TRIS RATING
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CHARN ISSARA DEVELOPMENT PLC

No. 44/2020
9 April 2020

CORPORATES

Company Rating:	BB+
Outlook:	Negative

Last Review Date: 05/04/19

Company Rating History:

Date	Rating	Outlook/Alert
23/04/18	BB+	Stable
16/08/13	BBB-	Stable

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RATIONALE

TRIS Rating affirms the company rating on Charn Issara Development PLC (CI) at “BB+”. At the same time, TRIS Rating revises the company’s outlook to “negative” from “stable”. The “negative” outlook reflects the below-expectation performance of CI’s residential property and hotel operations, and the lingering high leverage level.

The rating continues to reflect the company’s small business size, volatile operating performance, and its acceptable brand recognition in the middle- to high-end residential property and hotel segments. The rating also takes into consideration the slowdown in demand for residential properties in the medium term due to the unprecedented risk from the coronavirus (COVID-19) outbreak, which will add more pressure amid the economic downturn.

KEY RATING CONSIDERATIONS

Small-scale business

In TRIS Rating’s view, CI’s business scale is small compared with other rated property developers. CI’s revenue has been in the range of Bt2.2-Bt2.9 billion per year during the 2016-2018 period. Revenue in 2019 was only Bt1.5 billion, dropping by 49% year-on-year (y-o-y). Presales in 2019 also dropped sharply to Bt677 million from an average of Bt1.5 billion per year during 2016-2018. The dramatic drop in revenue was mainly due to the negative effects of the implementation of new loan-to-value (LTV) rules by the Bank of Thailand (BOT) in April 2019 and the slowdown in the domestic and global economies.

In our base case forecast, we project CI’s revenues to amount to around Bt1.6 billion in 2020 and recover to above Bt2 billion per annum during 2021 and 2022. About 50% of its revenues will be derived from the transfer of its backlog, the remaining will be from new sales. At the end of 2019, CI’s backlog stood at Bt1.1 billion. The backlog will likely translate into revenues of around Bt800 million this year and the rest in 2023. The company had 12 active projects. The residential projects are located in Bangkok and popular tourist destinations, notably Phuket and Cha-am. The value of the available units in 12 projects (both built and un-built units) was Bt9.8 billion.

Operating performance falls below expectation

CI’s operating performance in 2019 fell short of TRIS Rating’s expectations. The gross profit margin of the residential property segment in 2019 was 28%, declining from 30% in 2018 and 35%-38% in the prior years. The decline was primarily caused by promotional price reductions for some projects to accelerate sales. Furthermore, the hotel business recorded a loss, with gross profit margin falling to minus 8%, down from 5%-7% in the previous three years.

Sales of units in existing projects fell short of target and operating expenses were higher than expected. Selling and administrative costs have remained high at Bt720-Bt860 million per annum over the past three years, largely from fixed operating expenses. As a result, the company reported a loss in funds from operations (FFO) for 2019 of Bt385 million and earnings before interest, tax, depreciation, and amortization (EBITDA) of only Bt1 million. However, the company reported net profit of Bt271 million in 2019, reflecting a recognized gain of Bt748 million from sales of 10.5% of the trust units in Sri Panwa Hospitality Real Estate Investment Trust (SRIPANWA). After the sale, CI’s stake in SRIPANWA was reduced to 19.5%.

Going forward, CI plans to sell its new hotel to the SRIPANWA during 2020-2022. If successful, the move would enable the company's FFO to bounce back to around Bt200-Bt300 million. On that basis, the FFO to debt ratio could potentially improve to around 5% while the EBITDA interest coverage ratio to stay above 1.5 times over the next three years.

Financial leverage remains high

CI's leverage continues to linger at high levels following a heavy debt load over the past five years. Outstanding debt at the end of 2019 stood at Bt4.4 billion, increasing from Bt3.7 billion in 2018 and less than Bt2 billion in 2014. CI also has hotel lease-back obligations with SRIPANWA amounting to Bt2.2 billion (calculated from the net present value with a discount rate of 7%), or lease payments of Bt300-Bt330 million per annum for the next 10 years. At the end of 2019, CI's debt to capitalization ratio stood at 65.6%, unchanged from 2018.

