

Thai Residential Property

Stay Selective Despite Sell-off: Buy LH, LPN and QH

- **Talk of Fed tapering leads to sell-off** — SET Prop has dropped 24% from its peak in May 13 on fears of Fed tightening, in line with the patterns in 1994 and 2004. If outflows continue, Thai property stocks are unlikely to regain the high multiples of Mar-May 13. We see the sell-off as an enhanced opportunity to buy stocks with defensive qualities, visible earnings growth, strong balance sheets and high yields. Our preference ladder is *LH*, *LPN* and *QH*. *LH* has good EPS growth potential and a short cash-conversion cycle as it focuses on landed property. *LPN* has a strong balance sheet, and high earnings growth and visibility. *QH* looks cheap at a housing P/E of 1.5x.
- **Higher interest rates would hit earnings** — Thai developers do not have exposure to US\$ debt and hence are free from forex risk. Of the biggest seven Thai developers, *LPN* and *SPAL* have low net D/Es of 38% and 40% (1Q13). By contrast, *QH*, *AP*, and *SIRI* are highly geared with net D/Es exceeding 90%. While insolvency among developers is not our base case, we see downside risk to forecasts if interest costs rise. *QH* and *SIRI* are highly sensitive to rising interest rates.
- **Stay defensive** — Based on existing backlogs, *LPN* offers good earnings visibility with 83%/61% of 2013/14E revenue secured. *LH*'s earnings visibility is low at 41% in 2013E as it focuses on landed property, which normally has faster turnover than condo. Rising bond yields would lower investor interest in dividend stocks but not end it. *LH* and *LPN* stand out for sustained payouts.
- **Gauging macro risks** — We believe the fundamentals of the Thai residential property market remain strong as the demand-supply equation is still favourable. Presales, based on 1H13 trends, are on track to meet full-year targets. A key risk is potential cuts in LTV by the BoT, but we see the impact lasting only 1-2 quarters. Cuts in the rice pledging price in the next cropping season should not pose a serious threat to presales as developers' targeted markets are not rice-dependent provinces. But housing demand in the low-end market could soften due to higher household debt caused by the first-car scheme.

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Figure 1. Thailand Property — Valuation Summary

RIC	Price (Bt)	Target	Citi Rating	EPS Growth (%)		P/E (x)		Yield (%)	
	3-Jul	(Bt)		13E	14E	13E	14E	13E	14E
AP.BK	6.75	7.0	2	0.6	15.1	8.1	7.1	3.7	4.2
LH.BK	11.20	13.5	1	26.3	15.4	17.0	14.7	4.7	5.4
LPN.BK	23.70	27.8	1	38.7	15.1	11.6	10.1	4.3	4.9
QH.BK	3.06	4.3	1	35.3	19.3	11.4	9.6	3.9	4.7
PS.BK	21.60	21.0	3H	17.9	9.2	10.4	9.5	2.4	2.6
SPAL.BK	16.80	19.2	2	14.9	39.5	9.1	6.6	4.9	6.9
SIRI.BK	3.06	3.3	2H	13.1	12.8	8.2	7.3	5.9	6.7

Source: Citi Research estimates

See Appendix A-1 for Analyst Certification, Important Disclosures and non-US research analyst disclosures.

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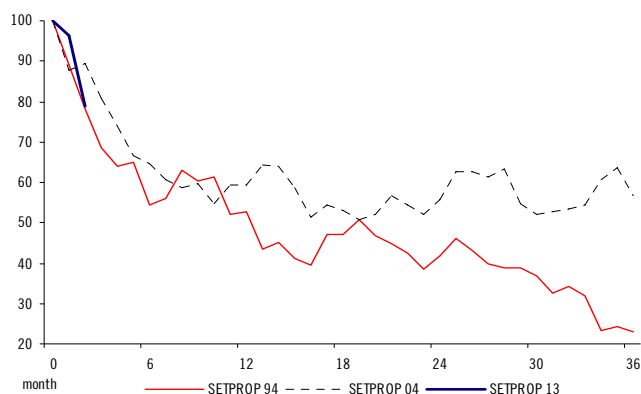
Stay Selective: Buy LH, LPN and QH

Thai property stocks have suffered a sharp sell-off on fears of Fed tightening, and have underperformed the SET by 24% since their 2013 peak in May. We highlighted in our past reports that the outperformance of the Thai property sector in early 2013 was in part driven by liquidity, which took P/E multiples above the +2SD historical mean level (see [Thai Residential Property - Do Not Overprice Strong Sales, Stay Selective](#)). If funds continue to flow out of emerging markets, Thai property stocks are unlikely to regain the high P/E multiples of early May. During the US Fed tightening in 1994 and 2004, SET Prop de-rated from 54.9x P/E to 27.5x P/E and from 17.8x P/E to 10.5x P/E, respectively, over the first three quarters.

Fundamentals of the Thai residential property sector remain intact as the demand-supply equation in the physical market still looks healthy. Presales, going by 1H13 run rates, are still on track to meet full-year targets. But we believe the market will pay more attention to earnings delivery, which is our key concern, as highlighted in early 2013. For example, AP shares have of late suffered from construction delays since 2012, a fact ignored by the market until recently.

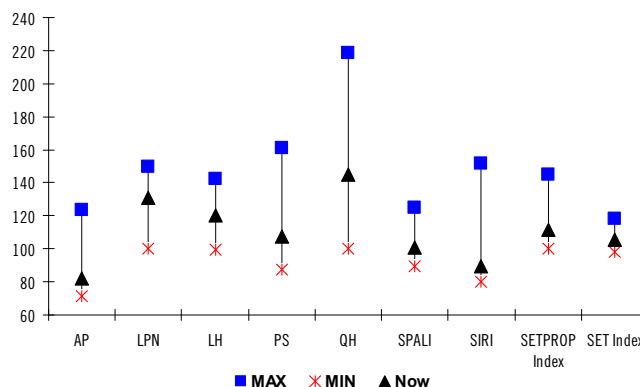
We prefer stocks with defensive qualities, visible earnings growth, strong balance sheets, high dividend payouts, and those less prone to cancellations/presales crunch if the BoT imposed new regulations on the physical market. LH is our top pick for its focus on the SDH/TH segment (short cash-conversion cycle) and strong earnings growth in 2013/14E. We also like LPN for its strong balance sheet, earnings growth and high earnings visibility. After being sold down, QH looks cheap at a PE of 1.5x (core business) compared with history and sector peers.

