

HEMARAJ LEASEHOLD REAL ESTATE INVESTMENT TRUST

No. 123/2020
14 August 2020

CORPORATES

Company Rating: BBB+
Outlook: Stable

Last Review Date: 14/08/19

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 or trust) at “BBB+” with a “stable” outlook. The rating reflects the trust’s improving operating performance, small size, portfolio concentration risk in terms of tenant base, and its moderate financial leverage. The rating also takes into consideration the Coronavirus Disease 2019 (COVID-19) outbreak might put some pressure on the demand for industrial properties in overall in the short to medium term.

KEY RATING CONSIDERATIONS

Improvement in operating performance

HREIT’s operating performance has consistently improved. TRIS Rating views that HREIT should be able to maintain its satisfactory occupancy rate (OR) in the medium term.

As of December 2019, the average OR (exclusive of the yield-enhancement from the sponsor’s undertaking) was 94%, up from 68% at the end of 2017 and 81% at the end of 2018. As of June 2020, the average OR (exclusive of the yield enhancement from the sponsor’s undertaking) was 94%. The main reason for the increase in the OR is from the trade tension between the USA and China. The relocation of manufacturing bases to Thailand by many Chinese manufacturers has led to rising demand for industrial properties for their supply chains. Based on occupied area, the proportion of Chinese tenants jumped to 26% in the first half of 2020, up from 4% in 2017, 11% in 2018, and 22% in 2019.

In addition, regular injections of assets with high OR supported by the trust’s sponsor, WHA Industrial Development PLC (WHAID), have helped improve portfolio performance. WHAID 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.

Comparatively small size of business

HREIT is significantly smaller than the other industrial REITs rated by TRIS Rating. Considering the investment properties recorded as of June 2020, HREIT held properties worth THB9.57 billion, while Frasers Property Thailand Industrial Freehold and Leasehold REIT (FTREIT: rated “A” by TRIS Rating) held properties valued at THB39.18 billion and WHA Premium Growth Freehold and Leasehold Real Estate Investment Trust (WHART: rated “A” by TRIS Rating) held THB36.50 billion. We view that asset size matters with respect to the capability to generate revenue. For the 12-month period of fiscal year (FY) 2019, HREIT’s total revenues reached Bt767 million compared with revenues of THB2.79 billion for FTREIT and THB2.23 billion for WHART. However, we believe HREIT has the potential to scale up over time given the support of its sponsor.

Exposure to tenant concentration risk

HREIT is exposed to tenant concentration risk. The top-ten tenants occupied 41% of the total occupied area and contributed 39% of total rental and service income in the first half of 2020. However, the tenant concentration risk is partly alleviated by the strong credit profiles of its top largest tenants. Moreover, the property manager normally negotiates lease renewal

agreements with tenants about six months in advance of expiration. Thus, the trust has time to look for new tenants in the event that incumbent lessees decide to terminate their contracts. TRIS Rating expects the tenant concentration risk to gradually dissipate as asset size grows.

Moderate financial leverage

TRIS Rating views HREIT's financial leverage as moderate. According to its financial policy, HREIT aims to keep its loan to fair value of total assets ratio (LTV) not higher than 40% in the medium to long term. The ratio has been in the range of 27%-34% over the past three years. At the end of June 2020, the trust's LTV ratio stood at 33%.

HREIT intends to enlarge its property portfolio consistently, mainly through its sponsor. As its growth plan, HREIT plans to acquire new assets worth around THB1.50 billion by December 2020 using equity and/or debt. As a result, the LTV is expected to reach around 34.5% at the end of 2020. Going forward, we forecast HREIT to acquire new assets of around THB1.20 billion per annum in 2021-2022. We expect the trust to fund its future acquisitions by using a combination of capital and debt, resulting in an LTV ratio of around 34% in 2021 and 2022.

The financial covenant of HREIT's loan obligations requires it to keep its interest-bearing debt to earnings before interest, taxes, depreciation, and amortization (EBITDA) ratio below 6.5 times and the interest-bearing debt to equity ratio below 1 times. The ratios at the end of June 2020 were 5.5 times and 0.5 times, respectively. TRIS Rating considers that the company should have no problem complying with this financial covenant over the next 12 months.

