

HEMARAJ LEASEHOLD REAL ESTATE INVESTMENT TRUST

No. 149/2018

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CORPORATES

Company Rating: BBB+
Outlook: Stable

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RATIONALE

TRIS Rating assigns the company rating on Hemaraj Leasehold Real Estate Investment Trust (HREIT) at “BBB+” with “stable” outlook. The rating reflects HREIT’s predictable income stream from rental contracts, and solid support from its sponsor, WHA Industrial Development PLC (WHAID; rated “A-/Stable”). The strengths are partially offset by the occupancy and rental rates of its industrial properties, which are sensitive to economic condition and market competition. The rating also incorporates the prospect of rising leverage given its financial policy that targets a high debt financing threshold and investment plans.

KEY RATING CONSIDERATIONS

Stable income stream, backed by medium-term contracts and undertaking scheme from its sponsor

HREIT will have stable rental and service income from its medium-term contracts and undertaking scheme from its sponsor over the next 15 months. Three-year contracts make up 67% of the total leasable area. Both occupancy rate (OR) and rental rate guarantees from its sponsor’s undertaking scheme help alleviate the impact of all vacancies. WHAID, the trust’s sponsor as one of the major industrial estate land developers in Thailand, 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 pay for the shortfall if the offered rental rates to tenants fall below the guaranteed rental rate.

We project the trust’s total revenue of Bt710-Bt730 million in 2018-2019, mainly from rental and service income, to account for 74%-77% of total revenue in 2018-2019, followed by income from rental and service guarantees at around 22%-25% during the same period. However, the undertaking agreement from sponsor, accounting for 82.6% of total leasable area as of June 2018, will expire by November 2019. In our view, if this support from its sponsor discontinues, total revenue will drop to around Bt610 million in 2020. Hence, before the expiration of the agreement, the trust will face challenges to raise the OR in order to maintain its earnings performance.

Improving operating performance through asset injection from sponsor, but remain relatively weak compared to peers

We expect the OR of HREIT will improve, supported by continued asset enhancement by its sponsor. HREIT’s investment portfolio continue to grow to Bt8,853 million as of June 2018 from Bt7,975 million in 2016. We expect HREIT will improve and maintain its occupancy level (without the sponsor’s undertaking) at around 75%, supported by the property pipeline of its sponsor, comprising standard warehouses and ready-built factories with OR of 100%. HREIT plans to acquire additional assets valued approximately Bt500 million by the end of 2018, total revenue is projected to grow to about Bt710 million, from Bt576 million in 2017. Funds from operations (FFO) will rise to about Bt510-Bt520 million in 2018-2019 from Bt433 million in 2017. Despite a recovery in OR, HREIT still underperforms its industrial peers. Considering the performance records as of December 2017, HREIT had an OR of 68%, while TICON Freehold and Leasehold Real Estate Investment Trust (TREIT) achieved a satisfactory OR of 79% and WHA Premium Growth Freehold and Leasehold Real Estate Investment Trust (WHART) achieved a high OR of 95%.

Improving tenant diversification from the acquisition of additional assets

Tenant concentration will gradually temper as asset size grows. As of June 2018, the top 10 largest tenants contributed 45% of total rental and service income, declining from 46% in 2017 and 57% in 2016. The leased area was mainly driven by demand from the automotive industry, logistics providers, and consumer product manufacturers with 39%, 20%, and 14% of the tenants' portfolio, respectively. We predict that its tenant base will be more diversified as the number of quality assets grows.

Increasing financial leverage

We forecast HREIT's financial leverage will rise based on its debt-funded growth financial policy, which targets to keep interest-bearing debt to total assets ratio (LTV) of not higher than 40% in the medium to long term. The trust plans to spend Bt500 million for new asset acquisition from sponsor by 2018 with around 84% debt financing. Consequently, the LTV is projected to climb to 34.7% at the end of 2018.

Manageable refinancing risk

Given its access to financial markets and availability of back-up facilities for bullet repayments, we believe its refinancing risk is manageable. Out of the Bt2,900 million in debt, HREIT's debt maturity profile includes repayments of Bt2,325 million due in November 2021, followed by Bt575 million due in January 2023. HREIT has managed the refinancing risk by securing back-up long-term loan facilities with a financial institution to repay the scheduled repayments in 2021 and 2023.

RATING OUTLOOK

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

Under TRIS Rating's base case scenario, we assume that HREIT's assets will increase by Bt500 million per year in 2018-2020. Total revenue is projected to grow to Bt730 million in 2019 from Bt710 million in 2018, and then drop to Bt610 million in 2020 after the expiration of some of the sponsor undertaking agreements. OR would be at approximately 75%. Operating margin could stay around 86%-89%. The LTV is forecast to stay below 40% as per the trust's policy.

RATING SENSITIVITIES

We could lower the rating if the OR drops and/or there is larger than expected debt-funded expansion for a sustained period. In contrast, we could raise the rating if HREIT is able to improve its operating performance significantly and/or its capital structure improves noticeably, which will lead to higher cash flow protection over an extended period.

