TRIS RATING
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M.K. REAL ESTATE DEVELOPMENT PLC

No. 48/2020
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CORPORATES

Company Rating: BBB-
Outlook: Stable

Last Review Date: 12/04/19

Company Rating History:

Date	Rating	Outlook/Alert
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 "BBB-" from "BBB", and changes MK's rating outlook to "stable" from "negative". The downgrade reflects our concerns over a rise in the company's financial leverage resulting from its significant investment and the prospect of a decline in profitability resulting from on-going investment of its health and wellness business. The rating continues to reflect MK's acceptable brand recognition in the housing market. The rating also takes into consideration the adverse effects of the COVID-19 outbreak which is causing severe impacts to the domestic economy and the purchasing power of homebuyers.

KEY RATING CONSIDERATIONS

Financial leverage continues to rise

TRIS Rating expects MK's financial leverage to further rise given its sizable capital spending on its recurring income business. Under its strategic business diversification, MK started to invest in rental assets in 2015 and aimed to raise the earnings contribution from its recurring income business to 50% by 2021. The expansion into the recurring income business has required a substantial amount of investment, causing the debt to capitalization ratio to rise sharply since 2015. The ratio rose from 20% in 2014 to 36% in 2015, and has been above 50% from 2017 onwards. At the end of 2019, the debt to capitalization ratio stood at 56%.

At present, businesses under its recurring income portfolio comprise factories and warehouses for rent in the "Bangkok Free Trade Zone" (BFTZ) project and rental apartments on Sukhumvit 77 Road. In addition, MK has started tapping into the health and wellness business under the brand "RAKxa" and plans to launch the project in the second half of 2020. The total capital expenditure of the health and wellness business will be around Bt2.1 billion of which Bt500 million remains as of March 2020. Additional Bt2 billion will be spent toward expansion of the warehouse and factory for rent business between 2020-2022.

MK plans to sell some of its investment properties into a real estate investment trust (REIT) around mid-2020. The proceeds of the REIT will be around Bt2 billion. The net proceeds after unencumbered Bt652 million of the debt associated with the properties will be around Bt1.35 billion. The company plans to use around 50% of the proceeds to further reduce debt and the other 50% for expansion of the project and/or investment in REIT units. In addition, the company plans to sell unencumbered condominium units and raw land value over Bt2 billion during 2020-2021. The proceeds from the sales will be earmarked for debt repayments and expansion of its industrial rental business. However, we view that the planned sales into the REIT may be delayed given the climate of economic uncertainty amid the COVID-19 pandemic.

As a result, the funds needed for construction will likely add to the debt burden. We forecast the debt to capitalization ratio to jump to a level above 60% in 2020, and then hover around 57% during 2021-2022. The ratio of funds from operations (FFO) to debt is forecast to drop to minus 0.2% in 2020 before recovering to around 4% in 2021-2022, while the earnings before interest, tax, depreciation and amortization (EBITDA) interest coverage ratio is forecast to stay above 1 times over the next three years.

Declining profitability expected

TRIS Rating projects MK's profitability to decline in the next 2-3 years. MK has faced declining profitability in recent years, mainly from extra spending in selling, general, and administrative expenses (SG&A). The operating margin (operating income as a percentage of sales) declined continually from 19% in 2016, to 16% in 2017, and 15% in 2019.

Going forward, we expect MK's profitability to continue to be under pressure from the additional costs of its new businesses. We expect the returns from its investments in the health and wellness business to be minimal during the initial period of operation, while MK has to shoulder considerable amount of fixed costs and administrative expenses. The operating margin is expected to drop to 13% in 2020 and then recover to the 15%-17% range in 2021-2022.

Acceptable brand recognition

MK's housing products under the "Chuan Chuen" brand are well accepted by customers in the middle- to low-income segments in terms of product quality and affordability. The company focuses mainly on the development of landed property projects, so its backlog is quite minimal. The company's revenues lie in its ability to generate new sales and transfers each year. MK has been able to maintain revenues of Bt2.6-Bt2.8 billion over the past three years. Despite the negative impacts caused by the implementation of new loan-to-value (LTV) rules by the Bank of Thailand (BOT) in April 2019, its revenue from the residential property business in 2019 declined by only 8% year-on-year (y-o-y) to Bt2.6 billion.

As of December 2019, MK had 26 projects, comprising 25 housing projects and one condominium project, the "Park Court" project. The value of the unsold units was Bt8 billion. MK plans to launch three new housing projects in 2020, worth Bt2.5 billion. TRIS Rating views the fallout from the on-going coronavirus pandemic will suppress housing demand and drastically slowdown purchases in residential property. Under our base-case scenario that assumes the contagion to be largely contained in the first half of this year, we forecast MK's residential sales in 2020 to decline to around Bt2 billion, and then rebound to Bt2.4-Bt2.6 billion per annum in 2021 and 2022**.** The revenue contribution from the recurring income business should increase gradually with an expansion of assets in the BFTZ project and once the company's wellness business commences operation.