Figure 2. SET Prop Absolute Performance During Fed Tightening



Source: Citi Research and Bloomberg

Figure 3. Absolute Performance YTD



Source: Citi Research; Bloomberg

Figure 4. Thai Developers — Check List

	LH	LPN	QH	SPALI	AP	SIRI	PS
Net gearing <50%		✓		✓			
High earnings visibility		✓		✓		✓	✓
Short cash-conversion cycle	✓		✓				✓
2014E dividend yield >6%				✓		✓	
Positive free cash flow	✓	✓	✓	✓			
2014E EPS growth >15%	✓	✓	✓	✓	✓		
Potential asset divestment to raise cash	✓		✓				
P/E below historical average	✓		✓				✓

Source: Citi Research

Figure 5. Thai Developers — Valuation Snapshot

Company	RIC	Price (Bt)		Citi Rating	EPS Growth (%)		P/E (x)		Net D/E (%)		Yield (%)		ROE (%)		ROA (%)	
		3-Jul	Target (Bt)		2013E	2014E	2013E	2014E	2013E	2014E	2013E	2014E	2013E	2014E	2013E	2014E
AP Thailand	AP.BK	6.75	7.0	2	0.6	15.1	8.1	7.1	92.6	86.9	3.7	4.2	17.7	17.9	7.7	8.0
Land & Houses	LH.BK	11.20	13.5	1	26.3	15.4	17.0	14.7	86.0	82.9	4.7	5.4	20.8	22.8	9.6	10.3
LPN Development	LPN.BK	23.70	27.8	1	38.7	15.1	11.6	10.1	29.1	29.1	4.3	4.9	33.0	32.2	19.4	18.8
Quality Houses	QH.BK	3.06	4.3	1	35.3	19.3	11.4	9.6	127.7	116.7	3.9	4.7	15.2	16.5	5.6	6.3
Pruksa Real Estate	PS.BK	21.60	21.0	3H	17.9	9.2	10.4	9.5	114.9	104.9	2.4	2.6	21.1	19.8	9.2	8.4
Supalai	SPAL.BK	16.80	19.2	2	14.9	39.5	9.1	6.6	27.3	33.0	4.9	6.9	23.6	28.5	12.7	15.5
Sansiri	SIRI.BK	3.06	3.3	2H	13.1	12.8	8.2	7.3	143.0	138.2	5.9	6.7	22.9	23.3	7.5	8.1

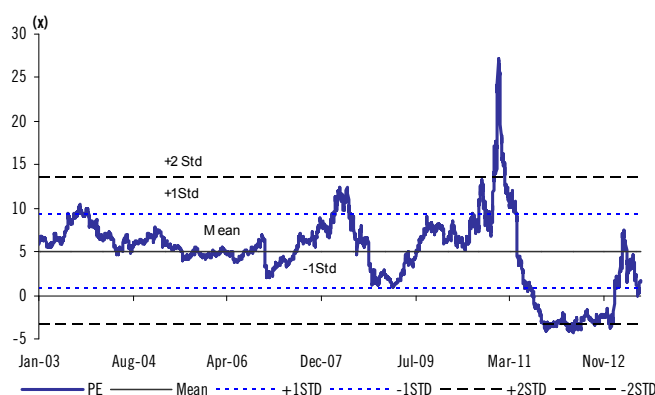
Source: Citi Research estimates

Figure 6. LH — Housing P/E (ex Market Cap of Listed Associates)



Source: Citi Research; Bloomberg

Figure 7. QH — Housing P/E (ex Market Cap of Listed Associates)



Source: Citi Research; Bloomberg

Balance sheet quality is key

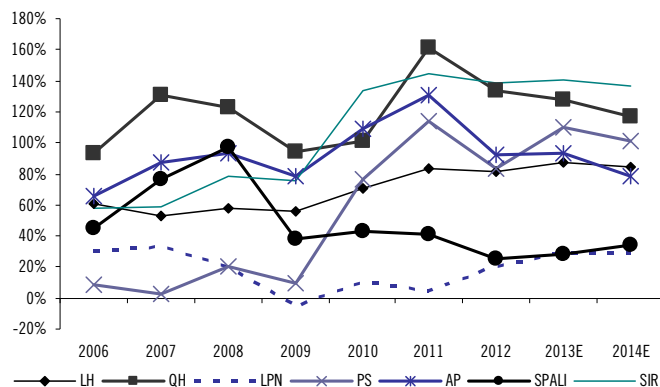
The Thai developers in our coverage have no exposure to US\$ debt, implying no forex risk. However, their D/E's diverge widely. Net gearing of LPN and SPAL is among the lowest at 37.8% and 40.1% at end-1Q13 respectively. LH's leverage is high at 80%. However, LH plans to divest Terminal 21, a retail property, into a new property fund by end-2013, which could lower the net D/E by 400bps.

QH, AP and SIRI are highly geared with net D/E's of above 90%. We believe QH's gearing ratio will fall slightly by end-2013-14E to 128% and 117% respectively. AP's net D/E at end-1Q13 was 105%, vs. its internal target of 100%. With its need to acquire more land for expansion, AP has to preserve cash which could lead to another year of a low dividend payout ratio of 30%, vs. 38-40% in 2007-10. (Bloomberg consensus still expects 37% in 2013E.)

SIRI's net gearing is the highest in the Thai property space, at 158% as of end-1Q13 and will likely hit a peak of 180% in 3Q13. We believe SIRI's net D/E will remain high at 143% and 138% at end-2013/14E due to large capex requirements for both land acquisition and construction.

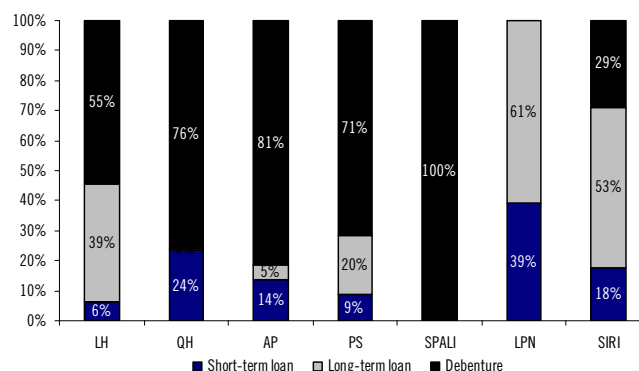
PS' net D/E at end-1Q13 was 89.6%. PS plans to set up a land acquisition budget of Bt15bn-16bn to be disbursed in the next 12 months in order to support new launches in 2014. We believe this should lead to higher net gearing of 115% by end-2013. PS' plan to launch more condo projects could lead to a longer than expected cash conversion cycle and higher than expected net D/E.

