CPN RETAIL GROWTH LEASEHOLD REIT

No. 109/2020
22 July 2020

CORPORATES

Company Rating: AA
Issue Ratings:
Senior unsecured AA
Outlook: Negative

Last Review Date: 25/06/19

Company Rating History:

Date	Rating	Outlook/Alert
25/05/18	AA	Stable

Contacts:

Jutamas Bunyawanichkul
jutamas@trisrating.com

Pramuansap Phonprasert
pramuansap@trisrating.com

Wajee Pitakpaibulkij
wajee@trisrating.com

Wiyada Pratoomsuwan, CFA
wiyada@trisrating.com

WWW.TRISRATING.COM

RATIONALE

TRIS Rating affirms the company rating on CPN Retail Growth Leasehold REIT (CPNREIT) and the ratings on its senior unsecured debentures at "AA", and revises downward the rating outlook to "negative" from "stable". The "negative" outlook reflects the delay in its asset acquisition and capital increase plan following the debt-funded acquisition of assets from GLAND Office Leasehold Real Estate Investment Trust (GLANDRT) in March 2020, and our expectation of a material deterioration in the trust's income, resulting from the Coronavirus Disease 2019 (COVID-19) fallout.

The "AA" ratings continue to reflect the trust's high-quality assets, its predictable cash flow from contract-based rental and service income, and its conservative financial policy. The ratings also take into consideration the future growth opportunities of the trust, supported by assets from its sponsor, Central Pattana PLC (CPN), rated "AA" with a "stable" outlook by TRIS Rating.

KEY RATING CONSIDERATIONS

Largest REIT in Thailand

CPNREIT is the largest real estate investment trust (REIT) in Thailand, with total investment properties worth THB69 billion as of March 2020. The trust's leasable area totaled 327,200 square meters (sq.m.), consisting of 214,547 sq.m. from five shopping centers and 112,653 sq.m. from four office buildings. The average occupancy rate (OR) of the shopping centers has been above 90% during the last five years, while the average rental rate has ranged from THB1,000-THB2,000 per sq.m. per month. The average OR of office space has been relatively stable at 90%-93%, with an average rental rate of THB420-THB720 per sq.m. per month.

Rental income from retail property to plummet by 40% in 2020

We expect the trust's rental and service income from retail property to drop by 40% year-on-year (y-o-y) in 2020, as a result of the fallout from the pandemic. CPNREIT provided rent waivers and rental fee discounts to affected tenants during the lockdown period when retail properties were shuttered by the government in an attempt to contain the spread of the virus.

All shopping centers of the trust were temporarily closed for around two months from mid-March to mid-May 2020. After the relaxation of lockdown measures, the trust is continuing to provide 30%-50% discounts on rental fees for affected tenants for the remainder of 2020. We anticipate the trust will also provide some discounts on rental rates for two office buildings in Bangkok's Pinklao area for the months affected. The rental rate discount in 2021 will continue to be around 5% from the 2019 level.

Mild impact from hotel property in 2020

CPNREIT will receive the full fixed rent payment of THB225 million from the Hilton Pattaya Hotel for 2020. The COVID-19 outbreak and adverse operating environment for hotels triggered the force majeure clause under the rental agreement between CPNREIT and CPN Pattaya Hotel Co., Ltd., the sublessee, in March 2020. Hilton Pattaya has been closed since April 2020, prompting the trust to bring forward its renovation plan to the period of April-October 2020. This action limits revenue loss for CPNREIT as the sublessee is only allowed to postpone the fixed rent payment during the renovation period to the end of

2020, compared with a fixed rent waiver if there is no renovation.

Hilton Pattaya's operations have been weakening following a fall in Chinese tourist numbers since the second half of 2019. We expect the recovery period of the tourism industry will likely be protracted until 2021 as increasing numbers of infections are still being reported worldwide and travel restrictions to remain in place longer than previously expected.

