

LH HOTEL LEASEHOLD REAL ESTATE INVESTMENT TRUST

No. 111/2023
20 June 2023

CORPORATES

Issuer Rating: BBB-
Outlook: Positive

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RATIONALE

TRIS Rating assigns an issuer rating of “BBB-” to LH Hotel Leasehold Real Estate Investment Trust (LHHOTEL or “trust”) with a “positive” rating outlook. The rating reflects the trust’s high-quality assets located in prime areas in Bangkok and a strong rebound in post-pandemic performance. The rating is weighed down by the trust’s elevated leverage and its small size of portfolio concentrated only in Bangkok.

The “positive” rating outlook reflects a potential rating upgrade should the trust successfully acquire two new assets in Pattaya and raise new capital to partly fund the acquisition as planned. The new assets will strengthen LHHOTEL’s portfolio with enlarged and more diversified sources of cash flow.

KEY RATING CONSIDERATIONS

Strong post-pandemic hotel performance

Following the severe impact of the COVID-19 pandemic, the performances of the trust’s hotels have recovered alongside the easing of travel restrictions and countries reopening globally. The revenue per available room (RevPAR), excluding value-added tax (VAT), service charges, and breakfast, of the trust’s three hotels has rebounded strongly, driven by both occupancy rates (OR) and room rates, since the third quarter of 2022. In the first quarter of 2023, adjusted for the impact of change in basis of revenue recognition, the RevPARs of the “Grande Centre Point Terminal 21 Hotel” (TM21) and the “Grande Centre Point Ratchadamri Hotel” (RD) exceeded the pre-pandemic level by 5%-10% while the RevPAR of the “Grande Centre Point Sukhumvit 55 Hotel” (S55) rebounded to pre-pandemic level.

Going forward, given the assets’ quality and prime locations, we expect these hotels to continue commanding high room rates while maintaining high ORs. We view the prospects for Thai tourism to be favorable, supported in part by increasing Chinese tourist arrivals. In 2023, our base-case assumption projects the RevPAR of TM21 to be around THB3,900 per room per night, RD to be around THB3,300 per room per night, S55 to be around THB2,715 per room per night, and to grow by low- to mid-single digits annually during 2024-2025.

New acquisitions to strengthen trust’s portfolio

The planned acquisition of two new hotels, namely “Grande Centre Point Pattaya” (PTY) and “Grande Centre Point Space Pattaya” (SPT), will help reduce the trust’s concentration risk and its dependence on tourism in Bangkok. The three hotels in the current portfolio are all in central Bangkok and focus on foreign tourists. The two new hotels are in Pattaya and cater to both the domestic and international markets. There could also be cross-selling opportunities for hotel guests planning to visit both Bangkok and Pattaya. We project the acquisitions will add another 85% of current rental income to the trust’s overall rental income in 2024.

Opened in October 2018, PTY has 396 rooms. The post-pandemic operating performance of the hotel recovered strongly. In the first quarter of 2023, the hotel RevPAR stood at THB3,398 per room per night, exceeding the same period in 2019, adjusted for the impact of change in basis of revenue recognition, by 5%-10%. We forecast the RevPAR of the hotel to be around THB3,100-THB3,200 per room per night in 2024-2025.

Opened in August 2022, SPT has 490 rooms with well-equipped meeting and conference facilities. Despite being newly opened and in the ramping up phase, SPT delivered an impressive performance with OR over 90% since the fourth quarter of 2022. The RevPAR was THB4,869 per room per night in the first quarter of 2023. We project the RevPAR to be THB4,800-THB5,000 per room per night during 2024-2025.

Apart from these two hotels, we expect the trust to regularly acquire new assets every 2-3 years. The assets will come primarily from Land and Houses PLC (LH), the sponsor, or affiliates. The growing size of the quality property portfolio will help boost rental income as well as further diversify the sources of cash flow of the trust in the future.

