

LH HOTEL LEASEHOLD REAL ESTATE INVESTMENT TRUST

No. 74/2020
25 May 2020

CORPORATES

Issuer Rating: BBB+
Outlook: Negative

Contacts:

Jutamas Bunyawanichkul

jutamas@trisrating.com

Chanaporn Pinphithak

chanaporn@trisrating.com

Wajee Pitakpaibulkij

wajee@trisrating.com

Thiti Karoonyanont, Ph. D., CFA

thiti@trisrating.com



WWW.TRISRATING.COM

RATIONALE

TRIS Rating assigns the issuer rating on LH Hotel Leasehold Real Estate Investment Trust (LHHOTEL or “trust”) at “BBB+” with a “negative” rating outlook. The “negative” outlook reflects our expectation of material deterioration in the trust’s rental income from the coronavirus (COVID-19) pandemic and the delay in its capital increase plan after the debt-funded acquisition of Grande Centre Point Sukhumvit 55 hotel (S55) in November 2019.

The rating reflects the trust’s high quality assets located in prime areas of Bangkok, the structure of rental income comprising fixed and variable portions, and our expectation of capital increase by mid-2021. The rating also takes into consideration future growth opportunities of the trust, supported by potential future sourcing of assets from its sponsor, Land and Houses PLC (LH), rated “A+” with a “stable” outlook by TRIS Rating. However, the rating is constrained by the cyclical nature of the hotel industry and the trust’s small size of portfolio.

KEY RATING CONSIDERATIONS

Significant impact from COVID-19 on operating performance of the trust’s hotel properties

We expect a drastic decline in hotel operations from the travel bans and movement restrictions imposed by authorities in an attempt to contain the spread of the virus. One out of the trust’s three hotels has been closed since beginning of April 2020 and the other two are operating at minimal occupancy rate (OR). Our base case assumes the outbreak could be largely contained by the third quarter of 2020 before the recovery begins. We expect the global recession and health concern to continue to affect the tourism industry in 2021.

LHHOTEL currently owns three hotel properties, Grande Centre Point Terminal 21 (TM21), Grande Centre Point Ratchadamri (RD), and the recently acquired S55, with a total of 1,401 rooms. All hotels are well-maintained and are located in the prime areas of Bangkok. TM21 has direct access to the BTS Asoke skytrain station and the MRT Sukhumvit subway station. RD is located near the BTS Ratchadamri skytrain station. S55 is in Soi Thonglor, the Sukhumvit area, and is accessible to the BTS Thonglor skytrain station. TM21, RD, and S55 have operated since 2012, 2008, and 2016, respectively.

The OR of TM21 was 85%-94% during 2017-2019, with the average room rate (ARR) growth by 1%-4% per annum. Revenue per available room (RevPar) of TM21 was in the range of Bt3,400-Bt3,700 per room per night during the past three years. RD had maintained OR at 78%-88% and ARR at Bt3,800 per room per night during 2018-2019. Its RevPar was around Bt3,100 per room per night. The OR of S55 was 79%-87% during 2017-2019, with ARR growth by 2%-8% per annum. RevPar of S55 was Bt2,200-Bt2,700 per room per night during the past three years. Although the COVID-19 pandemic has disrupted hotel operations since the beginning of 2020, we believe that the prime locations and the quality of LHHOTEL’s properties are important strengths when the prospect of the hotel industry begins to improve.

REIT's rental income expected to fall sharply in 2020

We expect the trust's rental income from L&H Hotel Management Co., Ltd. (LHH) as a sublessee could fall below half the previous-year level in 2020, as a result of the negative impact of the virus outbreak on the hotel operation. The decline is despite the inclusion of full year rent for S55.

