TRIS RATING
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# QUALITY HOUSES PLC

No. 107/2019
8 July 2019

## CORPORATES

| | |
|---|---|
| **Company Rating:** | A- |
| **Issue Ratings:** | |
| Senior unsecured | A- |
| **Outlook:** | Stable |

**Last Review Date:** 23/04/19

**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 on Quality Houses PLC (QH) and the ratings on QH's senior unsecured debentures at "A-". The ratings reflect QH's moderately strong position in the middle- to high-income segment of the housing market, its ability to maintain operating profit margin despite a decline in revenues, relatively stable dividend income from its investments in affiliates, and moderate financial leverage. The ratings also reflect our concern over the cyclicality and heightened competition in the residential property development industry, and the negative impact from the introduction of new loan-to-value (LTV) rules by the Bank of Thailand (BOT).

## KEY RATING CONSIDERATIONS

### Moderately strong market position

TRIS Rating holds the view that QH should be able to maintain its market position in the middle- to high-end housing segment over the next two to three years. The company has strong brand equity, especially in the high-end landed property segment. Its expansion into the medium-priced housing segment also has received a good response from homebuyers. The brands under QH, such as "Laddarom", "Preukpirom", "Vararom", and "Casa", are well accepted in terms of product quality. The company's revenue in 2018 ranked eighth among SET-listed property developers.

However, Presales have declined steadily since 2016. Presales from its landed property projects slid from Bt14.2 billion in 2016, to Bt13.1 billion in 2017, and slipped further to Bt11.9 billion in 2018. In the first quarter of 2019, presales stood at Bt2.4 billion, down 13% from the same period last year. Condominium presales also dropped significantly as the company has not launched any new condominium projects since 2016. The company has focused on selling units in its existing projects in an attempt to reduce inventory and improving operating efficiency. As of March 2019, QH had 80 projects, comprising 66 housing projects and 14 condominium projects. The value of the unsold units was Bt46 billion.

Going forward, QH plans to increase sales and reduce the time it takes to conclude projects by offering more product types with wider price range in each project. With this strategy, the company expects sales will rise without the need to launch many new projects. In addition, the company should be able to complete and transfer an entire project within a shorter period of time.

### Ability to maintain profitability despite a decline in revenues

TRIS Rating expects QH to maintain its operating margin (operating income as a percentage of total operating revenues) above 15% over the next two to three years. Despite a decline in revenues in the last few years, QH was able to improve its profitability. The operating margin rose to 18.4% in 2018, up from 11%-14% in 2015-2017. In the first quarter in 2019, the operating margin was 19%. The increase in profitability was mainly due to two factors: the transfer of units in high margin projects and cost saving from improvements in the construction process.

Going forward, TRIS Rating believes QH's revenues will not grow much from the current level. Revenue is forecast to range from Bt15-Bt16 billion during 2019-2021. QH has a small backlog since its policy is to sell finished housing units in landed property. Moreover, its entire condominium projects have been completed and ready to transfer. The backlog of condominium units was worth Bt1.1 billion, mostly from the "Q Sukhumvit" project. The entire backlog will be transferred to customers in 2019.

Due to QH's relatively small backlog on hand, its future revenues depend solely on the ability to generate new sales. QH plans to launch seven new low-rise projects, worth Bt8.6 billion, and re-launch the "Q Sukhumvit" project in the second half of 2019. The sales of landed property projects will make up most of its revenues. The remaining value of unsold landed property projects is Bt30.6 billion while the unsold completed condominium units is worth Bt15.6 billion. Given these values, plus its plans to launch new projects worth around Bt9-Bt15 billion per annum, we believe that the company should be able to achieve the revenue targets.

