

# CPN RETAIL GROWTH LEASEHOLD REIT

No. 94/2019

25 June 2019

## CORPORATES

<b>Company Rating:</b>	AA
<b>Issue Ratings:</b>	
Senior unsecured	AA
<b>Outlook:</b>	Stable

**Last Review Date:** 29/06/18

### Company Rating History:

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

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## RATIONALE

TRIS Rating affirms the company rating on CPN Retail Growth Leasehold REIT (CPNREIT) and the ratings on CPNREIT's senior unsecured debentures at "AA". The ratings 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" by TRIS Rating. However, the ratings are partially constrained by tenant concentration in terms of leasable area and revenue contribution.

## KEY RATING CONSIDERATIONS

### Largest REIT with high OR from high quality assets

CPNREIT has been the largest real estate investment trust (REIT) in Thailand, with total investment properties worth Bt44,750 million as of 31 March 2019. The leasable area totaled 248,925 square meters (sq.m.), consisting of 214,605 sq.m. from five shopping centers and 34,320 sq.m. from two office buildings. The average occupancy rate (OR) of the shopping centers was 96% as of 31 March 2019. The average rental rate ranged from Bt1,000- Bt2,000 per sq.m. per month in the first quarter of 2019. The average OR of the office space was 90% as of 31 March 2019, with an average rental rate of Bt480-Bt560 per sq.m. per month. CPNREIT also invests in Hilton Pattaya Hotel, a 302-room hotel, with an average OR of 93% in the first quarter of 2019. TRIS Rating forecasts the OR of each shopping center to stay above 93% and each office building to stay above 85% during 2019-2021.

### Reliable cash flow stream from contract-based rental and service income

TRIS Rating views that the rental and service income of the trust is predictable since most tenants have three-year contracts. Based on the area currently under lease, 27% of total occupied area will expire in 2019, 31% in 2020, 24% in 2021, and the rest will expire since 2022 onwards. Due to limited supply of high quality retail spaces in good locations, the renewal rate has been relatively high at around 90% for the past several years. TRIS Rating expects the REIT manager to be able to keep the high renewal rate with a favorable rental rate.

CPNREIT's rental and service income grew by 39% year-on-year (y-o-y) to Bt4,739 million in 2018 because the trust acquired CentralFestival Pattaya Beach and Hilton Pattaya in late 2017. Rental and service income during the first three months of 2019 increased by 7% y-o-y to Bt1,230 million. Around 30% of the rental and service income came from CentralPlaza Rama 2 and around 20% came from CentralPlaza Pinklao.

CPNREIT's operating income held at 80%-83% during 2015 through the first quarter of 2019. The EBITDA (earnings before interest, tax, depreciation, and amortization) margin was high at 80%-83% during the past five years. CPNREIT's ability to maintain its high OR, increase rental rates, and control operating costs have sustained this high profitability. Going forward, TRIS Rating forecasts the operating income and the EBITDA margin to be held at least 80%.

### Tenant concentration risk

The portfolio of CPNREIT is exposed to concentration risk. Operating performance depends on assets in limited locations: Bangkok (Rama 2, Rama 3,

and Pinklao), Chiangmai, and Chonburi (Pattaya). At the end of March 2019, the number of tenants was 965 for the shopping centers and 111 for the office spaces. During 2018 through the first three months of 2019, the 10 largest tenants in the shopping centers occupied 41% of the total occupied area and contributed 17%-18% of the total rental and service income from shopping centers. For office space, the top-10 largest tenants occupied 36% of the total occupied area and contributed 38%-39% of total income from office buildings. Tenants affiliated with the Central Group occupied 25% and 12% of the occupied area of the shopping centers and office space, respectively. However, this concentration risk is partly mitigated by the high credit profiles of the top largest tenants.

