TRIS RATING
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# CHARN ISSARA DEVELOPMENT PLC

No. 43/2019
5 April 2019

## CORPORATES

| | |
|---|---|
| **Company Rating:** | BB+ |
| **Outlook:** | Stable |

**Last Review Date:** 23/04/18

**Company Rating History:**

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

**Contacts:**

Auyporn Vachirakanjanaporn
auyporn@trisrating.com

Jutamas Bunyawanichkul
jutamas@trisrating.com

Hattayanee Pitakpatapee
hattayanee@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 Charn Issara Development PLC (CI) at "BB+". The rating reflects CI's small business size, volatile operating performance, and relatively high leverage. The rating also reflects CI's acceptable brand recognition in the middle- to high-end residential property and hotel segments, as well as the recurring rental income from the commercial office space and the dividends from its investments in Sri Panwa Hospitality Real Estate Investment Trust (SRIPANWA) and Bangkok Commercial Property Fund (BKKCP).

The rating also takes into consideration the cyclicality and competitive environment in the residential property development business and the slowdown in demand for housing in the short to medium term due to the stricter loan-to-value (LTV) rules of the Bank of Thailand (BOT).

## KEY RATING CONSIDERATIONS

### Small scale business

In TRIS Rating's view, CI's size is small compared with other rated property developers. CI's revenue ranged between Bt2,300-Bt2,700 million per year during 2015-2017. Revenue in 2018 was Bt3,001 million, driven by transferred condominiums and residential villas. Revenue from real estate sales made up the largest portion (69%), followed by hotel operations (23%) and rental and services (8%) making up the rest.

CI did not launch any new projects in the last two years. At the end of 2018, the company had 13 active projects worth approximately Bt7,954 million. Its backlog stood at Bt1,306 million. The backlog will translate to revenues of around Bt1,000 million in 2019 and the rest in 2020.

In 2019, the company plans to launch one condominium project worth Bt2,332 million and eight units of villas worth around Bt411 million. Thus, its revenue in 2019 will derive mainly from the sales of units in its existing projects. Under TRIS Rating's base case, CI's revenues will range between Bt2,500-Bt2,800 million during 2019-2021.

### Gain from asset sales but slip in operating performance

CI's operating performance in 2018 fell short of TRIS Rating's expectations, albeit a 29% year-on-year (y-o-y) rise in revenue in 2018. The gross profit margin of the real estate segment in 2018 was 30%, declining from 35%-38% in the past three years. This is because the company reduced the selling prices in some projects to accelerate sales.

In addition, operating expenses were higher than our expectation. Selling, general, and administration expenses (SG&A) continued increasing to Bt864 million in 2018, from around Bt650-Bt750 million per annum over the past three years. The operating margin (operating income before depreciation and amortization as a percentage of revenue) was 11.8% in 2018, dropping from 18.6% in 2017 and 14.0% in 2016. The company reported net profit of Bt82 million, reflecting a gain of Bt187 million from the sale of Baba Beach hotel in Cha-am district to SRIPANWA. Due to its relatively small revenue base and high fixed expenses, CI's operating margin is expected to swing in the range of 10%-15%.

### 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 property for sale and hotels at the same location.

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 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 portion of total revenue.

In 2015, CI developed its second mixed-use project in Phang Nga province under a 70:30 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. These two projects are just underway, so success remains to be seen.

### More recurring income from investments in SRIPANWA and BKKCP

Due to its relatively small capital base, CI focused on recycling its capital through property funds or real estate investment trusts (REIT). In 2013, CI sold Sri Panwa hotel phase 1 to Sri Panwa Hotel Property Fund (SPWPF) and recognized a gain of Bt767 million. CI holds 30% of the shares of SRIPANWA. In 2016, SPWPF converted from a property fund to an REIT named SRIPANWA. Capital received from selling its first hotel was used to fund the construction of Sri Panwa hotel phase 2. In 2016, CI sold Sri Panwa hotel phase 2 to SRIPANWA and recognized a gain of Bt429 million. In 2018, CI sold Baba Beach hotel in Cha-am, worth Bt530 million, to SRIPANWA and recognized a gain of Bt187 million. CI leased back the hotels from the REIT and operates the hotels.

