

HEMARAJ LEASEHOLD REAL ESTATE INVESTMENT TRUST

No. 128/2019
14 August 2019

CORPORATES

Company Rating: BBB+
Outlook: Stable

Last Review Date: 09/10/18

Company Rating History:

Date	Rating	Outlook/Alert
09/10/18	BBB+	Stable

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RATIONALE

TRIS Rating affirms the company rating on Hemaraj Leasehold Real Estate Investment Trust (HREIT) at “BBB+” with a “stable” outlook. The rating reflects a recent improvement in operating performance and the predictable income stream HREIT earns from rental contracts. The rating also takes into consideration the strong support from sponsor, WHA Industrial Development PLC (WHAID), through an asset injection and undertaking scheme. The rating is partially constrained by HREIT’s small size, tenant concentration, plus the volatile nature of the industrial property for rent business, which are sensitive to economic conditions and market competition.

KEY RATING CONSIDERATIONS

Improving operating performance

HREIT’s operating performance is improving, the result of organic growth and an increase in assets injected from WHAID, HREIT’s sponsor. HREIT was able to achieve a satisfactory occupancy rate (OR) of 83% as of June 2019, up from 68% in 2017 and 81% in 2018. The rising demand for industrial properties in the Eastern region, one of the main manufacturing locations in Thailand, and the trade-related tensions between the USA and China are the main reasons for the increase in the OR. Tenants from China represented 11% of HREIT’s property portfolio in 2018 and 13% in the first half of 2019, up from 4% in 2017. The asset enhancement supported by its sponsor, comprising standard warehouses and ready-built factories with a 100% OR, also helped improve the performance of HREIT’s property portfolio. HREIT plans to acquire additional assets from sponsor. By the first quarter of 2020, HREIT expects to purchase assets worth approximately Bt1.40 billion, and add assets worth Bt870 million by the first quarter of 2021. As a result, we expect the OR (without the sponsor’s undertaking) hover between 85%-90% in 2019-2021.

Comparatively small size of business

HREIT is smaller than other industrial REITs rated by TRIS Rating. Considering the investment properties recorded as of June 2019, HREIT held properties worth Bt9.55 billion. For comparison, Frasers Property Thailand Industrial Freehold and Leasehold REIT (FTREIT) held properties valued at Bt35.74 billion while WHA Premium Growth Freehold and Leasehold Real Estate Investment Trust (WHART) held Bt30.93 billion. Asset size matters with respect to the ability to generate revenue. For 12-month period in 2018, HREIT’s total revenues reached Bt725 million compared with revenues of Bt2.62 billion for FTREIT and Bt1.98 billion for WHART.

Maintaining current earnings performance will be challenge

Currently, the stable income streams of HREIT are supported by medium-term contracts and an undertaking scheme from its sponsor. WHAID, the trust’s sponsor, commits to pay rental income to the trust for three years for vacant property space in order to enhance OR to 100%, and further commits to make up any shortfall if the rental rates offered to tenants fall below a guaranteed rental rate. Both OR and rental rate guarantees from its sponsor’s undertaking scheme help alleviate the effect of vacancies.

However, the undertaking agreement from sponsor, covering 78.6% of total leasable area as of June 2019, will expire by November 2019. In our view, the trust will face a challenge maintaining the OR at the current level in order to maintain its earnings performance. Almost two-thirds (64%) of HREIT’s lease

contracts have a three-year lease term. Leases covering around 35% of the total leased area will expire in 2019, followed by 18% in 2020, and 32% in 2021. The property manager normally negotiates a renewal about six months in advance of expiration. Thus, the trust has time to look for new tenants should the lessees decide not renew their contracts.

Under TRIS Rating's base case forecast, we expect HREIT should be able to maintain its OR. As a result, total revenue should be Bt730-Bt820 million per annum while EBITDA (earnings before interest, taxes, depreciation, and amortization) should stay around Bt650-Bt700 million per annum during 2019-2021.

Tenant concentration risk

The top 10 largest tenants occupy almost half of total rental and service income. However, this concentration risk will gradually dissipate as asset size grows. As of June 2019, the 10 largest tenants contributed 43% of total rental and service income, down from 57% in 2016 and 46% in 2017. In addition, some contracts contain penalties for early termination. A tenant might have to pay the remaining rental value if the tenant terminates the contract ahead of the expiration date. The leased area was mainly driven by demand from the automotive industry, consumer product manufacturers, and logistics services providers with 31%, 23%, and 21% of the tenants' portfolio, respectively. Along its investment plan in the pipeline, we believe that a growing scale will contribute to incremental tenant diversification.

Moderate financial leverage

HREIT's financial leverage is moderate. In December 2018, HREIT spent Bt500 million for latest asset acquisition from its sponsor with a 84% debt financing structure. As a result, the interest-bearing debt to total assets ratio (LTV) increased to 33.9% at the end of 2018.

