DUSIT THANI FREEHOLD AND LEASEHOLD REAL ESTATE INVESTMENT TRUST

No. 206/2019
19 December 2019

CORPORATES

Company Rating: BBB

Outlook: Stable

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RATIONALE

TRIS Rating assigns the company rating on Dusit Thani Freehold and Leasehold Real Estate Investment Trust (DREIT or trust) at "BBB" with a "stable" rating outlook. The rating reflects the trust's small and concentrated portfolio of assets, a rise in leverage from the ongoing hotel renovation plans, and the acquisition of "Dusit Thani Maldives" (DTMD), as well as the volatile and cyclical nature of the hotel business. The rating also takes into consideration the downside protection of minimum rental revenue over the leaseback period provided by its sponsor, Dusit Thani PLC (DTC), rated "BBB" with a "stable" rating outlook by TRIS Rating.

KEY RATING CONSIDERATIONS

Small asset portfolio with concentration risk

DREIT's asset portfolio is small in terms of assets and earnings size. Its assets comprise four hotels in key but highly competitive tourist destinations in Thailand and the Maldives, including "Dusit Thani Laguna Phuket" (DTLP), "Dusit Thani Hua Hin" (DTHH), "Dusit D2 Chiangmai" (D2CM) and DTMD, acquired in late September 2019. As of September 2019, DREIT's properties were valued Bt6.77 billion. Rental income generated, mainly from the assets in Thailand, was Bt158 million in the first nine months of 2019.

Rental income is expected to double after the incorporation of DTMD, but will remain comparatively small. Nonetheless, concentration risk will remain as about 60% of rental income will come solely from the new Maldives asset.

Competitiveness to improve after renovations

In the past few years, DREIT's hotels have been unable to command premium room rates due in large part to the timeworn assets and also as a result of high competition within the hotel industry. DREIT is rolling out a renovation program in order to improve its asset quality and competitiveness, and raise its ability to command higher room rates.

DTLP completed its 2-year renovation program in 2017-2018. Revenue per available room (RevPar) rose by 7% year-on-year (y-o-y) in 2018 to Bt3,361 per room per night from Bt3,149 per room per night in 2017. For the first nine months of 2019, DTLP's RevPar was relatively flat y-o-y at Bt3,298 per room per night, compared with Bt3,302 per room per night for the same period in the prior year. During 2019-2021, our base-case scenario assumes that the annual RevPar of DTLP will grow by mid-single-digit figures on average.

DTHH's RevPar was Bt2,042 per room per night in 2018, a relatively stable rate compared with 2017 when RevPar declined 13% y-o-y. DTHH started its 2-year renovation program in June 2019 in order to improve its competitive position. DTHH's RevPar decreased by 21% y-o-y to Bt1,590 per room per night for the first nine months of 2019. DTHH's RevPar will be impacted by the ongoing renovation. Our base-case assumption projects DTHH's RevPar to be in the range of Bt1,600-Bt1,900 per room per night during 2019-2020 before jumping to around Bt2,300 per room per night in 2021 when the renovation is completed.

D2CM's RevPar was Bt2,114 per room per night in 2018, declining by 5% y-o-y. For the first nine months of 2019, the RevPar dropped 11% y-o-y to Bt1,767 per room per night. The drop in RevPar was due in part to the air quality problem in the last quarter of 2018 through the first quarter of 2019, coupled with a slowdown in Chinese tourist arrivals. We expect D2CM's RevPar to be flat or grow at a low-single-digit rate during 2019-2020 before dropping markedly in 2021 when D2CM is scheduled for major renovation.

DTMD's performance improved during the past two years from active sales and marketing efforts. In 2018, DTMD's RevPar was US$444 per room per night, up by 11% y-o-y from US$399 per room per night in 2017. For the first nine months of 2019, DTMD's RevPar declined 2% from the same period last year to US$427 per room per night. DTMD's earnings before interest, tax, depreciation and amortization (EBITDA) improved to US$8.76 million in 2018, from US$7.06 million in 2017. Our base-case scenario forecasts that DTMD's RevPar will grow by a low-to-mid-single digit rate annually during 2019-2021.

Key risk factors to DREIT's hotel performance will likely be the intense competition in the market, the slowdown in Chinese tourist arrivals, and the baht appreciation, making Thailand a less attractive tourist destination.

