

M.K. REAL ESTATE DEVELOPMENT PLC

No. 59/2021
21 April 2021

CORPORATES

Company Rating: BBB-
Outlook: Stable

Last Review Date: 10/04/20

Company Rating History:

Date	Rating	Outlook/Alert
10/04/20	BBB-	Stable
12/04/19	BBB	Negative
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

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RATIONALE

TRIS Rating affirms the company rating on M.K. Real Estate Development PLC (MK) at “BBB-” with a “stable” outlook. The rating reflects MK’s acceptable brand recognition in the landed property segment, its relatively low profitability resulting from the intense competition in the residential property business and the higher costs from the launch of its health and wellness business in 2020, and its high financial leverage. The rating also takes into consideration our concerns over the prolonged of the Coronavirus Disease (COVID-19) pandemic, which could put more pressure on both residential property development and wellness businesses.

KEY RATING CONSIDERATIONS

Acceptable brand recognition in the middle- and low-price housing segments

MK’s housing products under the “Chuan Chuen” brand are widely known in the middle- to low-income residential market segments. The company focuses mainly on the development of landed property projects with average selling prices mostly in the range of THB3-THB7 million per unit. Although the company reduced new project launches in 2020 by 63% year-on-year (y-o-y) to THB1.68 billion, its revenues from housing unit sales dropped by only 6% y-o-y to THB2.46 billion.

However, as the company focuses mainly on the development of landed property projects, its backlog was minimal. Thus, revenue from residential sales depends largely on the company’s ability to generate new sales and transfers each year. As of December 2020, MK had 25 projects, comprising 24 landed residential projects and one condominium project, the “Park Court” project. The value of the unsold units was THB7.34 billion. MK plans to launch three new housing projects in 2021, worth THB2.19 billion. We expect MK’s residential sales to range between THB2.63-THB2.82 billion per annum over the next three years.

Rising contribution from recurring income business

As part of its strategic move to increase business diversification, MK has expanded into the recurring income business since 2015. At present, businesses under its recurring income portfolio comprise factories and warehouses for rent located along Bangna-Trad and Theparak Roads, rental apartments on Sukhumvit 77 Road, and health and wellness business under the brand “RAKxa”. Revenue from its rental business has increased from less than THB100 million in 2015 to around THB500 million in 2020. Last year the company booked a gain of THB263 million from the sale of 130,092 square meter of its rental factory and warehouse properties to its newly set up real estate investment trust (REIT), “Prospect Logistics and Industrial Leasehold Real Estate Investment Trust” (PROSPECT). MK and Finansia PLC have a combined shareholding of around 30% in PROSPECT.

Under our base-case forecast, we project MK’s total operating revenue to be THB3.73-THB4.22 billion per annum during 2021-2023. The revenue contribution from the residential property business is expected to decline, from around 80% in 2020 to 70% by 2023. Revenues from its factory and warehouse rental business and REIT management fees are projected to be THB500-THB700 million per annum, while revenues from its wellness and other businesses to be

THB200-THB600 million per annum in 2021-2023. The company's earnings before interest, taxes, depreciation, and amortization (EBITDA) margin is expected to hold at 20%-25% over the next three years.

Operating performance remains under pressure

We expect that MK's operating performance to remain under pressure in 2021, due to the intense competition in the residential market and the launch of its health and wellness business. In our view, the wellness business may be a drain on MK's operating performance over the next few years. The target customers of RAKxa are mainly from the international market who may not be able to travel to the country because of the ongoing pandemic. Revenue from domestic customers alone may not be sufficient to cover fixed costs.

The profitability of its residential property business will also be pressured by the intense competition and slow growth in demand. The gross profit margin of its residential property business is expected to improve from 25% in 2020 to around 28% in 2021-2023, which is still lower than the figure of more than 30% achieved in the past. However, the company's stable rental and REIT management fee income of around THB500-THB700 million per annum, with a gross profit margin of around 57%-61%, should help support earnings over the next three years.

