TRIS RATING
A Strategic Partner of S&P Global

CreditNews ข่าวเครดิต

M.K. REAL ESTATE DEVELOPMENT PLC

No. 25/2018
15 March 2018

CORPORATES

Company Rating:	BBB
Outlook:	Stable

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:

Rapeepol Mahapant
rapeepol@trisrating.com

Hattayanee Pitakpatapee
hattayanee@trisrating.com

Jutamas Bunyawanichkul
jutamas@trisrating.com

Auyporn Vachirakanjanaporn
auyporn@trisrating.com

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

WWW.TRISRATING.COM

RATIONALE

TRIS Rating affirms the company rating of M.K. Real Estate Development PLC (MK) at "BBB". The rating reflects MK's acceptable brand recognition in the low-rise housing segment and a revenue base that is small but growing. In addition, product quality has improved after the new management team took control. However, profitability declined recently. The company incurred additional expenses to improve the landscape and common facilities at a number of its residential property projects. Leverage increased significantly in the past two years. MK, under the direction of the new management team, expanded into the rental property segment. The new management team has a limited track record in this segment. Therefore, the success of developing the rental property projects remains to be seen. The rating also takes into consideration the high level of household debt nationwide and the cyclical and competitive nature of the property industry.

KEY RATING CONSIDERATIONS

Acceptable brand recognition

MK has had a presence in the residential property market for over 40 years. Its housing projects, under the "Chuan Chuen" brand, have been accepted by customers in the middle- to low-income segments. The company, under the new management team, continues to leverage the strength of the "Chuan Chuen" brand. It recently improved product design and quality. Despite an entry into the rental property segment, the sale of residential property remains the largest sources of revenue. Housing sales have constituted more than 70% of revenue yearly during the past few years.

As of December 2017, MK had 21 active residential property projects. The combined value of the unsold units in these projects was about Bt4,700 million. The company had a small backlog, worth about Bt300 million. Low-rise housing units made up the majority of sales.

Limited track record of the top managers

The new major shareholder and the new top managers came in 2015, when the Tangmatitham family, the founder, sold its entire stake in the company. Most of the new top managers have a background in the financial service industry. Their track record as developers of residential property for sale and rent is limited.

However, one of the top managers in charge of residential property project development was employed by another property development company. The experience of this manager lessens concerns over the direction of the core business, residential property development for sale. The recent move into the rental property segment brings new challenges. Two large rental property projects, the "Park Court" and the "Bangkok Free Trade Zone", are now underway. The success of these projects should become clearer in the next three years. Both projects are currently in the development stage; a significant amount of investment lies ahead.

Cyclical and competitive industry

Demand for housing is cyclical, and depends largely on the strength of the economy. Due to a slowdown in the domestic economy and concerns over the high level of household debt nationwide, banks have tightened their lending policies since the last three years. As a result, the purchasing power of low-income buyers has fallen. Mortgage loan rejection rates have increased significantly, especially for buyers in the low-priced housing segment (a unit price of less than Bt3 million). Several property developers have moved their focus toward the higher-priced segment to avoid the problem buyers being unable to get a mortgage. However, demand in the high-priced segment is much lower than the low-priced segment. Increasing supply, plus limited demand, will raise competition in the high-priced segment.

Small but rising revenue base

MK is smaller than most of the other property developers rated by TRIS Rating. Revenue ranged from Bt2,300-Bt3,000 million annually over the past few years, except in 2015 when the company sold raw land and realized about Bt1,250 million in revenue. Revenue from low-rise housing projects rose steadily to about Bt2,500 million in 2017, from about Bt1,900 million in 2015.

Over the next three years, TRIS Rating's base-case forecast assumes revenue from low-rise housing projects will rise further. The revenue will range between Bt2,500-Bt2,800 million annually. Revenue from condominium projects will also increase due to the sales of units in the Park Court project. Because the company has a small backlog, the ability to generate new sales will determine the future revenue stream.

Volatile profit margins

Profitability has fluctuated. The operating margin, as measured by operating income before depreciation and amortization as a percentage of sales, has varied between 16% and 24% during the past five years. The operating margin slid to 16% in 2017, from 18.5% in 2016. MK spent more to improve the landscape and common facilities at its residential property projects. The improvements would not only improve product quality and brand image, but boost sales as well. The additional expenditures pushed selling, general, and administrative expenses (SG&A) higher and the operating margin lower.