The adverse operating environment caused by the pandemic has triggered the force majeure clause under the rental agreement between LHHOTEL and LHH in March and April 2020. This allows the rental payment to the trust to be waived for the months affected. We consider the likelihood of this situation continuing into the second quarter of 2020 or longer to be high. We assume the trust's rental income to be waived for several months from March to September of this year. Even if the situation improves in the last quarter of 2020 as anticipated, the trust's rental income would still be impacted by the weak hotel operating performance, which affects variable portion of the rental fee.

LHHOTEL's rental income depends largely on the performance of its hotels operated by its sublessee under the current structure of rental fees. The laws covering real estate investment trust (REIT) prohibit a REIT from operating a hotel. Because of this, LHHOTEL subleases the hotels to LHH, a subsidiary of LH. LHH pays LHHOTEL 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, subject to a floor set when the sublease was first signed. The variable portion of the rent is 85% of what the sublessee makes after deducting hotel operating expenses and the fixed portion of the rent. The initial term of the sublease for each hotel is three years. LHHOTEL has the right to renew the sublease twice (3 times for S55) after the first term expires.

Under normal circumstances, the existence of fixed rental fee is beneficial to the trust as it sets the floor to the trust's rental income each year. However, there are special conditions built into the sublease agreement designed to cover extraordinary events. For example, a force majeure event permits the sublessee to postpone or waive the fixed and variable rental payment to the trust. If room revenues in given months drop sharply, falling by 20%-50% year-on-year (y-o-y), the rental payment for those months could be postponed. If the event causes room revenues to drop by more than 50% y-o-y and meets other conditions specified in the sublease agreement, the sublessee could waive the rental payment to the trust for the months affected.

Asset concentration risk

LHHOTEL relies on rental income from only three hotels, all of which are situated in the central Bangkok. Operating cash flow is vulnerable to the cyclical nature of the hotel industry, and event risks, which might affect the performance of either or all hotels in certain period. If the trust expands in the future with a larger income-generating asset base, these risks could be mitigated to some extent.

Growth prospects from assets under the group

LH Group as a sponsor of LHHOTEL normally adds matured properties with high OR and stable rental rate growth to the trust. LH has two hotels that LHHOTEL might acquire; Grande Centre Point Pattaya and a new hotel in Chonburi province. Grande Centre Point Pattaya has 396 rooms and has started operation since late 2018. The new hotel in Chonburi province is in the initial stage of development planning. LHHOTEL has not yet decided which asset, or investment size, and timing of subsequent property acquisition at this moment. However, we expect the trust to acquire new assets regularly every 2-3 years. The assets will come primarily from the sponsor or affiliates. The growing size of the quality property portfolio will help boost rental income as well as diversify sources of cash flow of the trust in the future.

High leverage from COVID-19 impact and delay in capital increase

We view the trust's financial policy to be conservative as it aims to keep its loan-to-fair value of total assets ratio below 30%. However, the debt-funded acquisition of S55 has pushed the trust's debt to capitalization ratio to 45% at the end of 2019. The trust's original plan was to fund the acquisition with 80% equity and 20% debt, with new equity being raised in the beginning of 2020. But the unfavorable sentiment in the capital market from the pandemic has forced the trust to delay its capital increase plan, possibly into 2021.

Our base case scenario assumes capital injection, totaling Bt3.3 billion, in mid-2021. Cash proceed is expected to be used for debt repayment. The debt to capitalization ratio should then stay below 20% and the debt to earnings before interest, tax, depreciation and amortization (EBITDA) ratio should stay below 3 times in 2021.

Regarding the financial covenants on LHHOTEL's bank loans, the trust has to keep the interest-bearing debt to equity ratio below 1 times and the debt service coverage ratio (DSCR) more than 1.2 times. As of March 2020, the interest-bearing debt to equity ratio of the trust was 0.85 times. TRIS Rating expects the trust should have no problem keeping the interest-bearing debt to equity ratio and DSCR in compliance with the bank loan covenants.

