

# QUALITY HOUSES PLC

No. 95/2018  
9 July 2018

## CORPORATES

<b>Company Rating:</b>	A-
<b>Issue Ratings:</b>	
Senior unsecured	A-
<b>Outlook:</b>	Stable

### Company Rating History:

Date	Rating	Outlook/Alert
18/04/13	A-	Stable
24/11/11	A-	Negative
10/05/10	A-	Stable
02/07/09	A-	Negative
21/07/08	A-	Stable
12/07/04	BBB+	Stable
24/03/04	BBB+	
23/07/03	BBB	

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## RATIONALE

TRIS Rating affirms the company rating and the ratings of senior unsecured debentures of Quality Houses PLC (QH) at “A-”. The ratings reflect QH’s established track record in the property development industry, strong position in the middle- to high-income segment of the housing market, and the financial flexibility gained from its investments in marketable securities. The ratings also reflect our concern over QH’s declining presales and revenues over the past few years, its moderate financial leverage, relatively high level of household debt nationwide, as well as the cyclical and competitive nature of the residential property industry.

## KEY RATING CONSIDERATIONS

### Long track record and strong position in the middle- to high-end segment

QH has long track record and strong brand equity, particularly in the middle- to high-end housing segments. It is one of the leading property developers listed on the Stock Exchange of Thailand (SET). A strong market presence in the high-end segment gives QH a certain amount of operational stability, given that the segment is less vulnerable to changes in economic conditions than the lower-priced segments.

The company’s revenue in 2017 ranked sixth among SET-listed property developers. Presales and revenues from its low-rise housing projects ranged between Bt13-Bt15 billion per annum over the past three years. However, condominium presales dropped significantly in the past couple of years as the company did not launch any new condominium projects.

The company delivered an acceptable performance in the middle- to lower-priced segments during the past five years. QH expects that the middle- to lower-priced segments will be its key growth driver in the medium term. The lower-priced segment is quite large and its growth potential remains robust, despite a slowdown in the domestic economy.

### Declining operating performance

QH’s operating performance dropped gradually in the past three years. Presales dropped to Bt13.8 billion 2017 from Bt20.2 billion in 2015. Presales in the first quarter of 2018 stood at Bt2.7 billion, down 26% from the same period a year ago, since the company has not launched any new condominium projects recently. At the end of March 2018, QH’s backlog of condominium units was worth Bt3.1 billion; mostly from the “Q Sukhumvit” project. The company expects that the value of condominium units in the backlog transferred to customers will be around Bt2.1 billion during the remainder of 2018 and Bt1 billion in 2019.

QH’s revenues also declined to Bt17.1 billion in 2017 from its peak of Bt21.2 billion in 2014. Revenue in the first quarter of 2018 also dropped by 5.4% year-on-year to Bt3.3 billion. Revenue from the housing segment comprised 70%-80% of total revenues, while the rest came from the condominium segment and rental income. Due to QH’s relatively small backlog on hand, we do not expect its future revenue to grow much from the current level.

The operating margin (operating income before depreciation and amortization

as a percentage of revenue) also declined to 9.98% in 2017 from 15.10% in 2014 before recovering to 18.87% in the first quarter of 2018. The decline in profitability was due to the lower gross profit margin of the condominium segment and relatively high selling and administrative expenses. The gross profit margin of the condominium segment in 2016 and 2017 was only 27%-28%, declining from 33%-35% during 2013-2015, as the company accelerated the sales of finished units in the stock. In the first quarter of 2018, this ratio improved to 30%. The gross profit margin of the housing segment in the first quarter of 2018 was 35%, improved from 30% on average over the past three years.

### **Exposure to cyclical and competitive industry**

Demand for housing is cyclical and depends largely on the economy. Due to a slowdown in the domestic economy and concerns over the high level of household debt nationwide, lending policies at banks have tightened. Rejection rates for mortgage loans have increased significantly, especially in the low-priced housing segment (units priced at less than Bt3 million). To avoid the problem of rising rejection rates, several developers, including QH, focus more on the higher-priced segments. However, demand in the higher-priced segments is much lower than in the lower-priced segment. More competition among developers will result from an increased supply of housing units in this segment.

### **Moderate financial leverage**

QH's financial leverage is moderately high. QH's debt to capitalization ratio at the end of March 2018 was 46.73%, decreasing from 48.64% at the end of 2017. The leverage ratio temporarily dropped since the company purchased fewer land plots and launched only low-rise housing projects in the past two years. The total value of projects launched in 2016 and 2017 was below Bt10 billion per annum, significantly lower than in 2014 and 2015 when the company launched new projects worth around Bt20-Bt30 billion per annum. Going forward, the company has set a budget for land acquisition of around Bt5-Bt7 billion per annum over the next three years. This year, the company plans to launch new projects worth around Bt13 billion.