Concerns over the impacts of COVID-19

TRIS Rating expects the demand for residential property in 2021 to grow slightly from 2020, supported by low interest rates and improved economic recovery prospects following the rollout of vaccination programs. In addition, the extended stimulus measures and reduction in the transfer and mortgage registration fees for homes priced below THB3 million should help boost demand. Nonetheless, there still remains a significant risk to the recovery and earnings prospects of developers, which is not helped by the slow progress of vaccination rollouts. Moreover, the rise in non-performing mortgage loans has prompted banks to tighten their lending policies. The weak purchasing power of homebuyers combined with stringent bank lending policies will continue suppressing demand for housing, especially in the middle- to low-income segments, which are the target customers of the company.

Due to softening demand in the condominium segment among both local and foreign homebuyers, several developers have shifted their focus to launch more landed property projects, especially in the middle- and low-price housing segments, the main target groups of MK. The intense competition in these segments could pressure the company's profit margin in the short- to medium term.

Financial leverage remains high

We expect MK's financial leverage to hover in the 55%-60% range over the next three years. Under its business strategy, MK has intended to expand into recurring-income businesses in order to secure steady revenue streams. However, the substantial investments in recurring income businesses have caused the company's debt to capitalization ratio to increase continually since 2015. The ratio rose from 20% in 2014 to 36% in 2015, and has been above 50% since 2017. At the end of 2020, the debt to capitalization ratio stood at 60%. Its debt to EBITDA ratio has also risen sharply, from 7.3 times in 2017 to almost 15 times in 2020. MK's outstanding debt at the end of December 2020 stood at THB9.32 billion, comprising THB1.51 billion bills of exchange (B/Es), THB1.98 billion bank loans and THB5.83 billion debentures. Around THB1.98 billion of its debt is secured with land and/or housing units.

Over the next three years, MK plans to launch only landed property projects worth around THB2-THB2.5 billion per annum, and invest around THB650-THB800 million per annum for expansion of the warehouse and factory for rent business. The company plans to sell a land plot for around THB900 million and sell its joint-venture rental assets to the REIT within the fourth quarter of this year. The proceeds from the sales will alleviate the company's debt burden. As a result, we expect its debt to capitalization ratio to stay in the 57%-58% range, and debt to EBITDA ratio to be 9-12 times during 2021-2023.

Tight liquidity

MK's liquidity is tight but should remain manageable. As of December 2020, the company had debts coming due over the following 12 months of THB4.06 billion, comprising THB2.37 billion debentures, THB1.51 billion bills of exchange (B/Es), THB149 million promissory notes (P/Ns), and THB28 million long-term project loans. The whole amount of B/Es due in the first quarter of 2021 has already been rolled over. The company plans to refinance the remaining maturing debentures with new debenture issues. Also, the remaining B/Es coming due in 2021 are expected to be largely rolled over.

MK's sources of liquidity as of December 2020 comprised cash on hand of around THB124 million and undrawn committed credit facilities of around THB200 million. We forecast MK's FFO over the next 12 months to be around THB450 million. MK also has unencumbered assets at cost worth THB1.18 billion, which can be pledged as collateral for new credit facilities, if needed. In addition, the company is in the process of seeking back-up facilities with financial institutions to support liquidity.

The financial covenants on its bonds and bank loans require MK to maintain its net interest-bearing debt to equity ratio below 2 times and total liabilities to total equity (D/E) below 2 times. The ratios at the end of December 2020 were 1.5 times and 1.7 times, respectively. We expect that the company should have no problems complying with the financial covenants over the next 12 months.

BASE-CASE ASSUMPTIONS

- Operating revenue to be in the range of THB3.73-THB4.22 billion per annum during 2021-2023.
- Gross profit margin to be 30%-36% and EBITDA margin to stay in the 20%-25% range over the next three years.
- Budget for land acquisition of THB600 million per annum in 2021-2023.
- Capital expenditure for its recurring income business of around THB660-THB770 million per annum during 2021-2023.