COVID-19 to affect the trust's performance in the short to medium term

Even HREIT has not been negatively affected of the COVID-19 in the trust's performance for the first six months of 2020, TRIS Rating believes the COVID-19 pandemic could put pressure on the occupancy and rental rates on overall industrial properties. The COVID-19 outbreak has affected the overall economy since late January 2020. The trust's tenants are mainly engaged in the consumer products industry (27%), automotive industry (27%), and logistics providers (19%), based on occupied area.

Under TRIS Rating's base case, we assume the COVID-19 pandemic may not recede in the second half of this year. Thus, we forecast the trust's rental rate for warehouses and factories to drop by 5%-8% in 2020, followed by a rebound to the current level in 2021. The average OR (with the sponsor's undertaking) is expected to be in the 84%-92% range over the next three years. The trust's revenue in 2020 is expected to decline to around THB660 million, and recover to THB740-THB790 million per annum in 2021 and 2022. However, if the pandemic is prolonged, the trust's performance could be further affected by lower occupancy and lease renewal rates. Note that 81% of its rental contracts have a 3-year lease term, with 14% of the total area under lease due to expire in the remaining six months of 2020, 24% in 2021, 46% in 2022, and the remainder expiring thereafter. The contract renewal rate has been above 60% over the past two years.

Manageable liquidity

TRIS Rating assesses HREIT's liquidity to be manageable given its ability to access financial markets. The ratio of funds from operations (FFO) to debt was around 17% and the EBITDA interest coverage ratio was 5 times during the first half of 2020. We expect HREIT's FFO to drop to THB470 million in 2020 and recover to THB540-THB570 million per annum in the following years. The FFO to debt ratio is forecast to hover at around 13% and the interest coverage ratio is projected to be 5-6 times over the next three years.

As of June 2020, HREIT's outstanding debt was THB3.32 billion, all of which is made up of long-term loans. The debt maturity profile includes repayments of THB2.33 billion due in November 2021, followed by THB575 million in January 2023 and THB420 million in December 2023. The trust has already prepared back-up long-term loan facilities from a financial institution to refinance the debt due in 2021. In addition, the trust is working on back-up loan facilities from a financial institution to repay the scheduled repayments in 2023.

BASE-CASE ASSUMPTIONS

- Investment assets to increase by THB1.50 billion in 2020 and THB1.20 billion per year during 2021-2022.
- OR (with the sponsor's undertaking) to range from 84%-92% over the next three years.
- Rental rates of warehouses and factories to slip by 5%-8% in 2020 and rebound to the current level in 2021-2022.
- Total revenue of THB660-THB790 million per annum during 2020-2022.
- EBITDA margin to range 87%-88% 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 the loan covenants.

RATING SENSITIVITIES

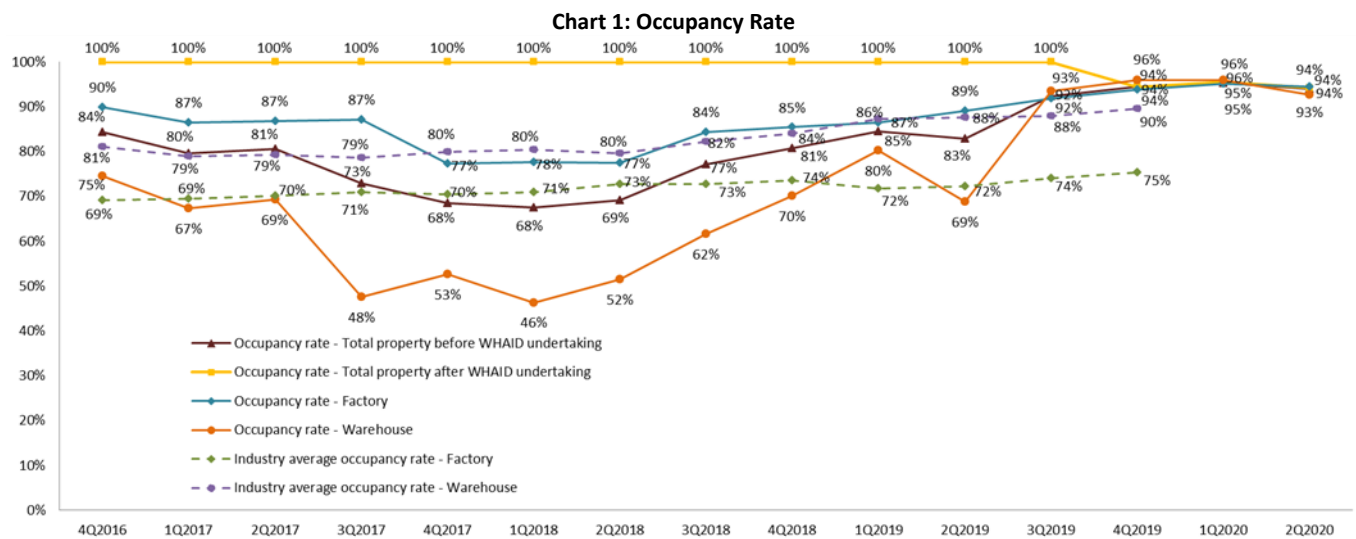
The credit rating on HREIT could come under downward pressure if the OR drops significantly below expectations and/or the trust undertakes a larger-than-expected debt-funded expansion for a prolonged period. On the other hand, the rating could be revised upward if HREIT is able to enlarge its business 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 THB5.69 billion. At present, WHAID holds a 15% stake 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 main sponsor of the trust. HREIT has focused on the acquisition of leasehold rights for good-quality and well-occupied industrial properties including standard warehouses and ready-built factories.