### 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. A sluggish domestic economy, coupled with a high level of household debt nationwide, have raised concerns over the affordability of middle- to low-income homebuyers. In addition, the implementation of the new LTV rules by the BOT should impact the sales of condominium units in the short term. Under the new LTV rules, homebuyers can borrow up to 70%-80% of the collateral value, down from 90%-100%, for their second and subsequent mortgage loans. Thus, QH has to carefully manage new project launches to match the demand in each segment. QH plans to focus on the real demand by launching more landed property projects than condominium projects. However, we believe the lower LTV ratio for the second and subsequent mortgage loans should benefit developers in the long run. Our view is based on the expectation that this measure will help reduce speculative buying.

### Moderate financial leverage

TRIS Rating forecasts QH's financial leverage will hold at the current level over the next three years. QH's financial leverage continually dropped because the company purchased fewer land plots and launched only low-rise housing projects over the past three years. At the end of March 2019, the debt to capitalization ratio was 41.3%, decreasing from 50%-56% in 2014-2016. Going forward, we expect QH's debt to capitalization ratio to stay below 50%. The debt to earnings before interest, taxes, depreciation, and amortization (EBITDA) ratio will hover around 4 times over the next three years. These forecasts take into account the plans to launch new landed property projects worth approximately Bt9-Bt15 billion per annum, and a land acquisition budget of Bt3-Bt5 billion per year during 2019-2021.

As financial leverage declines, the company will have more headroom on its financial covenant. According to its financial covenant, QH has to keep the net interest-bearing debt to equity ratio below 2 times. The ratio at the end of March 2019 was 0.7 times. TRIS Rating believes that the company should have no problem complying with this financial covenant over the next 12 to 18 months.

### Significant amount of dividend income from investments in affiliates

QH'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 (HMPRO, a 19.9% stake), LH Financial Group PLC (LHBANK, 13.7%), Quality Houses Leasehold Property Fund (QHPF, 25.7%), and Quality Houses Hotel and Residence Freehold and Leasehold Property Fund (QHHR, 31.3%). These four entities provide dividends to QH on a recurring basis. QH recognized share of profits from its investments of around Bt1.6-Bt1.8 billion per annum during 2016-2018, and received dividends of around Bt1.1-Bt1.3 billion per annum. Over the next three years, we expect dividends from the investments will range from Bt1.4-Bt1.6 billion per annum.

In addition, the market value of these investments is significant. At the end of March 2019, the portfolio carried a fair value of Bt47.6 billion. The investment in these affiliates enhances the financial flexibility of the company and divestment of these affiliates will help improve the financial leverage of the company significantly.

### Acceptable liquidity

QH's liquidity profile remains acceptable. QH has debts due over the next 12 months of Bt9.1 billion, all of which are debentures. QH's cash on hand at the end of March 2019 stood at Bt3.2 billion and QH had available short-term credit facilities of around Bt4.4 billion. We forecast funds from operations (FFO) over the next 12 months will hold above Bt3 billion.

We believe QH should have no problem accessing the capital market. QH plans to refinance the remaining maturing bonds with new bond issues and operating cash flow. In addition, the sizeable investments in its affiliates could be another source of funds, if needed. Going forward, the company intends to manage its bond repayment to around Bt6-Bt7 billion per year and engage long-term credit facilities with financial institutions for use as back-up credit facilities for bullet repayments each year.

## BASE-CASE ASSUMPTIONS

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

- Revenue will range from Bt15-Bt16 billion per annum during 2019-2021.
- The gross profit margin will hover around 33% and the operating margin is forecast to be at least 15% over the next three years.
- The land acquisition budget is at Bt3 billion in 2019 and Bt4-Bt5 billion per year during 2020-2021.

## RATING OUTLOOK

The "stable" outlook reflects our expectation that QH will be able to sustain its operating performance at the target levels. During 2019-2021, TRIS Rating expects QH to generate revenues of Bt15-Bt16 billion per annum. Despite more intense competition in the residential property market, we expect QH to keep its operating margin at least 15%. The company should maintain the debt to capitalization ratio below 50%, and the debt to EBITDA should stay at 4-5 times.