HREIT intends to expand its property portfolio continually mainly from its sponsor. HREIT expects to acquire additional assets totaling around Bt1.40 billion in the first quarter of 2020 and around Bt870 million in the beginning of 2021. In accordance with its financial policy, the trust targets to keep LTV of not higher than 35% in the medium to long term. We anticipate that the trust will fund its future acquisitions using a combination of capital raised and debt, resulting in the LTV expected to hover around the current level of 34% over the next three years.

Manageable refinancing risk

Given its access to financial markets and availability of back-up facilities for bullet repayments, we assess its refinancing risk is manageable. Total debt was Bt3.32 billion as of June 2019. The debt maturity profile includes repayments of Bt2.33 billion due in 2021, followed by Bt995 million due in 2023. HREIT has managed the refinancing risk by seeking back-up long-term loan facilities from a financial institution to repay the scheduled repayments in 2021 and 2023.

BASE-CASE ASSUMPTIONS

- HREIT's investment assets is assumed to increase by around Bt1.40 billion in 2020 and Bt870 million in 2021. The OR will hold at approximately 90% in 2020-2021.
- Total revenue will grow to around Bt730-Bt820 million per annum during 2019-2021.
- The operating margin (operating income before depreciation and amortization as a percentage of revenue) will range between 87%-90% over the next three years.

RATING OUTLOOK

The "stable" outlook reflects our expectation that HREIT's property portfolio will be able to sustain cash flow generation both before and after the expiration of the sponsor undertaking agreement, plus the ability to comply with its financial covenants.

RATING SENSITIVITIES

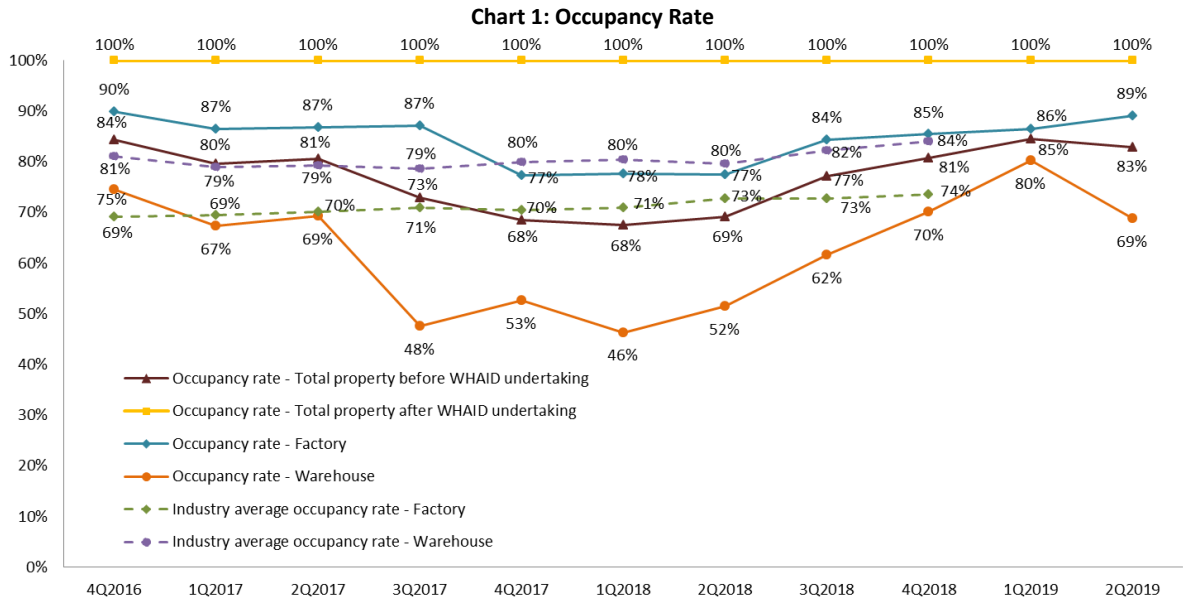
The credit rating of HREIT could be under downward pressure if the OR drops significantly below expectations and/or in a scenario of larger-than-expected debt-funded expansion for a prolonged period. On the other hand, the rating could be revised upward if HREIT is able to enlarge its business scale while maintaining satisfactory performance.