### **Growth prospect from assets under the group**

CPN has been CPNREIT's sponsor, with 26.69% stake as of 31 March 2019. CPNREIT's REIT manager is a wholly-owned subsidiary of CPN and the trust's property manager is CPN. CPN currently owns 33 shopping centers with 1.8 million sq.m. leasable area, seven office buildings, and one hotel. TRIS Rating's base case scenario forecasts that CPNREIT will add new properties worth Bt20,000 million into its portfolio in 2020, and the property will come primarily from the sponsor. According to REIT's policy, CPNREIT will acquire matured properties with high OR and stable rental rate growth into the trust. The growing size of the quality property portfolio is expected to boost CPNREIT's rental and service income from Bt4,800 million in 2019 to approximately Bt6,500 million in 2020.

### **Conservative leverage policy**

CPNREIT has a policy to maintain the loan to total asset value (LTV) at less than 35%. CPNREIT's debt to capitalization ratio was healthy at 31% at the end of March 2019. The interest-bearing debt to EBITDA ratio was 3-4 times during 2017 through the first quarter of 2019.

Although the trust plans to expand its portfolio in the future, the sources of fund for investment in new assets are expected to come from both debt and new equity from unit holders. We forecast the trust will keep the interest-bearing debt to EBITDA ratio below 5 times and the loan to total asset ratio below 35% in accordance with the trust's policy.

### **Adequate liquidity**

TRIS Rating views that CPNREIT's liquidity profile is adequate. The funds from operations (FFO) to total debt ratio was 27%-28% during 2018 through the first quarter of 2019. The EBITDA interest coverage ratio held at 10 times in 2018 and 8 times in the first three months of 2019. As of 31 March 2019, the financial flexibility of the trust was supported by cash on hand of Bt423 million, investments in securities at fair value of Bt1,002 million, and undrawn committed credit facilities from banks of Bt3,100 million. We forecast FFO over the next 12 months will be around Bt3,700 million.

At the end of March 2019, CPNREIT had outstanding debentures of Bt14,521 million due in 2021, 2023, and 2028. CPNREIT plans to refinance its maturing bond by new bond issuance. CPNREIT's liquidity uses include forecast capital expenditure for maintenance at 1% of total rental and service income and dividend payments of at least 90% of adjusted net investment income. TRIS Rating expects the trust will be able to refinance its debentures with no difficulty, given its strong operating performance and strong support from its sponsor.

### **BASE-CASE ASSUMPTIONS**

- New asset acquisitions will be worth Bt20,000 million in 2020;
- OR of each shopping center will stay above 93% and each office building will stay above 85% during 2019-2021;
- Average rental rate will grow by at least 3% per annum over the next three years;
- Rental and service income will be Bt4,800 million in 2019 and will increase to Bt6,500-Bt6,700 million per annum during 2020-2021;
- Operating income and EBITDA margin should be held at least 80%.

### **RATING OUTLOOK**

The "stable" outlook reflects the expectation that CPNREIT's property portfolio will generate predictable streams of cash flow during the next three years. TRIS Rating expects the trust's assets to sustain high OR and achieve favorable rental rates as targeted. In addition, CPNREIT's financial profile should remain strong as the interest-bearing debt to EBITDA ratio stays below 5 times and the loan to total asset ratio stays below 35%.

### **RATING SENSITIVITIES**

CPNREIT's rating and/or outlook could be revised downward if the interest-bearing debt to EBITDA ratio increases above 5 times for a prolonged period or there are any larger-than-expected debt-funded property acquisitions. The credit upside is limited in the near term.

## 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 and also invested in CentralFestival Pattaya Beach and Hilton Pattaya. CPN, the sponsor, has been the trust’s major unit holder with a 26.69% stake as of 31 March 2019. CPN also acts as CPNREIT’s REIT manager and property manager.

After the conversion, the trust’s property portfolio consisted of five shopping centers, two office buildings, and one hotel. The property manager manages a total leasable area of 248,925 sq.m. of shopping centers and office space, 86% of which is from shopping centers and the rest is from office space. The 302-room hotel is subleased to CPN Pattaya Hotel Co., Ltd., a subsidiary of CPN, and managed by Hilton Hotels and Resorts as the hotel manager.