Fixed rent likely to become a smaller proportion of expected rental income

The laws governing real estate investment trusts (REIT) prohibit a REIT from operating a hotel. Because of this, LHHOTEL subleases the hotels to L&H Hotel Management Co., Ltd. (LHH), a subsidiary of LH. LHH pays LHHOTEL a fixed rental fee and a variable rental fee. Prior to the regulation change in 2020, the trust was required to set up a rental scheme in which variable rent was not to exceed 50% of fixed rent. For the time being, the rent structure for the existing assets remains in compliance with the regulation at the time the trust acquired the assets as stipulated in the sublease agreements.

For the existing three hotels of LHHOTEL in Bangkok, the fixed portion of the rent is reset each year depending on the actual operating results of each hotel, subject to a floor amount set when the sublease was first signed. The variable portion is 85% of what the sublessee makes after deducting hotel operating expenses and the fixed portion of the rent. The aim is to adjust the fixed rent in each year such that the variable rent does not exceed 50% of the fixed 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. After such renewals, it is possible that the rent structure might be renegotiated.

For the two targeted hotel acquisitions, the initial fixed rent is set at around 50% of hotels' expected earnings before interest, taxes, depreciation and amortization (EBITDA). For PTY, fixed rent starts at THB136 million per year and increases by 2% every three years. SPT's fixed rent starts at THB270 million per year and increases by 2% every three years. The variable portion of both hotels is 90% of what the sublessee makes after deducting hotel operating expenses and the fixed portion of the rent.

Subleasing the hotels to LHH means that LHHOTEL would not directly suffer the operating losses of the hotels it owns during adverse operating conditions as the sublessee would be the one to absorb such losses. Under normal circumstances, the existence of fixed rental fee is also beneficial to the trust as it sets the floor to the trust's rental income. The benefit of such downside risk protection will, however, be diminished as the fixed portion of the rent decreases in the future.

There are 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. Subject to other conditions specified in the sublease agreement, 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, the sublessee could waive the rental payment to the trust for the months affected. It is possible that when an ongoing force majeure event allows the sublessee to waive the rental payment to the trust, the trust might not receive any rental income in some months even though the hotels it owns generate positive earnings before interest, taxes, depreciation and amortization (EBITDA), as evidenced during the pandemic period.

Leverage expected to decline after asset acquisition

Our base case projection assumes that the trust's planned acquisition will take place at the end of 2023 or the beginning of 2024 at the acquisition price of up to THB9.8 billion. We also assume the acquisition will be 60% funded by new equity capital with the remaining 40% by debt. As a result, we project the trust's loan-to-fair value (LTV) of total asset ratio to decline to around 44% after the acquisition from 47% in 2022.

Assuming a 45% EBITDA margin at the property level, we project the trust's rental income from the three existing hotels to be THB925 million in 2023. Together with the additional rental income from the two new hotels, we project the trust's rental income to be THB1.7-THB1.8 billion per annum in 2024 and 2025. Assuming similar cost structure at the trust's level as in 2022, we project the EBITDA of the trust to be around THB840 million in 2023 and THB1.5-THB1.6 billion per annum in 2024-2025.

We project its adjusted debt to be around THB5.7 billion at the end of 2023 before rising to above THB9 billion after the asset acquisition. As a result, we expect the adjusted debt to EBITDA ratio to fall to 6.8 times in 2023, compared with 9.5 times in 2022, before further declining below 6 times after the acquisition.

Adequate liquidity

As operation conditions return to normal, we expect the trust to have adequate liquidity over the next 12 months. Sources of funds include funds from operations (FFO) estimated at around THB1.1 billion, cash and cash equivalent on hand at the

end of March 2023 of THB169 million, and available credit line of THB150 million. Uses of funds comprise financial obligations including accrued interests during the pandemic period around THB140 million.

The financial covenants on LHHOTEL's bank loans require the trust's interest-bearing debt to equity ratio to remain below 1 times and the debt service coverage ratio (DSCR) to stay above 1.2 times, tested annually. As of March 2023, the interest-bearing debt to equity ratio of the trust was 0.92 times. The trust should have no problem keeping the interest-bearing debt to equity ratio and DSCR in compliance with the bank loan covenants.