COMPANY OVERVIEW

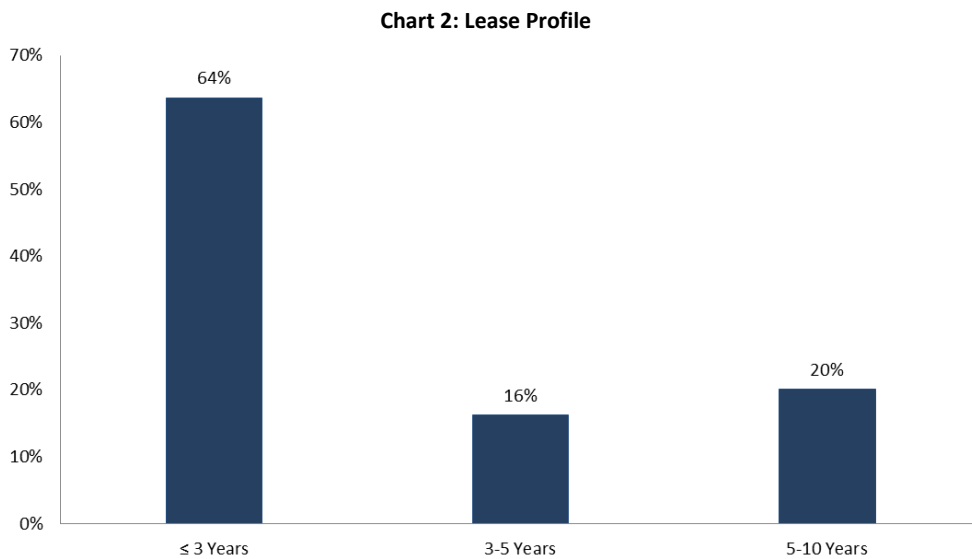
HREIT was established and listed on the Stock Exchange of Thailand (SET) in November 2016, with registered capital of Bt5.69 billion. At present, WHAID holds a 15% in HREIT. The REIT manager of the trust is WHA Industrial REIT Management Co., Ltd. (WHAIRM) which is wholly owned by WHAID, the property manager and the main sponsor of the trust. HREIT has focused on the acquisition of leasehold rights in good-quality and well-occupied industrial properties including standard warehouses and ready-built factories.

As of June 2019, the investment asset size of HREIT was valued at Bt9.55 billion with total leasable area of 332,505 square meters (sq.m.). HREIT’s property portfolio comprised factory (69%) and warehouse (31%) in three provinces: Chonburi, Rayong, and Saraburi. HREIT’s properties are located in key industrial estates and manufacturing hubs in Thailand. About 92% of the leasable properties are located in the Eastern Economic Corridor (EEC) development area.

KEY OPERATING PERFORMANCE

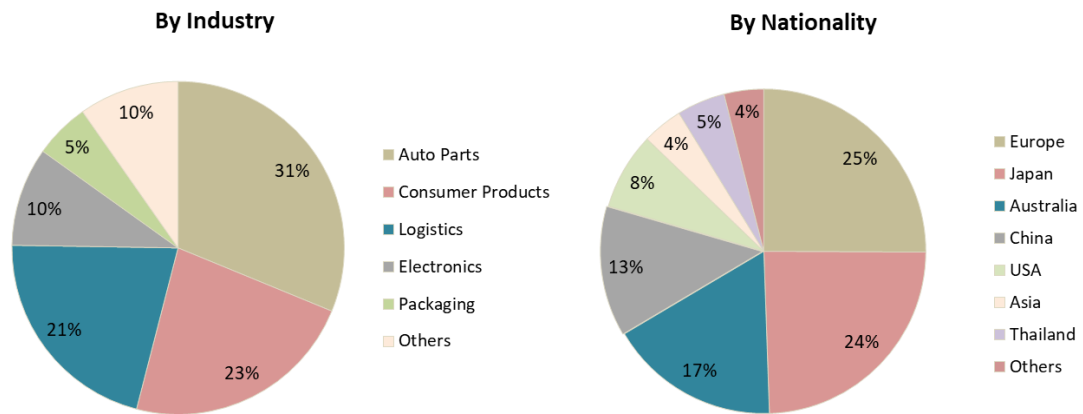


Note: Occupancy rate as of end of period
Sources: HREIT and CB Richard Ellis (CBRE)



Source: HREIT

Chart 3: Tenant Profile



Source: HREIT

FINANCIAL STATISTICS AND KEY FINANCIAL RATIOS*

Unit: Bt million

	Jan-Jun 2019	----- Year Ended 31 December ----		
		2018	2017	2016
Total operating revenues	380	725	576	62
Operating income	345	654	522	55
Earnings before interest and taxes (EBIT)	340	645	522	55
Earnings before interest, taxes, depreciation, and amortization (EBITDA)	346	655	523	55
Funds from operations (FFO)	278	537	426	44
Adjusted interest expense	68	118	97	11
Capital expenditures	0	2,091	0	7,975
Total assets	9,902	9,691	8,434	8,201
Adjusted debt	3,073	3,076	1,046	2,093
Adjusted equity	6,390	6,181	5,985	5,738
Adjusted Ratios				
Operating income as % of total operating revenues (%)	90.78	90.21	90.60	88.14
Pretax return on permanent capital (%)	7.12 **	7.27	6.40	0.68
EBITDA interest coverage (times)	5.09	5.55	5.41	5.24
Debt to EBITDA (times)	4.54 **	4.70	2.00	38.08
FFO to debt (%)	17.87 **	17.46	40.76	2.12
Debt to capitalization (%)	32.48	33.23	14.87	26.73

* Consolidated financial statements

** Annualized with trailing 12 months

RELATED CRITERIA

- Key Financial Ratios and Adjustments, 5 September 2018
- Real Estate Investment Trust, 12 October 2016

Hemaraj Leasehold Real Estate Investment Trust (HREIT)

Company Rating:	BBB+
Rating Outlook:	Stable

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