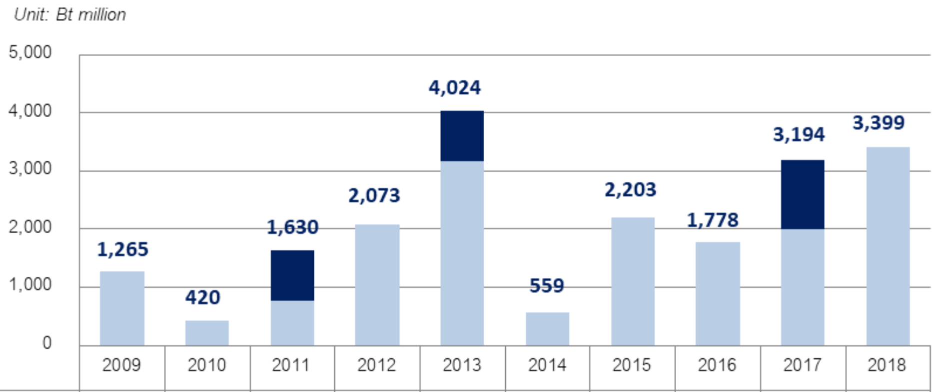
COMPANY OVERVIEW

MK was founded in 1973 by Mr. Chuan Tangmatitham, and listed on the Stock Exchange of Thailand (SET) in 1990. The Tangmatitham family had been MK's major shareholder, before it sold almost all its stakes in the company to Mr. Suthep Wongvorazathe in June 2015. Mr. Suthep consequently became the major shareholder of the company, holding 20.64% in MK as of September 2015. However, as MK later acquired a 100% of the equity of PD, partly through a share swap, Mr. Suthep's stake in MK was diluted to 17.9% as of December 2015. The existing shareholders of PD then held 13.3% of MK. Finansa PLC, the major shareholder of PD, held 7.15% of MK. As of March 2019, Finansa PLC and Mr. Suthep remained the major shareholders of MK, holding a 18.8% stake and a 11.6% stake, respectively. New top managers were put in place in 2015. Most have a background in the financial services industry.

MK focuses on developing low-rise residential property projects, with prices between Bt3-Bt6 million per unit, under the "Chuan Chuen" brand. Most of its products are semi-prebuilt or prebuilt single detached houses (SDHs), semi-DHs, and townhouses (THs). Apart from core business, MK keeps investing more in the rental properties as part of its business diversification strategy. The company operates RBFs and warehouses for rent in the BFTZ, and rental apartments on Sukhumvit 77 road. Also, MK is in the initial stage of investments in office buildings for rent, health and wellness business, and hospitality business. MK's revenue contribution from residential sales made up 90% of total revenue during the past three years. Revenue contribution from recurring income business grew to around 10% of total revenue in 2017, up from less than 3% in 2015.

KEY OPERATING PERFORMANCE

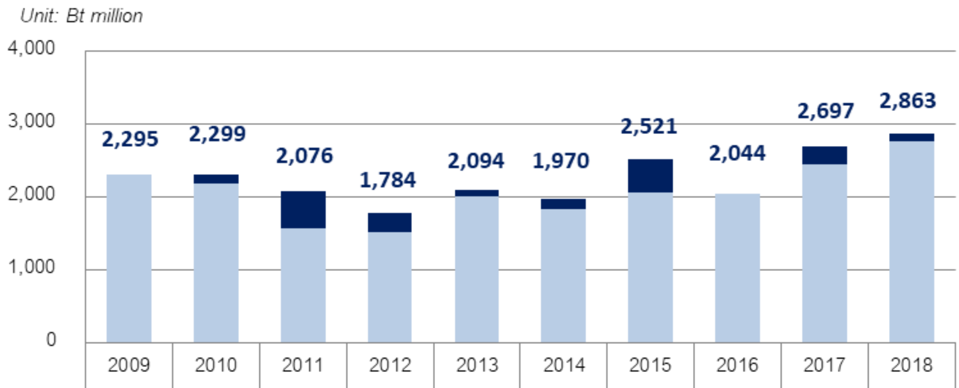
Chart 1: New Project Launches



	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Condominium	-		862	-	860	-	-	-	1,202	
Housing	1,265	420	768	2,073	3,164	559	2,203	1,778	1,992	3,399

Source: MK

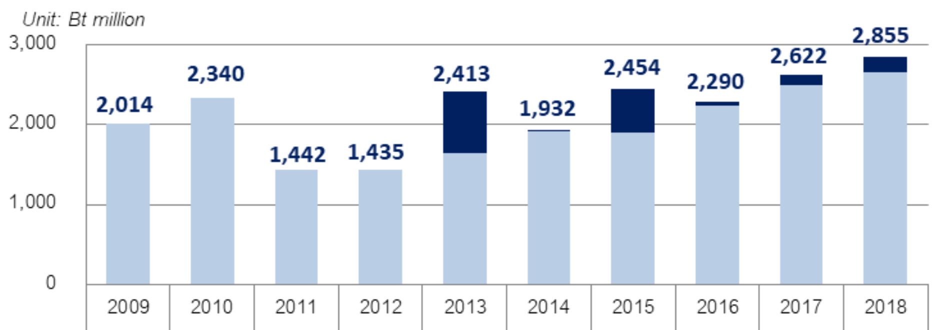
Chart 2: Presales



	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Condominium	-	121	499	263	88	137	464	-	252	110
Housing	2,295	2,179	1,577	1,521	2,006	1,833	2,057	2,044	2,445	2,753

Source: MK

Chart 3: Transfers



	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Condominium	-	-	-	-	772	10	559	50	127	191
Housing	2,014	2,340	1,442	1,435	1,641	1,923	1,895	2,241	2,494	2,664

Source: MK

FINANCIAL STATISTICS AND KEY FINANCIAL RATIOS*

Unit: Bt million

	--------------------Year Ended 31 December ------------------				
	2018	**2017**	**2016**	**2015**	**2014**
Total operating revenues	4,547	3,064	2,871	3,750	2,347
Operating income	737	499	536	592	563
Earnings before interest and taxes (EBIT)	678	601	673	644	592
Earnings before interest, taxes, depreciation, and amortization (EBITDA)	865	736	808	699	633
Funds from operations (FFO)	465	392	513	482	475
Adjusted interest expense	320	262	180	100	50
Capital expenditures	3,363	223	847	2,100	10
Total assets	15,727	14,180	13,508	11,674	7,361
Adjusted debt	8,007	6,756	5,898	3,752	1,351
Adjusted equity	6,646	6,668	6,693	6,638	5,470
Adjusted Ratios					
Operating income as % of total operating revenues (%)	16.21	16.27	18.67	15.79	24.00
Pretax return on permanent capital (%)	4.75	4.49	5.62	7.21	8.99
EBITDA interest coverage (times)	2.70	2.81	4.48	7.00	12.75
Debt to EBITDA (times)	9.25	9.18	7.30	5.37	2.13
FFO to debt (%)	5.80	5.81	8.70	12.85	35.18
Debt to capitalization (%)	54.64	50.33	46.84	36.11	19.80

* *Consolidated financial statements*

RELATED CRITERIA

- Key Financial Ratios and Adjustments, 5 September 2018
- Rating Methodology – Corporate, 31 October 2007

M.K. Real Estate Development PLC (MK)

Company Rating:	BBB
Rating Outlook:	Negative

TRIS Rating Co., Ltd.
Silom Complex Building, 24th Floor, 191 Silom Road, Bangkok 10500, Thailand Tel: 0-2098-3000