Tight but manageable liquidity

Despite the drastic decline in rental income expected in 2020, we believe the trust will be able to manage its liquidity adequately through this difficult time. As of March 2020, LHHOTEL's source of liquidity included investments in securities, Bank of Thailand (BOT) bonds, with Bt247 million fair value. Operating expense at the REIT level is minimal. The major cash outflow would be interest expense and dividend.

The trust has managed to get the approval from all lenders to postpone repayment of its loan principal in 2020, except for the Bt3.1 billion bridging loan. The REIT manager plans to refinance the maturing bridging loan with the unused committed long-term loan facility.

The trust's ratio of funds from operations (FFO) to total debt may sharply fall in 2020, before recovering to 30%-40% during 2021-2022. The EBITDA interest coverage ratio could shrink to 2 times this year, before improving to 6-9 times during 2021-2022.

BASE-CASE ASSUMPTIONS

- Minimal OR during the second and third quarter of 2020 before recovering to around 60% in the last quarter. ARR to decline by 10% in 2020.
- RevPar in 2021 to remain 10%-15% below the level in 2019, before reaching the pre-crisis level in 2022.
- Rental income of the trust to fall by more than half in 2020, and should recover to Bt0.9-Bt1.0 billion per annum during 2021-2022.
- The trust to be able to increase capital of Bt3.3 billion in 2021. Cash received from equity injection will be used to repay debt.

RATING OUTLOOK

The "negative" outlook reflects expected decline in hotel operating performance and the trust's rental income throughout 2020, and the elevated level of debt from the delay in capital increase plan.

RATING SENSITIVITIES

LHHOTEL's rating and/or outlook could be revised downward should the pandemic situation evolves in a way that leads us to believe the hotel industry is unlikely to begin recovering by the third quarter of 2020. We could also lower the rating if LHHOTEL's liquidity depletes faster than we expect, or if the trust pays outsized dividend for the quarter in which the rental income is waived by force majeure, or if the prospect of capital injection in 2021 becomes unclear.

On the contrary, LHHOTEL's outlook could be revised upward if there are signs of recovery in hotel industry after the pandemic could be largely contained. A further success in its equity injection and improving capital structure, such that the debt to capitalization ratio stays below 20% and the debt to EBITDA ratio stays below 3 times, could be positive for LHHOTEL's outlook.

COMPANY OVERVIEW

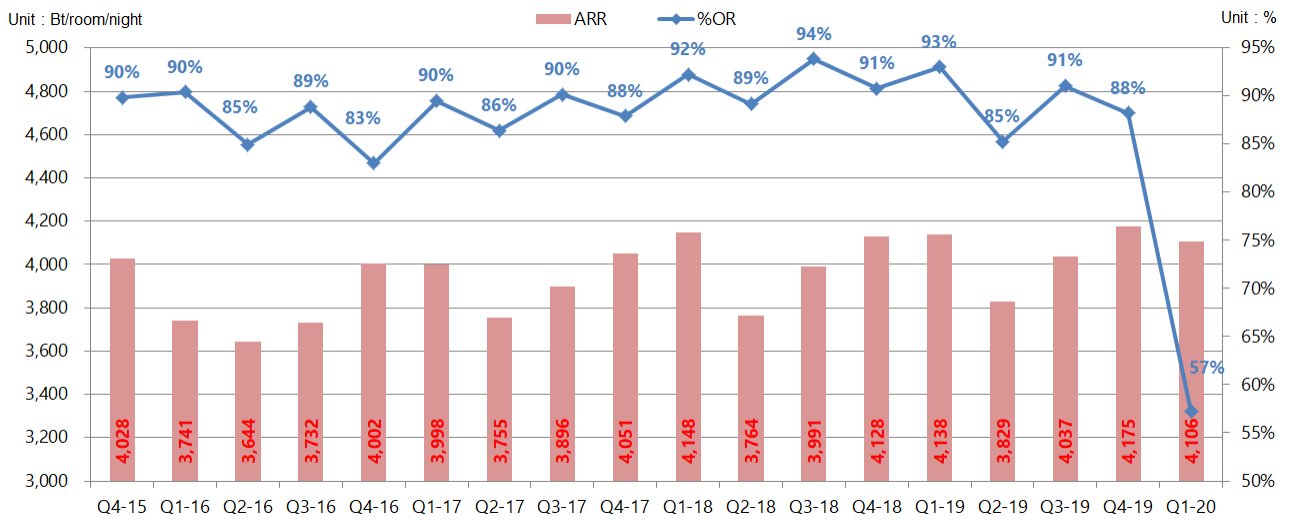
LHHOTEL is a non-redeemable and indefinite REIT. The trust was established in December 2015. As of February 2020, the major shareholders of the trust consisted of LH Mall and Hotel Co., Ltd. (LHMH), a subsidiary of LH, and LH Financial Group PLC, an associate of LH, with stakes of 13.25% and 4.82%, respectively. Companies affiliated with LH own 23% of the trust. The REIT manager is Land and Houses Fund Management Co., Ltd. The trust leases TM21 and RD from L&H Property Co., Ltd. (LHP) as well as S55 from LHMH. The trust subleases the hotels to LHH as a special purpose vehicle (SPV). LHMH acts as a hotel operator to manage the assets. LHP, LHH, and LHMH are subsidiaries of LH.

