GCR RATINGS

Public Credit Rating Report | South African Corporate | March 2022

Hospitality Property Fund Limited

Rated Entity / Issue	Rating class	Rating scale	Rating*	Outlook/Watch
Hospitality Property Fund Limited	Long Term Issuer	National	BB+(ZA)	Negative Outlook
	Short Term Issuer	National	B(ZA)	
Senior Secured HPF11	Long Term Issue	National	A-(ZA)(EL)	Negative Outlook
Senior Secured HPF12	Long Term Issue	National	A-(ZA)(EL)	
Senior Secured HPF13	Long Term Issue	National	A-(ZA)(EL)	

*The Senior Secured Note ratings are based on an estimate of the expected loss in the event of an issuer default and are a function of the estimated probability of default of the issuer and the potential losses that may be incurred. As such, these ratings carry an "(EL)" suffix.

Strengths

- Strong business profile as a large hotel operator in South Africa
- Significant ongoing funder support to alleviate liquidity pressures

Weaknesses

- Earnings remain constrained due to prolonged industry recovery
- Notable deterioration in leverage metrics due to pandemic related earnings weakness

Rating Rationale

The downgrade on the Issuer ratings in February 2022 is based on Tsogo Sun Hotels Limited's ("TSH" or "the group") tighter liquidity headroom in view of the high near-term refinancing requirements, whilst cash flows and credit metrics are expected to remain weak over the next two years as the fallout from the pandemic is expected to have a prolonged impact on its credit profile. GCR considers Hospitality Property Fund's ("HPF") to be a core operating entity of TSH, being the direct owner of most of the group's hotel properties and having a very high level of operational integration. As such, HPF's rating is equalised to the wider group.

TSH's performance in FY21 was severely impacted by the pandemic-induced disruptions, which saw occupancy levels fall to unprecedented lows and most of the hotel portfolio closed due to the collapse of both business and leisure travel. This saw TSH report a 74% YoY decline in revenues to R1.2bn in FY21 and a large operating loss of R290m, despite management undertaking stringent cost control measures. Even as occupancies of various hotel properties have improved somewhat since Q1 2021, further waves of the pandemic, intermittent international travel restrictions and lacklustre corporate travel have continued to constrain operations. At 1H FY22, revenues were up at R959m (1H FY21: R121m), with an operating loss of R50m reported (1H FY21: R44m loss). Global vaccination programmes and expectations of economic recovery are favourable for the industry's recovery, however as already experienced, new variants could further stall momentum. Business travel, which is a key contributor to group revenues, is also anticipated to revive at a slower pace to leisure travel. Thus, whilst we expect TSH's operations to show gradual improvement, the earnings profile is likely to remain weak until at least 2024.

GCR notes the material funding support provided by the group's lenders through the downturn. To this end, the severe earnings weakness experienced has led to distorted leverage and coverage metrics in FY21 and 1H FY22, with the group having secured consecutive waivers of its traditional financial covenants to ease compliance since the third-quarter 2020. The current revised covenant limits set out minimum liquidity thresholds (R500m at TSH level and R125m at HPF level) and a maximum group earnings loss over a 12-month rolling period, with quarterly testing periods. While GCR expects TSH'S credit metrics to improve as market conditions start to gradually normalize and further deleveraging efforts are prioritised, a return to non-distorted leverage levels is only projected by FY24. Nevertheless, we have factored in the group's conservative LTV ratio of around c.30% in our leverage assessment (as most of the outstanding debt is secured), as well as the fact that TSH has continuously reduced gross interest-bearing debt levels to R3.5bn at December 2021 from R4.5bn at FY20, despite the challenging environment.

In our view liquidity risk has increased, as a significant R1.9bn in debt maturities fall due in FY23 (63% of total debt obligations). GCR calculates liquidity coverage at a modest 1.0x-1.3x over the next 12 months. Nevertheless, our rating continues to factor in ongoing refinancing support from the group's lenders to maintain liquidity at a time when its capital access remains limited. Looking ahead, the meaningful terming out of the debt profile will be crucial to alleviating liquidity pressures and to return to a sustainable capital structure.

The ratings positively factor in TSH's position as one of the largest South African hotel groups, with good diversification of hotels across multiple price points with highly recognisable and established brands. Whilst the group's hotels are located across the country, concentration to certain provinces and the South African operating environment constrain its business profile.

