

M.K. REAL ESTATE DEVELOPMENT PLC

No. 38/2024
26 March 2024

CORPORATES

Company Rating: BB-
Outlook: Stable

Last Review Date: 12/04/23

Company Rating History:

Date	Rating	Outlook/Alert
12/04/23	BB+	Stable
26/04/22	BBB-	Negative
10/04/20	BBB-	Stable
12/04/19	BBB	Negative
10/02/16	BBB	Stable
24/06/15	BBB+	Alert Negative
17/06/15	BBB+	Negative
05/03/10	BBB+	Stable
20/03/08	BBB	Stable

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RATIONALE

TRIS Rating downgrades the company rating on M.K. Real Estate Development PLC (MK) to “BB-” from “BB+” with a “stable” outlook”. The “BB-” rating reflects our lower assessment of its standalone credit profile (SACP) to “bb” from “bb+” due to weaker-than-expected operating performance and high financial leverage. In addition, the rating also reflects the company’s group status as a “strategic” member of FNS Holdings PLC (FNS), which became the single largest shareholder of MK with a 49.5% stake in August 2023. Consequently, MK’s company rating is capped by the “bb-” group credit profile (GCP) of FNS.

MK’s standalone credit profile (SACP) of “bb” reflects its modest business scale and relatively tight liquidity. Although its plan to exit the residential property and wellness businesses could potentially enhance its operating performance in the short to medium term, the company rating on MK remains capped by the GCP.

KEY RATING CONSIDERATIONS

Weaker-than-expected operating performance

MK’s operating performance in 2023 remained weak, falling well below our projections. Operating revenue in 2023 was THB2.3 billion, achieving only 80% of our target. Residential sales generated lower-than-expected revenues while the wellness business struggled amid low occupancy rates and rising selling and administrative expenses, resulting in a significant operating loss. MK reported negative funds from operations (FFO) of THB419 million, while earnings before interest, taxes, depreciation, and amortization (EBITDA) remained relatively flat at around THB460 million compared to the previous year.

Looking forward, MK’s operating performance is expected to improve, driven by its expanding industrial property business. In addition, the divestment of RX Wellness Ltd. (RXW) to FNS is expected to improve its performance in the near term. However, the ongoing weakness in the residential property business and escalating financing costs will likely continue to exert pressure on both the business and financial profiles of the company over the next two to three years.

Rating constrained by the group credit profile

The company rating on MK has been capped by the GCP since FNS acquired additional shares in MK and became its single largest shareholder. Although the divestiture of RXW to its parent company is expected to help improve the operating performance of MK, the consolidated performance of the group and the GCP remain unchanged, in our view. This is because RXW remains a subsidiary of FNS and continues to lease and sub-lease MK’s assets at Bangkrachao and Sampran.

In our view, the wellness business is likely to continue impeding the overall operating performance of the group in the short to medium term. The post-COVID-19 recovery of the wellness business has been slower than expected. In 2023, revenue from the wellness segment amounted to only THB133 million, insufficient to cover fixed costs of around THB308 million per annum.

Plan to exit residential property business

MK's management has acknowledged their lack of a competitive edge in the residential property business. Revenues from residential property sales have steadily declined, dropping from over THB2.5 billion in 2018 to only THB653 million in 2023. Additionally, gross profit margins have contracted, decreasing to 22% in 2023 from over 30% in 2018. MK has not launched any new projects since 2021.

In August 2023, MK entered into an agreement with non-related party to transfer the rights to receive payments from housing units sold in seven existing projects, worth at least THB3.6 billion, in exchange of an upfront payment of THB3.08 billion. Approximately 50% of the proceeds will be used for construction and selling and administrative expenses. MK aims to finalize the construction and sale of the remaining housing units in its existing projects within the next three to five years. As of the end of 2023, the remaining value of housing units available for sale stood at approximately THB3.4 billion.

