Media Release

Taipei Financial Center Corp. Assigned 'twAA-/twA-1+' Ratings; Outlook Stable

October 18, 2019

PRIMARY CREDIT ANALYST

Jin Dong, CFA
Taipei
+886-2-8722-5821
jin.dong
@spglobal.com
jin.dong
@taiwanratings.com.tw

SECONDARY CONTACT

Irene Lai
Taipei
+886-2-8722-5825
irene.lai
@spglobal.com
irene.lai
@taiwanratings.com.tw

Rating Action Overview

- Taipei 101 building's excellent branding power as one of Taiwan's most renowned landmarks underpins Taipei Financial Center's market position in key businesses and above-average profitability through its ability to attract high quality tenants at a premium price. This strength is tempered by the company's high asset concentration risk.
- Taipei Financial Center's conservative financial policy should help to lower the company's debt level further and contain the likelihood of a heightening in financial risk associated with debt-funded asset acquisitions over the next two years.
- On Oct. 18, 2019, Taiwan Ratings Corp. assigned its 'twAA-' long-term and 'twA-1+' short-term issuer credit ratings to Taipei Financial Center.
- The rating outlook is stable to reflect our expectation that Taipei Financial Center's robust asset quality will continue to support strong and stable operating cash flow generation, which will be used for deleveraging. This should keep the company's ratio of debt to EBITDA at 5.5x-6x over the next two years.

Rating Action Rationale

The ratings reflect Taipei Financial Center Corp.'s ability to attract high-quality office and retail tenants as well as international tourists, underpinned by the well-established reputation of the company's key asset, Taipei 101 building, which is one of the most famous landmarks in Taiwan. This building grants the company a strong market position in the domestic office, retail and observation deck business that in turn create above-average profitability. The ratings also reflect Taipei Financial Center's conservative financial policy that we expect to help the company further lower its debt over the next few years. These strengths are tempered by Taipei Financial Center's high asset concentration risk, given its single-site location.

Taipei Financial Center was incorporated in 1997 for the purpose of bidding for the build-operate-transfer (BOT) project of Taipei 101 building. The Taipei City government granted Taipei Financial Center the rights to build and operate the Taipei 101 office building and shopping complex for 70 years from November 1997 to November 2067. Upon expiration of the BOT rights, the company should return the property to Taipei City government without any debt obligation or legal constraint attached to the property, though it has a right of priority to rent the property for further operation from the government. Taipei Financial Center's business is divided into three major segments: retail, office, and observation deck. These businesses account for 40%, 37% and 23%, respectively, of the company's revenue in 2018 and 40.5%, 22.1%, and 37.4% of the company's operating income at the same time.

Taipei 101 building is an interconnected office and shopping complex which also provides an observation deck service on several high-level floors. It's Taiwan's tallest building with 101 floors, and was also the world's tallest building from 2004-2010. The building is renowned for its annual New Year's Eve fireworks display and is one of Taiwan's most popular tourist attractions. Taipei 101 office building and shopping center are co-located in the Sinyi central business district, and is surrounded by Grade A office buildings, exhibition centers, 5-star hotels, department stores, and the Taipei City government office building. Taipei 101 is also connected to city's mass rapid transport system via an underground station and sits on various bus routes, providing convenient transportation links to office tenants, shoppers, and tourists.

Taipei 101 office building benefits from an excellent market position in Taipei's office lease market. Taipei Financial Center is able to attract high-profile global tenants and large domestic corporates that can afford an above-average rent. Taipei 101 houses some of the largest financial institutions and high-tech companies operating in Taiwan including KPMG, Taiwan Stock Exchange, and Google. The building's excellent asset quality and high service standard allow the company to charge a premium rental rate higher than that of most peers in the Sinyi District, which supports stable and above-average profitability. This is despite the substantial increase in new office space in the region over the past few years. Taipei Financial Center has very high standards for maintenance, operation and safety, in our view, which should continue to underpin Taipei 101's asset quality, despite its age at about 15 years.

The office building's prestigious reputation also attracts international tourists to its observation deck, which is an important profit driver for Taipei Financial Center. Taipei 101's observation deck benefits from a monopolistic position, owing to the building's fame and incomparable view of Taipei City. The business also has a high profit margin, reflecting the premium ticket price and low overhead cost. However, the percentage of observation deck visitors to total number of tourists has been declining over the past few years as Taiwan's tourism market matures. The falling percentage of first-time visitors from total tourists indicates this decline. In addition, the observation deck's performance is subject to substantial volatility in the tourism market. We expect China's decision to suspend the issuance of individual tourist visas for its citizens to travel to Taiwan from Aug. 1, 2019 and inherent volatility in Taiwan's tourism market to underpin performance volatility in the observation deck business over the next two years. This is despite the company's efforts to increase souvenir sales and develop new products, such as the newly launched skyline 460 observation deck.