Secured Notes ratings downgraded in line with Issuer rating

The Senior Secured Notes' expected loss ratings are derived by applying a notching-up approach, starting from the long-term Issuer credit rating. The number of notches granted depends on the recovery prospects in the event of default and enforcement of the security in a fire-sale scenario, as modelled by GCR. Whilst the stressed amount recovered from the sale of properties and rentals has been negatively impacted by the prolonged period of minimal to zero occupancy at the hotels since the onset of the pandemic, four additional properties have been added to the security pool. The modelled recovery rate of 100%, qualifies for a four-notch national scale uplift from the Issuer rating.

Outlook Statement

The Negative outlook continues to reflect the uncertainty over the pace of post-pandemic business normalisation in the hospitality industry, with performance to remain under notable pressure. We also note elevated credit risks to address upcoming debt maturities.

Rating Triggers

GCR could take negative rating action if 1) liquidity coverage reduces below 1.0x; 2) leverage metrics deteriorate further and/or 3) the risk of accelerated debt repayments becomes heightened due to covenant strain. Additionally, failure to demonstrate measured improvement in occupancies and cash flows over the next twelve months could also lead to downward ratings pressure.

A ratings upgrade is unlikely and would require a marked improvement in the overall hospitality sector outlook. Additionally, a recovery in operational metrics and profitability indicators towards historical trading volumes, together with a material improvement in credit protection metrics(and reset to normalised covenant requirements) would be required for ratings improvements.

Downward migration of the issuer ratings and/or a material reduction in the estimated recovery rate could translate to a downgrade of the Senior Secured Notes.

Analytical Contacts

Primary analyst	Sheri Morgan	Senior Analyst: Corporate Ratings
Johannesburg, ZA	Morgan@GCRratings.com	+27 11 784 1771
Committee chair	Yohan Assous	Sector Head: Structured finance & securitisation
Johannesburg, ZA	Yohan@GCRratings.com	+27 11 784 1771

Related Criteria and Research

Criteria for the GCR Ratings Framework, Jan 2022
Criteria for Rating Corporate Entities, Jan 2022
Criteria for Rating Secured Bonds, July 2021
GCR's Country Risk Score report, December 2021
GCR's SA Sector Risk Score report, March 2022

Ratings History

Hospitality Property Fund Limited

Rating class	Review	Rating scale	Rating	Outlook/Watch	Date
Long term Issuer	Initial	National	BBB-(ZA)	Stable Outlook	Nov 2012
Short Term Issuer	Initial	National	A3(ZA)		
Long term Issuer	Last	National	BBB-(ZA)	Negative Outlook	Feb 2021
Short Term Issuer	Last	National	A3(ZA)		

Stock Code	Review	Rating scale	Rating*	Outlook/Watch	Date
HPF11	Initial	National	AA-(ZA)	Stable Outlook	Feb 2018
	Last	National	A(ZA)(EL)	Negative Outlook	Feb 2021
HPF12	Initial	National	AA(ZA)	Stable Outlook	April 2019
	Last	National	A(ZA)(EL)	Negative Outlook	Feb 2021
HPF13	Initial	National	AA(ZA)(EL)	Stable Outlook	Dec 2019
	Last	National	A(ZA)(EL)	Negative Outlook	Feb 2021

* Structured bond ratings are based on an estimate of the expected loss in the event of an issuer default and are a function of the estimated probability of default of the issuer and the potential losses that may be incurred. As such, the ratings carry an 'EL' suffix. Prior to the publication of GCR's Rating Scales, Symbols and Definitions in May 2019, structured bond ratings did not carry the 'EL' suffix.

Analytical Entity: Tsogo Sun Hotels Limited

TSH is one of the largest hotel groups in South Africa. In 2016, TSH started acquiring HPF shares through various transactions and finally increased its ownership stake to 100% in January 2021 through the buy-out of remaining minority shareholders. Subsequently, HPF was delisted from the JSE. Without any outside shareholders or its REIT status, GCR considers HPF (the rated entity) to be a core operating entity of TSH, being the direct owner of most of the group's hotel properties and having a very high level of operational integration. As such, HPF's rating is equalised to the wider group.

Operating Environment

The operating environment assessment reflects the group's exposure to South Africa's economic woes, overlayed with a struggling domestic hospitality sector triggered by the pandemic

Country risk

Although the group has some properties in sub-Saharan Africa and abroad, its country risk assessment is predominantly linked to South Africa as that is where over 90% of its assets are located.