Industrial property remains the core business

We expect the industrial property (IP) business operated under Prospect Development PLC (PD) to become the key earnings contributor of MK and the group over the next two to three years. PD's reliable cash flows from its rental business and property management fees are expected to bolster the overall performance of the group. In addition, following the establishment of the "Prospect Logistics and Industrial Freehold and Leasehold Real Estate Investment Trust" (PROSPECT) in 2020, PD aims to realize gains from selling leasable space to PROSPECT on a regular basis. In 2023, PD successfully completed development of 136,770 square meters (sq.m.) of leasable space, including 41,172 sq.m. from its joint ventures (JVs), and sold 70,129 sq.m of leased space to PROSPECT, resulting in gains from asset sales totaling THB262 million.

However, PD's business scale remains relatively modest. At the end of 2023, PD's portfolio comprised only 0.27 million sq.m. of its own ready-built warehouses/factories for rent. Total leasable areas under its management, including areas under PROSPECT and its JVs, amounted to just 0.63 million sq.m. Excluding gains from selling assets to PROSPECT, PD's EBITDA has been only THB300-THB400 million annually over the past three years.

Looking forward, PD plans to add 0.05-0.15 million sq.m. of newly built warehouses/factories annually. PD expects to maintain a leasable area of around 0.2 million sq.m. for rental income while selling assets totaling approximately 0.05-0.10 million sq.m. per annum to PROSPECT over the next three years. With an expanding asset size, PD's EBITDA is expected to grow from THB720 million in 2023 to THB1 billion per annum in 2024-2026, accounting for 80%-85% of MK's total EBITDA.

High financial leverage

Due to its investments in the IP and wellness businesses, MK's debt surged to THB12.5-12.6 billion in 2022-2023, from THB8 billion in 2018. Its debt to capitalization ratio reached 69% by the end of 2023, increasing from 66% in 2022. Looking forward, given its investments in the pipeline, MK's leverage is expected to remain high throughout the forecast period.

Capital expenditure for its investment property is estimated at THB2.8 billion in 2024 (including the acquisition of 50% of BFTZ Wangnoi Co., Ltd.) and around THB1 billion per annum during 2025-2026, while PD's share of capital expenditure for constructing two warehouses under JVs will be around THB0.4-THB1.0 billion per annum during 2024-2025. In addition, MK will acquire additional 22% shares in PROSPECT from FNS at THB734 million. Despite winding down its residential property business, MK is obliged to build and sell its remaining projects in the next three to five years. As a result, we project MK's debt to capitalization ratio will increase to around 70%-72% during 2024-2026. The FFO to debt ratio is forecast to hover around 2%-3% over the next two to three years.

MK's priority debt, including secured debt at the company and debts at its subsidiaries, was THB6.5 billion. This translates to a priority debt to total debt ratio of 62%. As the priority debt ratio surpasses our trigger level of 50%, we view that MK's unsecured creditors could be at a significantly disadvantaged position to its priority debt holders with respect to claims against the company's assets.

Tight liquidity

We assess MK's liquidity to be constrained over the next 12 months. As of December 2023, MK's sources of liquidity included THB232 million in cash, and loans from non-related party totaling THB1.6 billion. We forecast FFO of around THB400 million over the next 12 months. MK also has unencumbered assets worth THB334 million at cost, which could be pledged as collateral for new credit facilities, if needed.

Debt maturing over the next 12 months amounts to THB3.2 billion, comprising THB1.7 billion debentures, THB483 million short-term borrowings, THB947 million long-term project loans, and THB90 million short-term loans from FNS. MK usually refinances its matured debentures by new debenture issuances. The company also expects to sell leased assets to PROSPECT of THB2 billion and some land plots for around THB400 million within this year.

The revised financial covenants on MK's debentures and bank loans stipulate that the company must maintain its net interest-bearing debt to equity ratio below 3 times and 2 times, respectively. As of December 2023, the ratio was 1.8 times.