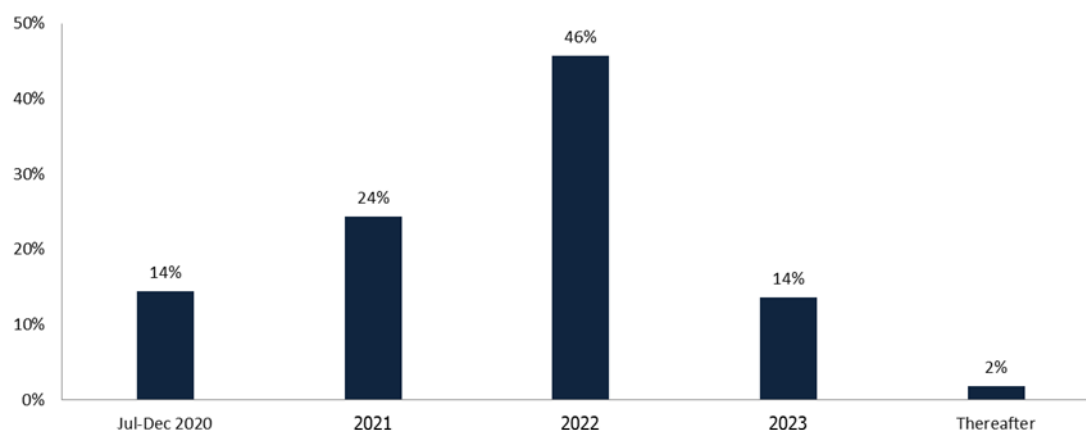
As of June 2020, the investment asset size of HREIT was valued at THB9.57 billion with total leasable area of 332,505 square meters (sq.m.). HREIT’s property portfolio comprised factories (69%) and warehouses (31%) in three provinces: Chonburi, Rayong, and Saraburi. HREIT’s properties are located in 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)

Chart 2: Lease Expiry by Occupied Area


Source: HREIT

FINANCIAL STATISTICS AND KEY FINANCIAL RATIOS*

Unit: Mil. THB

	Jan-Jun 2020	----- Year Ended 31 December -----			
		2019	2018	2017	2016
Total operating revenues	345	767	725	576	62
Earnings before interest and taxes (EBIT)	302	681	645	522	55
Earnings before interest, taxes, depreciation, and amortization (EBITDA)	307	693	655	523	55
Funds from operations (FFO)	246	556	537	426	44
Adjusted interest expense	62	137	118	97	11
Capital expenditures	0	0	2,091	0	7,975
Total assets	9,913	9,914	9,691	8,434	8,201
Adjusted debt	3,050	3,058	3,076	1,046	2,093
Adjusted equity	6,390	6,384	6,181	5,985	5,738
Adjusted Ratios					
EBITDA margin (%)	89.09	90.38	90.31	90.76	88.63
Pretax return on permanent capital (%)	6.64 **	7.12	7.27	6.40	0.68
EBITDA interest coverage (times)	4.97	5.06	5.55	5.41	5.24
Debt to EBITDA (times)	4.66 **	4.41	4.70	2.00	38.08
FFO to debt (%)	17.18 **	18.19	17.46	40.76	2.12
Debt to capitalization (%)	32.31	32.39	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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