

M.K. REAL ESTATE DEVELOPMENT PLC

No. 9/2016

10 February 2016

Company Rating: BBB

Outlook: Stable

Company Rating History:

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

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Rating Rationale

TRIS Rating downgrades the company rating of M.K. Real Estate Development PLC (MK) to “BBB” from “BBB+”, and replaces its “negative” CreditAlert with a “stable” outlook. The rating downgrade reflects a limited track record of the company’s new shareholders and top management team in the residential property business. In addition, the company’s plan to invest more in the rental property business, which requires a significant amount of investment, will put pressure on its financial profile in the short to medium term. MK’s profitability and financial leverage are expected to deteriorate from its past records. The rating also takes into consideration MK’s relatively small revenue base, the relatively high household debt level nationwide, and the cyclical and competitive nature of the residential property industry.

MK was established in 1973 and listed on the Stock Exchange of Thailand (SET) in 1990. The Tangmatitham family had been the company’s major shareholder, before selling almost all its stakes in MK to Mr. Suthep Wongvorazathe in June 2015. Mr. Suthep Wongvorazathe consequently became the major shareholder of MK, holding 20.64% in MK as of September 2015. All members of the Tangmatitham family resigned from directors and managers of MK. The new top managers were in place. Most of them have backgrounds in the financial industry. However, the new managers who are in charge of residential project development came from another property development company, while the middle and lower managers remain the same team. The new management team will continue to focus on developing low-rise residential property projects under the “Chuan Chuen” brand and plans to invest more in the rental properties.

After the new shareholders of MK had stepped in, MK announced to acquire a 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, the purple zone, from PD’s existing shareholders. The acquisition cost about Bt1,200 million. MK funded the transaction through a capital increase of Bt810 million and a cash payment of Bt390 million. The transaction was approved by its shareholders at an extraordinary general meeting (EGM) in August 2015, and was completed in the last quarter of 2015. PD’s revenue in 2014 was Bt282 million, approximately 80% of which, or Bt220 million, came from rental and service income. As of December 2015, PD had about 410 rai of land, of which 150 rai will be arranged for sale and 260 rai will be developed to be factories and warehouses for rent. PD requires about Bt2,600 million to develop an additional rental space of more than 200,000 square meters (sq.m.), from the current space of about 55,000 sq.m., over the next three to four years. If PD completes the development, its revenue will rise to Bt500-Bt700 million per year.

In addition to the acquisition of PD, in the last quarter of 2015, MK purchased two land plots, costing about Bt2,000 million, to develop a serviced apartment project on the Sukhumvit 77 road. The sources of funds came from debentures and proceeds from sales of raw land. The project’s first phase will comprise five low-rise buildings, with 70 rooms in total. Construction costs for the first phase are estimated at Bt500 million. MK plans to start the construction in the third quarter of 2016, and complete it in 2017.

Since the new top management team has a limited track record in the property development business, its ability to continue the property-for-sale

business is needed to be proven. Moreover, the expansion of its rental property business requires a significant amount of investment. This will probably cause MK's financial profile to weaken over the next two to three years. However, a success in the business diversification into the rental property business will be a plus for MK.

As of September 2015, MK had 18 projects available for sale. The units in these projects have remaining value of about Bt6,200 million in total. The company had a backlog worth about Bt1,000 million, two-thirds of which were scheduled to be transferred to customers in the last quarter of 2015. Revenue ranged from Bt1,700-Bt2,800 million during 2012 and 2014, smaller than most of TRIS Rating's rated developers. Revenue in the first nine months of 2015 rose by 23.5% year-on-year (y-o-y) to Bt1,981 million, compared with Bt1,604 million in the same period of 2014. Sales of raw land of about Bt700 million boosted revenue during the period. Over the next three years, revenue is expected to range from Bt2,500-Bt3,500 million, mostly from its residential projects. Income from its rental property business is expected to contribute 10%-15% to total revenue.

MK's operating margin, as measured by operating income before depreciation and amortization as a percentage of sales, ranged from 18%-24% during 2012 through the first nine months of 2015. The operating margin fell to 18% in the first nine months of 2015, from 24% in 2014, due mainly to a drop in its gross margin. The gross margin (excluding the raw land sales) decreased to about 33% in the first nine months of 2015, from 41% in 2014, because MK attempted to reduce its inventory by offering sales promotions. Over the next three years, MK's operating margin is expected to stay at 15%-20%. The new management team will focus only on developing low-rise housing projects, with a price range of Bt2-Bt5 million per unit.

MK's financial leverage rose in the first nine months of 2015. Its debt to capitalization ratio increased to 32% as of September of 2015, compared with 19% in 2014. Over the next three years, the debt to capitalization ratio is expected to increase, due mainly to the expansion of its rental property business. However, MK plans to dispose some raw land to reduce funding needs. Therefore, the debt to total capitalization ratio should stay below 50%.

MK's cash flow protection decreased as profitability fell and leverage rose. The funds from operations (FFO) to total debt ratio decreased to 17.9% (annualized, from the trailing 12 months) in the first nine months, from 36.9% in 2014. The earnings before interest, taxes, depreciation, and amortization (EBITDA) interest coverage ratio dropped to 5.9 times in the first nine months of 2015, from 11.8 times in 2014. Over the next three years, MK's cash flow protection is expected to decline. The FFO to total debt ratio is expected to stay at 6%-8%, and the EBITDA interest coverage ratio should stay at about 2-3 times.

Rating Outlook

The "stable" outlook reflects the expectation that the new management team can smooth MK's operations. As a consequence of its expansion into the rental property business, the debt to total capitalization ratio is expected to rise, but should stay below 50%. During the business transition and investment periods, MK's rating upside is limited. However, the rating and/or outlook could be revised upward if the company successfully diversifies into the rental property business, while maintaining its financial leverage as targeted. In contrast, the rating and/or outlook could be downgraded if its operating performance and financial position drop below expectations.

M.K. Real Estate Development PLC (MK)

Company Rating:	BBB
Rating Outlook:	Stable

Financial Statistics and Key Financial Ratios*

Unit: Bt million

	Year Ended 31 December					
	Jan-Sep 2015	2014	2013	2012	2011	2010
Revenue	1,981	2,347	2,760	1,724	1,673	2,592
Gross interest expense	62	50	67	78	55	29
Net income from operations	251	447	429	260	234	479
Funds from operations (FFO)	277	478	495	278	212	522
Inventory investment	(371)	(624)	761	(527)	(471)	(309)
Total assets	8,733	7,361	6,783	7,359	6,773	6,442
Total debts	2,578	1,297	920	1,768	1,267	917
Shareholders' equity	5,554	5,470	5,280	5,007	4,901	4,942
Operating income before depreciation and amortization as % of sales	18.16	24.00	19.73	18.44	19.62	26.00
Pretax return on permanent capital (%)	7.43 **	8.64	8.39	5.28	5.66	11.93
Earnings before interest, tax, depreciation, and amortization (EBITDA) interest coverage (times)	5.93	11.80	8.53	4.70	6.66	24.11
FFO/total debt (%)	17.90 **	36.88	53.86	15.75	16.72	56.91
Total debt/capitalization (%)	31.70	19.17	14.83	26.10	20.54	15.66

* Consolidated financial statements

** Annualized with trailing 12 months

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