BASE-CASE ASSUMPTIONS

These are the key assumptions in TRIS Rating's base-case forecast for MK's operations during 2024-2026:

- Operating revenues to range from THB1.6-THB2.0 billion per annum.
- MK to build and transfer housing units worth around THB650-THB750 million per annum over the next three years
- Capital expenditure in the industrial estate for rent business of THB2.8 billion in 2024 (including the acquisition of 50% of BFTZ Wangnoi Co., Ltd.) and around THB1 billion per annum during 2025-2026.
- PD's share of capital expenditure for constructing two warehouses under JVs will be around THB0.4-THB1.0 billion per annum during 2024-2025
- MK to acquire additional 22% shares in PROSPECT from FNS at THB734 million
- PD to sell around 0.05-0.1 million sq.m. of rental space worth around THB1-THB2 billion per annum to PROSPECT

RATING OUTLOOK

The "stable" outlook reflects our expectation that MK's residential property business should not deteriorate further from the current level while the scale of the IP business is expected to expand and generate stable cash flows to the group as targeted. In addition, we anticipate improvement in the wellness business from its current state, which should not drag down the GCP.

RATING SENSITIVITIES

Given that MK's company rating and outlook are constrained by the GCP, the improving credit profile of the group could potentially uplift the company rating on MK. On the contrary, should the credit profile of the group deteriorate beyond the current level, there is a possibility of a downward revision of the company rating.

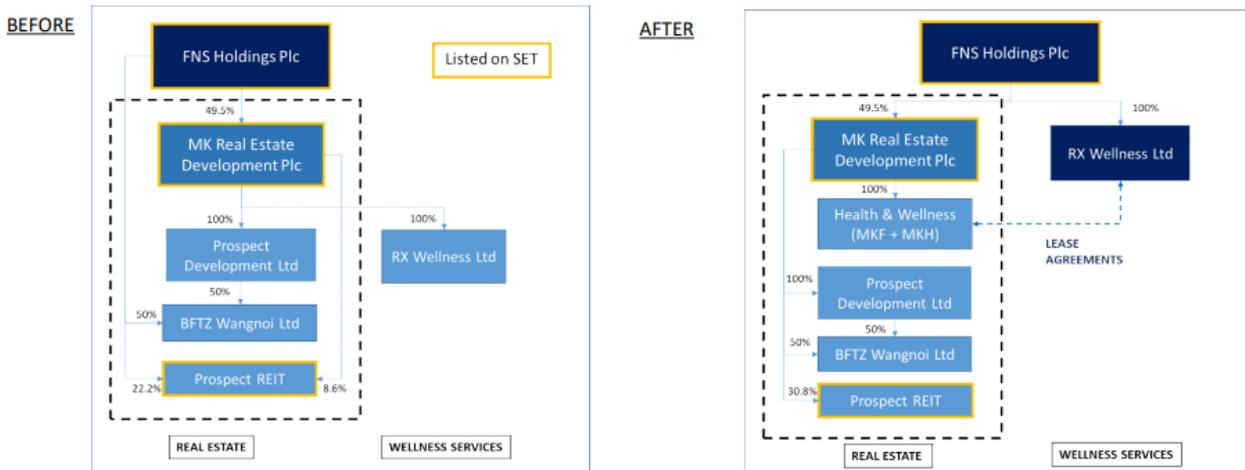
COMPANY OVERVIEW

MK was founded in 1973 by Mr. Chuan Tangmatitham and listed on the Stock Exchange of Thailand (SET) in 1990. The Tangmatitham family was MK's major shareholder before it sold almost its entire stake in the company to Mr. Suthep Wongvorazathe in June 2015. Mr. Suthep consequently became the major shareholder of the company, holding a 20.64% stake as of September 2015. However, as MK later acquired 100% of the equity of PD, partly through a share swap, Mr. Suthep's stake in MK was diluted to 17.9% as of December 2015. The existing shareholders of PD then held 13.3% of MK with FNS (formerly Finansa PLC), the major shareholder of PD, holding 7.15% of MK. New top managers were put in place in 2015, most with a background in the financial services industry. In August 2023, FNS acquired additional shares in MK, becoming the single largest shareholder with a 49.5% shareholding.