Under TRIS Rating's base case, we expect QH's debt to capitalization ratio to stay around 50%-55%, or a net debt to equity ratio of around 1-1.2 times over the next three years, taking into account the company's plans to launch new real estate development projects worth approximately Bt10-Bt15 billion per annum.

### **Financial flexibility gained from investments in marketable securities**

The company's sizeable portfolio of marketable securities enhances its liquidity position. QH holds stakes in two listed companies and two property funds: Home Product Center PLC (HMPCO) (a 19.9% stake), LH Financial Group PLC (LHBANK) (13.7%), Quality Houses Leasehold Property Fund (QHLPF) (25.7%), and Quality Houses Hotel and Residence Freehold and Leasehold Property Fund (QHHR) (31.3%). At the end of March 2018, the portfolio carried a fair value of Bt44.9 billion. These four entities provide dividends to QH on a recurring basis. QH's recognized share of profits from its investments were around Bt1.2-Bt1.5 billion annually.

### **Acceptable liquidity**

QH's liquidity profile remains acceptable. QH has debts due over the next 12 months of Bt4,300 million, all of which are debentures. We expect QH to refinance most of the debts with new debentures. QH's cash on hand at the end of March 2018 stood at Bt2,926 million. The company forecasts the funds from operations (FFO) over the next 12 months to hold above Bt3 billion. We expect the FFO to total debt ratio to range between 10%-12%. In addition, the company's sizeable investments in the two SET-listed companies and two property funds enhance its liquidity profile.

### **RATING OUTLOOK**

The "stable" outlook reflects TRIS Rating's expectations that QH's business profile will remain strong in the medium term. During 2018-2020, TRIS Rating's base-case scenario expects QH to generate revenues of Bt18-Bt20 billion per annum. Revenues from housing projects should account for 75%-80% of total revenues. We expect QH's operating margin to hold at 12%-14%. The total debt to capitalization ratio should stay below 55%, taking into account the company's plan to launch new real estate development projects worth approximately Bt10-Bt15 billion per annum.

### **RATING SENSITIVITIES**

TRIS Rating would revise QH's ratings and/or outlook downward should its financial profile deteriorate dramatically. For example, a prolonged market slump, leading to lower sales, would raise the debt to capitalization ratio above 60% on a sustainable basis. In contrast, we would revise the ratings upward if the company could improve its operating performance significantly from the current levels while keeping its debt to capitalization ratio lower than 50% on a sustainable basis.

**COMPANY OVERVIEW**

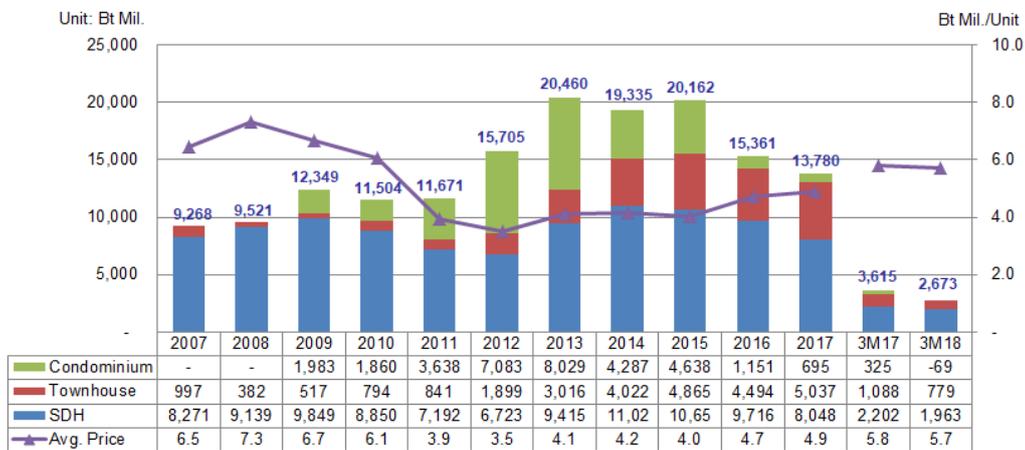
QH was established in 1983 by Land & Houses PLC (LH), the Gaysorn Group, and Dhana Siam Finance and Securities PLC. The company was listed on the Stock Exchange of Thailand (SET) in 1991. As of March 2018, LH was the largest shareholder of QH, holding a 25% stake.

