# CPN RETAIL GROWTH LEASEHOLD REIT

No. 172/2023
12 September 2023

## CORPORATES

| | |
|---|---|
| **Company Rating:** | AA- |
| **Issue Ratings:** | |
| Senior unsecured | AA- |
| **Outlook:** | Negative |

**Last Review Date:** 20/12/22

**Company Rating History:**

| Date | Rating | Outlook/Alert |
|---|---|---|
| 22/07/20 | AA | Negative |
| 25/05/18 | AA | Stable |

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## RATIONALE

TRIS Rating downgrades the company rating on CPN Retail Growth Leasehold REIT (CPNREIT or "trust") and the ratings on CPNREIT's senior unsecured debentures to "AA-" from "AA". The rating outlook remains "negative".

The downgrade and the "negative" outlook reflect our concerns over a potential material deterioration in the trust's financial position, caused by its debt funding plan for the renewal of leasehold rights of two large assets in 2024-2025. The ratings also take into consideration the trust's expected lower profitability ratio and tight but manageable liquidity. Nevertheless, the ratings continue to reflect the trust's highly predictable cash flows from contract-based income and the prospect of continued recovery in the operating performance of its shopping centers and hotel operation.

## KEY RATING CONSIDERATIONS

### Financial leverage to increase substantially following major asset renewals

We expect CPNREIT's financial leverage to materially increase from 2025 onwards. Its financial leverage, as measured by the debt to earnings before interest, taxes, depreciation and amortization (EBITDA) ratio, will likely be heading materially upward starting from 2024. The ratio could rise to a highly leveraged level in 2025, according to our forecast.

Our assessment of the trust's financial profile is based on its asset renewals and financing plan from the resolutions of Extraordinary General Meeting (EGM) of unitholders held in July 2023. CPNREIT plans to renew the leaseholds of two major assets namely the Central Pinklao and the Central Rama 2 projects in 2024-2025. These two assets accounted for around 40% of CPNREIT's net leasable area (NLA) and contributed around half of the trust's total operating revenues in 2022. Total costs for lease extension of the two assets will be THB25 billion which the trust intends to fund with 60% debt financing.

The trust will pay up to THB12.2 billion for the 15-year lease extension of Central Pinklao project once the current lease agreement ends in December 2024. In addition, CPNREIT will change the payment conditions of the 30-year lease renewal of Central Rama 2 project from a lump sum payment of THB25.4 billion in August 2025, to the first 10-year lease payment of THB12.9 billion. The payment term for the later 20-year lease will be determined by CPNREIT and the lessor in the future.

The planned financing structure for the lease extension of Central Pinklao project is 80% from capital increase and 20% from debt financing. CPNREIT plans to raise equity of around THB10 billion and borrow additional debt of THB2.2 billion in 2024. We view that it could be a challenging task for the trust to raise fund as targeted given the currently unfavorable market sentiment. However, we expect that Central Pattana PLC (CPN), as the sponsor of the trust, will support the equity-raising plan to make the lease renewal a success. Per CPN's announcement in June 2023, CPN is willing to increase its stake in CPNREIT from 30% to approximately 40%, with an additional investment of around THB6 billion, or roughly 60% of new units in this upcoming capital increase.

The funding source for the first 10-year lease extension of Central Rama 2 project will totally come from debt financing. The trust is expected to incur a substantial amount of debt of THB12.9 billion in 2025. Although the payment term for the later 20-year lease has not yet been determined, we included the projected net present value (NPV) for the later 20-year lease in our base-case scenario.

**Financial profile to deteriorate significantly in 2025**

Given the planned aggressive-debt funding for the lease renewal, we expect that CPNREIT will not acquire any new assets in 2023-2025. We also incorporate capital expenditures for asset renovation of THB1.3 billion in our forecast.

Following the trust's investment and financing plans, we project the trust's interest-bearing debt to increase to THB59 billion (including around THB16.4 billion of the later 20-year lease of Central Rama 2 project) by the end of 2025. Its EBITDA in 2023-2025 will likely be maintained at THB4.0-THB4.5 billion. As a result, CPNREIT's debt to EBITDA ratio is projected around 5 times in 2023, then increase to 7 times in 2024, and elevate to over than 10 times (including lease liabilities) in 2025. Its EBITDA interest coverage ratio could deteriorate to 1-2 times in 2025 from 6-7 times in 2022-2023. The trust's loan-to-fair value of total assets (LTV) ratio could exceed 50% from 2025 onwards.