Initially, MK focused on developing low-rise residential property projects, with prices ranging from THB3-THB6 million per unit, under the "Chuan Chuen" brand. Most of its products are semi-prebuilt or prebuilt single detached houses (SDHs), semi-detached houses (semi-DHs), and townhouses (THs). Since 2021, MK shifted the focus of its investment into the industrial property and wellness businesses. The management plans to phase out and exit the residential property business in the next three to five years.

On March 1, 2024, MK's shareholders approved a business restructuring plan. Under this plan, MK will sell its 100% stake in RXW to its parent company, FNS Holdings PLC. MK will retain ownership of the operating assets but will lease and sub-lease the land and buildings at Bangkrachao and Sampran to RXW. In addition, MK will acquire a 50% share of in BFTZ Wangnoi Ltd. and a 22.2% share of PROSPECT from FNS. Going forward, MK expects the IP business to be a significant earnings contributor.

Group Restructuring Plan

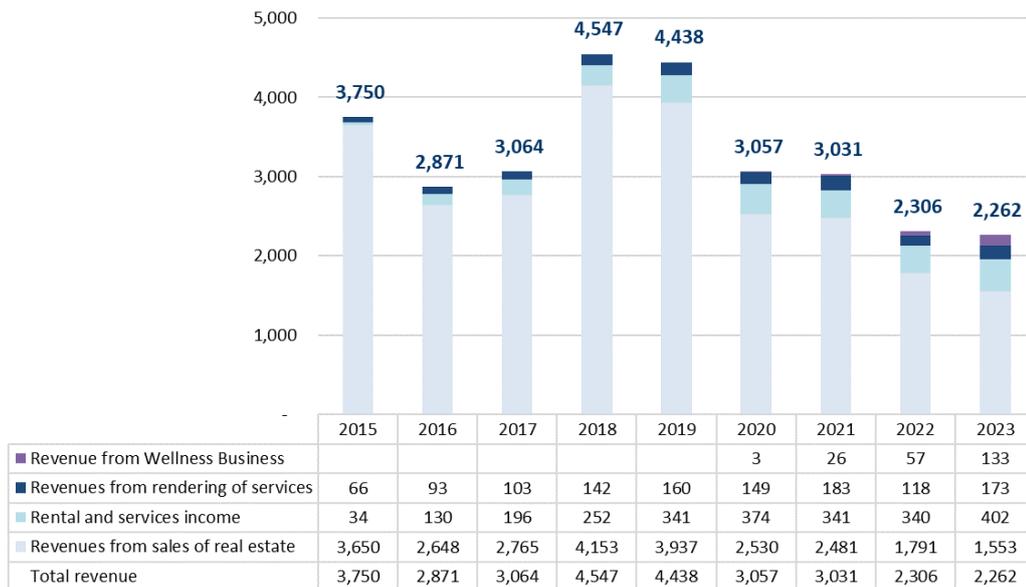


Source: MK

KEY OPERATING PERFORMANCE

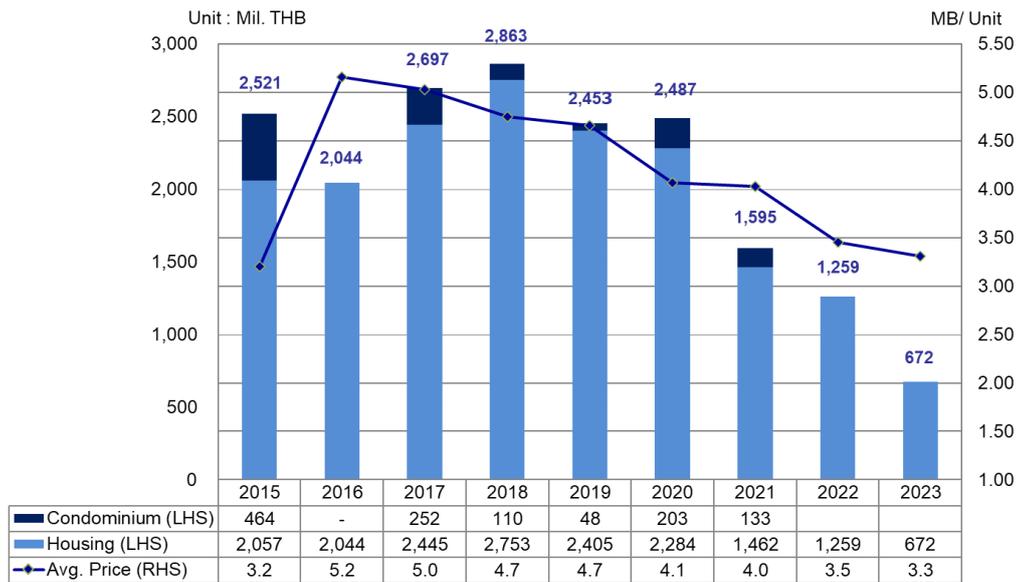
Chart 1: Revenue Contribution from Each Business