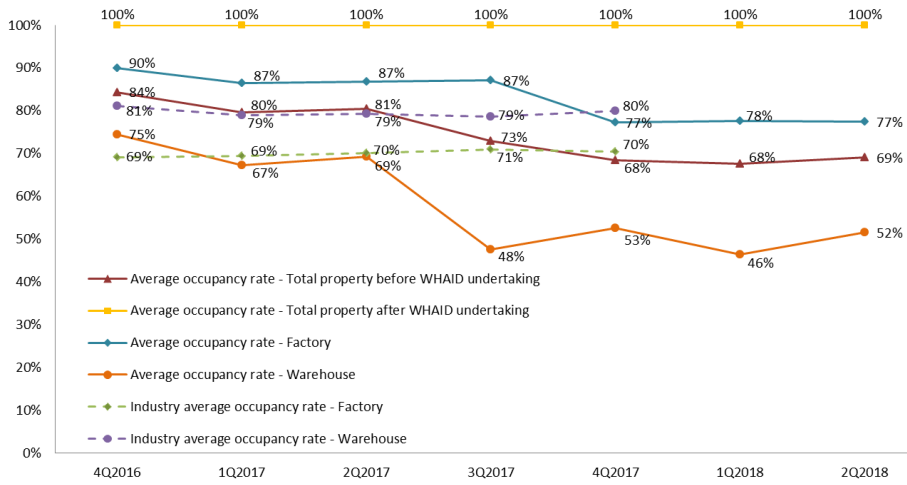
COMPANY OVERVIEW

HREIT was established and listed on the Stock Exchange of Thailand (SET) in November 2016, with registered capital of Bt5,694 million. At present, WHAID holds a 15% of HREIT's stake in total. 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 2018, the investment asset size of HREIT was valued at Bt8,853 million with total leasable area of 316,445 square meter (sq.m.), comprising 68% factory and 32% warehouse, in three provinces, i.e., Chonburi, Rayong, and Saraburi. HREIT's properties are located in key industrial estates and manufacturing hubs in Thailand. About 96% of the leasable properties are located in the Eastern Economic Corridor (EEC) development area.

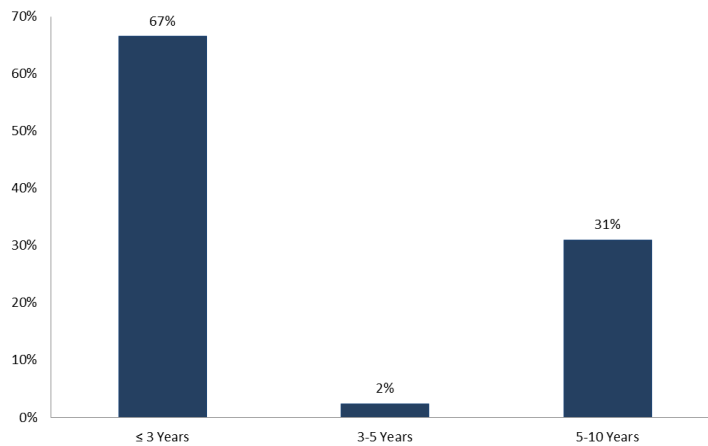
KEY OPERATING PERFORMANCE

Chart 1: Occupancy Rate



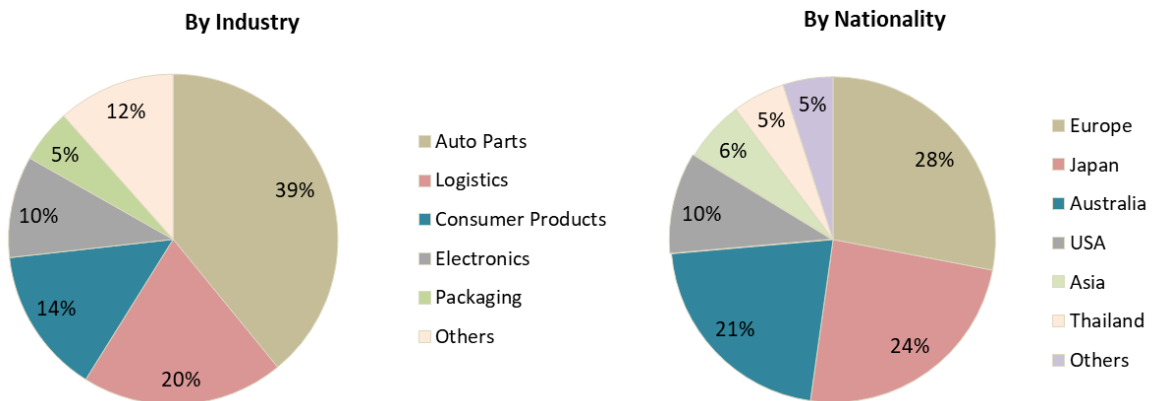
Sources: HREIT and CB Richard Ellis (CBRE)

Chart 2: Lease Profile



Source: HREIT

Chart 3: Tenant Profile



Source: HREIT

FINANCIAL STATISTICS AND KEY FINANCIAL RATIOS

Unit: Bt million

	Jan-Jun 2018	--Year Ended 31 December--	
		2017	2016
Revenue	355	576	62
Rental and service income	253	447	53
Income from rental and service guarantees	99	124	9
Gross interest expense	58	97	10
Net income from operations	259	425	44
Funds from operations (FFO)	271	433	44
Investment in properties at fair value	8,853	7,123	7,975
Total assets	9,245	8,434	8,201
Total debts	2,863	2,294	2,286
Net debts	2,684	1,077	2,132
Net asset value	6,199	5,985	5,738
Operating income before depreciation and amortization as % of sales	91.1	90.6	88.1
Pretax return on permanent capital (%)	6.6 *	6.4	1.4
Earnings before interest, tax, depreciation, and amortization (EBITDA) interest coverage (times)	5.6	5.4	5.2
FFO/total debt (%)	16.8 *	18.6	1.9
FFO/net debt (%)	18.2 *	40.2	2.1
Total debt/capitalization (%)	31.9	28.0	28.8
Net debt/capitalization (%)	30.2	15.3	27.1

Notes: Total debt means interest-bearing debt.

* Annualized with trailing 12 months

Hemaraj Leasehold Real Estate Investment Trust (HREIT)

Company Rating:	BBB+
Rating Outlook:	Stable

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