The financial covenants on CPNREIT's debentures and bank loans require the trust's LTV ratio (excluding lease liability in loans) to remain below 60% and the debt service coverage ratio (DSCR) to stay above 1.2 times. As of June 2023, the trust's LTV ratio (excluding lease liability in loans) was 28% and DSCR was 1.3 times. We expect the trust should have no problem keeping the LTV ratio and DSCR in compliance with the financial covenants over the next 12 to 18 months.

**Expected lower margin but remain strong**

We view that CPNREIT's profit margin will decline from 2025 onwards as a result of the common area maintenance charge (CAM charge) in revenue and expenses of both Central Pinklao project and Central Rama 2 project as per the new lease agreements. Thus, the trust's EBITDA margin is poised to soften compared to the past few years. However, the CAM charge in revenue and expenses does not impact to absolute EBITDA.

Our base-case scenario projects CPNREIT's rental and service costs of around THB400 million per annum in 2023-2024. We expect its rental and service costs to double in 2025, as a result of a huge CAM charge of two major assets. The trust's EBITDA margin could decline to 73% in 2025 from around 80% in 2022-2024. If excluding CAM charge, the trust's EBITDA margin would remain at around 80% in 2025.

**Tight but manageable liquidity**

We assess the trust's liquidity as tight but should be manageable over the next 12-18 months. As of June 2023, CPNREIT's sources of liquidity included cash on hand of THB2.2 billion and investments in securities of THB1.1 billion at fair value. The trust also had undrawn committed working capital facilities from banks of THB100 million. We estimate the trust's funds from operations (FFO) in 2023 to be THB3.9 billion.

CPNREIT's debts due in the second half of 2023 will be THB553 million long-term loans. Maturing debts in 2024 will amount to THB4.5 billion, comprising THB2.5 billion long-term loans and THB2.0 billion debentures. We expect CPNREIT to be able to repay the THB553 million long-term loans by internally generated cash and find appropriate sources of funds to refinance long-term loans due in 2024. The trust plans to refinance the maturing debentures with new debenture issuances. CPNREIT's liquidity uses also include dividend payments of at least 90% of adjusted net investment income and projected operating expenses of THB1.3-THB1.8 billion per annum in 2023-2025.

As of June 2023, the trust's total debt (per priority debt consideration) was THB22.6 billion, including THB17.4 billion senior unsecured debentures and THB5.2 billion bank loans. All debts are unsecured and rank pari passu.

**Predictable cash flow from contract-based income**

CPNREIT's credit profile is underpinned by its steady cash flow streams from contract-based rental and service income for its leasehold rights of shopping centers and office buildings. As most tenants have three-year rent contracts, the trust's income has been steady. We view that the fixed-rent contracts provide the benefit of stable cash flows. Nevertheless, some revenue-sharing contracts provide more income during the economic upturn, while the minimum rental fee limits downside risk in the case that tenant performances fall below expectations.

Across the entire portfolio, around 60% of the trust's occupied area is rented under fixed-rate contracts, while the rest are revenue-sharing contracts. The trust has been gradually converting its typical fixed-rate rental contracts to revenue-sharing contracts for shopping center tenants. These contracts are based on an agreed sharing of the tenant's revenue on top of a minimum rental fee. An increasing proportion of the revenue-sharing contracts should help support the trust's revenue and earnings growth.

**Revival of retail property and hotel operation, but downward trend for office spaces**

We expect CPNREIT's operating performance to continue improving in 2023-2025 in tandem with the recovery of customer traffic and spending after the pandemic. We anticipate the occupancy rate (OR) of each shopping center to remain robust and the rental rates to improve with small discounts provided to tenants from 2023 onwards. For hotel operation, we expect the trust to receive a full amount of fixed and variable rent over the forecast period as we have seen a recovery of tourist arrivals since the second half of 2022. Nonetheless, we view that the OR and rental rates of office spaces will face serious threats from a huge supply influx in the next few years amidst shrinking demand from the popularity of remote working.

