

PROSPECT DEVELOPMENT CO., LTD

No. 151/2022
31 August 2022

CORPORATES

Company Rating: BBB-
Outlook: Negative

RATIONALE

TRIS Rating assigns a company rating of “BBB-” to Prospect Development Co., Ltd (PD) with a “negative” outlook. The rating reflects the company’s status as a core subsidiary of M.K. Real Estate Development PLC (MK, rated “BBB-/Negative” by TRIS Rating). The company rating on PD is equivalent to and moves in tandem with the company rating on MK, according to TRIS Rating’s “Group Rating Methodology”.

As a core subsidiary, PD’s business is aligned with the group’s strategy, and the company is expected to be a major earnings contributor to the group in the long term. In our view, MK is highly likely to provide needed support to PD in times of stress.

KEY RATING CONSIDERATIONS

Core subsidiary of MK

We view PD as a core subsidiary of MK. MK has owned 100% of PD since 2015. FNS holdings PLC (FNS, formerly known as Finansia PLC) held a 36.4% stake in PD before MK acquired 100% of the equity, partly through a share swap, in December 2015. The acquisition of PD resulted in the diversification of MK’s businesses from residential properties for sales to industrial properties for rent and for sales.

PD has become a major contributor to MK’s earnings, contributing more than 40% of MK’s total earnings before interest taxes, depreciation, and amortization (EBITDA) since 2019. At the end of 2021, PD’s assets accounted for 35% of MK’s total assets and more than 33% of PD’s debt was made up of loans from MK. Looking forward, we expect PD’s EBITDA contribution to MK to range between 40%-46% over the next three years.

Evolving market position

We view PD’s market position as an industrial estate developer is evolving over time. The company provides warehouses and factories for rent in the “Bangkok Free Trade Zone” (BFTZ) area, Samut Prakarn province. Currently, PD’s assets comprise ready-built warehouses and factories in four projects: 1) BFTZ 1, located on Bangna-Trad Km.23 Road, 2) BFTZ 2, located on Theparak Road, and 3) BFTZ 3 and 4) BFTZ 6, located on Bangna-Trad Km. 19 Road.

As 73% of its existing properties are located within free trade zones. PD has received good responses from import- and export-oriented tenants. The average occupancy rate (OR) has maintained above 80% since 2016 except for a slight drop in the third quarter of 2020 due to the sales of assets with high OR to Prospect Logistics and Industrial Freehold and Leasehold Real Estate Investment Trust (PROSPECT). As of June 2022, PD had 164,890 square meters (sq.m.) of total leasable area with an average OR of 86% and an average rental rate (ARR) of 179 THB/sq.m./month.

Besides its owned assets, PD has joined hands with a few partners to develop additional industrial property projects. In 2016, PD joined with Frasers Property Industrial (Thailand) Co, Ltd. (formerly known as Ticon Logistics Park Co., Ltd.) to set up a joint venture (JV), Frasers Property BFTZ Co., Ltd., to develop ready-built warehouses (RBWs) and ready-built factories (RBFs) in the BFTZ 1 area. PD holds a 40% stake in the JV. In 2021, PD joined with Sansiri PLC (SIRI) to set up BFTZ Bangpakong Co.Ltd (BFTZB) for the development of industrial property for rent in Chachoengsao province. The total leasable area

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of BFTZB will be around 186,000 sq.m. PD also set up a JV with FNS, BFTZ Wangnoi Co., Ltd. (BFTZW), to develop 88,000 sq.m. of built-to-suit warehouse and RBWs in Ayutthaya province. The leasable area of BFTZW will be around 110,000 sq.m.

Relatively small and volatile revenues and earnings

PD's revenues and earnings are rather small and fluctuated compared with other rated industrial property developers. The company's annual revenues ranged from THB431 million to THB1.3 billion during 2019-2021, depending on the value of assets sales each year. Its EBITDA also swung widely from around THB340-THB650 million per annum over the same period. However, we expect the company's operating performance to improve continually supported by its plan to develop and sell assets to PROSPECT over the next three years. PD is also expected to earn property management fee income from PROSPECT, BFTZW, and BFTZB. As of June 2022, PD's leasable area under management was 387,093 sq.m., comprising 164,890 sq.m. of PD and 222,203 sq.m. of PROSPECT.

PD plans to develop an additional 116,896 sq.m. of leasable area in 2022 and around 35,000-39,000 sq.m. per annum in 2023-2024. The company expects to maintain its own leasable area of 210,000-230,000 sq.m. to generate recurring income. EBITDA from its own leasable area is expected to be around THB320-THB350 million per annum. Excess rental space and projects under JVs will be sold to PROSPECT to top up its revenue recognition and capital gains. As a result, we forecast PD's operating revenues to be THB1.1-THB2.3 billion per annum in 2022-2024. EBITDA is likely to range between THB630-THB930 million per annum over the same period.