Downside protection

The laws governing real estate investment trust (REIT) prohibit a REIT from operating a hotel. Because of this, DREIT leases and subleases DTLP, DTHH, and D2CM to Dusit Management Co., Ltd. (DMCO), a subsidiary of DTC. The term of the leases and subleases of the three hotels are three years. DREIT has the right to renew the lease and sublease four more times until 2031.

As DREIT's investment assets are hotels, operating cash flow is volatile and susceptible to event risks. However, the revenue downside risk is limited by a committed minimum rental fee payable by DMCO, the lessee. DMCO pays DREIT a fixed rental fee and a variable rental fee. The fixed portion of the rent will be reset each year depending on the actual operating results of each hotel, but is not less than Bt205 million. The variable portion of the rent is 85% of what DMCO makes after deducting hotel operating expenses and the fixed portion of the rent.

For DTMD, Dusit Maldives Management Co., Ltd. (DMS3), a subsidiary of DTC and a sub lessee, will rent DTMD for 21 years for operation. DMS3 will pay a minimum fixed rental fee of US$7 million per year. The variable portion of the rent is 90% of what DMS3 makes after deducting hotel operating expenses and the fixed portion of the rent.

Our base-case scenario takes into account the fact that DREIT will start receiving a rental fee from DTMD in the fourth quarter of 2019. We forecast the EBITDA of all four hotels will translate into rental income of at least Bt270 million in 2019, and Bt470-Bt500 million per annum during 2020-2021. DREIT's EBITDA is projected to be Bt245 million in 2019 and Bt420-Bt445 million annually during 2020-2021. Funds from operations (FFO) are expected to be Bt200 million in 2019 and Bt310-Bt335 million per year during 2020-2021.

Rising leverage

DREIT's leverage has risen due to the acquisition of DTMD and renovation expenditures. DREIT completed the acquisition of DTMD in September 2019 for Bt2.36 billion. Funding sources comprised new equity from unit holders of Bt1.78 billion with the remaining balance funded by debt. At the end of September 2019, DREIT's total debt was Bt1.49 billion, up from Bt599 million in 2018. The hotel renovation budget is Bt276 million in 2019 and Bt150-Bt220 million annually in 2020-2021.

TRIS Rating expects DREIT's adjusted debt to capitalization ratio to rise to 29%-32% during 2019-2021, compared with 13.1% in 2018. The adjusted debt to EBITDA ratio will rise to 5-6 times post DTMD acquisition from 2.7 times in 2018. The adjusted FFO to total debt ratio is forecast to decline to 12%-14% during 2020-2021 from 33% in 2018.

Adequate liquidity

DREIT's liquidity is assessed to be adequate during the next 12-18 months. Primary uses of funds are capital expenditures of Bt400-Bt460 million in total, and dividend payout of Bt180-Bt260 million per annum. The principle sources of funds are FFO of at least Bt200 million in 2019 and at least Bt310 million in 2020, cash at banks of Bt136 million at the end of September 2019, as well as available credit facilities of Bt456 million.

BASE-CASE ASSUMPTIONS

- Combined EBITDA of all four hotels to generate rental income of at least Bt270 million in 2019, and Bt470-Bt500 million per annum during 2020-2021.
- DREIT's EBITDA is projected to be Bt245 million in 2019 and Bt420-Bt445 million annually during 2020-2021.
- FFO is expected at Bt200 million in 2019 and Bt310-Bt335 million annually during 2020-2021.
- Hotel renovation budget is Bt276 million in 2019 and Bt150-Bt220 million annually in 2020-2021.

RATING OUTLOOK

The "stable" outlook reflects our expectation that DREIT's property portfolio will continue to generate reliable cash flow from rental income. We expect the acquisition of new assets will be funded mainly by new capital from unit holders.

RATING SENSITIVITIES

The prospect of rating upside is constrained by DREIT's small portfolio and earnings size. The rating downside case could be triggered if DREIT makes larger-than-expected debt-funded property acquisitions such that the adjusted debt to EBITDA ratio stays above 7.5 times on a sustained basis. In addition, as DTC is the only source of cash flow to DREIT, a significant deterioration in DTC's credit quality could have an impact on DREIT's credit rating.