Gradual recovery of shopping centers in the second half of 2020

TRIS Rating views that the operations of all shopping centers have passed their deepest slumps amid the lockdown in the second quarter of 2020. After the re-opening, we expect a gradual recovery of traffic in the second half of this year. As of 30 June 2020, traffic at CPNREIT's four shopping centers located in Bangkok and Chiangmai had improved to 70%-80% of the pre- COVID-19 levels and traffic at another shopping center located in Pattaya had increased to 50%.

We foresee the vacancy rate of office space to increase in the next few years as a result of the remote working trend evolved from the fear of contracting virus. The demand for new or expanded office space is likely to slow down significantly.

We forecast CPNREIT's rental and service income will stay in the THB7-THB8 billion per annum range during 2021-2022, thanks to the expected recovery in the retail property and hotel industries in 2021, by which time we believe that the pandemic should have been largely contained and travel restrictions eased. The projected revenue growth in 2021 is partly derived from the contributions of new assets that are expected to be acquired.

Pending asset acquisition plan from CPN and equity injection

CPN, as a sponsor of CPNREIT, normally adds mature properties with high OR and stable rental rate growth to the trust portfolio. Based on the trust's original plan and our previous assumption, CPNREIT was to acquire new assets worth THB56 billion in total and fund the acquisition with 65% equity and 35% debt in March and April 2020. The trust only succeeded in acquiring two office buildings from GLANDRT in March 2020, worth THB8 billion, totally funded by debt. The COVID-19 induced risk-off sentiment in the capital market then forced the trust to delay its subsequent property acquisitions and capital increase, originally planned for early April.

In our revised projection, we expect the trust to acquire new assets worth THB23 billion by 2021 using both equity and debt funding. If the acquisitions go ahead as targeted, we expect the trust's leasable area to expand by 81,000 sq.m. and its annual income to soar by THB1.7 billion. The growing size of the quality property portfolio would help boost rental income as well as diversify the trust's sources of cash flow in the future.

Leverage elevated from delayed capital increase and temporary lease obligation

We consider the trust's financial policy to be conservative as it aims to keep its loan-to-value of total assets (LTV) ratio, below 35%. However, the postponed equity injection caused by COVID-19 has pushed the trust's LTV ratio to 41% as of March 2020. We expect the LTV ratio to recover to its policy level of below 35% when the trust acquires new assets with funds raised mostly from equity in 2021.

Our base-case scenario assumes capital injections, totaling THB21 billion, by 2021. Cash proceeds are expected to be used for the acquisition of four shopping centers of CPN. The LTV ratio should then remain below 35% with the debt to earnings before interest, taxes, depreciation, and amortization (EBITDA) ratio to stay below 5 times after the equity increase.

TRIS Rating views the renewal obligation of CentralPlaza Rama 2 worth THB17 billion to be temporary during the pre-lease period from 2020 to 2025. We expect this obligation will ultimately be financed by 65% equity and 35% debt in 2025 once the lease term is executed.

Regarding the financial covenants on CPNREIT's bonds and bank loans, the trust is required to keep the LTV ratio, excluding lease liability, below 60% and the debt service coverage ratio (DSCR) above 1.2 times. As of March 2020, the trust's LTV ratio, excluding lease liability, was 41%. TRIS Rating believes the trust should have no problem keeping the LTV ratio and DSCR in compliance with the debenture and bank loan covenants.

Adequate liquidity in 2020

Despite the expected decline in rental and service income in 2020, we believe the trust will be able to manage its liquidity adequately through this difficult time. As of March 2020, CPNREIT's sources of liquidity included cash on hand of THB182 million and investments in securities, fixed deposits, and mutual funds, worth THB968 million at fair value. The trust also had undrawn committed and uncommitted credit facilities from banks worth THB5.2 billion and THB4.2 billion, respectively, as of April 2020. TRIS Rating forecasts funds from operations (FFO) in 2020 to be THB2.3 billion. The trust has no debt due in 2020. CPNREIT's liquidity uses include planned capital expenditure for the Hilton Pattaya renovation of THB316 million in 2020 and the CentralPlaza Rama 2 renovation of THB1.0-1.2 billion during the remainder of 2020 through late 2021, as well as dividend payments of at least 90% of adjusted net investment income.