The South African country risk score of '7.0' factors in the numerous challenges facing the economy, amidst a prolonged pandemic that has continued to blunt recovery prospects. As with many global countries, South Africa implemented various financial stimulus and support packages to soften the devastating impact of the pandemic to the worst affected areas. Government debt is fast approaching unsustainable levels, with debt to GDP forecast above 80% over the next two years. The pandemic has also had a disproportionate impact on the population with the most vulnerable individuals being hardest hit, further exposing the high inequality gap in society. Another key challenge facing the country is large scale job losses with unemployment levels ballooning.

Government faces an uphill task in its drive to arrest the rise in unemployment and create sustainable new jobs over the medium to longer term given the limited headroom in the fiscus. This is exacerbated by the vulnerable financial positions of many State-Owned Entities which continue to require large amounts of capital support amidst a diminishing capability to do so. Overall, downside risks dominate the outlook horizon for the South African country risk score. While the pandemic's impact has been felt around the globe, the severity has been more pronounced in South Africa given its pre-existing economic frailties. South Africa is facing an uphill task to make up the lost ground with the government fast approaching unsustainable debt levels.

Sector risk

The hospitality sector presents above average cyclicality, with international trends reflecting overall vulnerability to shifts in local, regional, and global macroeconomic trends. This is largely due to the discretionary nature of spending on hotels and general leisure activities, which compete for disposable income with other forms of non-critical spend. Hotels and leisure sectors are especially susceptible to seasonality and exogenous shocks, as well as international tourism. The low entry barriers also point to higher competition, with susceptibility to substitution observed in certain pricing segments, and comparatively higher potential for disruption relative to other sectors.

The hospitality sector has been the most severely impacted by the onset of the global pandemic and is likely to be the slowest to recover in the face of ongoing disruptions. In this regard, travel and social distancing restrictions continue to negatively impact multiple pockets of the industry, such as hotels, tour operators, travel agents, tourist focussed attractions, as well as sporting and conferencing venues. Nevertheless, green shoots of a recovery phase have emerged through 2021 as pent-up travel demand continues to pick up as lockdown restrictions have eased and more international borders open. Whilst this should continue to support improved lodging occupancies, these remain well below pre-COVID-19 levels, and have largely been underpinned by domestic tourism, particularly last-minute bookings due to new waves and variants curtailing forward bookings. A return of the higher value international and business travel remains key to the sector's recovery over the medium term, although the business segments are likely to be on a slower recovery path with some permanent loss as a result of the change to more flexible/virtual work conditions.

GCR continues to hold a negative outlook on the sector, as continued volatility in earnings is expected, although increased cost flexibility by hotel operators and with most assets trading should help ease losses.

Business Profile

Competitive position

TSH is one of the largest hotel groups in South Africa, with brands catering to different pricing segments for both local and international travellers

TSH displays a strong position in the South African hotel industry, supported by its brand equity. Most of the hotel properties in the portfolio are owned by and managed by TSH, but it also benefits from tie-ups with hotels leased and managed by renowned international brands (including Marriott and Radisson) and management of hotels at the various casino complexes owned by Tsogo Sun Gaming. Revenue is mainly generated through the provision of hotel accommodation, supplemented by income from food and beverage sales, as well as rental income from hotels that are leased by external operators. GCR notes however, that ancillary income is largely dependent on the hotel rooms being occupied.

Table 1: Hotel portfolio

	Owned/Leased		Managed		Total	
	Hotels	Rooms	Hotels	Rooms	Hotels	Rooms
Coastal	**22**	**5,583**	**7**	**659**	**29**	**6,242**
Luxury	2	234	1	165	3	399
Full Service	17	4,745	6	494	23	5,239
Economy	3	604	-	-	3	604
Inland	**23**	**4,623**	**12**	**1,426**	**35**	**6,049**
Luxury	4	753	2	384	6	1,137
Full Service	16	3,474	7	669	23	4,143
Economy	3	396	3	373	6	769
Other	**24**	**1,879**	**7**	**889**	**31**	**2,768**
Luxury	-	-	-	-	-	-
Full Service	2	138	7	889	9	1,027
Economy	22	1,741	-	-	22	1,741
South Africa	**69**	**12,085**	**26**	**2,974**	**95**	**15,059**
Offshore	**6**	**961**	**4**	**746**	**10**	**1,707**
Third Party Operated (HPF owned)	7	2,038	-	-	7	2,038
Total	**82**	**15,084**	**30**	**3,720**	**112**	**18,804**