Figure 8. Thai Property — Net Debt to Equity by Company



Source: Citi Research; Company data

Figure 9. Thai Property — Debt Structure by Company



Source: Citi Research; Company data

Developers' insolvency is not our base case as we believe domestic liquidity is abundant and developers' balance sheets are far stronger than they were during the 1997 Asian crisis. However, we see a possible downside risk to earnings forecasts if interest rates increase. Our economist expects the policy rate to remain at 2.5% in 2013E and increase by 25bps in 3Q14E and another 25bps in 4Q14E.

We ran a sensitivity analysis on developers' EPS to an assumed 100bp increase in interest costs. QH and SIRI appear most sensitive to rising interest costs. We note that part of the interest expenses is capitalized in inventory (construction in progress) and recognized as part of cost of goods sold when revenue is recognized.

Figure 10. Thai Property — Earnings Sensitivity to Interest Cost

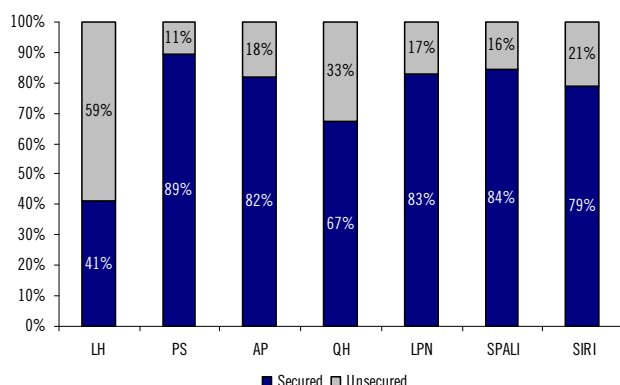
	Weighted average cost of debt	Net D/E		% of interest capitalize	% EPS for 100 bps change	
		2013E	2014E		2013E	2014E
LH	3.9%	86.0%	82.9%	56.1%	-3.5%	-3.5%
QH	3.8%	127.7%	116.7%	68.2%	-7.6%	-6.8%
AP	4.3%	92.6%	86.9%	64.6%	-4.2%	-4.0%
PS	3.5%	114.9%	104.9%	67.7%	-3.9%	-4.4%
SPALI	3.9%	27.3%	33.0%	41.7%	-1.4%	-1.2%
LPN	4.5%	29.1%	29.1%	93.4%	-0.9%	-0.9%
SIRI	4.9%	143.0%	138.2%	72.2%	-5.7%	-5.2%

Source: Citi Research; Company data

Earnings visibility and cancellation risk

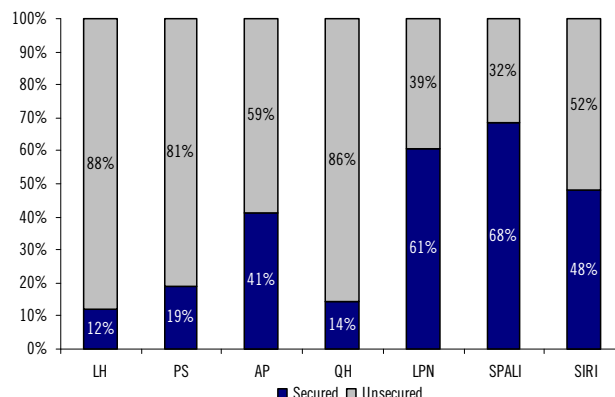
Based on backlogs as at end of May-2013, SPALI stands out for its high earnings visibility in 2013-14E at 84% and 68% respectively. LH's earnings visibility is among the lowest but purely due to its business structure, which has >85% revenue contribution from the SDH/TH segments (which have shorter construction cycles than condo; Hence presales are not counted as backlog for more than 6-8 months).

Figure 11. Thai Property — Earnings Visibility, 2013E



Source: Citi Research estimates

Figure 12. Thai Property — Earnings Visibility, 2014E



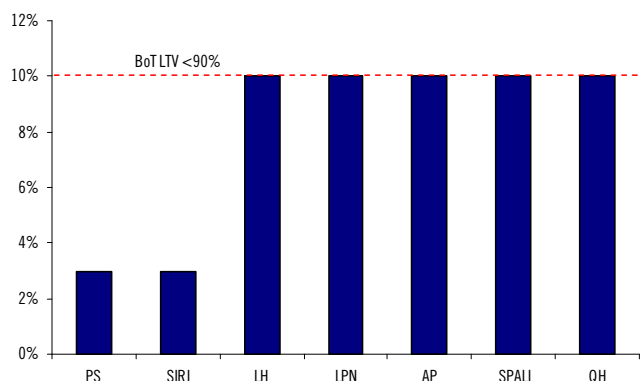
Source: Citi Research estimates

While developers with high exposure to landed property normally have low earnings visibility, the quality of their backlogs is stronger than for those with a high concentration in the condo segment.

We think both low-end and mid/high end condo segments are exposed to the same level of cancellation in a high-yield environment. In the low-end market, buyers' affordability is dampened when mortgage rates rise. In mid/high-end condo, the incentive for buyers who are in search of alternative investments when interest rates are low will also be weak.

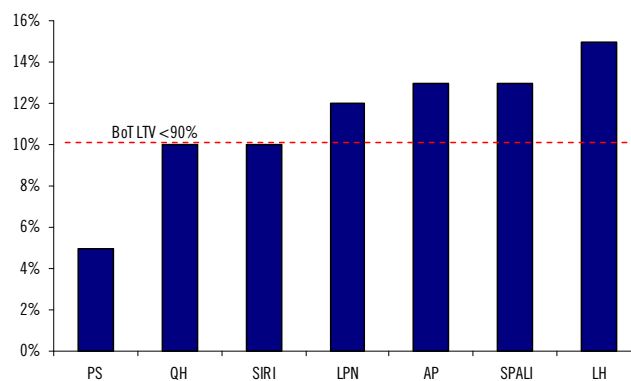
We believe the cancellation risk for the condo segment is high when developers collect small down-payments as it is easy for buyers to cancel the bookings before the transfer date. We believe cancellation risk is high for SIRI and PS as down-payment requirements for low-end condo are less than 10% while the Bank of Thailand has imposed <90% loan to value regulation since 2011.