TRIS Rating expects the operating margin will stay under pressure for the next couple of years due to the additional expenditures. The improvements in the landscape and common facilities hurt MK's operating performance in the short term. However, the extra spending will strengthen the brand and improve the competitive position of the company over the long term. The operating margin is forecast to stay above 14% over the next three years, under the assumptions in TRIS Rating's base-case forecast.

Recent rise in leverage

Leverage rose significantly after MK, under the new management team, expanded into the rental property segment. 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. The acquisition cost about Bt1,000 million. In addition, during 2015 and 2016, the company acquired three land plots to develop the Park Court, a mixed-use project blending rental apartments and condominium units. The three land plots cost MK about Bt3,000 million. As a result, the total debt to capitalization ratio increased steadily to 50.9% in 2017, from the past levels of about 20%. Cash flow protection also declined recently as profits fell and debts rose. The ratio of funds from operation (FFO) to total debt fell to 4.4% in 2017, from a peak of 54.4% in 2013. The earnings before interest, tax, depreciation, and amortization (EBITDA) interest coverage ratio slid to 2.9 times in 2017, from a high of 12.4 times in 2014.

Going forward, MK will continue to expand in the rental property segment. TRIS Rating forecasts MK will invest about Bt2,000 million more in the two rental property projects over the next three years. The company may undertake other rental property projects, considering its policy to increase the income from rental assets. Investments in other rental property projects, if any are taken, are assumed at about Bt1,000 million. However, the total debt to capitalization ratio is forecast to stay at about 50%. The company plans to dispose some raw land plots to reduce its funding needs.

Refinancing risk remains, but should be manageable

MK is exposed to refinancing risk. In 2018, the company has debts of about Bt2,300 million coming due. The debts comprise Bt1,325 million in debentures, Bt920 million in bills of exchange (B/Es), and the rest in project loans. Capital expenditures in 2018 are projected at about Bt1,200 million.

As of December 2017, MK had undrawn credit facilities of about Bt420 million, plus cash and marketable securities of about Bt450 million. FFO in 2018 is projected to be Bt400 million. As a result, sources of cash will total nearly Bt1,300 million. The gap between the cash needs and the sources of cash means MK has to refinance some of the debts coming due. TRIS Rating expects MK will manage its liquidity prudently. The company plans to sell a few raw land plots, worth

Bt2,000-Bt3,000 million in total, over the next three years. The proceeds will boost liquidity and be used to fund MK's expansion efforts.

A key financial covenant in MK's debentures requires the net interest-bearing debt to equity ratio to stay below 2 times. The ratio at the end of 2017 was 0.96 times. Thus, the company was in compliance with this key financial covenant. TRIS Rating believes that the company will stay in compliance for the next 12 to 18 months.

RATING OUTLOOK

The "stable" outlook reflects the expectation that MK's operating performance will not drop significantly as it expands. Over the next three years, the operating margin will stay above 14% and the total debt to capitalization ratio will hold around 50%.

RATING SENSITIVITIES

MK's rating upside is limited while it is investing and expanding. The rating and/or outlook could be revised upward if the company successfully diversifies into the rental property segment, while meeting the financial leverage target. In contrast, the rating and/or outlook could be downgraded 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.

COMPANY OVERVIEW

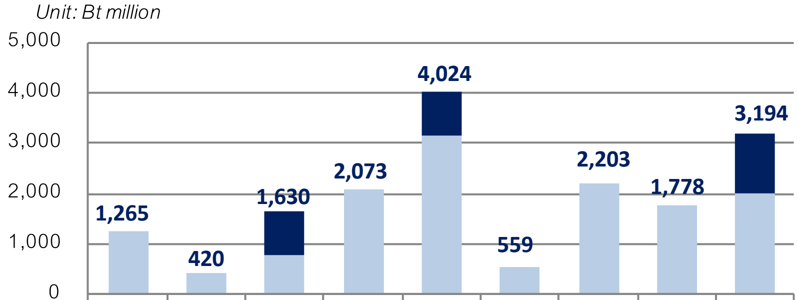
MK was established by Mr. Chuan Tangmathitham in 1973 and listed on the Stock Exchange of Thailand (SET) in 1990. The Tangmatitham family had been the company's major shareholder, before it sold almost all its stake in MK to Mr. Suthep Wongvorazathe in June 2015. Mr. Suthep Wongvorazathe consequently became the major shareholder of MK, holding about 18% in the company as of December 2017. New top managers were put in place. Most have a background in the financial service industry. MK focuses on developing low-rise residential property projects, with prices from Bt2-Bt5 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).