Unit: Mil. THB



Source: MK

Chart 2: Residential Property Presales



Source: MK

Table 1: Details of Assets in IP Business

Project	Location		Land area (rai)	Total NLA (sq.m.)	Developed (sq.m.)
PD					
- BFTZ1	Bangna-Trad Km.23	Leasehold	236	181,673	176,312
- BFTZ2	Theparak Rd.	Leasehold	42	33,477	33,477
- BFTZ3	Bangna-Trad Km.19	Leasehold	8	12,163	12,163
		Freehold	132	100,015	100,015
- BFTZ6	Bangna-Trad Km.19	Leasehold	50	50,004	
		Freehold	33	29,736	
- BFTZ7	Bangna-Trad Km.10	Leasehold	28	35,608	20,072
Total			456	442,676	342,048
JV					
- TPARK BFTZ (FPIT 60%)	Bangna-Trad Km.23	Leasehold	92	80,930	80,930
- BFTZ4 (SIRI 50%)	Bangpakongng	Freehold	323	184,348	46,356
		Land for develop			
		For sale	212		
- BFTZ5 (FNS 50%)	Wangnoi	Leasehold	145	109,355	20,932
Total			772	374,633	148,218

Note: All projects managed by PD except TPARK BFTZ

Source: MK and PD

FINANCIAL STATISTICS AND KEY FINANCIAL RATIOS*

Unit: Mil. THB

	-----Year Ended 31 December -----				
	2023	2022	2021	2020	2019
Total operating revenues	2,262	2,306	2,939	3,057	4,438
Earnings before interest and taxes (EBIT)	87	159	(55)	413	626
Earnings before interest, taxes, depreciation, and amortization (EBITDA)	460	435	240	668	838
Funds from operations (FFO)	(419)	(151)	(249)	229	432
Adjusted interest expense	806	637	489	398	350
Real estate development investments	2,449	3,692	4,601	6,143	6,164
Total assets	19,360	19,865	19,041	17,985	16,707
Adjusted debt	12,519	12,678	10,970	9,803	8,551
Adjusted equity	5,672	6,463	6,468	6,641	6,795
Adjusted Ratios					
EBITDA margin (%)	20.4	18.9	8.2	21.8	18.9
Pretax return on permanent capital (%)	0.5	0.9	(0.3)	2.5	4.1
EBITDA interest coverage (times)	0.6	0.7	0.5	1.7	2.4
Debt to EBITDA (times)	27.2	29.2	45.7	14.7	10.2
FFO to debt (%)	(3.3)	(1.2)	(2.3)	2.3	5.0
Debt to capitalization (%)	68.8	66.2	62.9	59.6	55.7

* Consolidated financial statements

RELATED CRITERIA

- Homebuilders and Real Estate Developers Rating Methodology, 12 January 2023
- Corporate Rating Methodology, 15 July 2022
- Key Financial Ratios and Adjustments for Corporate Issuers, 11 January 2022

M.K. Real Estate Development PLC (MK)

Company Rating:

BB-

Rating Outlook:

Stable

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