Figure 13. Thai Property — Downpayment for Low-End Condo



Source: Citi Research; Company data

Figure 14. Thai Property: Downpayment for Mid Range/High-End Condo

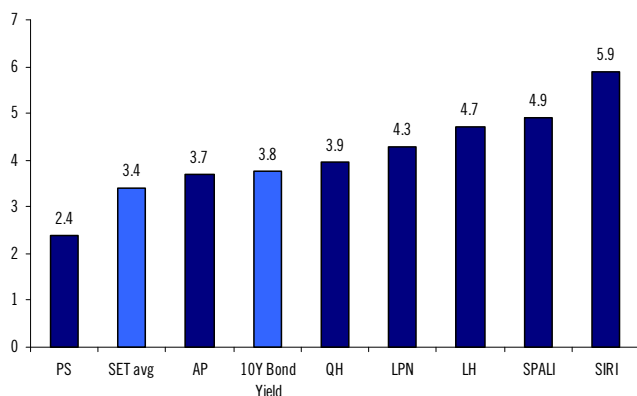


Source: Citi Research; Company data

In search for dividend yield

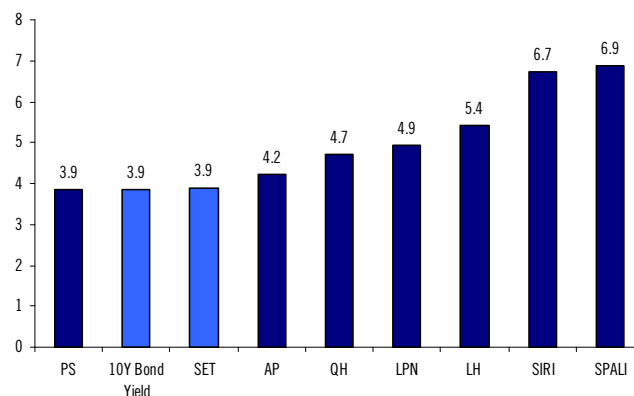
Rising bond yields could lower investors' interest in dividend stocks but not kill it. Thai developers still offer attractive dividend yields that are higher than the 10-year government bond yield. SPALI has the highest dividend yield in the sector, at 6.9% in 2014E. Its strong balance sheet makes us believe that the payout ratio of 45% is sustainable over the next two years. LH offers a 5.4% dividend yield in 2014E and potential cash inflow from asset divestment provides comfort that its >70% payout policy will be kept. For AP, we think its payout sustainability remains in question. We believe management has incentives to cut payouts in order to preserve cash for landbank acquisition in light of a highly geared balance sheet. SIRI has the second highest 2014E dividend yield of the 7 developers in our universe but its highly geared balance sheet could lead to dividend cuts.

Figure 15. Thai Property — Dividend Yield, 2013E



Source: Citi Research estimates; Bloomberg

Figure 16. Thai Property — Dividend Yield, 2014E

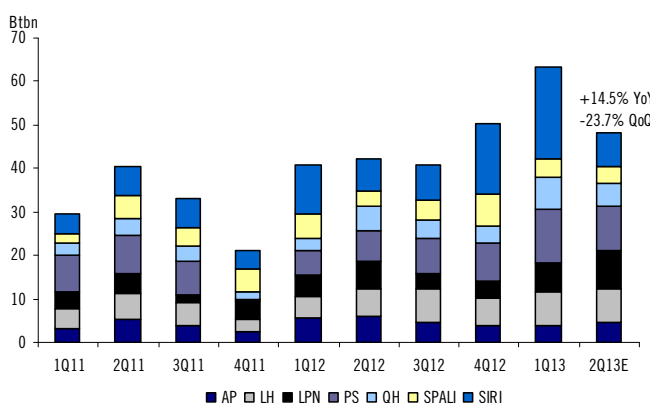


Source: Citi Research estimates; Bloomberg

1H13E presales – hits and misses

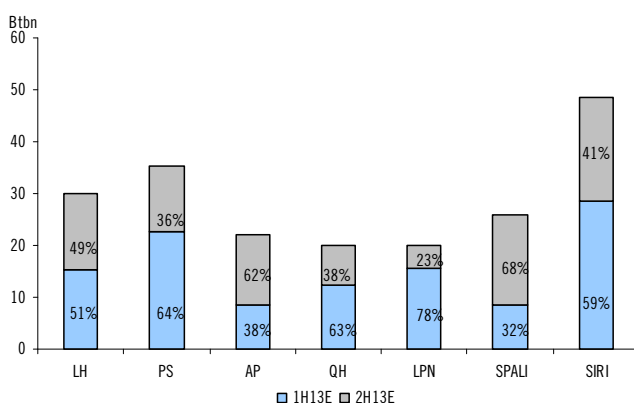
In 2Q13, we estimate the big 7 developers under our coverage will achieve aggregate presales of Bt47.9bn, +14.5% YoY and -23.7% QoQ. 1H13E presales should reach Bt111.1bn, +22.0% HoH and 34.3% YoY. We believe QH, LPN, and PS are likely to beat their respective presales targets in 2013. LH and SIRI are on course to meeting their targets. AP and SPALI are likely to miss targets by 5-15%.

Figure 17. Thai Property — Aggregate Presales of 7 Developers



Source: Citi Research estimates; Company data

Figure 18. Thai Property — 2013E Presales by Company



Source: Citi Research estimates; Company data

Based on announced launch plans (as of May-13), presales of SPALI should accelerate in 2H13, providing higher value for both low-rise and condo launches. However, to reach its full-year target of Bt26bn, SPALI would need to achieve an average take-up rate of ~80% for the 6 new condo projects worth Bt13.2bn in total. SPALI plans to add another 2 condo projects in Bangkok in its 2013 launch plan to boost presales by year-end.

AP believes 2H13E low-rise presales could increase by 54% HoH given the higher value of low-rise project launches. To meet its 2013 presales target of Bt22bn, however, we estimate that AP will still need to achieve at least a 75% average take-up rate in its Rhythm 42 and 3 new condo projects to be launched in 4Q13E. This looks aggressive as the average take-up rate for condo launches in 1H13 was lower than 70%.