RATING OUTLOOK

The “stable” outlook reflects our expectation that the company will maintain its operating performance and financial position as targeted. The debt to capitalization ratio should stay below 60% and the EBITDA margin should stay above 20% in 2021-2023.

RATING SENSITIVITIES

The rating and/or outlook could be revised upward if the company successfully diversifies into the recurring income business and/or improves its financial leverage. On the other hand, the rating and/or outlook of MK could come under downward pressure if the operating performance and/or financial position deteriorate significantly from expected levels.

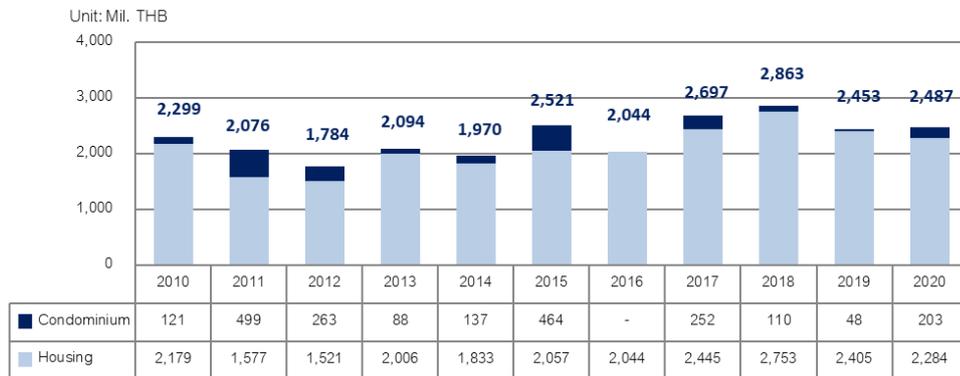
COMPANY OVERVIEW

MK was founded in 1973 by Mr. Chuan Tangmatitham, and listed on the Stock Exchange of Thailand (SET) in 1990. The Tangmatitham family was MK’s major shareholder, before it sold almost its entire stake in the company to Mr. Suthep Wongvorazathe in June 2015. Mr. Suthep consequently became the major shareholder of the company, holding a 20.64% stake in MK as of September 2015. However, as MK later acquired 100% of the equity of Prospect Development Co., Ltd. (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 with Finansa PLC, the major shareholder of PD, holding 7.15% of MK. As of October 2020, Finansa and Mr. Suthep were the major shareholders of MK, holding 26.5% and 11% stakes, respectively. New top managers were put in place in 2015, most with a background in the financial services industry.

MK focuses on developing low-rise residential property projects, with prices between THB3-THB6 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 its core business, MK has been investing more in rental properties as part of its business diversification strategy. The company operates factories and warehouses for rent in the Bangkok Free Trade Zone (BFTZ), and rental apartments on Sukhumvit 77 Road. Also, MK is in the initial stage of operation in the health and wellness business. MK’s revenue contribution from residential sales and from the recurring income businesses were 83% and 17% of total revenue, respectively, in 2020.