BASE-CASE ASSUMPTIONS

- In 2023, RevPAR of TM21 to be around THB3,900 per room per night, RD to be around THB3,300 per room per night, and S55 to be around THB2,715 per room per night, then grow by low- to mid-single digits annually during 2024-2025.
- RevPAR of PTY to be THB3,100-THB3,200 per room per night and RevPAR of SPT to be THB4,800-THB5,000 per room per night in 2024-2025.
- LHHOTEL will acquire PTY and SPT for up to THB9.8 billion at the end of 2023 or the beginning of 2024, 60% of which will be funded by equity capital.
- Combined hotels' EBITDA to be around THB960 million in 2023 and increase to THB1.8-THB1.9 billion per annum during 2024-2025.
- Rental income to reach THB925 million in 2023 and THB1.7-THB1.8 billion per annum in 2024-2025.

RATING OUTLOOK

The "positive" outlook reflects a potential rating upgrade should the trust successfully acquire the two new assets in Pattaya and raise new capital to partly fund the acquisition as planned. The new assets would help enlarge LHHOTEL's earnings base and mitigate the concentration risk of the trust's asset portfolio.

RATING SENSITIVITIES

The rating could be revised upward if the trust successfully acquires PTY and SPT as planned with similar funding mix as assumed in our base-case projection. The upgrade would also be conditional on recovery in the hotel operation progressing as projected or better. Conversely, the outlook could be revised to "stable" should the trust fail to complete its acquisition or make a larger than expected debt-funded portion. We could also lower the rating and/or outlook if the operating performances of the hotels deteriorate significantly, pushing rental income much below our expectation.

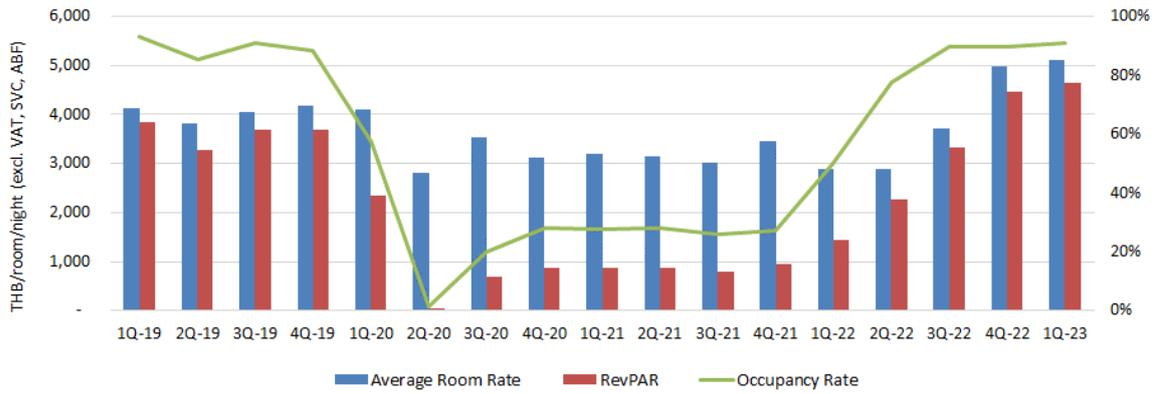
COMPANY OVERVIEW

LHHOTEL is a non-redeemable and indefinite REIT. The trust was established in December 2015. As of March 2023, 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 14.73% and 4.82%, respectively. Companies affiliated with LH own 24.65% 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 in Bangkok. TM21 is located on the corner of Asoke Junction and connected with the Asoke BTS skytrain station and the Sukhumvit MRT subway station. RD is located near the Ratchaprasong Junction and the Ratchadamri BTS skytrain station. S55 is located in Soi Thonglor, which is well-known for its trendy nightlife, and is accessible to the Thonglor BTS skytrain station. As of March 2023, the fair value of LHHOTEL's properties was THB11.8 billion.