Figure 19. Thai Property — Quarterly Presales

	1Q12	2Q12	3Q12	4Q12	1Q13	2Q13E	%YoY	%QoQ
AP	5,737	5,946	4,689	3,864	3,829	4,606	-22.5%	20.3%
LH	4,797	6,517	7,455	6,305	7,798	7,600	16.6%	-2.5%
LPN	4,863	6,137	3,767	3,974	6,730	8,770	42.9%	30.3%
PS	5,669	7,019	7,993	8,715	12,328	10,256	46.1%	-16.8%
QH	3,000	5,600	4,200	3,700	7,300	5,200	-7.1%	-28.8%
SIRI	10,963	7,274	8,112	16,245	20,903	7,698	5.8%	-63.2%
SPALI	5,607	3,641	4,489	7,521	4,302	4,100	12.6%	-4.7%
Total presales	40,635	42,134	40,705	50,324	63,190	48,230	14.5%	-23.7%

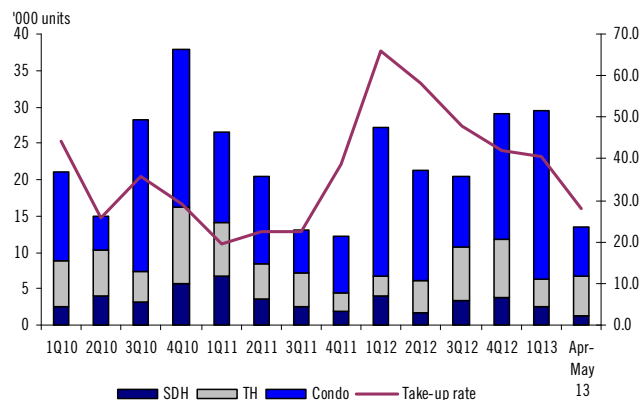
Source: Citi Research estimates and Company data

Supply glut not scary

Based on AREA data, new launches in 5M13 were 42.8k units, up 9.4% YoY. While condo remains the biggest segment (70% of total new supply), the growth rate decelerated to 4.8% YoY. The SDH segment showed the sharpest drop in new launches. New SDH units in 5M13 were 3,699 units, down sharply by 28.8% YoY. On the contrary, TH new supply rose sharply to 9,288 units, up 69.6% YoY.

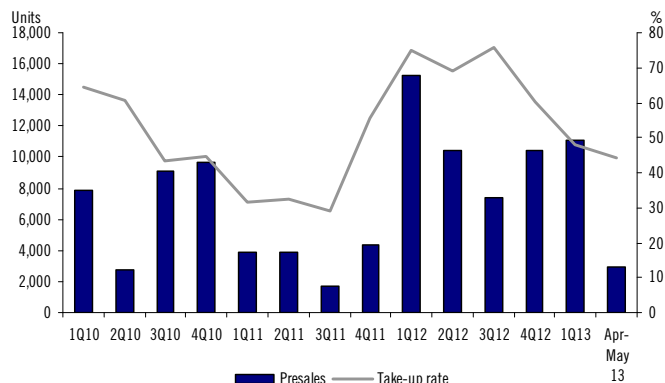
In the absence of pent-up demand like what we saw after the floods in 1H12, presales in 5M13 were down 35.8% YoY to 15,666 units. We see declines in take-up rates in all product segments, in sharp contrast to what the 7 listed companies are likely to achieve in 1H13. We believe this is due to the growing market share of listed developers at the expense of non-listed developers. Also, the big 7 listed developers achieved strong presales from provincial markets, which are largely untapped by small players.

Figure 20. New Launches and Take-up Rate (All Segments)



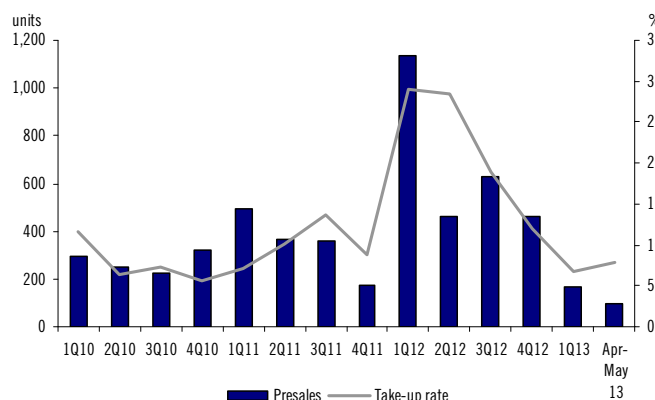
Source: Citi Research; AREA

Figure 21. New Launches and Take-up Rate (Condominium)



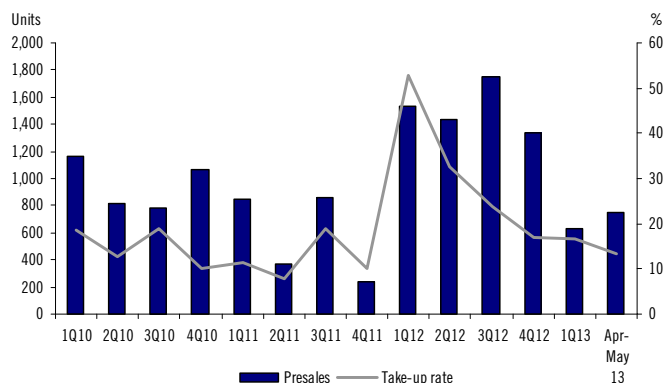
Source: Citi Research; AREA

Figure 22. New Launches and Take-up Rate (Single Detached House)



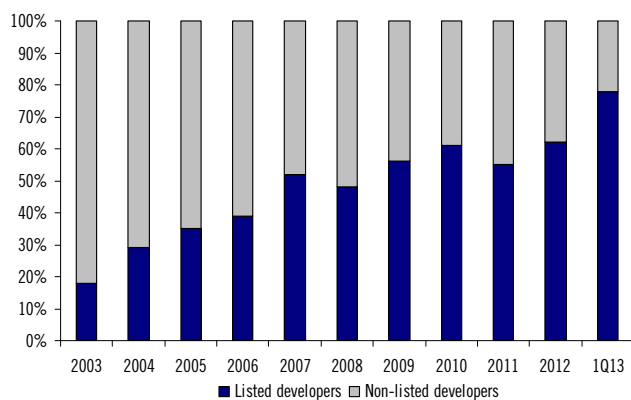
Source: Citi Research; AREA

Figure 23. New Launches and Take-up Rate (Townhouse)