MK expanded into rental property after the new major shareholders and the management team came. In October 2015, the company completed an acquisition of 100% of the equity of PD, a developer of RBFs and warehouses for rent in the Bangkok Free Trade Zone. The acquisition cost about Bt1,000 million. As of December 2017, PD had about 115,500 square meters (sq.m.) of rental space, with an occupancy rate (OR) of 89%. PD will spend approximately Bt1,700 million to develop about 150,000 sq.m. of new rental space over the next three to four years. Rental and service income is projected to rise to Bt400-Bt500 million annually, from the current level of almost Bt200 million, if all the rental space is completed.

In addition to the RBFs and warehouses for rent, MK is developing the Park Court, a mixed-use project, on Sukhumvit 77 road. The mixed-use development blends rental apartments and condominiums. The company paid about Bt3,000 million for a 30-rai plot of land during 2015 and 2016. The project has three phases. The first phase, launched at the end of December 2017, comprises five low-rise buildings with 70 units in total. Twenty eight units are for sale while 42 units are for rent. Construction costs for the first phase ran about Bt920 million. The other phases call for construction during 2019 and 2020.

KEY OPERTING PERFORMANCE

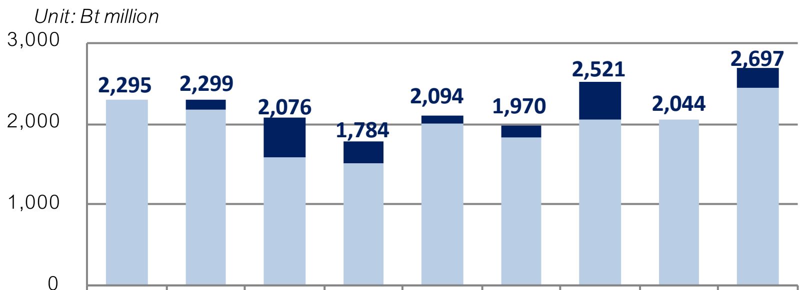
Chart 1: New Project Launches



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

Source: MK

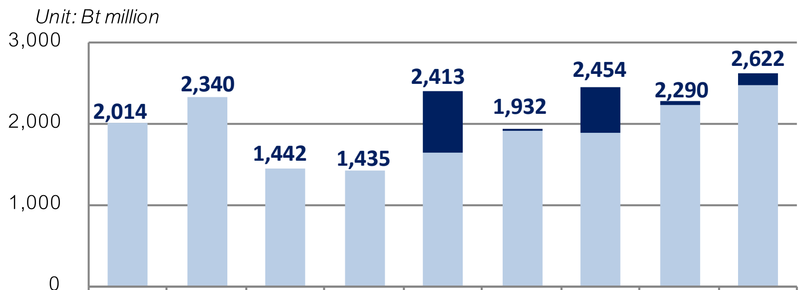
Chart 2: Presales



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

Source: MK

Chart 3: Transfers



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

Source: MK

FINANCIAL STATISTICS AND KEY FINANCIAL RATIOS*

Unit: Bt million

	---------------------- Year Ended 31 December -------------------				
	2017	**2016**	**2015**	**2014**	**2013**
Revenue	3,064	2,871	3,750	2,347	2,760
Gross interest expense	254	177	98	50	67
Net income from operations	225	346	427	443	429
Funds from operations (FFO)	305	332	483	482	500
Inventory investment	(559)	(1,196)	357	(624)	761
Total assets	14,180	13,508	11,678	7,361	6,783
Total debts	6,899	6,141	4,239	1,297	920
Shareholders' equity	6,668	6,693	6,638	5,470	5,280
Operating income before depreciation and amortization as % of sales	16.03	18.54	15.73	24.00	19.73
Pretax return on permanent capital (%)	4.00	5.09	6.59	8.58	8.39
Earnings before interest, tax, depreciation, and amortization (EBITDA) interest coverage (times)	2.86	4.46	7.01	12.43	9.22
FFO/total debt (%)	4.43	5.40	11.39	37.18	54.36
Total debt/capitalization (%)	50.85	47.85	38.98	19.17	14.83
Total debt/capitalization (%) **	50.69	47.85	38.98	19.17	14.83

Note: All ratios have been adjusted with proportionate debt from JVs since 2017 onwards
** Consolidated financial statements*
*** Excluding proportionate debt from JVs*

M.K. Real Estate Development PLC (MK)

Company Rating:	BBB
Rating Outlook:	Stable

TRIS Rating Co., Ltd.
Silom Complex Building, 24th Floor, 191 Silom Road, Bangkok 10500, Thailand Tel: 02-098-3000