Source: Tsogo Sun Hotels 2021 Annual Integrated Report

The group has a portfolio of over 100 hotels, predominately located in South Africa, with a few properties in sub-Saharan Africa, Seychelles, Abu Dhabi, as well as an investment the UK. Despite the turmoil brought on by the onset of the pandemic, the portfolio of properties remains largely intact, in that relatively few assets have/will be sold off to lower the debt burden, whilst closed hotels only made up 19% of total room stock as at September 2021 and are all set to reopen during 2022 as demand continues to pick up. That said, the portfolio does show geographic concentration regionally to Sandton and Cape Town, which increases the vulnerability of revenues to any localised downturn/unforeseen events. More specifically, the majority of the group's occupancy depends on international tourists, the business traveller, government and convention markets because of the favourable locations of most of the properties. The business segment may not fully recover in the medium term given the structural change in working environments, increasing the challenges to reach pre-pandemic occupancy levels. Nevertheless, the portfolio's wellrecognised brands and diversification across the luxury, full service and economy hotel segments should appeal to a wide range of customers, including those travelling for leisure as well as business.

Management and governance

Management and governance factors are considered neutral to the ratings analysis.

Financial Profile

Earnings

Elongated recovery cycle due to ongoing risks posed by the pandemic

On the back of the sharp decline in travel because of sequential pandemic-related mobility restrictions through FY21, TSH's occupancy levels fell to unprecedented lows. The group was forced to close the vast majority hotels at the onset of the crisis during the hard lockdown between April to June 2020, thus the only revenue generated was from COVID-19 quarantine related business. Overall, YoY revenues declined by 74% to R1.2bn and a large operating loss of R290m was reported for FY21.

Aided by the gradual relaxation of lockdown restrictions and uptick in local leisure travel, occupancies of various hotel properties have shown improvement since Q1 2021. Nevertheless, the recovery trend continues to be volatile, highlighting the ongoing risks posed by the pandemic in terms of subsequent variants and the ramifications thereof. To this end, after reaching the highest level of system-wide room sales of 117,952 since the beginning of the pandemic in April 2021, room sales declined notably in July 2021 to 55,280 as the third wave struck domestically, before climbing back up to 167,967 in October 2021. Hotel bookings were once again impeded by the emergence of the new Omicron variant in November 2021 which saw cancellations from abroad but offset by last minute local leisure bookings as South Africa's restrictions remained at eased levels. As such, operations remain constrained, with the group trading at only 50% of system-wide rooms sold prior to COVID19 and at occupancies far below its long-term average as at 1H FY22. Revenue rose to R959m (1H FY21: R121m) for 1H FY22, with an operating loss of R50m reported (1H FY21: R44m loss).

Global vaccination programmes and expectations of economic recovery are favourable for the industry's recovery, however as already experienced, new variants could further stall momentum. Business travel, which is a key contributor to group revenues, is also anticipated to revive at a slower pace to leisure travel. Thus, whilst FY22 is expected to be significantly better than FY21, TSH's earnings profile is likely to remain weak until at least 2024 when we see a potential normalisation in trading.

We do positively note the group's efforts to substantially restructure its core cost base. The occupancy level required to reach a breakeven point at each hotel will be lower than historically observed, which should support stronger margins at each incremental increase in revenue thereafter.

Leverage

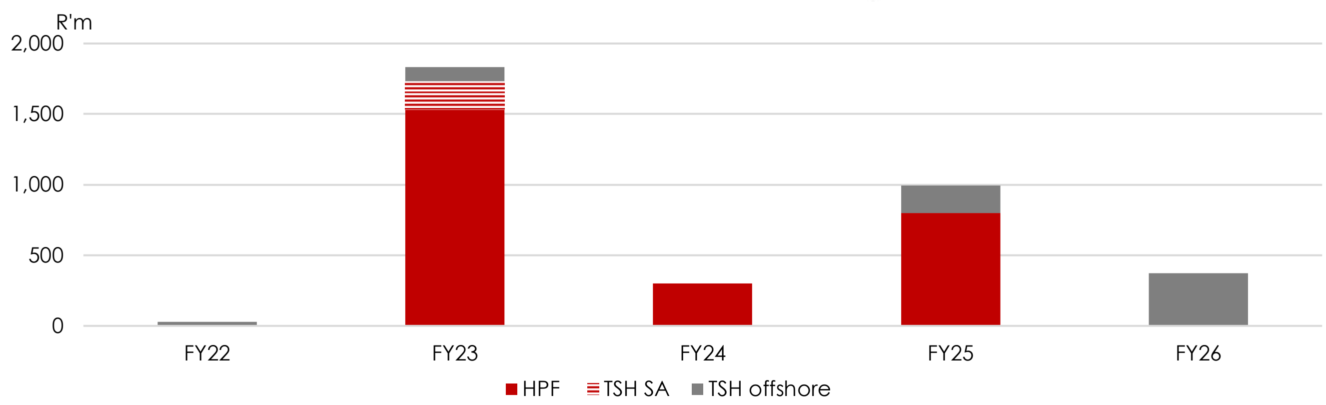
Leverage metrics remain out of range for the ratings, but credit risk is mitigated by demonstrated funder support