Due to its relatively small capital base, CI has focused on recycling its capital through property funds or real estate investment trusts (REIT). Under its financing plan, the company plans to sell the hotel units in the Baba Beach Club Cha-am worth Bt1.5 billion to SRIPANWA by the end of 2020. Subsequently, CI will sell the Baba Beach Club Phang Nga and residential units in Phuket worth Bt700 million in 2021, and the convention hall in Sri Panwa hotel worth Bt1 billion to SRIPANWA in 2022. CI will lease back the properties from the REIT and operate the hotels. Thus, in our base case forecast, we project the company to maintain its debt to capitalization ratio at 60%-65% over the next few years.

Acceptable brand recognition in the middle- to high-end segments

CI's residential property products focus on customers in the middle- to high-income segments. The brands "Issara" and "Bann Issara" are well accepted in terms of product quality and style. In order to enhance the value of its housing products, CI's strategy is to focus on developing mixed-use projects with both properties for sale and hotels at the same site.

CI started to develop luxury residences for sale and built its first boutique hotel, Sri Panwa hotel, in Phuket province in 2003. The on-site hotel increases the value of the residential villas offered for sale inside the Sri Panwa project. Sri Panwa hotel has received a very favorable response from both domestic and foreign customers, especially Chinese customers. As a result, the company was awarded a contract to manage a new hotel under the Sri Panwa brand in Hainan province in China. However, hotel management services comprise only a small proportion of the total revenue of CI.

In 2015, CI developed its second mixed-use project in Phang Nga province under a 86:14 joint venture (JV) with Junfa Real Estate Co., Ltd., a Chinese operator. This project included 24 villas for sale and a boutique hotel under the "Baba Beach" brand. In 2016, CI formed a 50:25:25 JV with Sahapat Co., Ltd. and I.C.C. International PLC (ICC) to develop another mixed-use project under the "Baba Beach" brand in Cha-am district, Phetchaburi province.

Concerns over softening demand and impacts of the COVID-19 pandemic

The residential property market closely follows trends in the domestic economy. However, volatility in this market is much more pronounced than in the overall economy. The slowdown of the domestic economy, coupled with a high level of household debt nationwide, has raised concerns over the purchasing power of local homebuyers. Negative impacts from the global trade war and appreciation of the Thai baht have also caused a drop in demand from foreign homebuyers, especially Chinese buyers, since 2019.

This year, the economic fallout from the COVID-19 outbreak is going to further suppress market demand. Most developers are adopting a wait-and-see approach as demand from local and foreign buyers dries up during the first half of 2020. CI has experienced double negative impacts in both the high-end residential property segment and the hotel segment due to the travel restrictions imposed by several countries, especially China. The sharp decline in tourism coupled with low demand from buyers will impact the company's income recognition.

Moderate liquidity

We assess CI to have moderately adequate liquidity over the next 12 months. At the end of 2019, CI had cash on hand of Bt597 million plus current investments of Bt619 million. CI also had available credit facilities of Bt300 million. We forecast CI's FFO over the next 12 months to be around Bt200-Bt300 million. In addition, the company has a 16% stake in a land plot held by its affiliate, International Resource Development Co., Ltd., which can be used as another source of funds. The appraisal value of the land plot was around Bt2.5 billion. Debts worth Bt953 million will come due in the next 12 months, comprising Bt234 million in short-term borrowings, Bt283 million in project loans, and bond redemptions of Bt436 million.

According to the financial covenants of its debt obligations, CI must keep its net total liability to equity ratio below 3.75 times and total liability (netting out loans from related parties) to total equity ratio below 2 times. The ratios were 1.76 times and 1.75 times, respectively, at the end of 2019. TRIS Rating believes the company should have no problem complying with these financial covenants over the next 12 months.

BASE-CASE ASSUMPTIONS

These are the key assumptions in TRIS Rating's base-case forecast for 2020-2022:

- No launches of residential property projects in 2020. Sales of units in stock to be accelerated.
- Sales of hotel properties to a REIT to be Bt1.5 billion in 2020, Bt700 million in 2021, and Bt1 billion in 2022.
- Revenue of Bt1.6 billion in 2020, increasing to Bt2.3-Bt2.5 billion per annum during 2021-2022. Contribution from hotel operations and office rental segments to total Bt500-Bt900 million per annum.
- Capital expenditure for hotels of around Bt400 million in 2020 and Bt100 million per annum in 2021 and 2022.

