

M.K. REAL ESTATE DEVELOPMENT PLC

No. 56/2023
12 April 2023

CORPORATES

Company Rating: BB+
Outlook: Stable

Last Review Date: 26/04/22

Company Rating History:

| Date | Rating | Outlook/Alert |
|----------|--------|----------------|
| 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 “BBB-” and revises the outlook to “stable” from “negative”. The company rating downgrade reflects MK’s weaker-than-expected operating performance while financial leverage remains high. The rating continues to reflect the company’s modest business scale and the challenges being faced in the wellness business. The rating also incorporates our concerns over the persistently high household debt levels and rising inflation which could impact the purchasing power of homebuyers in the middle- to low-income segments.

KEY RATING CONSIDERATIONS

Weaker-than-expected operating performance

MK’s operating performance in 2022 remained weak and far below our previous forecast. Operating revenue was THB2.3 billion, declining from around THB3 billion per annum during 2020-2021 and THB4.5 billion in 2018-2019. A sharp drop in residential sales coupled with poor performance in the wellness business caused MK’s operating profit to remain in negative territory. The company reported negative funds from operations (FFO) of THB113 million and earnings before interest, taxes, depreciation and amortization (EBITDA) of THB435 million in 2022.

We expect MK’s credit profile to weaken more than our previous estimates. Our base-case forecast expects MK’s total operating revenue to gradually recover, ranging between THB2.6-THB2.8 billion per annum during 2023-2025. We forecast FFO and EBITDA to increase to THB400-THB600 million per annum and to THB1-THB1.3 billion, respectively. However, due to its sizable debt, MK’s average FFO to debt ratio is likely to remain below 5% while its debt to EBITDA will stay above 8 times over the forecast period.

Challenges remain in wellness business

In our view, the wellness business continues to pressure MK’s overall operating performance in the short to medium term. Although the negative impact of the Coronavirus Disease 2019 (COVID-19) pandemic have subsided, the pace of recovery of its first wellness project under the “RAKxa” brand continues to fall short of expectations. In 2022, revenue from the wellness business was only THB57 million, insufficient to cover fixed costs of around THB200 million per annum. MK plans to rent out nine villas in this project to Vitalife to set up “BH Medical Village”, a rehabilitation center for patients of Bumrungrad Hospital. The investment cost was around THB80 million. This will help improve its earnings in the coming years.

Although the first wellness project is still evolving and has not yet reached break-even point, MK has moved forward with its second project, “RXV Wellness Village” (RXV) at Sampran District. In this project, MK aims to cater to the domestic market with smaller service packages. The investment cost for the 1st phase, which includes an 83-key hotel on 12 rais of land, was around THB700 million. RXV was opened on 15 March 2023. In our view, aggressive expansion into this business, if not successful, is likely to burden the company’s financial profile over the forecast period.

Declining contribution from residential property business

MK's revenues from residential units sold have declined steadily, from more than THB2.5 billion in 2018 to only THB1.3 billion in 2022. The gross profit margins has also narrowed, declining to 25% in 2022 from more than 30% in 2018. Weaker purchasing power and intense competition in the middle- to low-price housing segment has prompted the company's management to downsize its investment in this business. MK did not launch any projects in the last two years. The remaining value of housing units available for sales was around THB4 billion at the end of 2022, around 16% of which was made up of finished units. Thus, the revenue contribution from housing sales is expected to remain at around THB1.3-THB1.5 billion per annum over the next three years.

PD as a core operating entity

We expect the industrial property (IP) business operated under Prospect Development PLC (PD) to become the strongest business line and key earnings contributor of the group over the next 2-3 years. PD's stable cash flows from its rental business and property management fee should help support the overall performance of the group. In addition, after setting up the "Prospect Logistics and Industrial Freehold and Leasehold Real Estate Investment Trust" (PROSPECT) in 2020, PD expects to realize gains from selling leasable space to PROSPECT on a regular basis. However, PD's business scale remains small. At the end of 2022, PD's portfolio comprised only 0.25 million square meters (sq.m.) of its own ready-built warehouses/factories for rent. Total leasable areas under its management, including leasable areas under PROSPECT and its joint ventures, was just 0.5 million sq.m. Without the gains from selling its assets to PROSPECT, PD's EBITDA was only THB300-THB350 million per annum in the past three years.