QH’s business profile is satisfactory. The company is one of the leading property developers in Thailand. QH’s market position is quite strong in the housing segment priced over Bt5 million per unit. Its market position in the lower-priced housing segment, with a price range between Bt1-Bt3 million per unit, is also acceptable. The company’s housing brands are well-known and accepted by buyers.

In 1992, the company entered the residential property development segment, with a focus on high-end single-detached houses, under three brand names: “Pruekpirom”, “Laddarom”, and “Vararom”. In 2006, the company introduced the Casa brand to capture the middle-income segment. In 2009, QH developed semi-prebuilt condominium projects under the “Q” and “Q House Condominium” brands. In 2010, QH introduced “The Trust” brand, which offers residential property units priced between Bt1-Bt3 million per unit. QH introduced the “Gusto” brand in 2012, for its townhouses priced at Bt2-Bt4 million per unit.

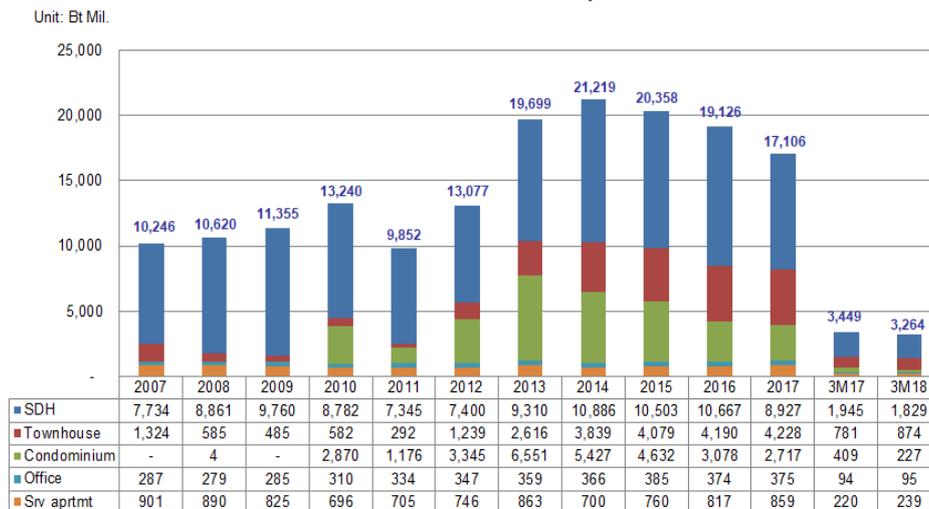
**KEY OPERATING PERFORMANCE**

**Chart 1: Presales Performance**



Source: QH

**Chart 2: Revenue Breakdown by Product**



Source: QH

**FINANCIAL STATISTICS AND KEY FINANCIAL RATIOS\***
*Unit: Bt million*

	Jan-Mar 2018	----- Year Ended 31 December -----			
		2017	2016	2015	2014
Revenue	3,263	17,106	19,125	20,358	21,220
Gross interest expense	110	821	955	1,049	964
Net income from operations	845	2,750	3,085	3,106	3,329
Funds from operations (FFO)	578	3,105	2,876	2,731	2,662
Inventory investment (-increase/+decrease)	(205)	1,830	741	(1,475)	(4,161)
Total assets	53,139	53,059	53,014	52,998	48,634
Total debts	22,489	23,490	25,487	26,796	25,192
Shareholders' equity	25,640	24,802	22,940	21,545	19,149
Operating income before depreciation and amortization as % of sales	18.87	9.98	11.86	13.26	15.10
Pretax return on permanent capital (%)	7.66 **	7.13	7.98	8.55	10.28
Earnings before interest, tax, depreciation, and amortization (EBITDA) interest coverage (times)	9.89	4.42	4.24	3.96	4.56
FFO/total debt (%)	14.64 **	13.22	11.28	10.19	10.57
Total debt/capitalization (%)	46.73	48.64	52.63	55.43	56.81

\* Consolidated financial statements

\*\* Annualized with trailing 12 months

## Quality Houses PLC (QH)

<b>Company Rating:</b>	A-
<b>Issue Ratings:</b>	
QH194A: Bt3,400 million senior unsecured debentures due 2019	A-
QH196A: Bt1,200 million senior unsecured debentures due 2019	A-
QH198A: Bt2,000 million senior unsecured debentures due 2019	A-
QH19NA: Bt2,500 million senior unsecured debentures due 2019	A-
QH205A: Bt4,000 million senior unsecured debentures due 2020	A-
QH20NA: Bt1,500 million senior unsecured debentures due 2020	A-
QH213A: Bt3,000 million senior unsecured debentures due 2021	A-
QH214A: Bt600 million senior unsecured debentures due 2021	A-
<b>Rating Outlook:</b>	Stable

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