

QUALITY HOUSES PLC

No. 107/2020

14 July 2020

CORPORATES

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

Last Review Date: 08/11/19

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 diversified portfolio with moderately strong market position in the landed property segment, satisfactory profitability despite a decline in revenues, financial flexibility from its investments in affiliates, and its lower leverage level during the downturn. The rating also takes into consideration our concern over the adverse effects of the coronavirus (COVID-19) pandemic, which has put more pressure on the domestic economy and suppressed demand in the residential property market.

KEY RATING CONSIDERATIONS

Diversified product portfolio with moderately strong market position in landed property segment

TRIS Rating views QH has a relative diverse residential property portfolio. Its product portfolio covers various product types and price ranges. The company offers single-detached houses (SDH), townhouses, and condominiums to homebuyers in different market segments. Selling prices range from THB3 million to THB50 million. Its market position in the landed property segment is relatively strong compared with the condominium segment. QH's housing brands, such as "Laddarom", "Preukpirom", "Vararom", and "Casa", are widely acknowledged in terms of product quality.

QH's revenue base has ranged THB15-THB20 billion per annum, except in 2019 when its revenue dropped to THB10.68 billion. In 2019, QH's market share ranked 12th among SET-listed property developers based on operating revenue, falling from 8th rank in 2018. As of March 2020, QH had 83 projects, comprising 69 housing projects and 14 condominium projects. The value of unsold units was worth THB47.53 billion. Landed property projects accounted for 70% of the total remaining value, while the rest was ready-to-transfer condominium projects.

Satisfactory profitability despite a decline in revenues

TRIS Rating expects QH to maintain its satisfactory level of profitability over the next three years, given its cost efficiency. QH's profitability has improved in recent years despite a decline in revenues. QH's revenue from the residential property business in 2019 dropped sharply by 36% year-on-year (y-o-y), to THB9.29 billion amid concerns over the slowdown in the domestic economy and the implementation of the new loan-to-value (LTV) rules by the Bank of Thailand (BOT) in April 2019. However, the cost saving from improvements in the construction process have helped improve the gross profit margin of its residential property business to levels above 33% since 2018, up from 29%-31% during 2015-2017. The earnings before interest, taxes, depreciation, and amortization (EBITDA) margin also rose, from 21%-23% in 2015-2017 to 35.5% in 2019, due to the significant amount of share of profits from the company's investments in affiliates.

Going forward, we expect QH's profitability to weaken but remain satisfactory as the company recently adopted pricing strategy for some projects, particularly in condominium projects, to accelerate sales. The EBITDA margin is expected to range around 30%-31% in 2020-2022. Amid the concerns over the COVID-19 pandemic, we believe QH's operating revenue will continue to be

under pressure this year but should then recover in the following years. TRIS Rating forecasts QH's operating revenue to further decline to the THB8-THB9 billion range in 2020 and recover to THB10-THB11 billion per annum in 2021-2022.

Concerns over softening demand and impacts of COVID-19

The residential property market closely follows trends in the domestic economy. However, the volatility in this market is much more pronounced than in the overall economy. A prolonged outbreak of COVID-19 could cause a severe economic downturn and further suppress market demand. In addition, the number of non-performing mortgage loans (NPL) could rise further. The weak purchasing power of homebuyers combined with stringent bank lending policies will adversely affect demand for housing, especially in the middle- to low-income segments.

However, we expect some positive effects from several stimulus measures launched by the government to boost housing demand. Recently the BOT relaxed the LTV regulations by allowing first-time homebuyers to take out a top-up of 10% on their housing loans, constituting 110% for the mortgage bundled with the top-up. Another measure is a cut in housing transfer and mortgage fees to 0.01% for homes priced below THB3 million, effective till the end of December 2020. Nonetheless, with the current market situation, many developers have shifted their focus toward landed property projects, particularly in the middle- to low-income segments which have relatively high demand. As a result, competition in this market segment seems to have intensified. QH will need to constantly update its products and marketing strategy in order to stay competitive in this market.