## RATING SENSITIVITIES

QH's ratings and/or outlook could be revised downward should its operating performance and/or financial profile deteriorate significantly from the target levels, such that the debt to capitalization ratio raises above 60%, and the interest-bearing debt to EBITDA ratio higher than 6 times on sustainable basis. In contrast, the ratings and/or outlook could be revised upward if the company could improve its operating performance significantly, while its financial profile does not deteriorate from the current levels.

## COMPANY OVERVIEW

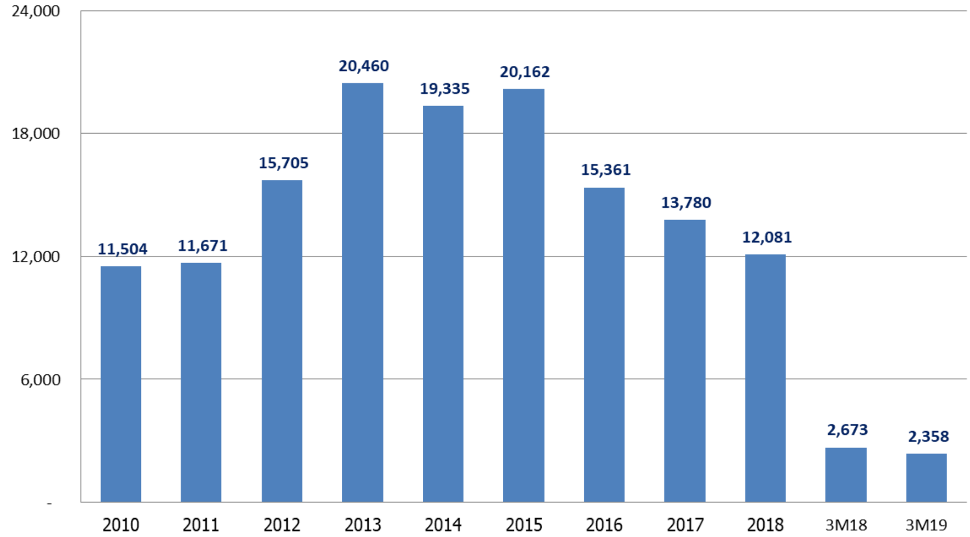
QH was established in 1983 by Land & Houses PLC (LH), the Gaysorn Group, and Dhana Siam Finance and Securities PLC. The company was listed on the Stock Exchange of Thailand (SET) in 1991. As of March 2019, LH was the largest shareholder of QH, holding a 25% stake.

QH's business profile is satisfactory. The company is one of the leading property developers in Thailand. The company offers a wide range of residential property products, including single-detached house (SDH), semi-detached houses (Semi-DH), townhouses, and condominiums. 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, where prices 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.