CPNREIT reported total operating revenue growth by 38% year-on-year (y-o-y) to THB4.9 billion in 2022. Its operating revenue soared by 20% y-o-y to THB2.8 billion in 6M2023. The trust's EBITDA jumped to THB3.9 billion in 2022 from THB2.5-THB3.0 billion in 2020-2021. Its EBITDA increased by 24% y-o-y in 6M2023. CPNREIT's operating results from each property type continued improving, thanks to the return of local shoppers and foreign tourists as well as lower discounts provided to tenants. The average OR of shopping centers remained sound at 94%-96% in 2022-6M2023. The OR of the Hilton Pattaya Hotel also revived to 87% in 6M2023 from 75% in 2022. However, the OR of office buildings declined to 85% in 6M2023 from above 90% of the pre-pandemic level.

In our base-case scenario, we project the average OR of the trust's shopping centers to achieve 93%-96%, with average room rate (ARR) growth of around 2% per annum as we see evidence of gradual traffic recovery from local and foreign customers. We expect the trust to earn fixed and variable rent totaling around THB400 million per annum from the Hilton Pattaya Hotel. For office spaces for rent, we anticipate the OR at 85% in 2023 but it will soften to below 80% in 2024-2025, with an expected slight drop in ARR. We expect CPNREIT's total operating revenue to reach the THB5-THB6 billion level per annum and EBITDA to stand in the THB4.0-THB4.5 billion range per annum in 2023-2025.

## BASE-CASE ASSUMPTIONS

The key assumptions in TRIS Rating's base-case forecast for CPNREIT's operations in 2023-2025 are as follows:

- Lease renewal of Central Pinklao project, and Central Rama 2 project will total THB25 billion, with 60% debt financing and 40% capital increase.
- Projected NPV of another 20-year lease obligation of Central Rama 2 project is based on a 4% revenue growth per annum and a 9% discount rate.
- No new asset acquisition.
- Capital expenditures for asset renovation of THB1.3 billion.
- Total operating revenue to increase to THB5-THB6 billion per annum.
- EBITDA margin to hover around 80% in 2023-2024, but decline to 73% in 2025. EBITDA to range THB4.0-4.5 billion per annum.

## RATING OUTLOOK

The "negative" outlook reflects our concerns over a potential material deterioration in CPNREIT's financial profile arising from its debt financing plan that will significantly elevate financial leverage and the prospect of a weakening profit margin.

## RATING SENSITIVITIES

CPNREIT's ratings could be further downgraded if the trust's operating performance and/or financial profile deteriorate materially from our base-case forecast. Conversely, the outlook could be revised to "stable" if the trust is able to execute a less debt-loaded financing structure to fund the major lease renewals, such that the LTV ratio stays below 50% and the debt to EBITDA ratio stays in the 5-8 times range after lease renewals of both projects.

## COMPANY OVERVIEW

CPNREIT was founded as part of the process to convert CPN Retail Growth Leasehold Property Fund (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 the shopping centers as follows: Central Rama 2, Central Rama 3, Central Pinklao, and Central Chiangmai Airport; as well as two office buildings of Central Pinklao. At the same time, CPNREIT invested in Central Pattaya Shopping Center and Hilton Hotel Pattaya. The trust acquired two office buildings, The 9th Towers and Unilever House, from GLAND Office Leasehold Real Estate Investment Trust (GLANDRT) in March 2020 and invested in Central Marina Shopping Center and Central Lampang Shopping Center in February 2021. As of June 2023, CPN was the trust's largest unitholder with a 30.28% stake.

The property portfolio of the trust currently comprises seven shopping centers, with NLA of 249,830 square meters (sq.m.), four office buildings, with NLA of 111,536 sq.m., and one hotel, with 304 rooms. The assets are located in Bangkok, Chiangmai, Chonburi, and Lampang. CPN REIT Management Co., Ltd., a wholly-owned subsidiary of CPN, acts as the REIT manager. CPN is the property manager of the 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.

## KEY OPERATING PERFORMANCE

**Table 1: CPNREIT's Property Portfolio**

| | **Central Rama 2** | **Central Rama 3** | **Central Pinklao** | **Central Chiangmai Airport** | **Central Pattaya** | **Central Marina** | **Central Lampang** |
|---|---|---|---|---|---|---|---|
| Type | Shopping center | Shopping center | Shopping center | Shopping center | Shopping center | Shopping center | Shopping center |
| Location | Bangkok | Bangkok | Bangkok | Chiangmai | Chonburi | Chonburi | Lampang |
| Net leasable area (sq.m.) | 88,606 | 36,037 | 27,711 | 36,472 | 29,201 | 15,439 | 16,363 |
| OR (%) (as of 30 Jun 2023) | 96 | 96 | 99.5 | 97 | 93 | 93 | 95 |
| Investment at fair value (Mil. THB) (as of 30 Jun 2023) | 27,640 | 13,099 | 2,184 (incl. office buildings) | 10,439 | 7,474 | 1,904 | 2,963 |
| Remaining leasehold period (years) | 2+30 | 12+30+30 | 1.5 | 21 | 14 | 12 | 19 |