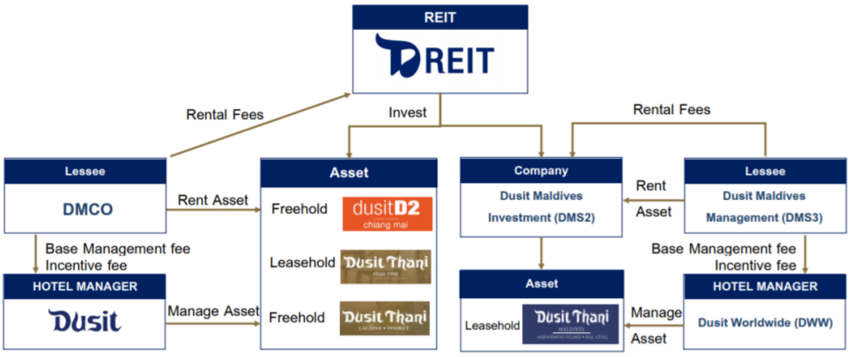
COMPANY OVERVIEW

DREIT is a non-redeemable and indefinite REIT. It was established on 29 November 2017 and obtained assets and liabilities transferred from Dusit Thani Freehold and Leasehold Property Fund (DTCPF) on 8 December 2017. DREIT was listed on the Stock Exchange of Thailand (SET) on 15 December 2017. As of September 2019, the major shareholders of the trust consisted of DTC with a stake of 30.02% and the Social Security Office (SSO) with 25.42%. The REIT manager is Dusit Thani Properties REIT Co., Ltd., a subsidiary of DTC.

DREIT has a policy to generate benefits from hotel investments by leasing assets and subleasing leasehold rights to DMCO, a subsidiary of DTC. The property portfolio currently comprises four hotels, DTLP, DTHH, D2CM, and DTMD. As of September 2019, the fair value of DREIT's properties was Bt6.77 billion.

At the asset level, DTLP, DTHH, and D2CM, together, generated revenue of Bt949 million and EBITDA of Bt230 million in 2018. The EBITDA margin was 22%-24% during 2016-2018. Rental income from DTLP contributed 49% of total rental income, with DTHH contributing 37%, and D2CM the remaining 14%.