The property portfolio of the trust currently comprises three hotels, TM21, RD, and S55, with 1,401 rooms. All hotels are located in prime areas of Bangkok. TM21 is located on the corner of Asoke junction and connected with the BTS Asoke skytrain station and the MRT Sukhumvit subway station. RD is located near the Ratchaprasong junction and the BTS Ratchadamri skytrain station. S55 is located in Soi Thonglor, which is well known for fashionable nightlife, and is accessible to the BTS Thonglor skytrain station. As of March 2020, the fair value of LHHOTEL's properties was Bt12.2 billion.

Under the trust structure, the sublessee operates hotels and is responsible for hotel operating expenses. Thus, the trust's operating expense is minimal. At the asset level, three hotels generated revenue of Bt1.5 billion and EBITDA of Bt0.9 billion in 2019. The EBITDA margin was 55%-57% during 2016-2019. The trust's rental income increased by 5% y-o-y to Bt0.8 billion in 2019.

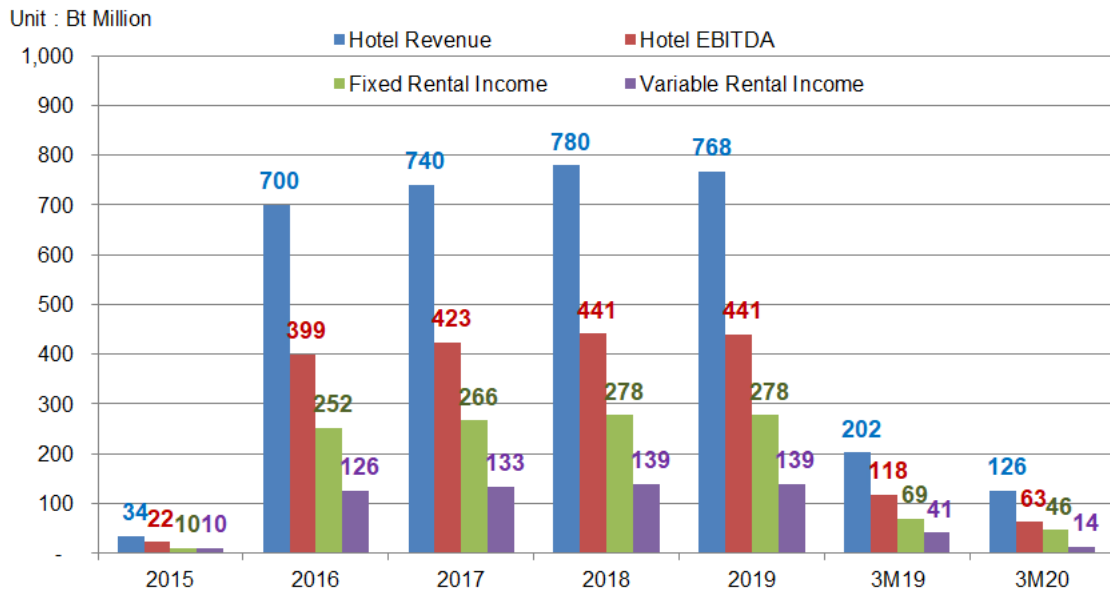
KEY OPERATING PERFORMANCE

Chart 1: Average Room Rate and Occupancy Rate of TM21



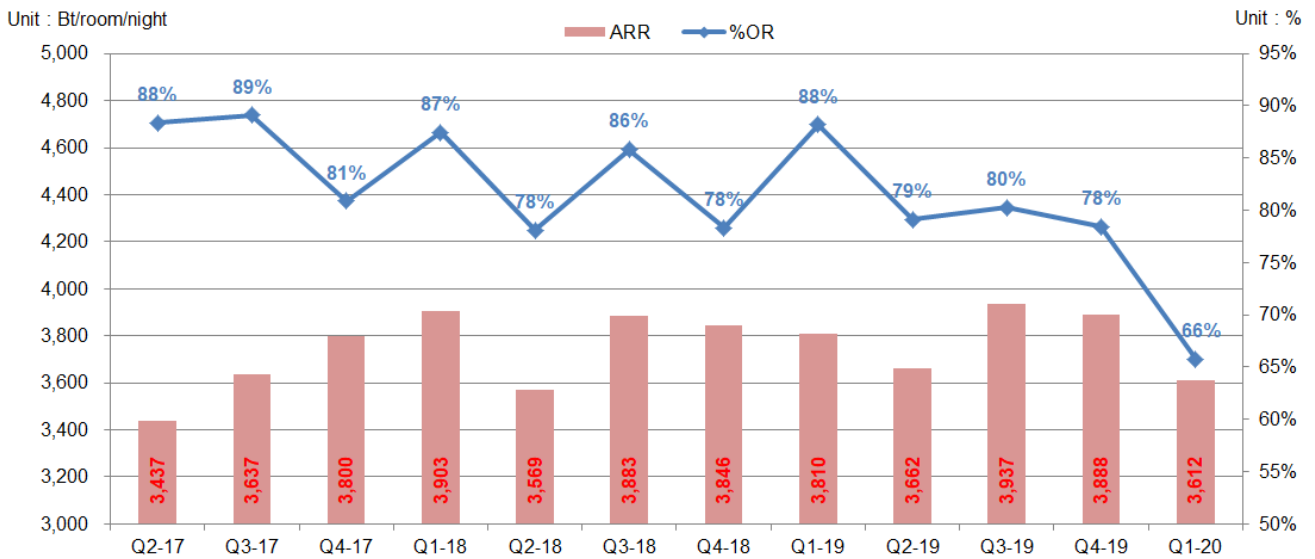
Source: LHHOTEL

Chart 2: Performance of TM21