Increasing volatility amid concerns over COVID-19 pandemic

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 the COVID-19 could cause a severe economic downturn. Demand for residential properties could slump significantly and the number of non-performing mortgage loans could rise further. The weak purchasing power of homebuyers combined with stringent bank lending policies will adversely affect the demand for housing in the middle- to low-income segments, which are MK's main customer groups.

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 the mortgage for 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 Bt3 million, effective till the end of December 2020. MK expects these new government stimulus measures should help encourage and attract potential homebuyers, especially in the middle- to low-income segments. 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.

Liquidity crunch in the bond market could pose a major refinancing risk

MK's liquidity risk is rising owing to the risk-off sentiment in the fixed income market. As of December 2019, the company had Bt2.9 billion in debt due over the next 12 months, comprising debentures of Bt1.4 billion, project loans of Bt107 million, and bills of exchange (B/Es) of Bt1.4 billion. The company has already repaid Bt250 million of bonds due in February and March 2020 with its internal cash flow, and Bt790 million of B/Es due in the first quarter of 2020 were mainly rolled over. Debentures and B/Es coming due in the remaining nine months of 2020 comprise Bt1 billion of debentures due in August 2020, Bt300 million of short-term debentures due in December 2020, and Bt1.01 billion of B/E. Of the outstanding B/Es, Bt370 million will be due in the second quarter of 2020, Bt600 million in the third quarter of 2020, and Bt40 million in the fourth quarter of 2020.

As of March 2020, MK's sources of liquidity included cash on hand of around Bt480 million. MK is in the process of seeking back-up facilities of Bt500 million from a financial institution to cover payments of B/Es. The company also had unencumbered assets worth around Bt2.6 billion to support liquidity. MK also plans to set up a REIT in the second half of this year. The proceeds from selling its assets to the REIT will amount to around Bt2 billion. However, based on the current market environment, it might be difficult to raise funds in the capital market. We consider that the "Bond Stabilization

Fund", set up by BOT in collaboration with the Thai Bankers' Association, the Government Savings Bank, Thai insurance providers, and the Government Pension Fund, could serve as another source of liquidity to help bridge the liquidity gap.

According to the financial covenants of its debt obligations, the company's net interest-bearing debt to equity ratio must be maintained below 2 times and the total liabilities to total equity (D/E) ratio below 2 times. The ratios at the end of December 2019 were 1.2 times and 1.5 times, respectively. TRIS Rating expects the company to closely monitor its liquidity and have no problems in complying with these financial covenants over the next 12 months.

BASE-CASE ASSUMPTIONS

- Operating revenue in the range of Bt2.7-Bt4.3 billion per annum during 2020-2022.
- Gross profit margin to range 33%-36% and operating margin in the range of 13%-17% over the next three years.
- Land acquisition budget of Bt500 million per annum in 2020-2022.
- Capital expenditure of around Bt1.6 billion in 2020, and in the Bt500-Bt600 million per annum range in 2021-2022.

RATING OUTLOOK

The "stable" outlook reflects the expectation of TRIS Rating that MK's operating performance and financial position not to deteriorate from the target level. TRIS Rating expects MK's revenue to stay in the range of Bt2.7-Bt4.3 billion over the next three years. The debt to capitalization ratio is forecast to jump in 2020 and then drop back to around 57% in 2021-2022. The operating margin is expected to drop in 2020 and then recover and maintain above 10% in 2021-2022.

RATING SENSITIVITIES

The rating and/or outlook could be revised upward if the company successfully diversifies into the recurring income business and/or improves its financial leverage. On the contrary, the rating and/or outlook of MK could come under downward pressure if the operating performance and/or financial position deteriorate significantly from expectations. The rating could be revised downward in multiple notches if the company is not able to manage its liquidity properly and faces a liquidity shortage situation.

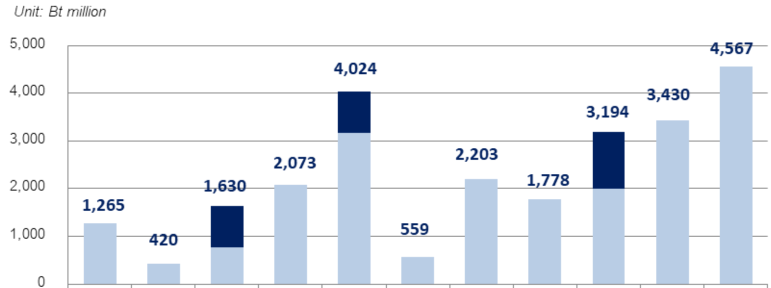
COMPANY OVERVIEW

MK was founded in 1973 by Mr. Chuan Tangmatitham, and listed on the Stock Exchange of Thailand (SET) in 1990. The Tangmatitham family had been MK's major shareholder, before it sold almost all its stakes 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 Finansa PLC, the major shareholder of PD, holding 7.15% of MK. As of May 2019, Finansa and Mr. Suthep remained the major shareholders of MK, holding 21.3% and 12.6% stakes, respectively. New top managers were put in place in 2015, most with a background in the financial service industry.

