

CHARN ISSARA DEVELOPMENT PLC

No. 45/2018
23 April 2018

CORPORATES

Company Rating: BB+
Outlook: Stable

Company Rating History:

Date	Rating	Outlook/Alert
16/08/13	BBB-	Stable

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RATIONALE

TRIS Rating downgrades the company rating of Charn Issara Development PLC (CI) to “BB+” from “BBB-”. The rating downgrade reflects CI has a smaller scale of business than rated peers, as well as the company’s volatile and declining operating performance and its increasing leverage.

The rating continues to reflect its brand recognition in the middle- to high-end condominium and hotel segments. The rating also reflects recurring rental income the company earns from the commercial office space it owns, and the dividends received from investments in Sri Panwa Hospitality Real Estate Investment Trust (SRIPANWA) and Bangkok Commercial Property Fund (BKKCP). Lastly, the rating takes into consideration the cyclical and highly competitive nature of the real estate development industry.

KEY RATING CONSIDERATIONS

Small-scale business

CI is smaller than rated peers. The company offers a number of types of residential properties. However, it had only 13 active projects at the end of 2017. Its residential projects are located in Bangkok and the provinces which are popular tourist destinations. The value of the remained units in 13 projects was approximately Bt9,724 million. Around 75% of the remaining value was in the work in progress units, and the rest was ready for sale units. When split by type of project, the remained units in housing projects made up half of the value while condominium units and residential villas made up the balance.

CI’s sales relied heavily on sales in just a few projects because it has a small portfolio of active projects. Revenue has ranged between Bt2,200-Bt2,600 million per year over the past three years. Revenue in 2017 was Bt2,198 million. Sales of real estate made up the largest portion (69%), with hotel operations (27%), and rental and services (4%) making up the rest.

Operating performance falls below expectations

Operating performance in 2017 was lower than TRIS Rating’s expectations. Revenue was Bt2,198 million in 2017, decreasing 14% from 2016. Most revenue came from the transfer of finished condominium units in stock. Presales in 2017 was Bt1,057 million, down from Bt1,608 million in 2016. The company did not launch any new projects in 2017. Presales in 2017 were driven by condominium projects. At the end of 2017, CI had a backlog worth Bt1,541 million. Almost all of the units in the backlog are scheduled to be transferred to customers during 2018-2019. The backlog will translate to revenues of around Bt1,300 million in 2018 and Bt241 million in 2019.

The operating margin (operating income before depreciation and amortization as a percentage of revenue) was 10% in 2016 and 11% in 2017, declining from 17% in 2015.

Sales of units in existing projects fell below the target. Selling, general and administration expenses (SG&A) held steady at around Bt650-Bt750 million per annum over the past three years. The drop in sales meant profitability slid below the target of 15%.

TRIS Rating’s base case scenario reflects two keys assumptions: CI has a limited number of the active projects and a small backlog. As a result, revenue is forecast to range from Bt2,400-Bt2,600 million per annum during 2018-2020.

The operating margin is expected to hold at 10%-12% for the next three years.

Well-known brand name in the target segments

CI's residential property products focus on customers in the middle- to high-income segments. The brands "Issara" and "Bann Issara" are well accepted in terms of product quality and style.

In 2003, the company started to develop luxury residences for sale and opened its first boutique hotel, Sri Panwa hotel, in Phuket province. The Sri Panwa hotel started operation in 2006. The on-site hotel increases the value of the residential villas offered for sale inside the Sri Panwa project. Sri Panwa hotel is a premium quality hotel. It has received a very favorable response from both domestic and foreign customers, especially Chinese customers. As a result, the company was awarded a contract to manage a new hotel, under the Sri Panwa brand, in Hainan province in China. However, hotel management services comprise only a small portion of total revenue.

CI has created a second boutique hotel brand: "Baba Beach". This effort is under two joint ventures. The first joint venture was formed in 2015 with Junfa Real Estate Co., Ltd. as a 70:30 partnership. The second joint venture was formed in 2016 and is a 50:25:25 combination with Sahapat Co., Ltd. and I.C.C. International PLC (ICC). CI has developed two hotels under the Baba Beach brand: one in Phang Nga province and the other in Cha-am district in Phetchaburi province. These two projects are just underway, so the success remains to be seen.

Recurring income from its investments in SRIPANWA and BKKCP

In 2013, CI sold the Sri Panwa hotel phase 1 to Sri Panwa Hotel Property Fund (SPWPF) and recognized a gain of Bt767 million. In 2016, SPWPF converted from a property fund to a real estate investment trust (REIT) named SRIPANWA. Also in 2016, CI sold Sri Panwa hotel phase 2 to SRIPANWA and recognized a gain of Bt429 million. CI holds 30% of the shares of SRIPANWA. CI plans to sell a Baba Beach hotel, worth around Bt600 million, to SRIPANWA in 2018.