Rating concerns also arise from TSH's weak and distorted credit protection metrics at FY21 and 1H FY22, following the material erosion in earnings. The coverage ratios are likely to remain at similar levels over the near term until the impact of the pandemic on the hospitality industry subsides. As such, the ratings continue to factor in significant funder support, demonstrated by past debt refinancing and the successive waivers received for the original financial covenants since the third-quarter of 2020. Instead, TSH is expected to maintain a minimum liquidity amount of R500m and HPF an amount above R125m, based on cash and unutilised committed facilities. In addition, the maximum EBITDA loss over a rolling 12-month period for the group is also expected to reduce to R330m for the March 2022 measurement period (was R412m for the December 2021 measurement period) and will continue to be measured on a quarterly basis. The group has thus far had sufficient headroom over the minimum EBITDA and liquidity thresholds, with covenant levels for future measurement periods to be reassessed post release of the FY22 results.

TSH and HPF have separate funding programmes, in that both entities independently ringfence specific assets as security for their respective debt obligations. Cognisant of the secured nature of outstanding debt obligations, GCR estimates the ratio of net debt (including lease liabilities) to fixed assets at group level to be moderate at around 30%. Further, GCR notes the positive strides TSH has made in reducing gross interest-bearing debt despite the challenging environment, which stood at R3.5bn in December 2021, from R4.5bn at FY20. In particular, the reduction of dollar denominated debt remains a priority (as it is unhedged).

A significant R1.9bn in debt maturities fall due in FY23 (63% of total debt obligations). Management is looking to term out the debt profile towards three-year tenors, however, in the interim GCR expects funders to continue to show support and roll upcoming facilities for at least one year.

Figure 1: Debt maturity profile, at 1H FY22



Liquidity

Tighter liquidity headroom in view of the high near-term refinancing requirements, but alleviated by expectations of significant ongoing funder support

Despite the group adhering to strong cash preservation measures, GCR calculates liquidity coverage at a modest 1.0x-1.3x over the next 12 months. This is as a result of the significant R1.9bn in debt maturities falling due in FY23. Nevertheless, our liquidity assessment continues to factor in ongoing refinancing support from the group's lenders to maintain liquidity at a time when its capital access remains limited.

Comparative Profile

The comparative profile is a neutral component for the ratings.

Peer analysis

The peer analysis is neutral to the ratings.

Group support

Group support is not applicable to the ratings.

Rating Adjustment Factors

Structural adjustments

No structural adjustments have been made to the ACE and the final ratings of HPF are equalised to the wider group.

Instrument ratings

GCR applies its 'Criteria for Secured Bond Expected Loss Credit Ratings' to determine the expected loss ratings assigned to HPF's Senior Secured Notes. The rating factors in expectations of post default recoverability from a specific collateral pool, along with the issuer's creditworthiness. GCR derives the rating by applying a notching approach, starting from the long-term national scale issuer rating, where a higher estimated recovery rate will give rise to a higher number of notches uplift. Given that the underlying security comprises real estate assets, GCR determines a stressed fire-sale value for the properties, incorporating an appropriate time to realise the proceeds to be applied to extinguish the secured debt obligations.

Interest payments due to Noteholders from the point of default up until the realisation of proceeds from the security pool are assumed to be missed and are aggregated with the principal amount outstanding to determine the total exposure that stands to benefit from the assets. GCR relies on independent valuations of the real estate security and applies stresses based on the average occupancy rates, location and rating of each hotel to establish a resale value.

Whilst the stressed amount recovered from the sale of properties and rentals has been negatively impacted by the prolonged period of minimal to zero occupancy at the hotels since the onset of the pandemic, four additional properties have been added to the security pool. The modelled recovery rate of 100%, qualifies for a four-notch national scale uplift from the Issuer rating. Should the issuer ratings change, or the value of the underlying collateral changes and impacts the estimated recovery rate calculated by GCR, then the ratings assigned to the Notes may change.