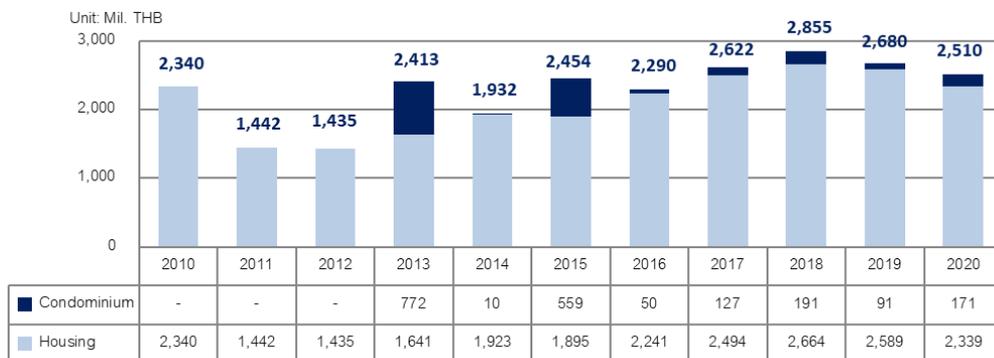
KEY OPERATING PERFORMANCE

Chart 1: Presales



Source: MK

Chart 2: Transfers



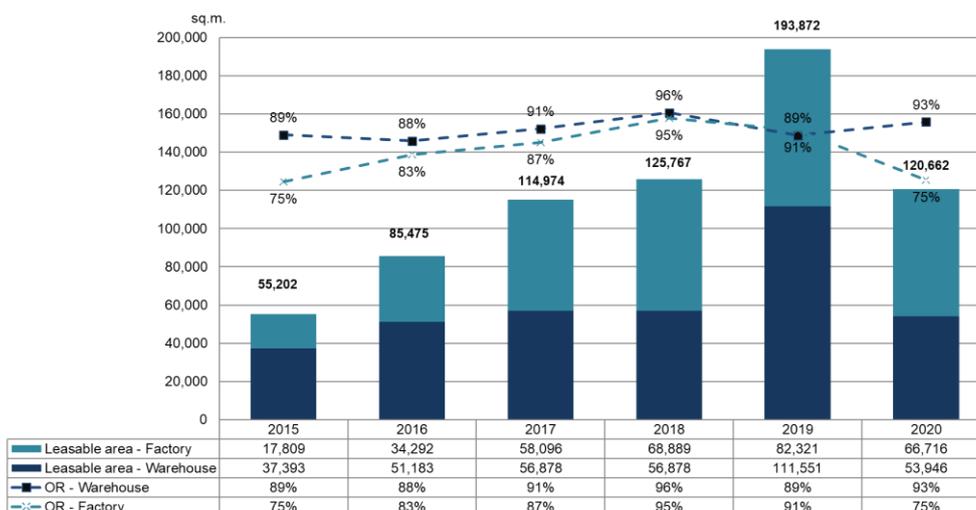
Source: MK

Chart 3: Revenue Breakdown



Source: MK

Chart 4: Warehouse and Factory Rental Space and OR



Source: MK

FINANCIAL STATISTICS AND KEY FINANCIAL RATIOS*

Unit: Mil. THB

	-----Year Ended 31 December -----				
	2020	2019	2018	2017	2016
Total operating revenues	3,057	4,438	4,547	3,064	2,871
Earnings before interest and taxes (EBIT)	419	626	681	601	673
Earnings before interest, taxes, depreciation, and amortization (EBITDA)	680	838	869	736	808
Funds from operations (FFO)	282	430	468	392	513
Adjusted interest expense	404	350	320	262	180
Real estate development investments	6,143	6,164	7,149	9,941	9,344
Total assets	17,985	16,707	15,727	14,180	13,508
Adjusted debt	9,821	8,551	8,007	6,756	5,898
Adjusted equity	6,641	6,795	6,646	6,668	6,693
Adjusted Ratios					
EBITDA margin (%)	22.23	18.89	19.11	24.02	28.14
Pretax return on permanent capital (%)	2.55	4.05	4.77	4.49	5.62
EBITDA interest coverage (times)	1.68	2.39	2.71	2.81	4.48
Debt to EBITDA (times)	14.45	10.20	9.22	9.18	7.30
FFO to debt (%)	2.87	5.03	5.84	5.81	8.70
Debt to capitalization (%)	59.66	55.72	54.64	50.33	46.84

* Consolidated financial statements

RELATED CRITERIA

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

M.K. Real Estate Development PLC (MK)

Company Rating:	BBB-
Rating Outlook:	Stable

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