CI leased back the hotels from the REIT and operates the hotels. The income from the hotel operations was low because both lease expenses and fixed operating costs are high. CI earns recurring income of Bt80-Bt90 million per annum from renting out the commercial space in two Bangkok office buildings, Charn Issara Tower I and Charn Issara Tower II. The dividends received from the investments in SRIPANWA and BKKCP amount to around Bt50-Bt60 million per annum.

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 CI, have moved their focus toward 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.

Financial leverage remains high

CI has a high level of leverage. Debt outstanding at the end of December 2017 was Bt3,959 million, increasing gradually from Bt3,682 million in 2016 and Bt3,450 million in 2015. CI's debt increased from its investments in two new hotels which should be completed and start to generate income in the next couple years. At the end of 2017, CI's reported debt to capitalization ratio stood at 61.06%. However, if we incorporate the present value of the hotel lease obligations that CI has with SRIPANWA amount to Bt250-Bt270 million per annum for the next 12 years, the adjusted debt to capitalization ratio of the company will be higher than 70% since 2015. At the end of 2017, the adjusted debt to capitalization ratio was 70.43%.

Going forward, CI plans to launch new condominium projects, worth around Bt2,000-Bt3,000 million per year during 2018 and 2019. In addition, the company plans to invest more in hotel and commercial properties. The investments will be funded in part by the sale of assets to SRIPANWA. Under its financing plan, the company will sell the new hotel units in the Baba Beach Club to SRIPANWA by the end of 2018. In addition, the company has a 15.98% stake in a land plot held by its affiliate, International Resource Development Co., Ltd., which can be used as another source of fund. The appraisal value of the land plot was around Bt2,500 million. Thus, under TRIS Rating's base case, the company should be able to maintain its adjusted debt to capitalization ratio at 65%-70% over the next few years.

Moderate liquidity

CI's liquidity profile was moderate. At the end of December 2017, CI had cash on hand of Bt282 million and current investments of Bt251 million plus undrawn long-term credit facilities of Bt2,899 million. Debts worth Bt1,286 million will come due in the next 12 months, comprising Bt367 million in short-term borrowing, Bt619 million in project loans, and bond redemptions of Bt300 million. CI plans to refinance most of the maturing bonds with new bond issues. During 2018-

2020, the EBITDA (earnings before interest, tax, depreciation, and amortization) interest coverage ratio is expected to stay above 2 times. The ratio of funds from operations (FFO) to total debt is expected to stay at around 5%.

RATING OUTLOOK

The “stable” outlook reflects the expectation that CI’s financial position will not decline from the current level. The company is expected to deliver the units in the backlog as planned. The adjusted debt to capitalization ratio is expected to stay around 65%-70% and the operating profit margin is forecast to hold at 10%-12% for the next three years.

During 2018-2020, TRIS Rating’s forecast assumes CI’s revenue will range from Bt2,400-Bt2,600 million per annum. The contribution from the hotel operations and office rental segment will total around Bt600-Bt700 million per annum. FFO is expected to hold at around Bt100 million per annum.

RATING SENSITIVITIES

A rating upgrade is unlikely in the near term but could occur if CI demonstrates a significant, sustained improvement in operating performance. On the contrary, the rating and/or outlook could be revised downward if operating performance declines further.

COMPANY OVERVIEW

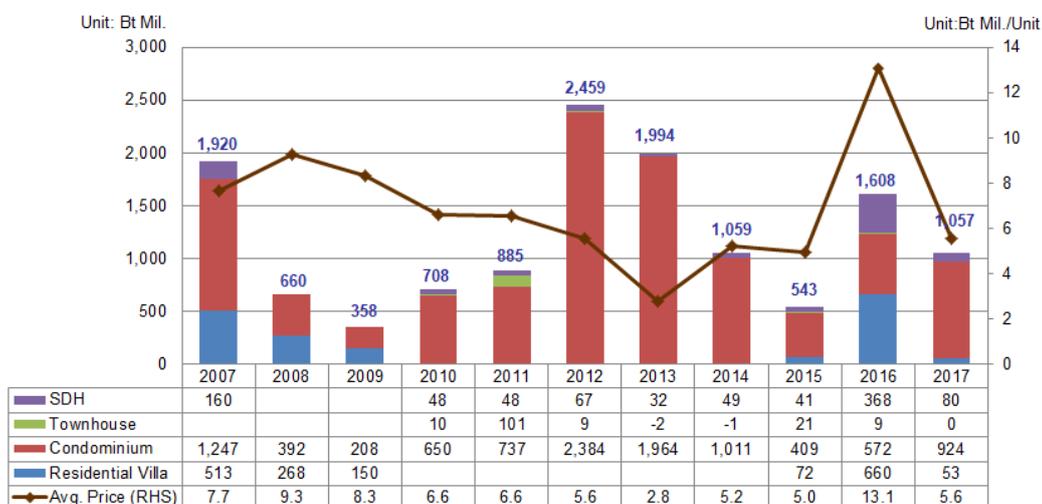
CI was established in 1989 by the Issara family. CI became a public company in June 2002 and was listed on the Stock Exchange of Thailand (SET) in December 2002. The Issara family has been the company’s major shareholder since its inception. As of March 2017, the Issara family held a 48% stake in the company.