Rental and service income was around Bt3,400 million per annum during 2016-2017 and increased to Bt4,739 million in 2018 after the acquisition of CentralFestival Pattaya Beach and Hilton Pattaya in late 2017. Rental and service income was Bt1,230 million in the first three months of 2019. Around 90% of rental and service income came from shopping centers and the rest came from office space and hotel. The variable portion of rental and service income from the hotel property constituted 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	Office Tower A at Pinklao	Office Tower B at Pinklao	Hilton Pattaya
Type	Shopping center	Shopping center	Shopping center	Shopping center	Shopping center	Office	Office	Hotel
Location	Bangkok	Bangkok	Bangkok	Chiangmai	Chonburi	Bangkok	Bangkok	Chonburi
Net leasable area (sq.m.)	82,588	37,137	27,656	37,820	29,404	22,693	11,627	302 rooms
OR (%) (as of 31 Mar 2019)	95.3	94.1	98.3	93.7	98.4	86.8	95.6	92.5
Investment at fair value(Bt million) (as of 31 Mar 2019)	6,962	10,698	5,678 (incl. office buildings)	10,658	7,289			3,465
Remaining leasehold period (years)	6	16+30+30	5	25	18	5	5	18

Source: CPNREIT

## FINANCIAL STATISTICS AND KEY FINANCIAL RATIOS\*

Unit: Bt million

	Jan-Mar 2019	-----Year Ended 31 December -----			
		2018	2017	2016	2015
Total operating revenues	1,312	4,923	3,522	3,525	3,129
Operating income	1,091	3,980	2,820	2,903	2,494
Earnings before interest and taxes (EBIT)	1,090	3,981	2,821	2,906	2,498
Earnings before interest, taxes, depreciation, and amortization (EBITDA)	1,092	3,984	2,825	2,909	2,501
Funds from operations (FFO)	961	3,581	2,727	2,834	2,424
Adjusted interest expense	130	403	98	75	76
Investments in leasehold properties at fair value	44,750	44,750	44,310	32,309	31,790
Total assets	46,924	46,850	47,056	33,604	32,784
Adjusted debt	13,375	13,441	12,695	952	1,258
Adjusted equity	30,007	29,995	29,462	29,993	29,242
<b>Adjusted Ratios</b>					
Operating income as % of total operating revenues (%)	83.13	80.84	80.08	82.36	79.70
Pretax return on permanent capital (%)	9.30 **	9.00	7.44	9.21	8.20
EBITDA interest coverage (times)	8.38	9.88	28.97	38.68	32.79
Debt to EBITDA (times)	3.24 **	3.37	4.49	0.33	0.50
FFO to debt (%)	27.55 **	26.64	21.48	297.68	192.72
Debt to capitalization (%)	30.83	30.94	30.11	3.08	4.12
Loan to fair value of total assets (%)	30.95	30.95	30.72	5.58	5.91

Note: Financial statistics during 2015-2016 are based on CPNRF's performance. Full year financial statistics of 2017 combine CPNRF's performance during 1 Jan 2017–4 Dec 2017 and CPNREIT's performance during 29 Nov 2017–31 Dec 2017.

\* 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
- Rating Methodology – Corporate, 31 October 2007

**CPN Retail Growth Leasehold REIT (CPNREIT)**

<b>Company Rating:</b>	AA
<b>Issue Ratings:</b>	
CPNREIT212A: Bt2,700 million senior unsecured debentures due 2021	AA
CPNREIT218A: Bt2,650 million senior unsecured debentures due 2021	AA
CPNREIT232A: Bt1,795 million senior unsecured debentures due 2023	AA
CPNREIT288A: Bt7,390 million senior unsecured debentures due 2028	AA
Up to Bt1,715 million senior unsecured debentures due within 10 years	AA
<b>Rating Outlook:</b>	Stable

**TRIS Rating Co., Ltd.**

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