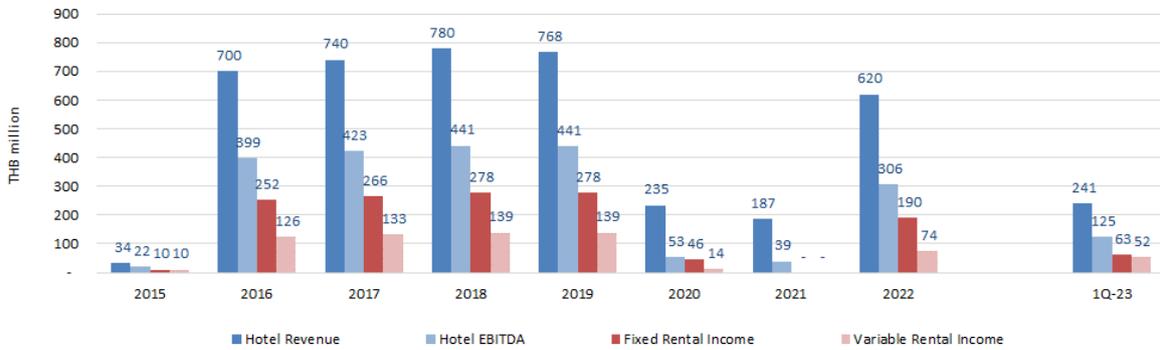
KEY OPERATING PERFORMANCE

Chart 1: Average Room Rate and Occupancy Rate of TM21



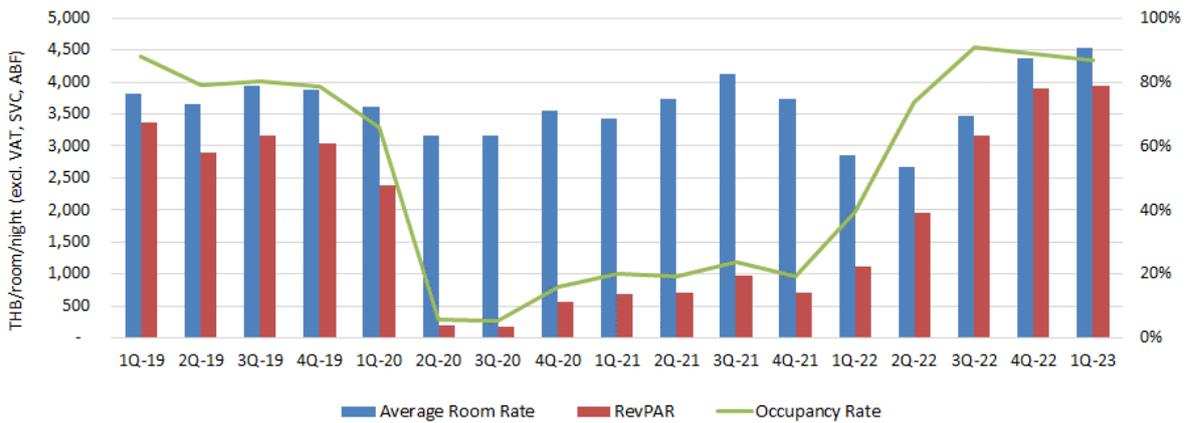
Source: LHHOTEL

Chart 2: Performance of TM21



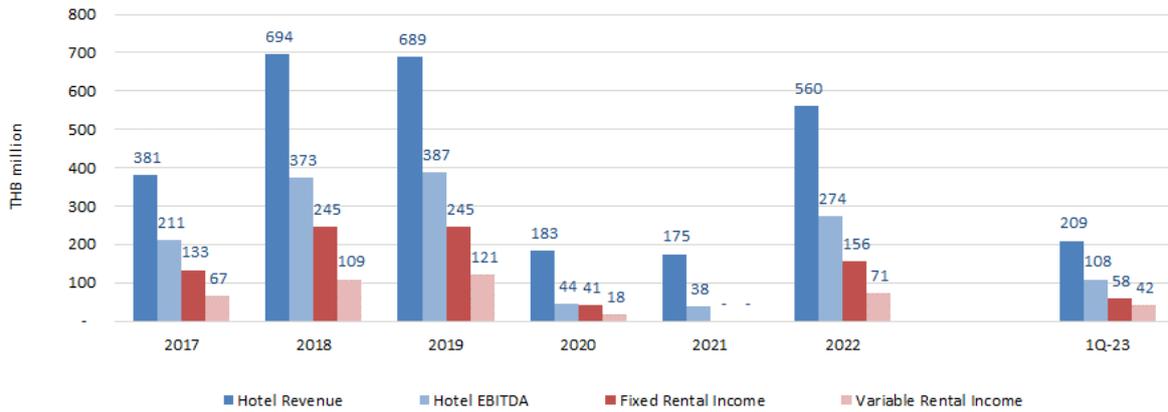
Source: LHHOTEL

Chart 3: Average Room Rate and Occupancy Rate of RD



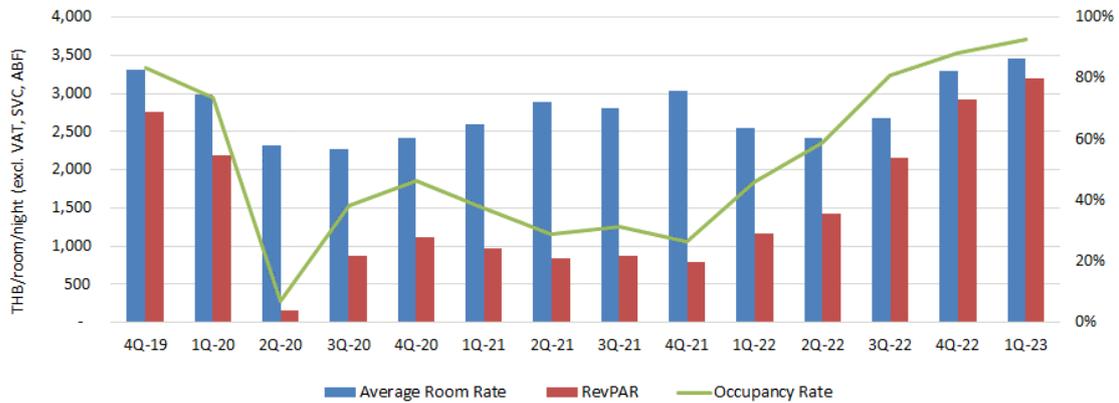
Source: LHHOTEL

Chart 4: Performance of RD



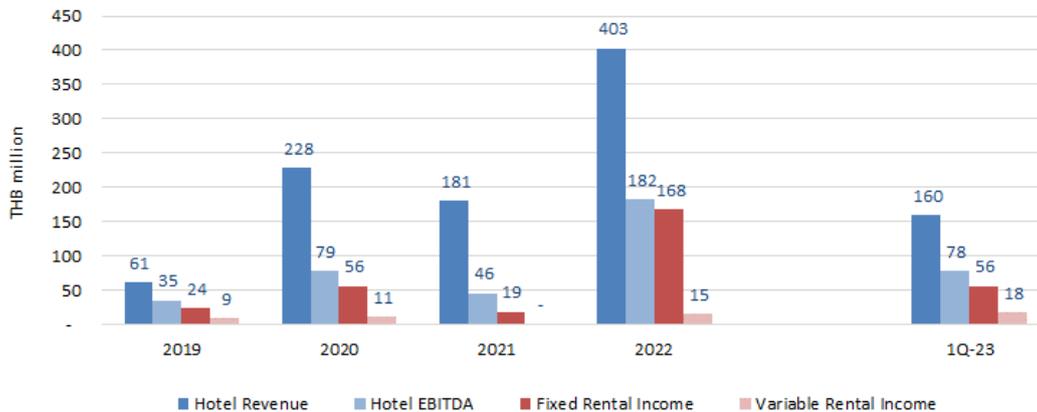
Source: LHHOTEL

Chart 5: Average Room Rate and Occupancy Rate of S55



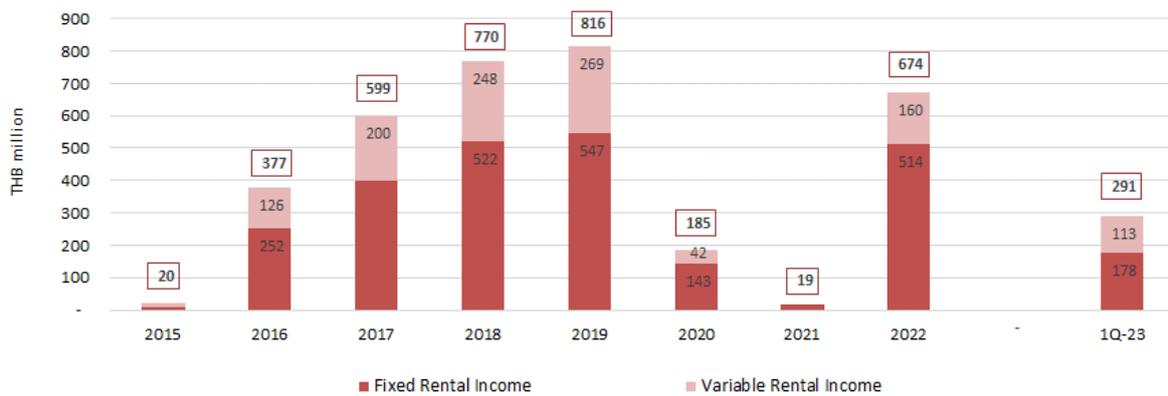
Source: LHHOTEL

Chart 6: Performance of S55



Source: LHHOTEL

Chart 7: LHHOTEL Rental Income



Source: LHHOTEL