CI’s residential property products target the middle- to high-income segments. At the end of 2017, the residential property portfolio comprised condominiums (32% of the total value of the project portfolio), single detached houses (SDH) (46%), residential villas (22%), and townhouses (0.2%). CI’s existing residential projects are located in Petchburi province (20% of the project portfolio value), Phuket (20%), Bangkok (48%), Nakorn Ratchasima (6%), and Chiang Mai (6%).

CI started to develop luxury residences for sale and opened its first boutique hotel, Sripanwa hotel, in Phuket in 2003. The Sripanwa hotel started operation in 2006. The company sold the Sripanwa hotel to SPWPF in 2013 and simultaneously purchased 30% of SPWPF. The company also owns 30% of BKKCP, a property fund that owns two office buildings, Charn Issara Tower I and Charn Issara Tower II. CI manages these two office buildings for the fund. In addition, the company also owns 3,578 square meters (sq.m.) of retail space in these two buildings.

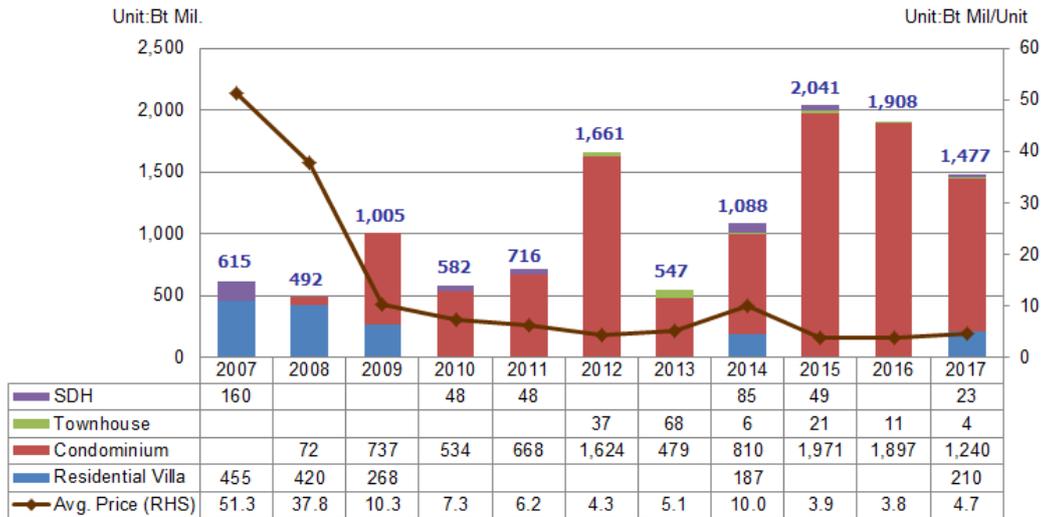
KEY OPERATING PERFORMANCE

Chart 1: Presales Performance



Source: CI

Chart 2: Revenue Breakdown by Products



Source: CI

FINANCIAL STATISTICS AND KEY FINANCIAL RATIOS*

Unit: Bt million

	-----Year Ended 31 December-----				
	2017	2016	2015	2014	2013
Revenue	2,198	2,558	2,592	2,648	1,593
Gross interest expense	185	192	151	102	82
Net income from operations	19	159	132	(28)	303
Funds from operations (FFO)	(114)	416	244	(64)	511
Inventory investment (-increase/+decrease)	(301)	(179)	(1,520)	(718)	(437)
Total assets	7,857	7,328	6,814	4,885	4,130
Total debts	3,959	3,682	3,450	1,982	1,292
Total adjusted debts	6,013	5,803	4,850	3,432	2,788
Shareholders' equity	2,525	2,289	2,027	1,606	1,633
Operating income before depreciation and amortization as % of sales	11.06	10.12	17.08	10.01	(8.70)
Pretax return on permanent capital (%)	5.50	11.26	10.82	5.52	17.30
Earnings before interest, tax, depreciation, and amortization (EBITDA) interest coverage (times)	1.08	2.37	2.04	1.03	4.96
FFO/total debt (%)	(2.32)	7.16	5.21	(1.76)	18.32
Total debt/capitalization (%)	70.43	71.72	70.53	68.12	63.06

Note: All ratios have been adjusted by operating leases of Sripanwa hotel since 2013.

* Consolidated financial statements

Charn Issara Development PLC (CI)

Company Rating:	BB+
Rating Outlook:	Stable

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