Looking forward, PD plans to add 0.05-0.1 million sq.m. of newly built warehouses/factories per annum. PD expects to maintain leasable area of around 0.2 million sq.m. for rental income and sell assets of around 0.06-0.08 million sq.m. per annum to PROSPECT over the next three years. As asset size expands, PD's EBITDA is expected to grow around THB700 million in 2023 to THB1 billion per annum in 2024-2025, accounting for 65%-90% of MK's total EBITDA.

High financial leverage

Due to its substantial investments in both the wellness and IP businesses, MK's debt increased sharply to THB12.6 billion in 2022 from THB8 billion in 2018. Its debt to capitalization ratio stood at 66% at the end of 2022, increasing from 55% in 2018.

Given the investment plans in the pipeline, MK's leverage is expected to remain high over the forecast period. Capital expenditures for its own investment property during 2023-2025 will total THB3.7 billion while the capital expenditure (PD's portion) needed to fund the construction of two warehouses under JVs will be around THB0.5-THB2 billion per annum during 2023-2025. The construction cost for its wellness business is estimated to be THB250-THB300 million in 2023. In order to maintain revenues from residential units sales at around THB1.3-THB1.5 billion per annum, MK may have to launch new landed property projects worth THB1.5-THB2 billion each year with a budget for land acquisition of THB300 million annually. As a result, we project MK's debt to capitalization ratio to remain high at 66% in 2023-2024 before improving to around 63% in 2025. The FFO to debt ratio is forecast to hover around 3% during 2023-2024 before improving to a level above 5% in 2025.

MK's priority debt, including secured debt at the MK's company and debts at its subsidiaries, was THB4.1 billion. This translates to a priority debt to total debt ratio of 35%.

Tight but manageable liquidity

We assess MK's liquidity to be tight but manageable over the next 12 months. MK's sources of liquidity at the end of December 2022 included cash on hand of THB479 million and undrawn unconditional committed credit facilities of THB463 million. We forecast FFO of around THB350 million over the next 12 months. MK also has unencumbered assets at cost worth THB149 million, which can be pledged as collateral for new credit facilities, if needed.

Debt maturing over the next 12 months will amount to THB5.2 billion, comprising THB4 billion debentures, THB650 million bill of exchange (B/Es), THB167 million short-term promissory notes (P/N), and THB362 million long-term project loans. MK usually refinances its matured debentures by new debenture issuances and rolls over its matured B/Es and P/Ns. In addition, the proceeds from selling assets to PROSPECT of THB1.7 billion and some land plots of around THB500 million within this year should partly alleviate its liquidity concerns.

The financial covenants on MK's debt obligations require the company to keep its net interest-bearing debt to equity ratio below 2 times. The ratio at the end of December 2022 was 1.8 times. We expect the company should have no problems complying with the financial covenants over the next 12 months.

BASE-CASE ASSUMPTIONS

These are the key assumptions in TRIS Rating's base-case forecast for MK's operations during 2023-2025:

- Operating revenues to range from THB2.5-THB2.8 billion per annum.
- MK to launch new landed property projects worth THB1.5-THB2 billion per annum with annual land acquisition of THB300 million in 2024-2025.
- Capital expenditure in industrial estate for rent business of THB1.9 billion in 2023 and THB800 million to THB1 billion in 2024-2025.
- Investment in two projects in JVs (PD's portion) of around THB500 million to THB2 billion per annum during 2023-2025.
- Capital expenditure in wellness business of THB250-THB300 million in 2023
- Gross profit margin to range from 34%-41% and EBITDA margin from 37%-45%.

RATING OUTLOOK

The "stable" outlook reflects our expectation that MK's residential property business should not deteriorate further from the current level while operating performance from the wellness business is expected to improve. We also expect MK's IP business scale to enlarge and generate stable cash flows to the group.