Portfolio concentration with moderately renewal risk

We consider PD's portfolio as significantly concentrated in terms of locations, tenants, and lease tenures. As all the leasable area is located in Samut Prakarn province, unfavorable local circumstances could significantly impact the operating performance of the company. In terms of tenant concentration, the top-ten tenants occupied 43% of total occupied area and contributed 44% of rental and service income in the first half of 2022. Contract terminations of major tenants could potentially have material negative impact on the company's operating results. In addition, the terms of its lease contracts are mostly less than three years, exposing the company to some degree of lease renewal risk every year.

As of the end of June 2022, around 26% of the existing lease contracts based on leased area were due to expire in the second half of 2022, 17% in 2023, 38% in 2024, and the rest thereafter. However, PD's renewal rate in the last four years has been above 90%. Increasing demand for warehouses and factories for rent resulting from the rapid growth in e-commerce, coupled with the relocation of manufacturing bases and supply chains from China to Thailand driven by trade tensions between the United States (US) and China, should partly help mitigate this risk. However, rising competition from the existing and new players and concerns over a global economic slowdown could present increasing challenges in the future. The company aims to raise awareness of its brand among target customers through several marketing channels. Looking forward, we forecast PD to maintain ORs in the range of 85%-87% for PD's own properties with a growth in rental rates of 0.5%-1% per annum.

High financial leverage

We expect PD's leverage to remain high as a result of large investments lying ahead. Capital expenditures for its own projects during 2022-2024 will total THB2.4 billion while capital expenditures for two projects under JVs are expected to be around THB1.2-THB1.5 billion per annum in 2022-2023 and THB300 billion in 2024. However, the company's plan to sell its own RBF and RBW to PROSPECT each year, together with the sale of 212 rais of land under BFTZB to a private entity and the sale of leased assets developed under JVs to PROSPECT in 2024 should partly alleviate its debt burden.

Our base-case scenario projects PD's debt to capitalization ratio (including proportionated debt from JVs) to hover around 72% during 2022-2023 and decline to around 50% in 2024 after the sale of assets to PROSPECT. Its funds from operations (FFO) to debt ratio will likely be in the 4%-6% range in 2022-2023 and reach 23% in 2024. As of December 2021, the ratios were 70% and 2.5%, respectively.

At the end of March 2022, PD's own debts stood at THB3.8 billion, comprising THB622 million debentures, THB1.1 billion long-term project loans, THB50 million short-term promissory notes (P/Ns), THB1.4 billion short-term loans from the parent company, and THB647 million long-term aval for land purchases. PD's priority debt, including secured debts at the company, was THB1.8 billion. This translates to a priority debt to total debt ratio of 47.5%. Debts of JVs were THB4.5 billion, including THB3.1 billion of aval.

Tight liquidity

We assess PD's liquidity to be tight yet manageable over the next 12 months. As of March 2022, the company had debts of THB1.2 billion coming due in the next 12 months, comprising THB322 million maturing debentures, THB182 million long-term project loans, THB50 million short-term P/Ns, and THB647 million long-term aval P/Ns for land purchases. PD's sources of liquidity as of March 2022 comprised cash on hand of around THB9 million. We forecast PD's FFO to be THB360 million in

2022. PD usually refinances its maturing debentures with new debenture issuances. Aval P/Ns for land purchases will be converted into long-term project loans thereafter. In addition, MK should help support PD's liquidity if needed.

The financial covenants on PD's bank loans require the company to maintain its interest-bearing debt to equity ratio below 2 times, total liabilities to total equity ratio below 1.5 times, and debt service coverage ratio above 1 times. As of December 2021, the ratios were 1.5 times, 1.7 times, and 0.8 times respectively. PD has already asked lenders to temporarily waive a breach of loan covenants.

RATING OUTLOOK

The "negative" outlook mirrors the outlook on the parent company and reflects our expectation that PD will maintain its status as a core subsidiary of MK.

RATING SENSITIVITIES

As a core subsidiary of MK, the rating on PD is equivalent to and moves in tandem with the rating on MK. Any weakening of PD's group status could result in a rating downgrade on PD.

COMPANY OVERVIEW

Prospect Development Co., Ltd (PD) was established by FNS holdings PLC (FNS, formerly Finansia PLC) in 2010. PD was set up to develop and operate factories and warehouses for rent in the "Bangkok Free Trade Zone" (BFTZ) project located on Bangna-Trad Km. 23 in Samut Prakarn province. FNS held a 36.4% stake in PD before M.K. Real Estate Development PLC (MK) acquired 100% of the equity of PD, partly through a share swap, in December 2015. As of June 2022, FNS was MK's largest shareholder, owning a 31.5% stake. MK holds 100% of PD.