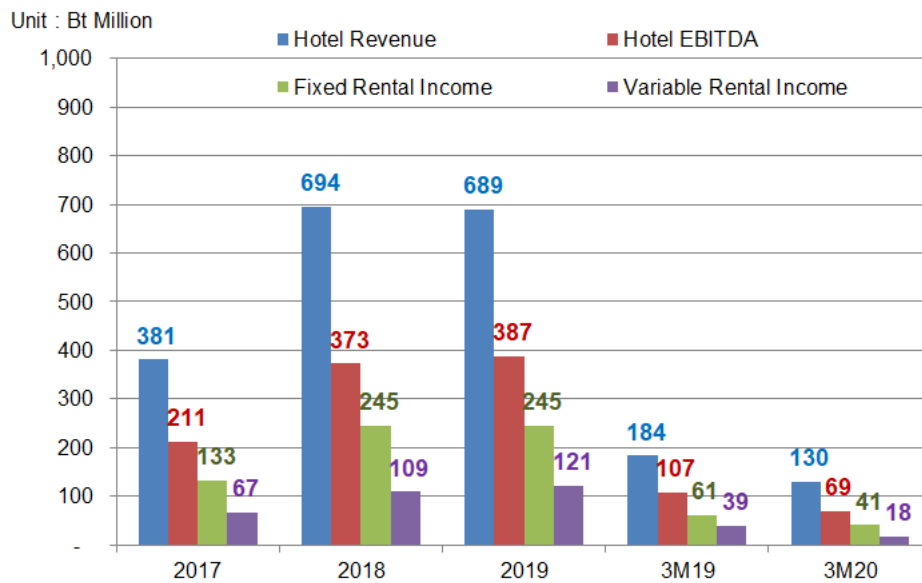
Source: LHHOTEL

Chart 3: Average Room Rate and Occupancy Rate of RD



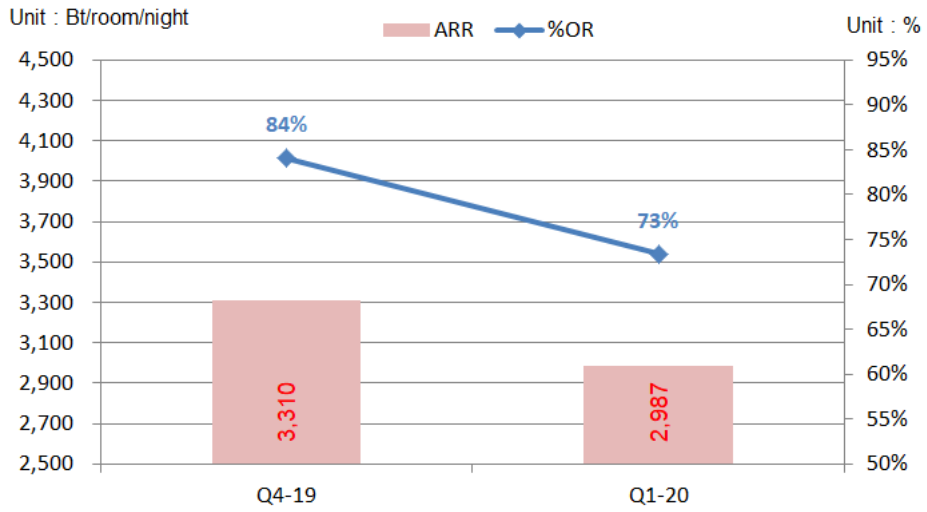
Source: LHHOTEL

Chart 4: Performance of RD



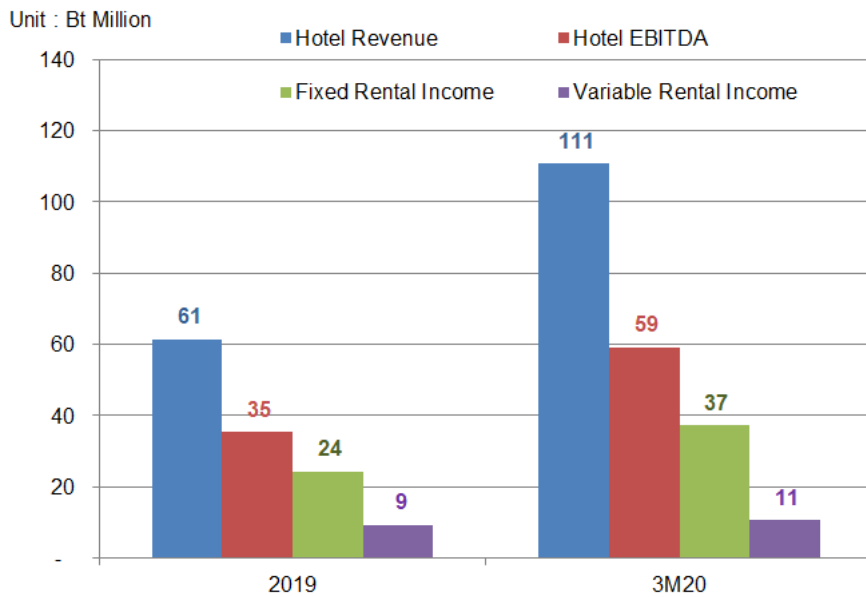
Source: LHHOTEL

Chart 5: Average Room Rate and Occupancy Rate of S55



Source: LHHOTEL

Chart 6: Performance of S55



Source: LHHOTEL

FINANCIAL STATISTICS AND KEY FINANCIAL RATIOS*
Unit: Bt million

	Jan-Mar 2020	-----Year Ended 31 December -----			
		2019	2018	2017	2016
Rental and service income	167	813	770	599	377
Earnings before interest and taxes (EBIT)	159	724	718	564	350
Earnings before interest, taxes, depreciation, and amortization (EBITDA)	159	761	740	581	359
Funds from operations (FFO)	114	683	679	537	335
Adjusted interest expense	45	78	61	44	24
Total assets	12,628	12,669	8,386	8,251	4,018
Adjusted debt	5,599	5,617	1,454	1,545	669
Adjusted equity	6,820	6,862	6,768	6,638	3,328
Adjusted Ratios					
EBITDA margin (%)	95.36	93.62	96.09	96.88	95.28
Pretax return on permanent capital (%)	6.51 **	6.89	8.64	9.21	8.90
EBITDA interest coverage (times)	3.50	9.79	12.12	13.34	14.82
Debt to EBITDA (times)	7.83 **	7.38	1.96	2.66	1.86