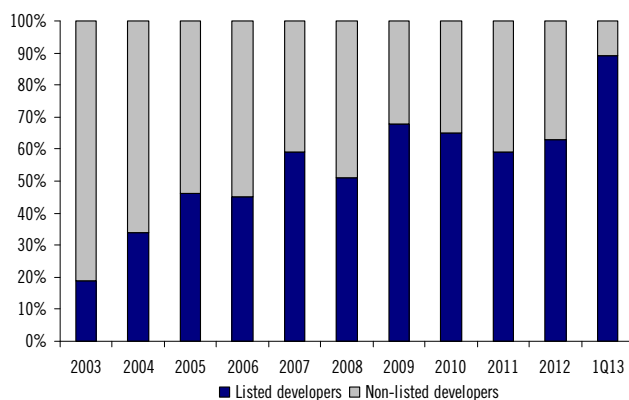
Source: Citi Research; AREA

Figure 24. Market Share Based on Unit Launched



Source: Citi Research; AREA

Figure 25. Market Share Based on New Units Sold



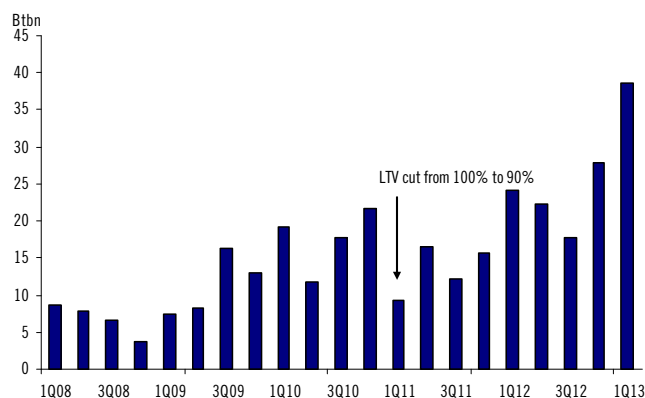
Source: Citi Research; AREA

Potential regulatory risk

Strong presales, especially in the condo segment (both Bangkok and provincial markets), have led to investor concerns that the BoT might introduce some measures to cool the physical market. In 4Q10, the BoT announced a regulation to crimp speculation such that risk weighting for mortgages on condo (<Bt10m/unit) with a loan to value ratio (LTV) more than 90% will increase to 75% (from 35% previously), effective in Jan-11. In case of SDH/TH mortgage with an LTV of more than 95%, risk weighting increased to 75% (from 35% previously), effective Jan-13.

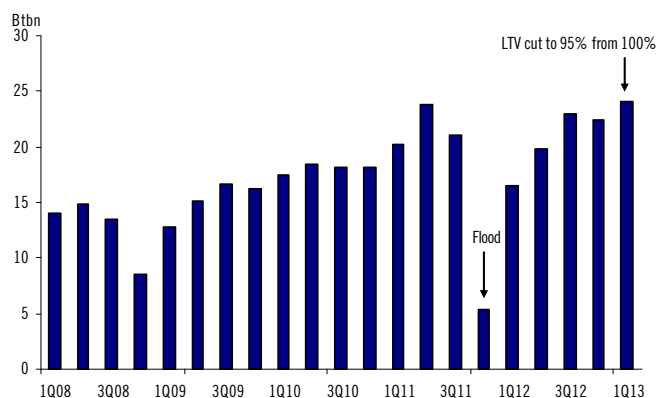
We think that if the BoT decides to cut LTV further, the impact should be only temporary, as in 2011. For condo, we see a negative impact on presales for 1-2 quarters. For SDH/TH, there should be no impact, as evidenced in 1Q13 low-rise presales.

Figure 26. Aggregate High Rise Presales (7 Listed Developers)



Source: Citi Research; Company data

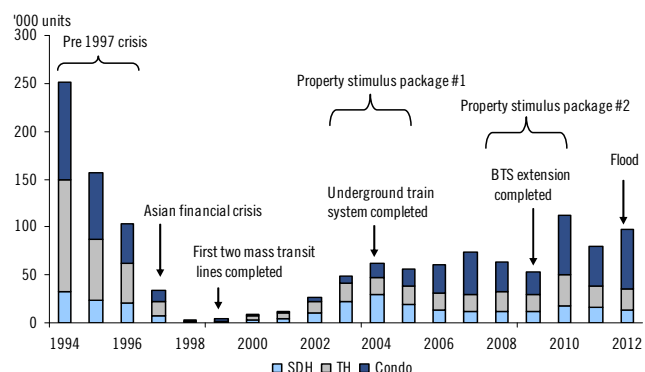
Figure 27. Aggregate Low Rise Presales (7 Listed Developers)



Source: Citi Research; Company data

We see no bubble in the physical market (see [Thai Residential Property - Do Not Overprice Strong Sales, Stay Selective](#)). Supporting factors are benign lending activities to both developers and buyers, lower new supplies compared to the pre-1997 crisis, strong GDP growth, and slow asset price appreciation except for Bangkok CBD and certain areas in provincial markets.

Figure 28. New Housing Supply in Bangkok and Vicinity



Source: Citi Research; AREA

Figure 29. Commercial Banks' Credit to Property Developer as % of Total Loans



Source: Citi Research; Bank of Thailand

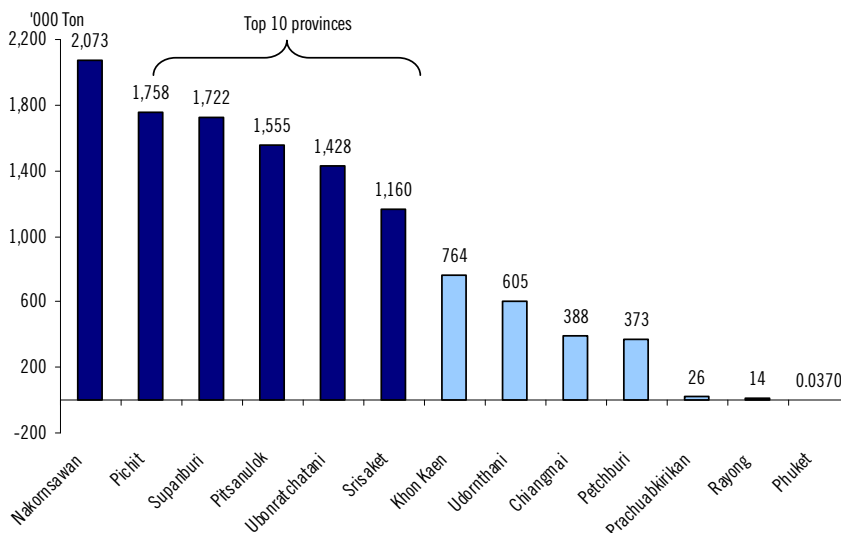
Provincial market – sentiment vs. reality

Price of rice

While the Thai government allowed for a U-turn on the rice pledging price to Bt15,000/t from Bt12,000/t announced on 18 June 2013, the price for the next cropping season (2013/14) is expected to be lower, at Bt12,000/t. This has led to investor concerns on affordability of house buyers in provincial areas.

However, the affordability of those in developers' targeted areas is not largely driven by the price of rice. In Phuket and Chiangmai, the number of inbound tourists is the key driver of wealth. Eastern seaboard (comprising Chonburi, Chachoengsao, Samut Prakarn and Rayong provinces) has near-zero rice production as it has been serving as a production hub for various industries, especially those that are export-oriented, e.g., automobile, electronics, chemicals, etc.