Lower financial leverage during downturn

TRIS Rating expects QH to maintain financial leverage at the current level over the next three years. As of March 2020, its debt to capitalization ratio was 42%, having declined gradually from around 50% in 2016. The debt to capitalization ratio is forecast to stay below 50% in the short to medium term as the company plans to launch only housing projects, which require less capital than high-rise condominium projects. Under TRIS Rating's base-case forecast, we expect QH to launch new landed property projects worth around THB6.48 billion in 2020 and THB8-THB10 billion per annum during 2021-2022. The budget for land acquisition is forecast to be THB1.50 billion in 2020 and THB2.00-THB2.50 billion per annum in 2021-2022. As a result, we forecast QH's debt to capitalization ratio to stay below 50% over the next three years. Its debt to EBITDA ratio could climb higher than 7 times in 2020 amid the lower demand for housing during the virus pandemic period. This ratio should then improve to 5-6 times in 2021-2022 once demand for housing recovers. A further decline in QH's earnings, causing its debt to EBITDA to remain higher than 6 times on a sustained basis, will negatively impact the rating of the company.

Financial flexibility supported by investments in affiliates

TRIS Rating assesses QH's sizeable portfolio of marketable securities as an enhancement of 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 (LHFG, 13.9%), Quality Houses Leasehold Property Fund (QHLPF, 25.7%), and Quality Houses Hotel and Residence Freehold and Leasehold Property Fund (QHHR, 31.3%). These four entities grant dividends to QH on a recurring basis. Over the past four years, QH recognized share of profits from its investments of THB1.60-THB1.93 billion per annum, and received dividends of THB1.06-THB1.45 billion per annum. TRIS Rating expects QH to receive dividends from its investments ranging from THB1.10-THB1.35 billion per annum over the next three years.

In addition, the market value of these investments is considerable. At the end of March 2020, the portfolio carried a fair value of THB34.43 billion. The investment in these affiliates reinforces the financial flexibility of the company and the divestment of the affiliates would strengthen QH's financial profile significantly.

Acceptable liquidity

TRIS Rating assesses QH to be able to manage its liquidity adequately for the next 12 months. As of March 2020, the company had THB13.20 billion in debt due over the next 12 months, comprising debentures of THB11 billion and other short-term loans of THB2.20 billion. The company has already refinanced THB4 billion of bond due in May 2020 with bank borrowings. The remaining debentures, comprising THB4 billion of bond due in November 2020 and THB3 billion of bond due in March 2021, could be refinanced with new bond issues and/or long-term loans. The short-term loans will be repaid with operating cash flow and/or bills of exchange (B/Es).

As of May 2020, QH's sources of liquidity included cash on hand of THB2.14 billion and undrawn committed credit facilities of around THB5.95 billion, including long-term credit lines of THB3.50 billion and short-term credit facilities of around THB2.45 billion. We forecast funds from operations (FFO) over the next 12 months to stay around THB1.86 billion. Moreover, the company also had unencumbered assets of around THB18.12 billion as an alternative source of liquidity, if needed. In addition, the company intends to secure long-term credit facilities with financial institutions for use as back-up credit facilities for bullet repayments each year. The FFO to debt ratio is forecast at 10%-16% while the EBITDA interest

coverage ratio is forecast to stay above 4.5 times over the next three years.

According to the financial covenants of its debt obligations, QH has to keep its net interest-bearing debt to equity ratio below 2 times. The ratio at the end of March 2020 was 0.7 times. 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:

- Operating revenue in the range of THB8-THB11 billion per annum during 2020-2022.
- Gross profit margin to range 31%-32% and the EBITDA margin in the range of 30%-31% over the next three years.
- Land acquisition budget of THB1.50 billion in 2020 and THB2.0-THB2.50 billion per year during 2021-2022.