FINANCIAL STATISTICS AND KEY FINANCIAL RATIOS

Unit: Mil. THB

	-----Year Ended 31 December -----				
	Jan-Mar 2023	2022	2021	2020	2019
Total operating revenues	291	676	19	185	813
Earnings before interest and taxes (EBIT)	271	612	(5)	154	724
Earnings before interest, taxes, depreciation, and amortization (EBITDA)	271	612	(5)	154	761
Funds from operations (FFO)	212	417	(188)	(29)	683
Adjusted interest expense	60	195	184	183	78
Capital expenditures	0	0	2	10	4,199
Total assets	12,269	12,320	11,672	11,970	12,669
Adjusted debt	5,832	5,816	5,796	5,631	5,617
Adjusted equity	6,277	6,307	5,730	6,167	6,862
Adjusted Ratios					
EBITDA margin (%)	93.28	90.53	(25.48)	83.11	93.62
Pretax return on permanent capital (%)	7.44	5.11	(0.04)	1.25	6.89
EBITDA interest coverage (times)	4.56	3.14	(0.03)	0.84	9.79
Debt to EBITDA (times)	6.56	9.51	(1,194.65)	36.52	7.38
FFO to debt (%)	11.60	7.17	(3.25)	(0.51)	12.16
Debt to capitalization (%)	48.16	47.98	50.28	47.73	45.01
Loan-to-fair value of total assets (LTV)	47.03	46.91	49.59	48.35	45.68

RELATED CRITERIA

- Corporate Rating Methodology, 15 July 2022
- Key Financial Ratios and Adjustments for Corporate Issuers, 11 January 2022
- Rating Methodology for Real Estate for Rent Companies, 15 July 2021

LH Hotel Leasehold Real Estate Investment Trust (LHHOTEL)

Issuer Rating:	BBB-
Rating Outlook:	Positive

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