We assess CPNREIT's liquidity will come under more pressure in 2021 as the trust will need funding for the maturing debt amounting to THB10.6 billion, comprising THB5.4 billion in debentures and THB5.3 billion in long-term loans. We expect the trust to be able to refinance its maturing debt with no difficulty, given the expected improvement in operating performance in 2021 and strong support from its sponsor. TRIS Rating also expects the trust to have sufficient back-up loan facilities to mitigate refinancing risk.

BASE-CASE ASSUMPTIONS

- CPNREIT to provide rental fee discounts of 30%-40% in 2020 and 5% in 2021 for shopping centers
- Rental and service income of the trust to tumble by 30% in 2020. We forecast CPNREIT's rental and service income will stay in the range of THB7-THB8 billion per annum during 2021-2022
- New asset acquisitions together with fund raising to be executed by 2021

RATING OUTLOOK

The "negative" outlook reflects our expectation of a material deterioration in the trust's operating performance throughout 2020 and rising leverage resulting from the delay in equity injection.

RATING SENSITIVITIES

CPNREIT's ratings could be revised downward should the fallout from the pandemic turn out in a way that leads us to believe that the trust's operating performance and/or financial profile are heading for a deeper deterioration than expected, or if the prospect of the capital injection in 2021 becomes uncertain. On the contrary, CPNREIT's outlook could be revised back to "stable" if the trust succeeds in its fund raising and thus improves its leverage level, such that the LTV ratio stays below 35% and the debt to EBITDA ratio stays below 5 times.

COMPANY OVERVIEW

CPNREIT was founded as part of the process to convert CPNRF, a property fund, into a real estate investment trust or "REIT". CPNRF was established and listed on the Stock Exchange of Thailand (SET) in 2005. Upon the conversion in December 2017, CPNREIT acquired CPNRF's entire property portfolio, including CentralPlaza Rama 2, CentralPlaza Rama 3, CentralPlaza Pinklao, CentralPlaza Chiangmai Airport, and two office buildings of CentralPlaza Pinklao. At the same time, CPNREIT invested in CentralFestival Pattaya Beach and Hilton Pattaya. At the beginning of March 2020, CPNREIT acquired two office buildings, The 9th Towers and Unilever House, from GLAND Office Leasehold Real Estate Investment Trust (GLANDRT). As of March 2020, CPN was the trust's major unit holder with a 26.69% stake.

The property portfolio of the trust currently comprises five shopping centers, with NLA of 214,547 sq.m., four office buildings, with NLA of 112,653 sq.m., and one hotel, with 302 rooms. The assets are located in Bangkok, Chiangmai, and Chonburi provinces. CPN REIT Management Co.,Ltd., a wholly-owned subsidiary of CPN, acts as the REIT manager of the trust. CPN is the property manager of assets acquired from itself. Grand Canal Land PLC (GLAND) is the property manager of The 9th Towers, and Sterling Equity Co., Ltd., a wholly-owned subsidiary of GLAND, is the property manager of Unilever House. The trust subleases the hotel to CPN Pattaya Hotel Co.,Ltd., a subsidiary of CPN, as a special purpose vehicle (SPV). Hilton Hotels and Resorts acts as the hotel manager.

The trust's rental and service income was around THB5 billion per annum during 2018-2019. Its rental and service income dropped by 10% y-o-y to THB1.2 billion in the first three months of 2020. Around 90% of rental and service income came from shopping centers and the remainder from office buildings and the hotel. The variable portion of rental income from Hilton Pattaya contributed only 2% of CPNREIT's total income.