Figure 30. Rice Production in 2012 (Light blue bars are key destinations for Residential Development)



Source: Citi Research; Office of Agricultural Economics

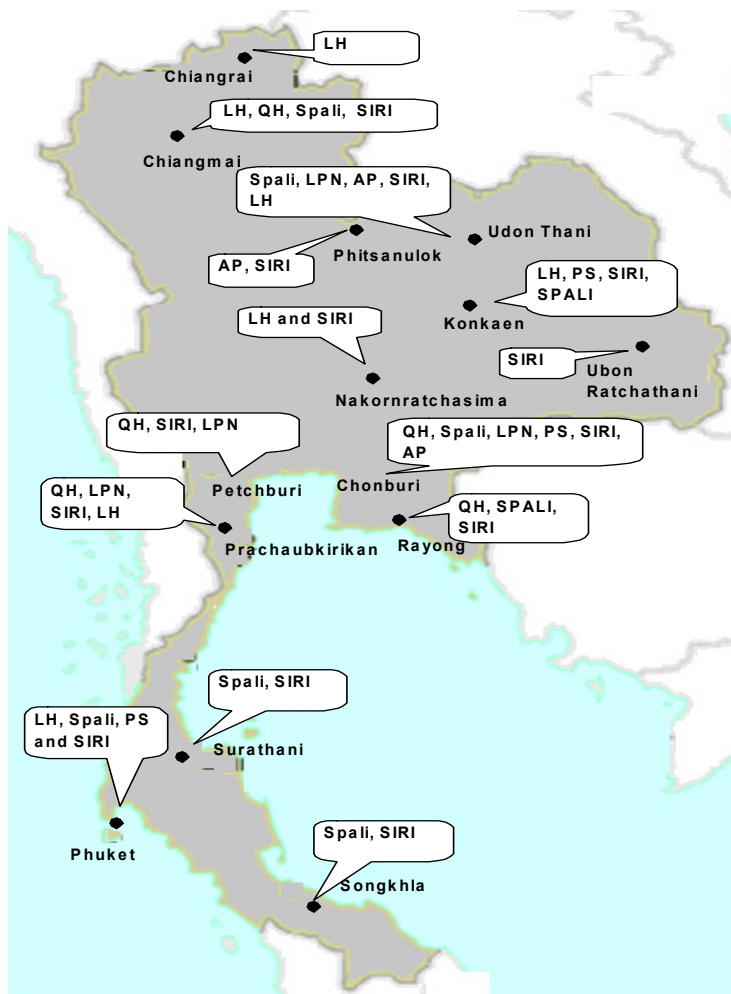
More SDH/TH, less condo

While we see limited impact on property demand from the cut in rice subsidies, the take-up rate in certain areas is poised to slow, especially in the condo segment in Huahin (Prachubkirikan) and Udonthani. In 2012, there were 10 new condo projects with a combined value of Bt11.3bn in Huahin. The average take-up rate was 77%. We have started seeing demand slowing in Huahin area as most of new condo launch achieved a take-up rate of 30-45%.

In 5M13, AP, LPN and SIRI launched condo projects in Udonthani. Only LPN and SIRI could sell 90-95% of total projects. AP is considered the weakest developer with a 68% take-up rate YTD despite being the first mover in the province.

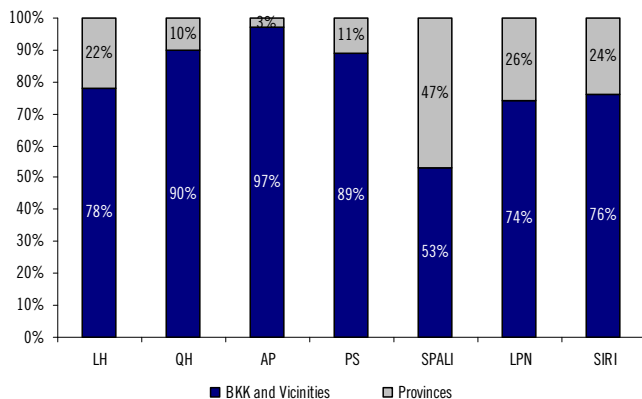
Big players like SIRI and SPALI in provincial markets have become more cautious on the condo market in 2H13E. Both companies plan to increase the proportion of low-rise projects to total launches in provincial areas as SDH/TH are the preferred products of the local people and more sustainable in the long-run than condo.

Figure 31. Provincial Market Penetration by Developer



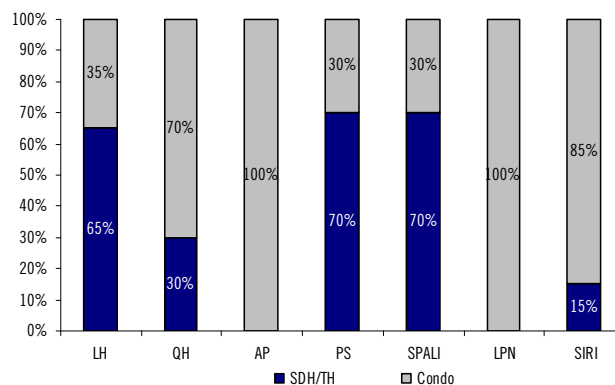
Source: Citi Research; Company data

Figure 32. New Launch by Area (2013)



Source: Citi Research; Company data

Figure 33. Product Mix in Provincial Market



Source: Citi Research; Company data

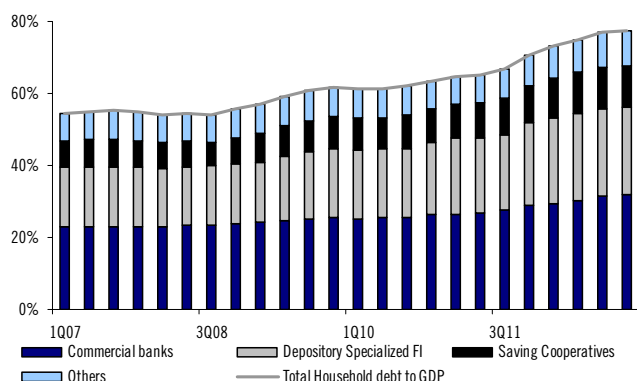
Household debt – risk is in the low-end segment

Based on BoT's data in May 13, Thai household debt to GDP was high at 77% in 2012, up from 71% in 2011 and 63% in 2010. However, we believe the BoT data overstate the level of household debt as the calculation includes personal loan for business use, working capital loan for farmers and family members, and any borrowing under a person's name which does not have to be loan for consumption purposes.