RATING OUTLOOK

The "stable" outlook reflects our expectation that QH will be able to sustain its operating performance at the target levels. During 2020-2022, TRIS Rating expects QH to generate revenues of THB8-THB11 billion per annum. The company should maintain the debt to capitalization ratio below 50%. The debt to EBITDA is forecast to jump in 2020 and then drop to stay below 6 times in 2021-2022. The EBITDA margin is expected to maintain above 30% over the next three years.

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 stays above 60%, and the interest-bearing debt to EBITDA ratio higher than 6 times for an extended period. 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

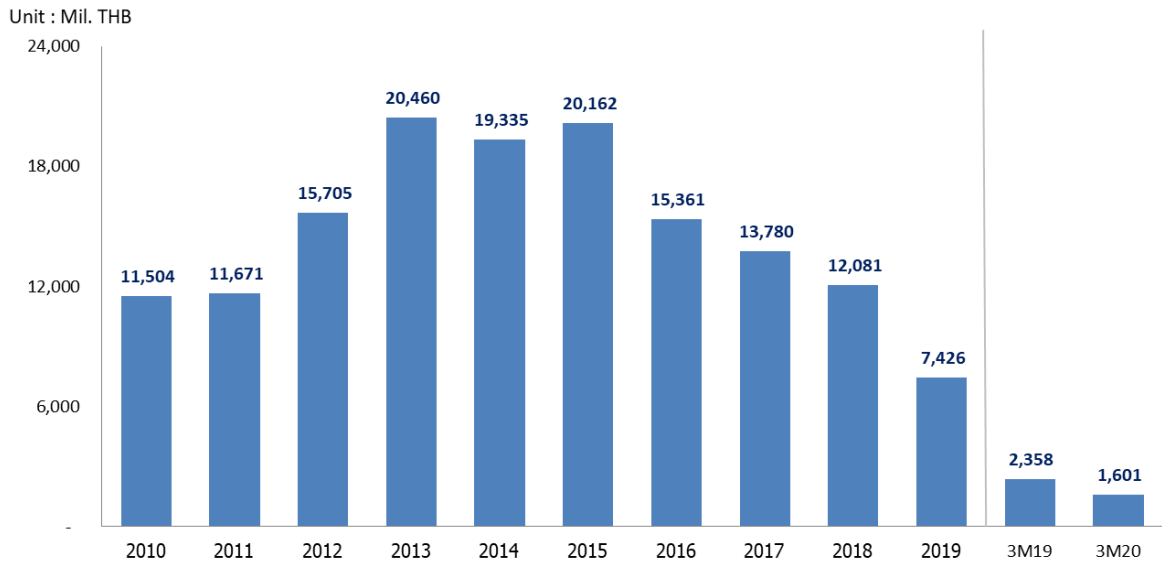
QH was established in 1983 by Land & Houses PLC (LH), the Gaysorn Group, and Dhana Siam Finance and Securities PLC. The company was listed on the Stock Exchange of Thailand (SET) in 1991. As of March 2019, LH was the largest shareholder of QH, holding a 25% stake.

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 THB5 million per unit. Its market position in the lower-priced housing segment, where prices range between THB1-THB3 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 THB1-THB3 million per unit. QH introduced the "Gusto" brand in 2012, for its townhouses priced at THB2-THB4 million per unit. In 2020, QH is introducing the "Q Prime" brand for townhouses in the premium segment priced at THB6-THB7 million per unit.