KEY OPERATING PERFORMANCE

Table 1: CPNREIT's Property Portfolio

	Central Plaza Rama 2	**Central Plaza Rama 3**	**Central Plaza Pinklao**	**Central Plaza Chiangmai Airport**	**Central Festival Pattaya Beach**
Type	Shopping center	Shopping center	Shopping center	Shopping center	Shopping center
Location	Bangkok	Bangkok	Bangkok	Chiangmai	Chonburi
Net leasable area (sq.m.)	82,930	36,495	27,656	38,062	29,404
OR (%) (as of 31 Mar 2020)	94.6	97.0	99.1	94.8	98.5
Investment at fair value (Mil. THB) (as of 31 Mar 2020)	23,107	11,447	5,216 (incl. office buildings)	10,655	7,290
Remaining leasehold period (years)	5	15+30+30	4	24	17

	Office Tower A at Pinklao	**Office Tower B at Pinklao**	**The 9th Towers**	**Unilever House**	**Hilton Pattaya**
Type	Office	Office	Office	Office	Hotel
Location	Bangkok	Bangkok	Bangkok	Bangkok	Chonburi
Net leasable area (sq.m.)	22,762	11,627	59,737	18,527	302 rooms
OR (%) (as of 31 Mar 2020)	84.7	93.9	94.1	100.0	61.6
Investment at fair value (Mil. THB) (as of 31 Mar 2020)			6,107	1,673	3,505
Remaining leasehold period (years)	4	4	27	14	17

Source: CPNREIT

FINANCIAL STATISTICS AND KEY FINANCIAL RATIOS*

Unit: Mil. THB

	Jan-Mar 2020	--------------Year Ended 31 December ----------- 2019	2018	2017	2016
Total operating revenues	1,178	5,131	4,923	3,522	3,525
Earnings before interest and taxes (EBIT)	947	4,261	3,981	2,821	2,906
Earnings before interest, taxes, depreciation, and amortization (EBITDA)	947	4,265	3,984	2,825	2,909
Funds from operations (FFO)	815	3,760	3,581	2,727	2,834
Adjusted interest expense	132	505	403	98	75
Investments in leasehold properties at fair value	69,001	44,472	44,750	44,310	32,309
Total assets	71,381	46,687	46,850	47,056	33,604
Adjusted debt (including lease liability)	38,313	13,367	13,441	12,695	952
Interest-bearing debt (excluding lease liability)	22,688	14,524	14,499	14,454	1,875
Adjusted equity	29,604	29,701	29,995	29,462	29,993
Adjusted Ratios					
EBITDA margin (%)	80.44	83.12	80.92	80.20	82.53
Pretax return on permanent capital (%)	7.26 **	9.60	9.00	7.44	9.21
EBITDA interest coverage (times)	7.15	8.45	9.88	28.97	38.68
Debt to EBITDA (times) (including lease liability)	9.30 **	3.13	3.37	4.49	0.33
Debt to EBITDA (times) (excluding lease liability)	5.29 **	3.13	3.37	4.49	0.33
FFO to debt (%)	9.43 **	28.13	26.64	21.48	297.68
Debt to capitalization (%)	56.41	31.04	30.94	30.11	3.08
Loan to fair value of total assets (%) (including lease liability)	54.95	31.11	30.95	30.72	5.58
Loan to fair value of total assets (%) (excluding lease liability)	41.36	31.11	30.95	30.72	5.58

Note: *Financial statistics in 2016 are based on CPNRF's performance. Full year financial statistics of 2017 combine CPNRF's performance during 1 January 2017–4 December 2017 and CPNREIT's performance during 29 November 2017–31 December 2017.*

* *Consolidated financial statements*

** *Annualized with trailing 12 months*

RELATED CRITERIA

- Rating Methodology – Corporate, 26 July 2019
- Key Financial Ratios and Adjustments, 5 September 2018
- Real Estate Investment Trust, 12 October 2016

CPN Retail Growth Leasehold REIT (CPNREIT)

Company Rating:	AA
Issue Ratings:	
CPNREIT212A: THB2,700 million senior unsecured debentures due 2021	AA
CPNREIT218A: THB2,650 million senior unsecured debentures due 2021	AA
CPNREIT232A: THB1,795 million senior unsecured debentures due 2023	AA
CPNREIT288A: THB7,390 million senior unsecured debentures due 2028	AA
Up to THB1,715 million senior unsecured debentures due within 10 years	AA
Rating Outlook:	Negative

TRIS Rating Co., Ltd.
Silom Complex Building, 24th Floor, 191 Silom Road, Bangkok 10500, Thailand Tel: 0-2098-3000