Our affordability calculation still indicates that the average household income is still enough to service mortgage payments (based on an average MLR rate of 7.2% in 2013E, 25 years mortgage terms and 85% LTV). The risk is in the low-end market with average housing prices lower than Bt2.0m and household income lower than Bt20,000/month, in our view.

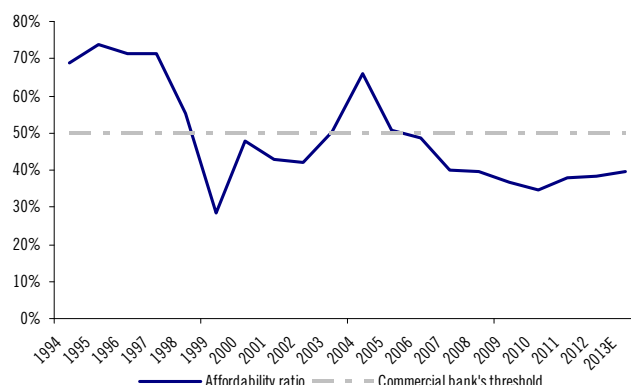
Under the Thai government's first-car scheme, the buyers of B-segment cars with engine $\leq 1,500\text{cc}$ are eligible to apply for excise tax rebate up to the limit of Bt100,000 per car. Assuming the price of a car is Bt550k, downpayment is 20% and loan life is 72 months, the monthly installment would be ~Bt8,000. Most Thai commercial banks do not allow for debt servicing higher than 40-50% of income. Thus, a potential home buyer with monthly income lower than Bt20,000 and car loan obligation will be rejected by a bank unless there is a co-borrower with enough monthly income.

Figure 34. Thailand Household Debt as % to Thai GDP



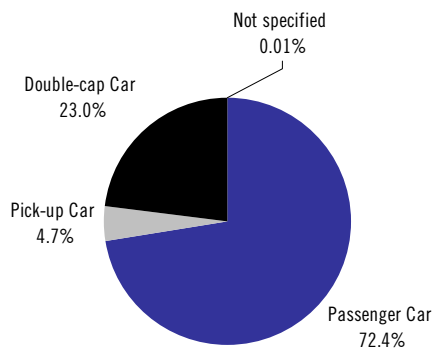
Source: Citi Research; Bank of Thailand

Figure 35. Affordability Index



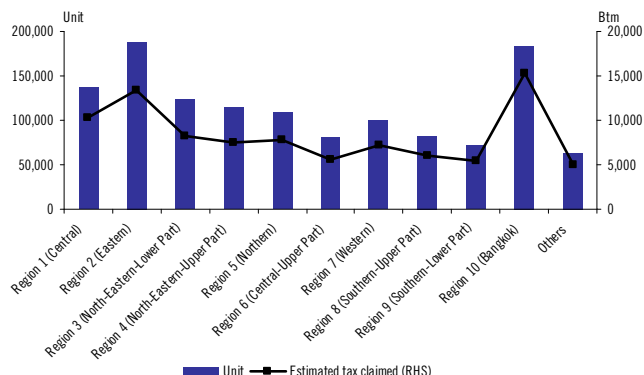
Source: Citi Research; Bank of Thailand; NSO

Figure 36. First-Car Scheme — Type of Car Sold



Source: Citi Research; Excise Tax Department

Figure 37. First-Car Scheme — Tax Claimed by Area



Source: Citi Research; Excise Tax Department

Figure 38. Scenario Analysis on Car and House Loans (Baht)

Month income	Maximum debt service (50%)	Monthly installment for car	Remaining value to pay for housing	Monthly installment for housing (Bt1m/unit)	Eligible for mortgage
20,000	10,000	8,000	2,000	5,988	No
30,000	15,000	8,000	7,000	5,988	Yes

Month income	Maximum debt service (50%)	Monthly installment for car	Remaining value to pay for housing	Monthly installment for housing (Bt2m/unit)	Eligible for mortgage
20,000	10,000	8,000	2,000	11,975	No
30,000	15,000	8,000	7,000	11,975	No
40,000	20,000	8,000	12,000	11,975	Yes

Source: Citi Research

Figure 39. LH — PE Band



Source: Citi Research; Bloomberg

Figure 40. AP — PE Band



Source: Citi Research; Bloomberg

Figure 41. QH — PE Band



Source: Citi Research; Bloomberg

Figure 42. PS — PE band



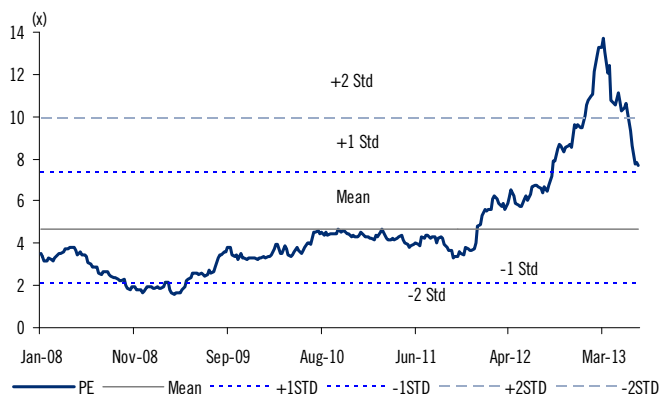
Source: Citi Research; Bloomberg

Figure 43. LPN — PE Band



Source: Citi Research; Bloomberg

Figure 45. SIRI — PE Band



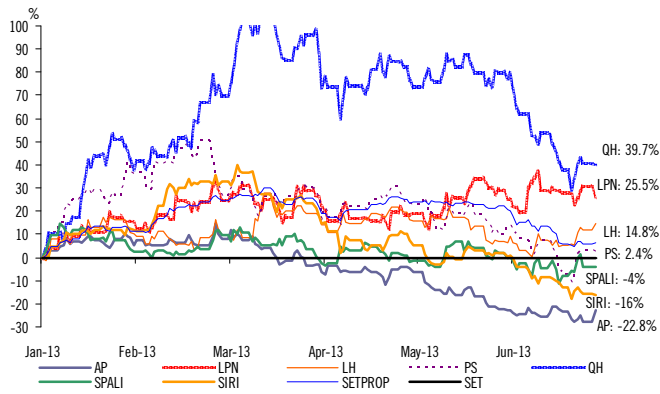
Source: Citi Research; Bloomberg

Figure 44. SPALI — PE Band



Source: Citi Research; Bloomberg

Figure 46. YTD Share Price Performance Relative to SET



Source: Bloomberg and Citi Research

Appendix A-1

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