RATING OUTLOOK

The "negative" outlook reflects our concerns over CI's weak operating performance in both its residential property and hotel businesses, and its lingering high leverage. The slow domestic demand coupled with the economic fallout from the COVID-19 pandemic could further worsen CI's operating performance.

RATING SENSITIVITIES

CI's ratings and/or outlook could be revised downward should its operating performance and/or financial profile decline further. On the contrary, the outlook could be revised upward if the company demonstrates a significant, sustained improvement in operating performance.

COMPANY OVERVIEW

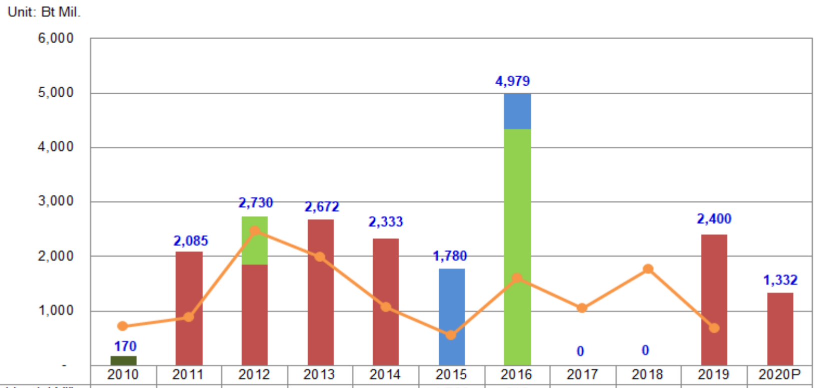
CI was established in 1989 by the Issara family. CI became a public company in June 2002 and was listed on the Stock Exchange of Thailand (SET) in December 2002. The Issara family has been the company's major shareholder since its inception. As of March 2020, the Issara family held a 44% stake in the company.

CI's residential property products target the middle- to high-income segments. At the end of 2019, the residential property portfolio comprised condominiums (40% of the total remaining value of the project portfolio), single detached houses (SDH) (44%), and residential villas (16%). CI's existing residential projects are located in Petchburi province (12% of the total remaining value of the project portfolio), Phuket (14%), Bangkok (66%), Nakorn Ratchasrima (3%), and Chiang Mai (5%).

CI started to develop luxury residences for sale and opened its first boutique hotel, Sri Panwa, in Phuket in 2003. The Sri Panwa hotel started operations in 2006. The company sold the Sri Panwa hotel to Sri Panwa Hotel Property Fund (SPWPF) in 2013 and simultaneously purchased 30% of SPWPF. In 2016, SPWPF converted from a property fund to a REIT named SRIPANWA. Currently, CI holds 19.4% of SRIPANWA. The company also owns 17.6% of BKKCP, a property fund that owns two office buildings, Charn Issara Tower I and Charn Issara Tower II. CI manages these two office buildings for the fund. In addition, the company owns 3,578 square meters of retail space in these two buildings.

KEY OPERATING PERFORMANCE

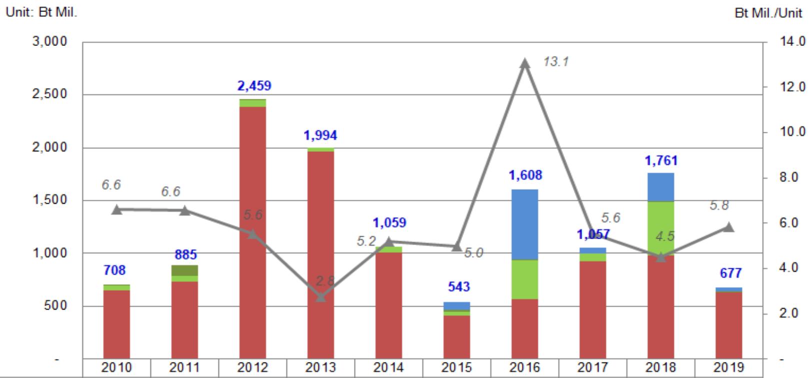
Chart 1: Residential Project Launches



	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020P
Residential Villa	-	-	-	-	-	1,780	648	-	-	-	-
Townhouse	170	-	-	-	-	-	-	-	-	-	-
SDH	-	-	880	-	-	-	4,331	-	-	-	-
Condominium	-	2,085	1,850	2,672	2,333	-	-	-	-	2,400	1,332
Presales	708	885	2,459	1,994	1,059	543	1,608	1,057	1,761	677	