RATING SENSITIVITIES

The rating and/or outlook could be revised downward should the company's operating results and/or financial profile deteriorate from our base-case forecast. On the other hand, a credit upside scenario could emerge if there are signs of significant improvement in its operations and financial profile, such that the ratio of FFO to debt stays above 5% and/or its debt to EBITDA drops below 8 times on sustained basis.

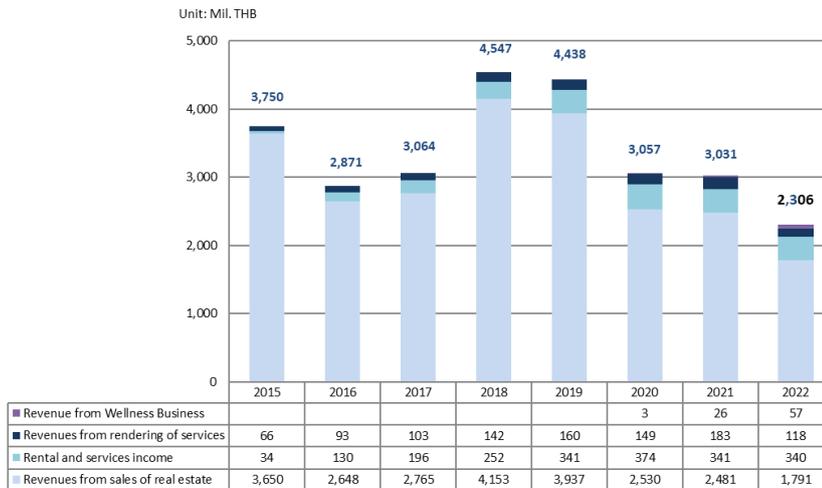
COMPANY OVERVIEW

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 in MK as of September 2015. However, as MK later acquired 100% of the equity of Prospect Development Co., Ltd. (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 Holdings PLC (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. As of December 2022, FNS and Mr. Suthep were the major shareholders of MK, holding 31.5% and 5.5% stakes, respectively.

MK focuses on developing low-rise residential property projects, with prices ranging between 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). At the end of 2022, MK had 15 landed property projects, with remaining units worth around THB4.1 billion (including both built and un-built units). Since 2021, MK shifted its major investment into the IP and wellness businesses. Looking forwards, MK expects the IP business to be a key earnings contributor to the group. Revenue contributions from residential sales, industrial estate business, and wellness business accounted for 78%, 20%, and 2% of MK's total revenue, respectively, in 2022.