At the end of June 2022, PD had freehold and leasehold rights on four industrial estates located on Bangna-Trad Km. 23 Road (BFTZ 1), Theparak Road (BFTZ 2), and Bangna-Trad Km. 19 Road (BFTZ3 and BFTZ 6) in Samut Prakarn province. In 2021, PD joined with Sansiri PLC (SIRI) to set up BFTZ Bangpakong Co.Ltd (BFTZB) to develop industrial property for rent in Chachoengsao province. PD also set up a joint venture (JV) with FNS, BFTZ Wangnoi Co.Ltd. (BFTZW), to develop warehouse for rent in Ayutthaya province. The total development area was 924 rais, comprising 456 rais owned by PD and 468 rais owned by JVs. As of June 2022, leasable areas managed by PD totaled 387,093 sq.m., comprising 164,890 sq.m. owned by PD, and 222,203 sq.m. owned by Prospect Logistics and Industrial Freehold and Leasehold Real Estate Investment Trust (PROSPECT). The average OR as of June 2022 of PD and PROSPECT were 86% and 92%, respectively.

KEY OPERATING PERFORMANCE

Chart 1: Revenue Breakdown

Unit: % of total operating revenue

Revenue Contribution	2016	2017	2018	2019	2020	2021
Residential sales				71		
Industrial estate for rent	50	93	92	27	81	75
Management fee income					7	18
Other operating revenues	50	7	8	2	12	6
Total operating revenues	100	100	100	100	100	100
Total operating revenues (mil. THB)	264	211	254	1,306	455	431

Note: Consolidated financial statements from 2019 onwards

Source: PD

Chart 2: Details of Assets

Project	Location		Land area (rai)	Total NLA (sq.m.)	Developed (sq.m.)
PD					
- BFTZ1	Bangna-Trad Km.23	Leasehold	236	185,032	158,224
- BFTZ2	Theparak Rd.	Leasehold	42	30,064	6,666
- BFTZ3	Bangna-Trad Km.19	Leasehold	8	12,163	
		Freehold	132	98,272	
- BFTZ6	Bangna-Trad Km.19	Leasehold	38	30,000	
Total			456	355,531	164,890
JV					
- TPARK BFTZ (FPIT 60%)	Bangna-Trad Km.23	Leasehold	92	80,929	80,929
- BFTZ4 (SIRI 50%)	Bangpakong	Freehold	Land for develop For sale	323 212	186,763
- BFTZ5 (FNS 50%)	Wangnoi	Leasehold	145	110,061	
Total			772	377,753	80,929

Note: All projects managed by PD except TPARK BFTZ

Source: PD

Chart 3: Leased Area Owned and Managed by PD



Source: PD

FINANCIAL STATISTICS AND KEY FINANCIAL RATIOS*

Unit: Mil. THB

	-----Year Ended 31 December -----				
	2021	2020	2019	2018	2017
Total operating revenues	431	455	1,306	254	211
Earnings before interest and taxes (EBIT)	192	476	205	67	42
Earnings before interest, taxes, depreciation, and amortization (EBITDA)	337	655	358	174	139
Funds from operations (FFO)	137	436	165	100	68
Adjusted interest expense	198	182	192	74	71
Capital expenditures	1,149	1,602	0	0	0
Total assets	6,662	6,615	6,040	2,839	2,528
Adjusted debt	5,580	4,356	3,852	1,694	1,465
Adjusted equity	2,433	2,203	1,944	1,033	1,040
Adjusted Ratios					
EBITDA margin (%)	78.18	143.98	27.38	68.50	65.80
Pretax return on permanent capital (%)	2.61	7.64	4.76	2.56	1.64
EBITDA interest coverage (times)	1.70	3.60	1.86	2.36	1.96
Debt to EBITDA (times)	16.58	6.65	10.77	9.75	10.53
FFO to debt (%)	2.46	10.02	4.29	5.91	4.65
Debt to capitalization (%)	69.64	66.41	66.46	62.12	58.49

* Consolidated financial statements from 2019 onwards

RELATED CRITERIA

- Corporate Rating Methodology , 15 July 2022
- Key Financial Ratio and Adjustments for Corporate Issuers, 11 January 2022
- Group Rating Methodology, 13 January 2021

Prospect Development Co., Ltd (PD)

Company Rating:	BBB-
Rating Outlook:	Negative

TRIS Rating Co., Ltd.

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