Going forward, CI plans to sell another two Baba Beach hotels, located in Cha-am and Phuket, and the convention hall in Sri Panwa hotel, worth around Bt3,000 million, to SRIPANWA in 2021. CI also earns recurring income of Bt80-Bt90 million per annum from renting out the commercial space in two Bangkok office buildings, Charn Issara Tower I and Charn Issara Tower II. The dividends received from the investments in SRIPANWA and BKKCP amount to around Bt60-Bt80 million per annum.

### Implementation of macro-prudential measures may not significantly impact demand in the high-end segment

TRIS Rating expects that the implementation of the new LTV rules should not have much impact on CI's operating performance. CI targets customers in the high-end segment for whom the down payment is usually higher than 20%. We believe that the implementation of new LTV rules by the BOT should impact the sales of condominium units in the middle- to low-priced segments. The BOT will implement a new macro prudential policy in April 2019. Under the new LTV rules, homebuyers can borrow up to 70%-80% of the collateral value, down from 90%-100% of the collateral value, for their second and subsequent mortgage loans. Therefore, developers may have to lengthen the down payment period for some homebuyers. We expect the lower LTV ratio for the second and subsequent mortgage loans will help reduce speculative demand and help strengthen the property market in the long run. In the meantime, several developers may take a wait-and-see approach.

### Exposure to cyclical and highly competitive residential property business

The residential property market closely follows the domestic economy. However, the volatility in this market is much more pronounced than in the overall economy. Slow recovery in the domestic economy, coupled with a high level of household debt nationwide, has raised concerns over the affordability of middle- to low-income homebuyers. CI's main customers are in the middle- to high-income segments, and these segments require a higher down payment of around 20%-30%. However, competition in this segment is becoming more intense as more players are moving towards this segment. Thus, CI has to carefully manage new project launches to match the demand in each segment.

### Financial leverage remains high

CI has a high level of leverage. Debt outstanding at the end of December 2018 was Bt3,672 million, excluding the present value of the hotel lease obligations that CI has with SRIPANWA of Bt320-Bt380 million per annum for the next 15 years. CI's debt also increased from its investments in two new hotels which should be completed and start to generate income by next year. At the end of 2018, CI's debt to capitalization ratio stood at 65.2%, down from 69.1% in 2017 due to CI increased capital of Bt251 million.

Going forward, CI plans to launch new condominium projects, worth around Bt2,300-Bt2,500 million, in 2019. In addition, the company plans to invest more in hotels and commercial properties. The investments will be funded in part by the sale of assets to SRIPANWA. Under its financing plan, the company will sell the new hotel units in the Baba Beach Club to SRIPANWA by the end of 2021. In addition, the company has a 15.99% 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 Bt2,500 million. Thus, under TRIS Rating's base case, the company should be able to maintain its debt to capitalization ratio at around 65%-70% over the next few years.

**Moderate liquidity**

CI's liquidity profile was moderate. At the end of December 2018, CI had cash on hand of Bt891 million plus undrawn long-term credit facilities of Bt2,152 million. TRIS Rating forecasts CI's funds from operations (FFO) over the next 12 months will be around Bt150 million. Debts worth Bt1,250 million will come due in the next 12 months, comprising Bt248 million in short-term borrowing, Bt406 million in project loans, and bond redemptions of Bt597 million. CI plans to refinance most of the maturing bonds with new bond issues.

During 2019-2021, the earnings before interest, tax, depreciation, and amortization (EBITDA) interest coverage ratio is expected to stay above 1.5 times. The FFO to debt ratio is expected to stay at around 5%.

## BASE-CASE ASSUMPTIONS

These are the key assumptions in TRIS Rating's base case forecast:

- CI will launch residential projects worth around Bt2,800-Bt3,000 million in 2019 and around Bt900-Bt1,000 million in 2020.
- CI's revenue will range around Bt2,500-Bt2,800 million per annum during 2019-2021. The contribution from the hotel operations and office rental segments will total around Bt800-Bt1,000 million per annum.
- The operating margin is expected to hold at 10%-15% for the next three years.
- Capital expenditures on its hotels will be set at around Bt300-Bt450 million per annum in 2019 and 2020.