Source: CI

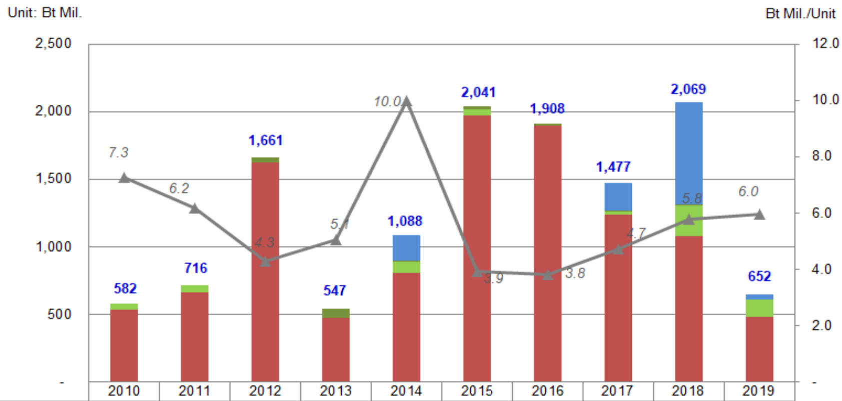
Chart 2: Presales Performance



	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Residential Villa	-	-	-	-	-	72	660	53	262	41
Townhouse	10	101	9	-2	-1	21	9	-	14	6
SDH	48	48	67	32	49	41	368	80	500	-4
Condominium	650	737	2,384	1,964	1,011	409	572	924	985	635
Avg. Price	6.6	6.6	5.6	2.8	5.2	5.0	13.1	5.6	4.5	5.8

Source: CI

Chart 3: Transfer Performance



	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Residential Villa					187			210	752	43
Townhouse			37	68	6	21	11	4	14	-
SDH	48	48			85	49		23	226	128
Condominium	534	668	1,624	479	810	1,971	1,897	1,240	1,077	481
Avg. Price	7.3	6.2	4.3	5.1	10.0	3.9	3.8	4.7	5.8	6.0

Source: CI

FINANCIAL STATISTICS AND KEY FINANCIAL RATIOS*

Unit: Bt million

	----------------------Year Ended 31 December -------------------				
	2019	**2018**	**2017**	**2016**	**2015**
Total operating revenues	1,501	2,950	2,261	2,650	2,735
Earnings before interest and taxes (EBIT)	(276)	484	328	763	589
Earnings before interest, taxes, depreciation, and amortization (EBITDA)	1	615	465	867	673
Funds from operations (FFO)	(385)	281	94	383	342
Adjusted interest expense	387	294	335	322	256
Real estate development investments	4,939	4,344	4,841	4,653	4,224
Total assets	8,681	7,767	7,884	7,328	6,814
Adjusted debt	5,628	5,275	5,587	5,092	4,594
Adjusted equity	2,949	2,798	2,525	2,289	2,027
Adjusted Ratios					
EBITDA margin (%)	0.09	20.83	20.54	32.73	24.61
Pretax return on permanent capital (%)	(2.97)	5.50	3.90	10.02	9.69
EBITDA interest coverage (times)	0.00	2.09	1.39	2.69	2.63
Debt to EBITDA (times)	4,067.48	8.58	12.03	5.87	6.83
FFO to debt (%)	(6.84)	5.33	1.68	7.52	7.44
Debt to capitalization (%)	65.62	65.34	68.87	68.99	69.39

* *Consolidated financial statements*

RELATED CRITERIA

- Rating Methodology – Corporate, 26 July 2019
- Key Financial Ratios and Adjustments, 5 September 2018

Charn Issara Development PLC (CI)

Company Rating:	BB+
Rating Outlook:	Negative

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