Risk Score Summary

Rating factors & components	Risk scores
Operating environment	**11.00**
Country risk score	7.00
Sector risk score	4.00
Business profile	**1.00**
Competitive position	1.00
Management and governance	0.00
Financial profile	**(3.00)**
Earnings performance	(2.00)
Leverage and capital structure	(1.50)
Liquidity	0.50
Comparative profile	**0.00**
Group support	0.00
Government support	0.00
Peer analysis	0.00
Total Score	**9.00**

Glossary

Balance Sheet	Also known as Statement of Financial Position. A statement of a company's assets and liabilities provided for the benefit of shareholders and regulators. It gives a snapshot at a specific point in time of the assets the company holds and how they have been financed.
Capital	The sum of money that is invested to generate proceeds.
Cash Flow	The inflow and outflow of cash and cash equivalents. Such flows arise from operating, investing and financing activities.
Cash	Funds that can be readily spent or used to meet current obligations.
Covenant	A provision that is indicative of performance. Covenants are either positive or negative. Positive covenants are activities that the borrower commits to, typically in its normal course of business. Negative covenants are certain limits and restrictions on the borrowers' activities.
Debt	An obligation to repay a sum of money. More specifically, it is funds passed from a creditor to a debtor in exchange for interest and a commitment to repay the principal in full on a specified date or over a specified period.
Diversification	Spreading risk by constructing a portfolio that contains different exposures whose returns are relatively uncorrelated. The term also refers to companies which move into markets or products that bear little relation to ones they already operate in.
Exposure	Exposure is the amount of risk the holder of an asset or security is faced with as a consequence of holding the security or asset. For a company, its exposure may relate to a particular product class or customer grouping. Exposure may also arise from an overreliance on one source of funding. In insurance, it refers to an individual or company's vulnerability to various risks
Income	Money received, especially on a regular basis, for work or through investments.
Interest Cover	Interest cover is a measure of a company's interest payments relative to its profits. It is calculated by dividing a company's operating profit by its interest payments for a given period.
Interest	Scheduled payments made to a creditor in return for the use of borrowed money. The size of the payments will be determined by the interest rate, the amount borrowed or principal and the duration of the loan.
Issuer	The party indebted or the person making repayments for its borrowings.
Leverage	With regard to corporate analysis, leverage (or gearing) refers to the extent to which a company is funded by debt.
Liquidity	The speed at which assets can be converted to cash. It can also refer to the ability of a company to service its debt obligations due to the presence of liquid assets such as cash and its equivalents. Market liquidity refers to the ease with which a security can be bought or sold quickly and in large volumes without substantially affecting the market price.
Long Term Rating	See GCR Rating Scales, Symbols and Definitions.
Margin	A term whose meaning depends on the context. In the widest sense, it means the difference between two values.
Market	An assessment of the property value, with the value being compared to similar properties in the area.
Maturity	The length of time between the issue of a bond or other security and the date on which it becomes payable in full.
Operating Cash Flow	A company's net cash position over a given period, i.e. money received from customers minus payments to suppliers and staff, administration expenses, interest payments and taxes.
Rating Outlook	See GCR Rating Scales, Symbols and Definitions.
Risk	The chance of future uncertainty (i.e. deviation from expected earnings or an expected outcome) that will have an impact on objectives.
Short Term Rating	See GCR Rating Scales, Symbols and Definitions.
Short Term	Current; ordinarily less than one year.

Salient Points of Accorded Ratings

GCR affirms that a.) no part of the ratings was influenced by any other business activities of the credit rating agency; b.) the ratings were based solely on the merits of the rated entity, security or financial instrument being rated; and c.) such ratings were an independent evaluation of the risks and merits of the rated entity, security or financial instrument.

The credit ratings have been disclosed to the rated entity. The rating was solicited by, or on behalf of, the rated entity, and therefore, GCR has been compensated for the provision of the ratings. The rated entity participated in the rating process via face-to-face management meetings, and other written correspondence. Furthermore, the quality of information received was considered adequate and has been independently verified where possible.

The information received from the entities and other reliable third parties to accord the credit rating included:

- The Tsogo Sun Hotels 2021 audited annual financial statements
- Tsogo Sun Hotels September 2021 Interim results
- Results presentations
- A breakdown of the group debt profile at 31 Dec 2021
- SENS announcements
- Secured Hospitality Property Fund portfolio: Occupancy and rental income data up to Dec 2021, as well as external security pool valuations at March 2021