## RATING OUTLOOK

The "stable" outlook reflects TRIS Rating's view that CI's financial position will not decline from the current level. The company is expected to deliver units in the backlog as planned. The debt to capitalization ratio is expected to stay around 65%-70%, and the operating profit margin is forecast to hold at 10%-15% for the next three years.

## RATING SENSITIVITIES

A rating upgrade is unlikely in the near term but could occur if CI demonstrates a significant, sustained improvement in operating performance. On the contrary, the rating and/or outlook could be revised downward if operating performance declines further.

## COMPANY OVERVIEW

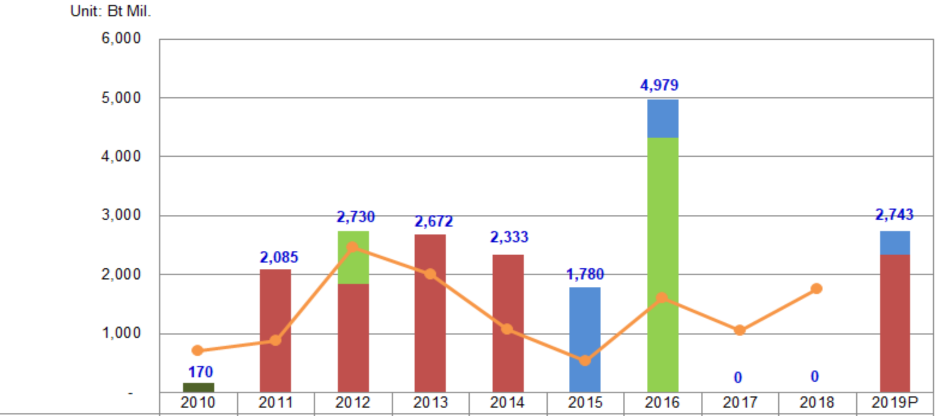
CI was established in 1989 by the Issara family. CI became a public company in June 2002 and was listed on the Stock Exchange of Thailand (SET) in December 2002. The Issara family has been the company's major shareholder since its inception. As of March 2019, the Issara family held a 47% stake in the company.

CI's residential property products target the middle- to high-income segments. At the end of 2018, the residential property portfolio comprised condominiums (23% of the total remaining value of the project portfolio), single detached houses (SDH) (50%), residential villas (27%), and townhouses (0.1%). CI's existing residential projects are located in Petchburi province (17% of the total remaining value of the project portfolio), Phuket (24%), Bangkok (50%), Nakorn Ratchasrima (5%), and Chiang Mai (4%).

CI started to develop luxury residences for sale and opened its first boutique hotel, Sripanwa hotel, in Phuket in 2003. The Sripanwa hotel started operations in 2006. The company sold the Sripanwa hotel to SPWPF in 2013 and simultaneously purchased 30% of SPWPF. The company also owns 30% 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 also owns 3,578 square meters (sq.m.) of retail space in these two buildings.

## KEY OPERATING PERFORMANCE

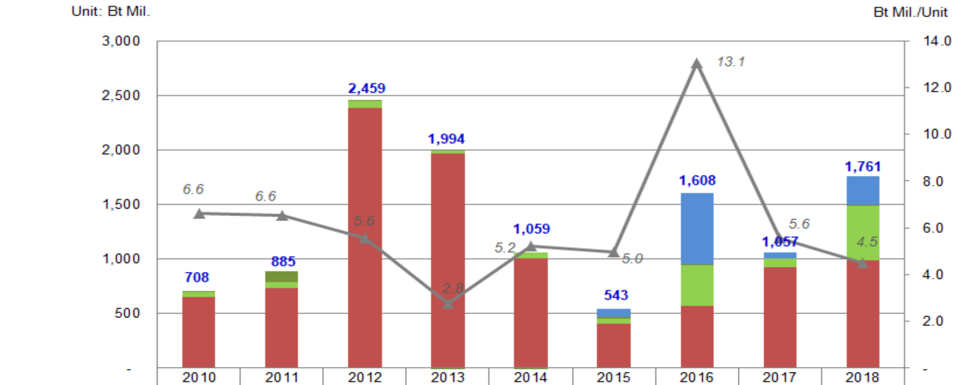
**Chart 1: Residential Project Launches**




| | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019P |
|---|---|---|---|---|---|---|---|---|---|---|
| Residential Villa | | | | | | 1,780 | 648 | | | 411 |
| Townhouse | 170 | | | | | | | | | - |
| SDH | | | 880 | | | | 4,331 | | | - |
| Condominium | - | 2,085 | 1,850 | 2,672 | 2,333 | - | - | - | - | 2,332 |
| Presales | 708 | 885 | 2,459 | 1,994 | 1,059 | 543 | 1,608 | 1,057 | 1,761 | |

