

CPN RETAIL GROWTH LEASEHOLD REAL ESTATE INVESTMENT TRUST

No. 70/2018

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CORPORATES

Issuer Rating: AA
Outlook: Stable

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RATIONALE

TRIS Rating assigns the issuer rating to CPN Retail Growth Leasehold Real Estate Investment Trust (CPNREIT) at “AA”. The rating reflects the trust’s high quality assets, the predictable cash flow stream from contract-based rental and service income, and its conservative financial policy. The rating also takes into consideration the future growth opportunities of the trust, supported by assets from its sponsor, Central Pattana PLC (CPN), rated “AA” with “stable” outlook by TRIS Rating. However, the rating is partially constrained by tenant concentration in terms of leasable area and revenue contribution.

KEY RATING CONSIDERATIONS

Largest REIT with high OR and rental rate from high quality assets

CPNREIT has been the largest real estate investment trust (REIT) in Thailand, with total investment properties worth Bt44,301 million as of 31 March 2018. The leasable area totaled 247,458 square meters (sq.m.), consisting of 213,426 sq.m. from five shopping centers and 34,031 sq.m. from two office buildings. The average occupancy rate (OR) of the shopping centers was 92% as of 31 December 2017 and 93% as of 31 March 2018. The average rental rate ranged from Bt1,000 per sq.m. per month to Bt1,900 per sq.m. per month in the first quarter of 2018. The average OR of the office space was 85% as of 31 December 2017 and 83% as of 31 March 2018, with an average rental rate of Bt450-Bt550 per sq.m. per month. CPNREIT also invests in Hilton Pattaya hotel, a 302-room hotel, with the average OR of 98% in the first quarter of 2018.

Recurring cash flows from contract-based rental and service income, with high profitability

CPNREIT rents most of the space in its shopping centers and office buildings on three-year contracts. Around one-third of total leasable area will expire each year during 2018-2020. 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 views that the REIT manager will be able to keep the high renewal rate with a favorable rental rate.

CPNREIT’s rental and service income for 2017 totaled Bt3,410 million. However, adding the Pattaya assets to its portfolio, CPNREIT’s rental and service income is projected to increase to approximately Bt4,000 million for 2018 operation.

CPNREIT’s operating profit margin held at 79%-82% during 2014 through the first quarter of 2018. The EBITDA (earnings before interest, tax, depreciation, and amortization) margin was high at 82%-86% during the past five years. CPNREIT’s ability to maintain its high OR, increase rental rates, and control operating costs have sustained high profitability. Going forward, TRIS Rating forecasts the operating profit margin to be held at least 79% and the EBITDA margin to be maintained at above 80%.

Growth prospect from assets under the group

CPNREIT’s REIT manager is a wholly-owned subsidiary of CPN and the trust’s property manager is CPN. As the sponsor of CPNREIT, CPN currently owns 32 shopping centers with 1.7 million-sq.m. leasable area, seven office buildings, and one hotel. TRIS Rating forecasts CPNREIT will add new properties into its

portfolio, and the properties will come primarily from the sponsor. TRIS Rating expects CPN will inject matured properties with high OR and stable rental rate growth into the trust. The lease period of new properties should remain at least 15 years. New acquisition is forecast to occur regularly every 3-4 years with target investment size of Bt8,000-Bt10,000 million each. The growing size of the quality property portfolio is expected to boost rental and service income and operating cash flow of the trust in the future.

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). The trust manages 213,426 sq.m. of shopping centers and 34,031 sq.m. of office space. At the end of March 2018, the number of tenants was around 950 for the shopping centers and around 110 for the office spaces. The 10 largest tenants of shopping centers occupy around 40% of total occupied leasable area and contribute around 15% of total rental and service income from shopping centers. For office space, the top-10 largest tenants contribute about 40% in terms of total occupied leasable area and total income. Tenants affiliated with the Central Group occupy 25% and 12% of the occupied leasable area of shopping centers and office space, respectively. However, this concentration risk is partly mitigated by the high credit profiles of its top largest tenants.