FFO to debt (%)	10.86 **	12.16	46.71	34.76	50.08
Debt to capitalization (%)	45.08	45.01	17.69	18.88	16.74
Loan to fair value of total assets (%)	45.83	45.68	19.18	19.50	17.13

* Consolidated financial statements

** Annualized with trailing 12 months

RELATED CRITERIA

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

LH Hotel Leasehold Real Estate Investment Trust (LHHOTEL)

Issuer Rating:	BBB+
Rating Outlook:	Negative

TRIS Rating Co., Ltd.

Silom Complex Building, 24th Floor, 191 Silom Road, Bangkok 10500, Thailand Tel: 0-2098-3000

© Copyright 2020, TRIS Rating Co., Ltd. All rights reserved. Any unauthorized use, disclosure, copying, republication, further transmission, dissemination, redistribution or storing for subsequent use for any purpose, in whole or Any unauthorized use, disclosure, copying, republication, further transmission, dissemination, redistribution, or storing for subsequent use for any purpose, in whole or in part, in any form or manner or by any means whatsoever, by any person, of the credit rating reports or information is prohibited, without the prior written permission of TRIS Rating Co., Ltd. The credit rating is not a statement of fact or a recommendation to buy, sell or hold any debt instruments. It is an expression of opinion regarding credit risks for that instrument or particular company. The opinion expressed in the credit rating does not represent investment or other advice and should therefore not be construed as such. Any rating and information contained in any report written or published by TRIS Rating has been prepared without taking into account any recipient's particular financial needs, circumstances, knowledge and objectives. Therefore, a recipient should assess the appropriateness of such information before making an investment decision based on this information. Information used for the rating has been obtained by TRIS Rating from the company and other sources believed to be reliable. Therefore, TRIS Rating does not guarantee the accuracy, adequacy, or completeness of any such information and will accept no liability for any loss or damage arising from any inaccuracy, inadequacy or incompleteness. Also, TRIS Rating is not responsible for any errors or omissions, the result obtained from, or any actions taken in reliance upon such information. All methodologies used can be found at www.trisrating.com/rating-information/rating-criteria