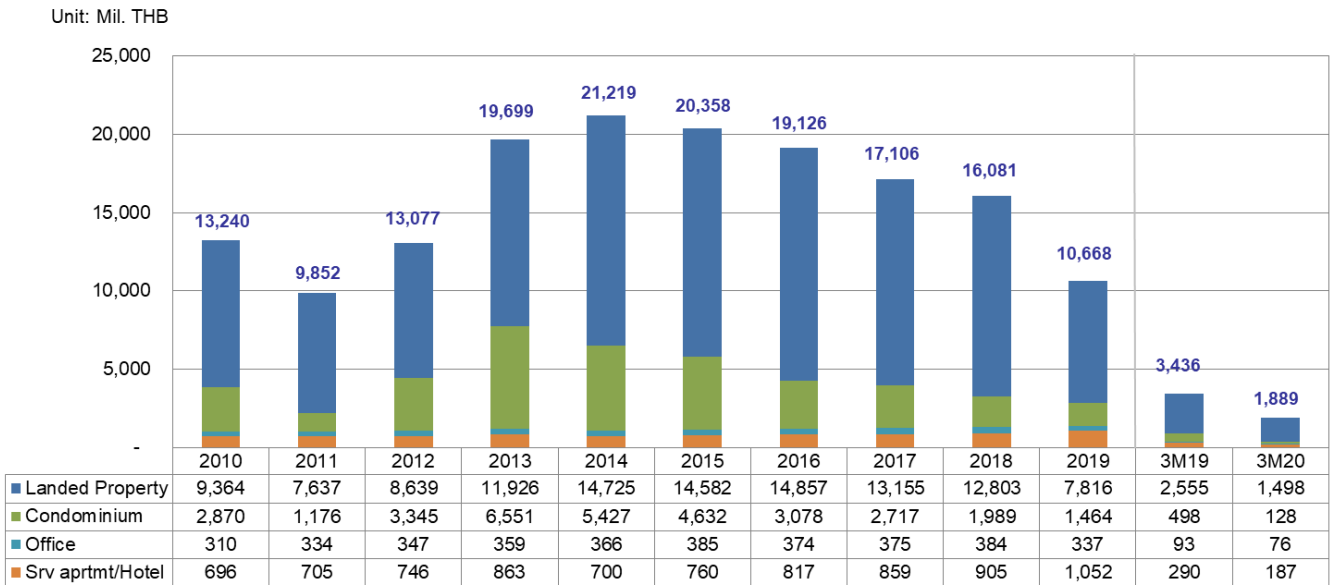
KEY OPERATING PERFORMANCE

Chart 1: Presales Performance



Source: QH

Chart 2: Revenue Breakdown



Source: QH

FINANCIAL STATISTICS AND KEY FINANCIAL RATIOS*

Unit: Mil. THB

	Jan-Mar 2020	-----Year Ended 31 December -----			
		2019	2018	2017	2016
Total operating revenues	1,890	10,680	15,888	17,106	19,125
Earnings before interest and taxes (EBIT)	708	3,871	5,199	4,038	4,513
Earnings before interest, taxes, depreciation, and amortization (EBITDA)	445	3,787	4,988	3,962	4,333
Funds from operations (FFO)	368	2,858	3,779	2,772	2,903
Adjusted interest expense	32	634	669	847	990
Real estate development investments	33,203	33,642	35,450	35,895	37,651
Total assets	53,377	50,902	54,164	53,059	53,014
Adjusted debt	19,376	18,949	19,727	19,986	23,092
Adjusted equity	26,858	26,863	26,286	24,802	22,940
Adjusted Ratios					
EBITDA margin (%)	23.57	35.46	31.40	23.16	22.66
Pretax return on permanent capital (%)	6.75 **	7.90	10.54	8.26	9.19
EBITDA interest coverage (times)	13.73	5.97	7.45	4.68	4.38
Debt to EBITDA (times)	5.78 **	5.00	3.95	5.04	5.33
FFO to debt (%)	13.37 **	15.08	19.16	13.87	12.57
Debt to capitalization (%)	41.91	41.36	42.87	44.62	50.17

* Consolidated financial statements

** Annualized with trailing 12 months

RELATED CRITERIA

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

Quality Houses PLC (QH)

Company Rating:	A-
Issue Ratings:	
QH20NA: THB1,500 million senior unsecured debentures due 2020	A-
QH20NB: THB2,500 million senior unsecured debentures due 2020	A-
QH213A: THB3,000 million senior unsecured debentures due 2021	A-
QH214A: THB600 million senior unsecured debentures due 2021	A-
QH225A: THB3,500 million senior unsecured debentures due 2022	A-
QH22NA: THB4,000 million senior unsecured debentures due 2022	A-
Rating Outlook:	Stable

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