Conservative leverage policy

As a result of new asset acquisition taking place at the same time of CPN Retail Growth Leasehold Property Fund's (CPNRF) conversion into REIT, CPNREIT's net debt to capitalization ratio increased to 30%-31% at the end of December 2017 and March 2018. The interest-bearing debt to EBITDA ratio was 4-5 times during 2017 through the first quarter of 2018. The loan to total asset ratio was 31% as of 31 March 2018. Although the trust plans to enlarge its portfolio in the next few years, the trust has a policy to keep the loan to total asset ratio below 35%.

Adequate liquidity

The trust's liquidity is adequate. The ratio of funds from operations (FFO) to net debt was 22% during 2017 through the first three months of 2018. The EBITDA interest coverage ratio held at 29 times in 2017 and 11 times in the first quarter of 2018. As of 31 March 2018, the financial flexibility of the trust was supported by cash on hand of Bt482 million, investments in securities at fair value of Bt992 million, and undrawn committed credit facilities from banks of Bt10,593 million.

At the end of March 2018, CPNREIT had outstanding debts of Bt1,918 million due in November 2018 and Bt12,538 million due in November 2019. CPNREIT plans to refinance its maturing debts by long-term debenture issuance. TRIS Rating expects the trust will be able to refinance its debts with no difficulty, given its strong operating performance and strong support from its sponsor.

RATING OUTLOOK

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

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 of time or there are any larger-than-expected debt-financed 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 all property portfolio of CPNRF and invested in Central Festival 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 2018. 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 247,458 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. Around 95% of rental and service income came from shopping centers and the remainder was from office space. Rental and service income during the first three months of 2018 grew by 32% year-on-year (y-o-y) to Bt1,150 million. Revenue contribution from shopping centers was 90% of total rental and service income, while 10% came from office space and hotel. The variable portion of rental and service income from hotel property constituted only 2% of total CPNREIT's 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.)	82,572	36,283	27,611	37,556	29,404	22,697	11,334	302 rooms
OR (%) (as of 31 Mar 2018)	94.8	84.2	99.1	92.3	95.2	81.9	83.8	97.5
Investment at fair value (Bt million) (as of 31 Mar 2018)	6,997	10,151	5,778 (incl. office buildings)	10,653	7,272			3,450
Remaining leasehold period (years)	7	17+30+30	6	26	19	6	6	19

Source: CPNREIT

FINANCIAL STATISTICS AND KEY FINANCIAL RATIOS*

Unit: Bt million

	Jan-Mar 2018	-----Year Ended 31 December-----			
		2017	2016	2015	2014
Rental and service income	1,150	3,410	3,425	3,038	3,185
Gross interest expense	87	95	72	73	56
Net income from operations	831	1,997	3,163	3,980	3,211
Funds from operations (FFO)	863	2,730	2,836	2,427	2,690
Earnings before interest, tax, depreciation, and amortization (EBITDA)	950	2,825	2,909	2,501	2,746
Investment in leasehold properties at fair value	44,301	44,310	32,309	31,790	29,920
Total assets	46,504	47,056	33,604	32,784	30,991
Reported debts	14,456	14,454	1,875	1,936	1,955
Net debts	13,263	12,695	927	1,213	1,201
Net asset value	29,656	29,462	29,993	29,242	27,690
Operating income before depreciation and amortization as % of sales	79.11	79.27	81.68	78.91	82.12
EBITDA margin (%)	82.59	82.83	84.92	82.32	86.22
Pretax return on permanent capital (%)	8.24**	7.72	9.47	8.42	11.74
EBITDA interest coverage (times)	10.59	28.97	38.68	32.79	46.19
FFO/net debt (%)	21.57**	21.50	306.02	200.11	223.98
Net debt/capitalization (%)	30.90	30.11	3.00	3.98	4.16
Total debt/EBITDA (times)	3.81	5.13	0.66	0.79	0.73
Loan to fair value of total assets (%)	31.09	30.72	5.58	5.91	6.31

Note: Financial statistics during 2014-2016 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

CPN Retail Growth Leasehold Real Estate Investment Trust (CPNREIT)

Issuer Rating:	AA
Rating Outlook:	Stable

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