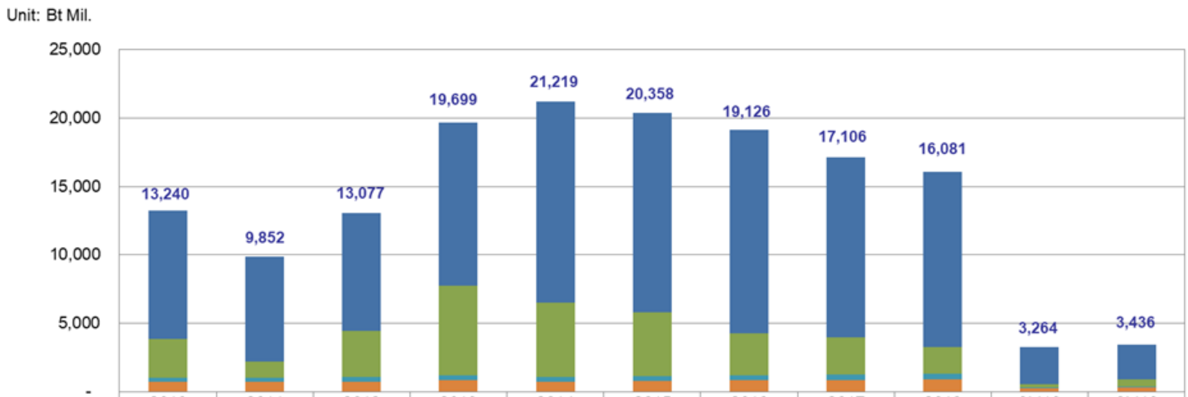
## KEY OPERATING PERFORMANCE

**Chart 1: Presales Performance**




*Source: QH*

**Chart 2: Revenue Breakdown by Product**




| | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 3M18 | 3M19 |
|---|---|---|---|---|---|---|---|---|---|---|---|
| Landed Property | 9,364 | 7,637 | 8,639 | 11,926 | 14,725 | 14,582 | 14,857 | 13,155 | 12,803 | 2,703 | 2,555 |
| Condominium | 2,870 | 1,176 | 3,345 | 6,551 | 5,427 | 4,632 | 3,078 | 2,717 | 1,989 | 227 | 498 |
| Office | 310 | 334 | 347 | 359 | 366 | 385 | 374 | 375 | 384 | 95 | 93 |
| Srv aprtmt/ Hotel | 696 | 705 | 746 | 863 | 700 | 760 | 817 | 859 | 905 | 239 | 290 |

*Remarks: QH adopted TFRS15 for accounting periods beginning on or after 1 January 2019*
*Source: QH*

## FINANCIAL STATISTICS AND KEY FINANCIAL RATIOS*

*Unit: Bt million*

| | | ---------------Year Ended 31 December ----------- | | | |
|---|---|---|---|---|---|
| | Jan-Mar 2019 | 2018 | 2017 | 2016 | 2015 |
| Total operating revenues | 3,436 | 16,080 | 17,106 | 19,125 | 20,358 |
| Operating income | 664 | 2,956 | 1,903 | 2,466 | 2,821 |
| Earnings before interest and taxes (EBIT) | 1,190 | 5,203 | 4,038 | 4,513 | 4,605 |
| Earnings before interest, taxes, depreciation, and amortization (EBITDA) | 882 | 4,992 | 3,962 | 4,333 | 4,340 |
| Funds from operations (FFO) | 687 | 3,782 | 2,772 | 2,903 | 2,729 |
| Adjusted interest expense | 84 | 669 | 847 | 990 | 1,085 |
| Real estate development investments | 35,099 | 35,450 | 35,895 | 37,651 | 37,276 |
| Total assets | 53,526 | 54,164 | 53,059 | 53,014 | 52,998 |
| Adjusted debt | 19,184 | 19,727 | 19,986 | 23,092 | 24,709 |
| Adjusted equity | 27,295 | 26,286 | 24,802 | 22,940 | 21,545 |
| **Adjusted Ratios** | | | | | |
| Operating income as % of total operating revenues (%) | 19.32 | 18.38 | 11.12 | 12.89 | 13.86 |
| Pretax return on permanent capital (%) | 10.65 ** | 10.55 | 8.26 | 9.19 | 9.80 |
| EBITDA interest coverage (times) | 10.52 | 7.46 | 4.68 | 4.38 | 4.00 |
| Debt to EBITDA (times) | 3.82 ** | 3.95 | 5.04 | 5.33 | 5.69 |
| FFO to debt (%) | 20.05 ** | 19.17 | 13.87 | 12.57 | 11.05 |
| Debt to capitalization (%) | 41.27 | 42.87 | 44.62 | 50.17 | 53.42 |

* *Consolidated financial statements*
** *Annualized with trailing 12 months*

## RELATED CRITERIA

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

## Quality Houses PLC (QH)

| | |
|---|---|
| **Company Rating:** | A- |
| **Issue Ratings:** | |
| 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- |
| QH20NB: Bt2,500 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- |
| QH225A: Bt3,500 million senior unsecured debentures due 2022 | A- |
| **Rating Outlook:** | Stable |

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