| | **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 | 11,334 | 58,914 | 18,527 | 304 rooms |
| OR (%) (as of 30 Jun 2023) | 87 | 80 | 86 | 83 | 87 |
| Investment at fair value (Mil. THB) (as of 30 Jun 2023) | | | 5,921 | 1,361 | 3,790 |
| Remaining leasehold period (years) | 1.5 | 1.5 | 24 | 12 | 14 |

*Source: CPNREIT*

## FINANCIAL STATISTICS AND KEY FINANCIAL RATIOS*

*Unit: Mil. THB*

| | Jan-Jun 2023 | -----------Year Ended 31 December ----------- 2022 | 2021 | 2020 | 2019 |
|---|---|---|---|---|---|
| Total operating revenues | 2,760 | 4,881 | 3,524 | 4,062 | 5,131 |
| Earnings before interest, taxes, depreciation, and amortization (EBITDA) | 2,225 | 3,901 | 2,453 | 3,012 | 4,208 |
| Funds from operations (FFO) | 1,894 | 3,276 | 1,854 | 2,420 | 3,704 |
| Adjusted interest expense | 331 | 625 | 599 | 592 | 505 |
| Investments in leasehold properties at fair value | 76,775 | 76,304 | 75,371 | 68,270 | 44,472 |
| Total assets | 80,698 | 80,317 | 78,971 | 71,577 | 46,687 |
| Adjusted debt (excluding lease liability) | 19,678 | 20,397 | 20,688 | 21,068 | 13,367 |
| Lease liability | 21,965 | 21,045 | 19,315 | 17,727 | - |
| Adjusted equity | 33,020 | 33,277 | 33,819 | 28,044 | 29,701 |
| **Adjusted Ratios** | | | | | |
| EBITDA margin (%) | 80.62 | 79.93 | 69.60 | 74.14 | 82.02 |
| Pretax return on permanent capital (%) | 7.70 ** | 6.91 | 4.56 | 6.32 | 9.47 |
| EBITDA interest coverage (times) | 6.73 | 6.24 | 4.09 | 5.09 | 8.34 |
| Debt to EBITDA (times) | 4.55 ** | 5.23 | 8.43 | 6.99 | 3.18 |
| FFO to debt (%) | 18.62 ** | 16.06 | 8.96 | 11.49 | 27.71 |
| Debt to capitalization (%) | 37.34 | 38.00 | 37.95 | 42.90 | 31.04 |
| Loan to fair value of total assets (%) (according to bond covenants) | 28.06 | 28.64 | 28.57 | 32.18 | 31.11 |
| Loan to fair value of total assets (%) (excluding lease liability from loan and total assets) | 38.56 | 38.81 | 37.82 | 42.78 | 31.11 |

* *Consolidated financial statements*
** *Annualized with trailing 12 months*

## RELATED CRITERIA

- Corporate Rating Methodology, 15 July 2022
- Key Financial Ratios and Adjustments for Corporate Issuers, 11 January 2022
- Rating Methodology for Real Estate for Rent Companies, 15 July 2021
- Issue Rating Criteria, 15 June 2021

CPN Retail Growth Leasehold REIT (CPNREIT)

| | |
|---|---|
| **Company Rating:** | AA- |
| **Issue Ratings:** | |
| CPNREIT243A: THB2,000 million senior unsecured debentures due 2024 | AA- |
| CPNREIT262A: THB500 million senior unsecured debentures due 2026 | AA- |
| CPNREIT263A: THB1,500 million senior unsecured debentures due 2026 | AA- |
| CPNREIT268A: THB1,650 million senior unsecured debentures due 2026 | AA- |
| CPNREIT272B: THB1,400 million senior unsecured debentures due 2027 | AA- |
| CPNREIT272A: THB2,000 million senior unsecured debentures due 2027 | AA- |
| CPNREIT288A: THB7,390 million senior unsecured debentures due 2028 | AA- |
| CPNREIT318A: THB1,000 million senior unsecured debentures due 2031 | AA- |
| **Rating Outlook:** | Negative |

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