*Source: CI*

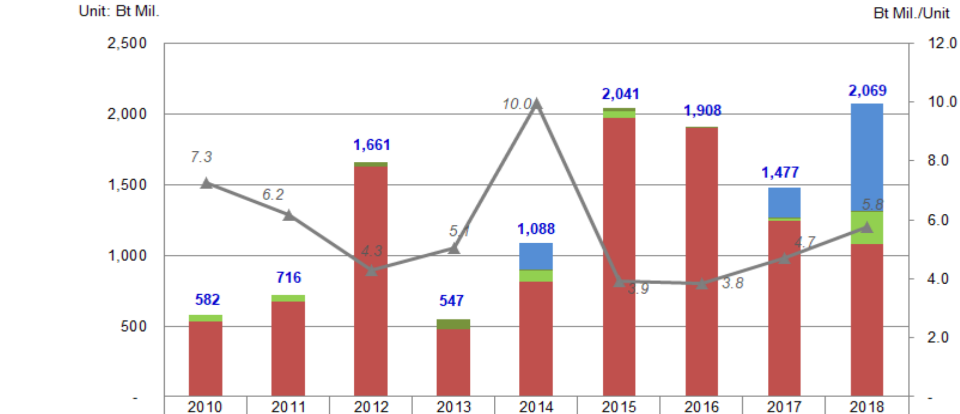
**Chart 2: Presales Performance**




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

*Source: CI*

**Chart 3: Transfer Performance**




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

*Source: CI*

## FINANCIAL STATISTICS AND KEY FINANCIAL RATIOS*

*Unit: Bt million*

| | ----------------------Year Ended 31 December ------------------- | | | | |
|---|---|---|---|---|---|
| | 2018 | 2017 | 2016 | 2015 | 2014 |
| Total operating revenues | 3,001 | 2,317 | 2,650 | 2,735 | 1,629 |
| Operating income | 354 | 432 | 370 | 599 | 102 |
| Earnings before interest and taxes (EBIT) | 531 | 324 | 746 | 592 | 176 |
| Earnings before interest, taxes, depreciation, and amortization (EBITDA) | 701 | 499 | 907 | 723 | 211 |
| Funds from operations (FFO) | 367 | 146 | 440 | 388 | 22 |
| Adjusted interest expense | 294 | 318 | 305 | 260 | 158 |
| Real estate development investments | 1 | 335 | 230 | 86 | 30 |
| Total assets | 7,767 | 7,884 | 7,328 | 6,814 | 4,885 |
| Adjusted debt | 5,242 | 5,636 | 4,545 | 4,642 | 3,083 |
| Adjusted equity | 2,798 | 2,525 | 2,289 | 2,027 | 1,606 |
| **Adjusted Ratios** | | | | | |
| Operating income as % of total operating revenues (%) | 11.80 | 18.64 | 13.97 | 21.92 | 6.26 |
| Pretax return on permanent capital (%) | 6.03 | 3.96 | 10.12 | 9.67 | 4.31 |
| EBITDA interest coverage (times) | 2.38 | 1.57 | 2.97 | 2.79 | 1.34 |
| Debt to EBITDA (times) | 7.48 | 11.28 | 5.01 | 6.42 | 14.61 |
| FFO to debt (%) | 7.01 | 2.59 | 9.69 | 8.36 | 0.71 |
| Debt to capitalization (%) | 65.20 | 69.06 | 66.51 | 69.61 | 65.75 |

* *Consolidated financial statements*

## RELATED CRITERIA

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

## Charn Issara Development PLC (CI)

| | |
|---|---|
| **Company Rating:** | BB+ |
| **Rating Outlook:** | Stable |

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