MK focuses on developing low-rise residential property projects, with prices between Bt3-Bt6 million per unit, under the "Chuan Chuen" brand. Most of its products are semi-prebuilt or prebuilt single detached houses (SDHs), semi-DHs, and townhouses (THs). Apart from its core business, MK keeps investing more in rental properties as part of its business diversification strategy. The company operates factories and warehouses for rent in the BFTZ, and rental apartments on Sukhumvit 77 Road. Also, MK is in the initial stage of investing in the health and wellness business. MK's revenue contribution from residential sales and from the recurring income business were 90% and 10% of total revenue, respectively.

KEY OPERATING PERFORMANCE

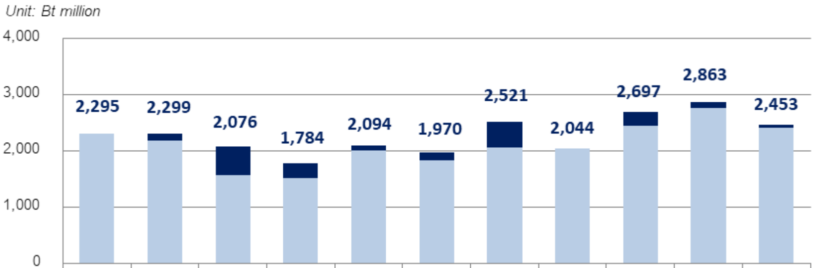
Chart 1: New Project Launches



	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Condominium	-		862	-	860	-	-	-	1,202		
Housing	1,265	420	768	2,073	3,164	559	2,203	1,778	1,992	3,430	4,567

Source: MK

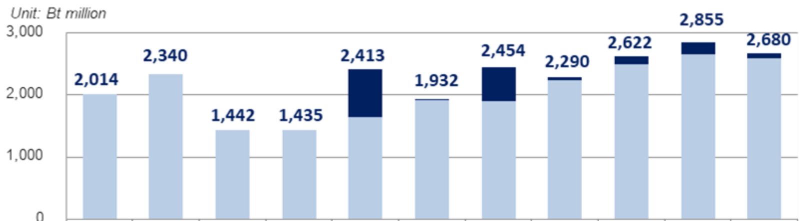
Chart 2: Presales



	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Condominium	-	121	499	263	88	137	464	-	252	110	48
Housing	2,295	2,179	1,577	1,521	2,006	1,833	2,057	2,044	2,445	2,753	2,405

Source: MK

Chart 3: Transfers



	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Condominium	-	-	-	-	772	10	559	50	127	191	91
Housing	2,014	2,340	1,442	1,435	1,641	1,923	1,895	2,241	2,494	2,664	2,589

Source: MK

FINANCIAL STATISTICS AND KEY FINANCIAL RATIOS*

Unit: Bt million

	-----------------------Year Ended 31 December -----------------				
	2019	2018	2017	2016	2015
Total operating revenues	4,438	4,547	3,064	2,871	3,750
Earnings before interest and taxes (EBIT)	626	681	601	673	644
Earnings before interest, taxes, depreciation, and amortization (EBITDA)	838	869	736	808	699
Funds from operations (FFO)	430	468	392	513	482
Adjusted interest expense	350	320	262	180	100
Real estate development investments	6,164	7,149	9,941	9,344	6,078
Total assets	16,707	15,727	14,180	13,508	11,674
Adjusted debt	8,551	8,007	6,756	5,898	3,752
Adjusted equity	6,795	6,646	6,668	6,693	6,638
Adjusted Ratios					
EBITDA margin (%)	18.89	19.11	24.02	28.14	18.64
Pretax return on permanent capital (%)	4.05	4.77	4.49	5.62	7.21
EBITDA interest coverage (times)	2.39	2.71	2.81	4.48	7.00
Debt to EBITDA (times)	10.20	9.22	9.18	7.30	5.37
FFO to debt (%)	5.03	5.84	5.81	8.70	12.85
Debt to capitalization (%)	55.72	54.64	50.33	46.84	36.11

* *Consolidated financial statements*

RELATED CRITERIA

- Key Financial Ratios and Adjustments, 5 September 2018
- Rating Methodology – Corporate, 31 October 2007

M.K. Real Estate Development PLC (MK)

Company Rating:	BBB-
Rating Outlook:	Stable

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