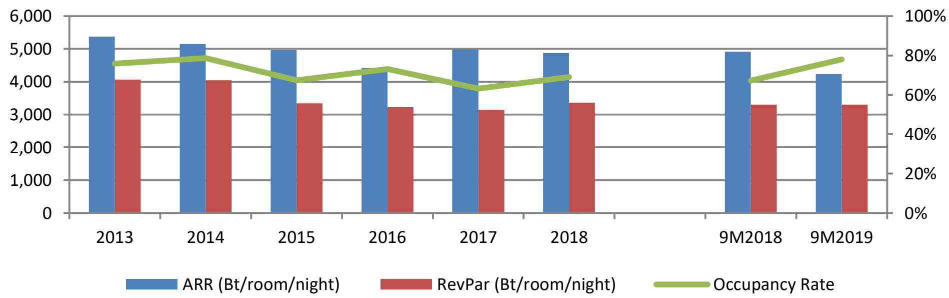
Picture 1: Trust Structure



Source: DREIT

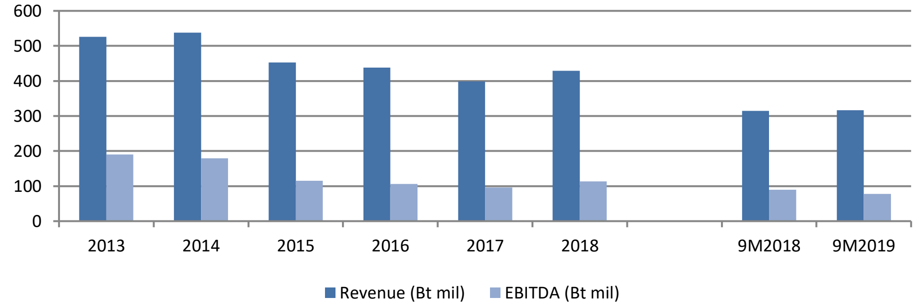
KEY OPERATING PERFORMANCE

Chart 1: Average Room Rate and Occupancy Rate of DTLP



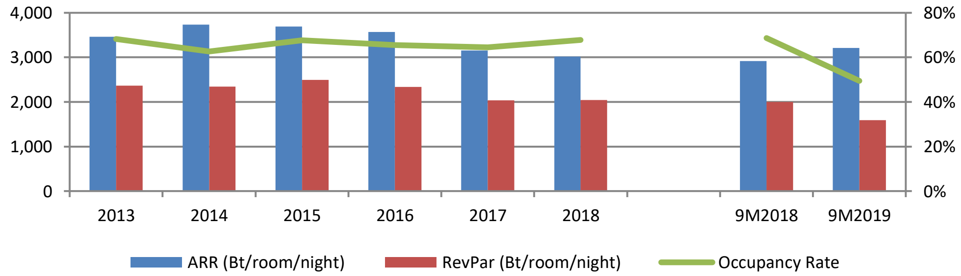
Source: DREIT

Chart 2: Performance of DTLP



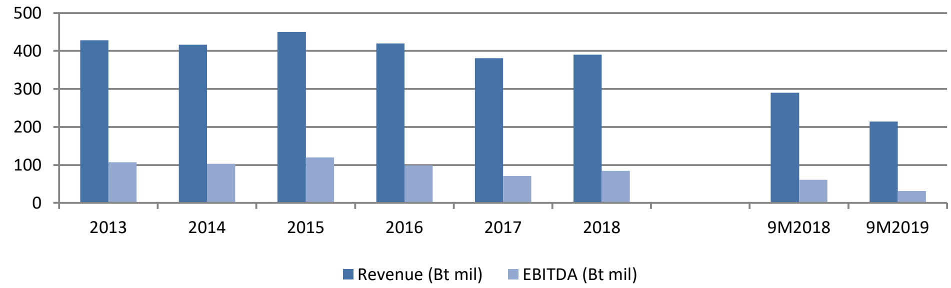
Source: DREIT

Chart 3: Average Room Rate and Occupancy Rate of DTHH



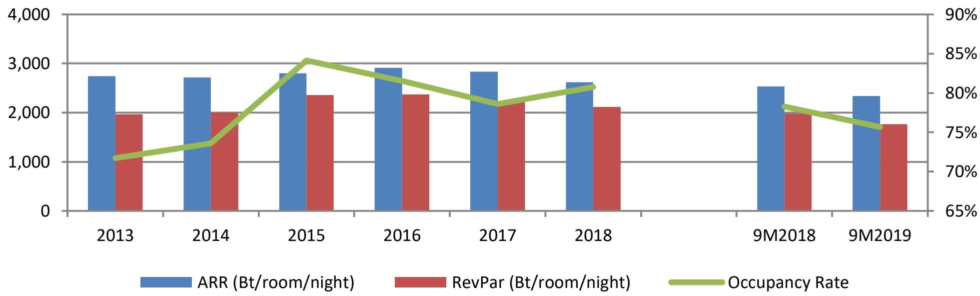
Source: DREIT

Chart 4: Performance of DTHH



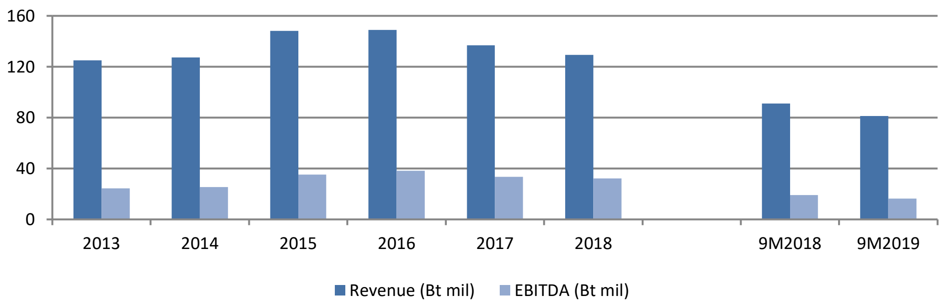
Source: DREIT

Chart 5: Average Room Rate and Occupancy Rate of D2CM



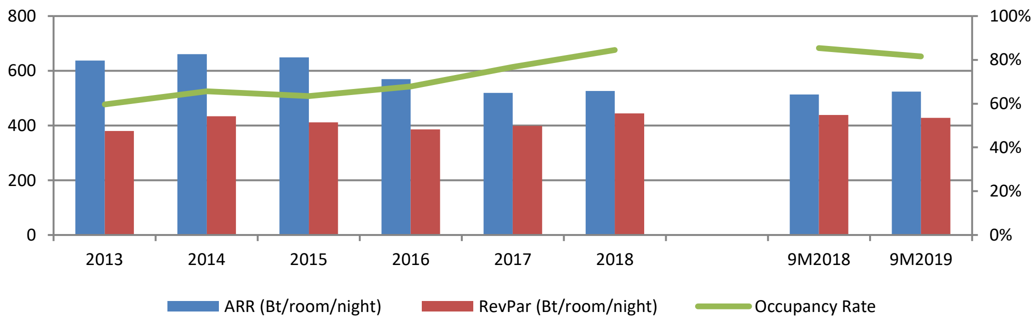
Source: DREIT

Chart 6: Performance of D2CM



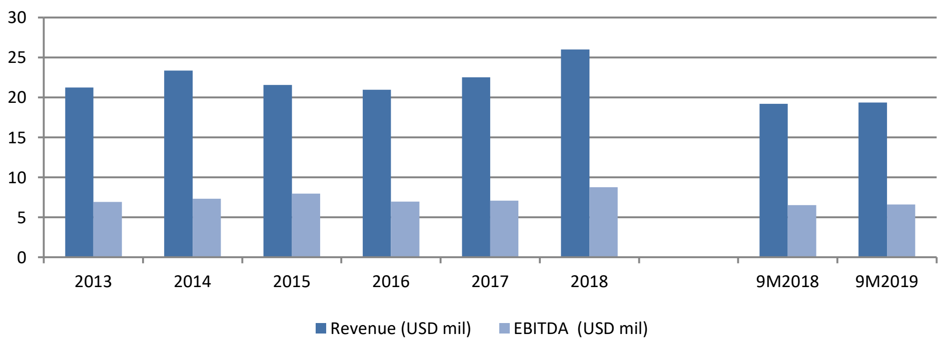
Source: DREIT

Chart 7: Average Room Rate and Occupancy Rate of DTMD



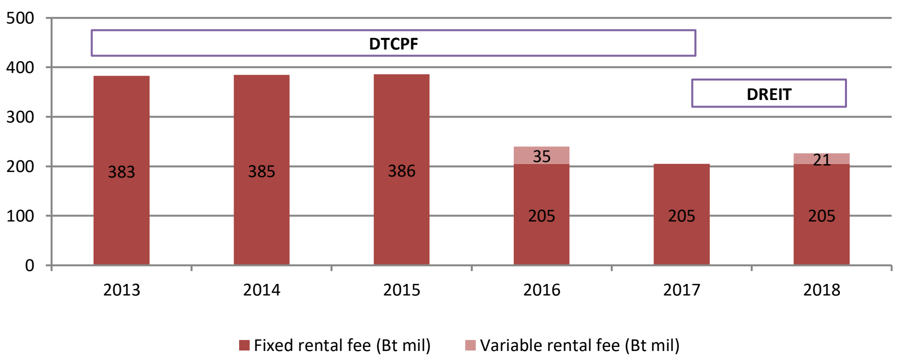
Source: DREIT

Chart 8: Performance of DTMD



Source: DREIT

Chart 9: Rental Revenue of DREIT



Source: DREIT

FINANCIAL STATISTICS AND KEY FINANCIAL RATIOS

Unit: Bt million

	Jan-Sep 2019	2018 *
Total operating revenues	160	226
Operating income	150	206
Earnings before interest and taxes (EBIT)	150	207
Earnings before interest, taxes, depreciation, and amortization (EBITDA)	150	207
Funds from operations (FFO)	118	186
Adjusted interest expense	32	22
Capital expenditures	2,423	173
Total assets	6,967	4,382
Adjusted debt	1,744	564
Adjusted equity	5,423	3,728
Adjusted Ratios		
Operating income as % of total operating revenues (%)	93.54	91.13
Pretax return on permanent capital (%)	4.88	4.82
EBITDA interest coverage (times)	4.75	9.62
Debt to EBITDA (times)	4.89	2.72
FFO to debt (%)	17.43	32.93
Debt to capitalization (%)	24.34	13.13
Loan to fair value of total assets (%)	21.36	13.67

* *Year Ended 31 December*

RELATED CRITERIA

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

Dusit Thani Freehold and Leasehold Real Estate Investment Trust (DREIT)

Issuer Rating:	BBB
Rating Outlook:	Stable

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