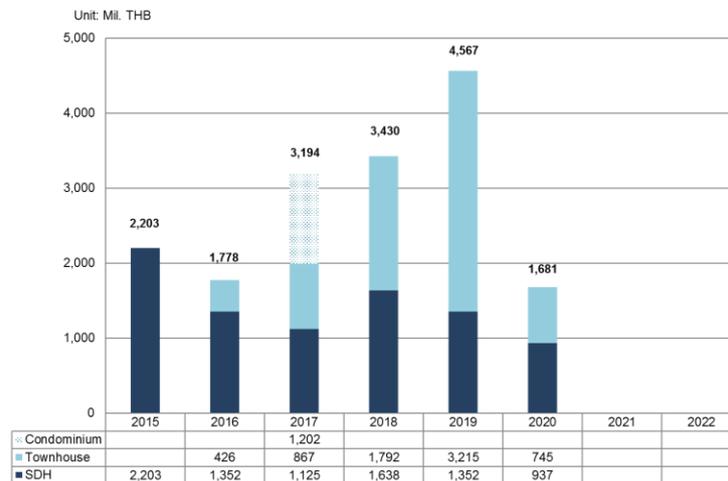
KEY OPERATING PERFORMANCE

Chart 1: Revenue Contribution from Each Business



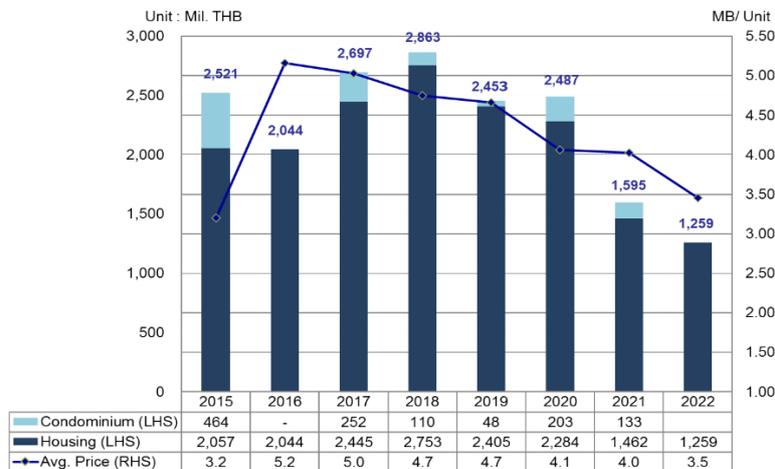
Source: MK

Chart 2: Residential Project Launches



Source: MK

Chart 3: 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 | 185,032 | 185,032 |
| - BFTZ2 | Theparak Rd. | Leasehold | 42 | 33,477 | 20,996 |
| - BFTZ3 | Bangna-Trad Km.19 | Leasehold | 8 | 12,163 | |
| | | Freehold | 132 | 99,947 | 49,133 |
| - BFTZ6 | Bangna-Trad Km.19 | Leasehold | 50 | 50,800 | |
| | | Freehold | 33 | 29,736 | |
| Total | | | 456 | 411,155 | 255,161 |
| JV | | | | | |
| - TPARK BFTZ (FPIT 60%) | Bangna-Trad Km.23 | Leasehold | 92 | 80,930 | 80,930 |
| - BFTZ4 (SIRI 50%) | Bangpakong | Freehold | 323 | 185,763 | 5,184 |
| | | Land for develop For sale | 212 | | |
| - BFTZ5 (FNS 50%) | Wangnoi | Leasehold | 145 | 109,411 | 21,010 |
| Total | | | 772 | 376,103 | 107,124 |

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 ----- | | | | |
|--------------------------------------------------------------------------|-----------------------------------|--------|--------|--------|--------|
| | 2022 | 2021 | 2020 | 2019 | 2018 |
| Total operating revenues | 2,306 | 2,939 | 3,057 | 4,438 | 4,547 |
| Earnings before interest and taxes (EBIT) | 159 | (55) | 413 | 626 | 681 |
| Earnings before interest, taxes, depreciation, and amortization (EBITDA) | 435 | 240 | 668 | 838 | 869 |
| Funds from operations (FFO) | (113) | (249) | 229 | 432 | 469 |
| Adjusted interest expense | 599 | 489 | 398 | 350 | 320 |
| Real estate development investments | 3,692 | 4,601 | 6,143 | 6,164 | 7,149 |
| Total assets | 19,865 | 19,041 | 17,985 | 16,707 | 15,727 |
| Adjusted debt | 12,678 | 10,970 | 9,803 | 8,551 | 8,007 |
| Adjusted equity | 6,463 | 6,468 | 6,641 | 6,795 | 6,646 |
| Adjusted Ratios | | | | | |
| EBITDA margin (%) | 18.85 | 8.16 | 21.84 | 18.89 | 19.11 |
| Pretax return on permanent capital (%) | 0.85 | (0.32) | 2.51 | 4.05 | 4.77 |
| EBITDA interest coverage (times) | 0.73 | 0.49 | 1.68 | 2.39 | 2.71 |
| Debt to EBITDA (times) | 29.16 | 45.74 | 14.69 | 10.20 | 9.22 |
| FFO to debt (%) | (0.89) | (2.27) | 2.34 | 5.05 | 5.86 |
| Debt to capitalization (%) | 66.24 | 62.91 | 59.61 | 55.72 | 54.64 |

* 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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