Taipei 101's strong branding enables its shopping center to attract top-tier global luxury and fashion brands. 101 shopping center's brand selection is highly comprehensive, in our view, covering over 80% of top international brands in jewelry, watch, and high-fashion. The shopping center's favorable brand mix and the management team's ongoing tenant mix optimization is likely to support relatively stable sales performance and strong profitability, despite intense competition in the Sinyi district and a likely material drop in Chinese tourists over the next two years. We believe Sinyi district's increasing popularity among consumers, especially for those shopping for luxury brands, given the clustering of over a dozen malls, attracts more consumers from other parts of Taipei and mitigates the risk of rising competitive pressure. We also expect an increase in sales from domestic consumers and non-Chinese tourists to mitigate the negative impact from a likely decline in sales from Chinese tourists in 2019 and 2020.

Taipei Financial Center faces significant asset concentration risk that tempers its business strength. The company has only one asset, Taipei 101 building , which exposes it to natural disaster and event risk that could damage the building's operation. These risks are partly offset by the building's advanced earthquake and storm resistant design as well as comprehensive insurance coverage. In addition, Taipei Financial Center's asset portfolio has a market value of New Taiwan dollar (NT$) 74 billion as of the end of 2018, and is larger than the portfolios of rated domestic REITs whose asset values are generally of NT$10 billion-NT$25 billion. However, Taipei Financial Center's portfolio remains smaller than that of global real estate peers due to its limited number of assets.

Taipei Financial Center has a conservative financial policy, in our view, as evidenced by its substantial decline in debt over the past five years and the company's commitment to further reduce debt to NT$5 billion by 2027, compared with NT$13.6 billion as of the end of June 2019. In addition, we believe the company has minimal development risk because the management team does not intent to expand its asset portfolio materially through debt-funded acquisitions. This is also consistent with its track record over the past decade. These factors should support the company's ratio of debt to EBITDA at 5.5x-6x over the next two years.

Outlook

The stable outlook reflects our expectation that Taipei Financial Center's robust asset quality will continue to support strong and stable operating cash flow generation, despite the negative impact of a likely material decline in Chinese tourists over the next two years. The stable outlook also reflects our view that the company will continue to use its operating cash flow to reduce debt over the same period, keeping its ratio of debt to EBITDA at 5.5x-6x.

Downward scenario

We may lower the long-term rating if the performance volatility of the company's asset magnifies; possibly due to Taipei 101's significant exposure to Taiwan's volatile tourism market. We may also lower the rating if the company's cash flow adequacy deteriorates and pushes its ratio of debt to EBITDA to above 7.5x for an extended period, possibly due to a large-scale debt funded asset acquisition, or a substantial weakening in the domestic economy that reduces Taipei Financial Center's cash flow and profitability substantially.

Upward scenario

The likelihood of an upgrade is low over the next two years. Nevertheless, we may raise the rating if the company could lower its debt level materially, which leads to a sustainable improvement in the ratio of debt to EBITDA to below 4.5x. Alternatively, we may raise the rating if Taipei Financial Center could grow its asset scale with enhanced asset and geographic diversification, while maintaining good asset quality, stable profitability, and the ratio of debt to EBITDA below 7.5x, though the likelihood of such a massive scale expansion is low, in our view.

Our Base-Case Scenario

We forecast Taipei Financial Center's revenue to remain largely flat in 2019, and decline by 4%-6% in 2020. The decline largely reflects the negative impact on the shopping center and observation deck businesses from a likely substantial decline in Chinese tourist numbers, albeit partly offset by continued growth in rental income from its office business. We expect the company's EBITDA margin to decline moderately in 2019 and 2020, reflecting higher maintenance expense during the period. Our assumptions include:

- Taiwan's GDP growth at 2.0 % in 2019 and 2020. We expect moderate GDP growth to support mild growth in consumer spending during the period. We also expect retail growth in the Sinyi district to be stronger than average in Taiwan, underpinned by the cluster effect that attracts consumers from other parts of Taipei.
- Office space demand in Taipei will remain solid over the next two years, driven by organic business expansion and the increasing number of Taiwanese firms expanding their operations in Taiwan in response to the U.S.-China trade conflict.
- We project rental income from Taipei 101 office building to increase by 4%-6% in 2019 and 2%-3% in 2020, reflecting elevation in rental rates and stable occupancy of about 96% over the period. We expect the limited supply of new office space in Sinyi district to drive a strong increase in rental rates over the next two years.
- We project Taipei 101 observation deck's revenue to decline by 3%-6% in 2019 and 15%-20% in 2020, due to a likely material decline in the number of Chinese tourists. We expect tourists from other countries to increase over the period, but to a level that only moderately lessens the impact of a fall in Chinese tourist volume.
- We project Taipei 101 shopping center's rental income to decline by 0%-3% in 2019 and 2%-6% in 2020, reflecting 1%-5% sales decline annually over the period. The impact from the reduction in Chinese tourist volume is likely to be milder for the shopping complex because local consumers account for the majority of the mall's sales.
- Higher maintenance expense in 2019 and 2020 to support renovation of the food court and parking lot.
- Capital expenditure of NT$450 million-NT$500 million in 2019 and NT$250 million-NT$300 million in 2020. The higher expenditure is to support several aforementioned renovation projects among others.
- Dividend payout of 90% of the previous year's net income.
- We deduct 100% of the company's cash balance in arriving at the adjusted debt level.

Based on the assumptions, we arrive at the following credit measures:

- EBITDA margin of 72%-74% in 2019 and 2020.
- Ratio of debt to EBITDA of 5.5x-6x in 2019 and 2020.
- Ratio of debt to capital of 52%-56% in 2019 and 2020.

Liquidity

The short-term rating on Taipei Financial Center is 'twA-1+'. We believe the company has adequate liquidity, which reflects a ratio of liquidity sources to liquidity uses of 1.5x-1.6x over the next 12 months. We also believe the company will have positive liquidity sources less uses, even if EBITDA declines by 10%.

In our assessment, Taipei Financial Center can absorb high-impact, low-probability events with limited need for refinancing, supported by stable cash flow generation from rental collection. We also believe the company has a sound relationship with banks as evidenced by the low interest rate on its bank loans. In addition, we believe Taipei Financial Center has a high standing in the credit markets, as shown by the low rate on the company's five-year NT$8 billion corporate bond issued in 2018. In our opinion, the company has prudent risk management, as evidenced by the substantially reduction in debt over the past few years. The company debt does not carry any financial covenant.

Principal Liquidity Sources:

- Cash and short-term investments: about NT$777 million as of the end of June 2019.
- Funds from operations: NT$2.8 billion-NT$3.2 billion over the 12 months ending June 2020.
- Undrawn mid-to-long term bank lines maturing beyond June 2020: NT$480 million-NT$520 million as of the end of June 2019.

Principal Liquidity Uses:

- Debt maturity of NT$400 million over the next 12 months ending June 2020.
- Working capital outflow: NT$120 million-NT$160 million over the 12 months ending June 2020.
- Capital expenditure: NT$350 million-NT$400 million over the 12 months ending June 2020.
- Cash dividend: NT$1.86 billion over the 12 months ending June 2020.

Rating Score Snapshot

Issuer Credit Rating: twAA-/Stable/twA-1+
Note: All scores are in comparison with global obligors.

Business risk: Strong
- Country risk: Intermediate
- Industry risk: Low
- Competitive position: Strong

Financial risk: Intermediate
- Cash flow/Leverage: Intermediate

Anchor: twaa-

Modifiers
- Diversification/Portfolio effect: Neutral (no impact)
- Capital structure: Neutral (no impact)
- Financial policy: Neutral (no impact)
- Liquidity: Adequate (no impact)
- Management and governance: Strong (no impact)
- Comparable rating analysis: Neutral (no impact)

Stand-alone credit profile: twaa-

Related Criteria

- General Criteria: Country Risk Assessment Methodology And Assumptions - November 19, 2013
- Criteria | Corporates | General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers - December 16, 2014
- General Criteria: Group Rating Methodology - July 01, 2019
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities - November 13, 2012
- General Criteria: Methodology: Industry Risk - November 19, 2013
- Criteria | Corporates | General: Corporate Methodology - November 19, 2013
- Criteria | Corporates | General: Corporate Methodology: Ratios And Adjustments - April 01, 2019
- General Criteria: Use Of CreditWatch And Outlooks - September 14, 2009
- Criteria | Corporates | Industrials: Key Credit Factors For The Real Estate Industry - February 26, 2018
- Understanding Taiwan Ratings' Rating Definitions, www.taiwanratings.com - June 26, 2018

(Unless otherwise stated, these articles are published on www.standardandpoors.com, access to which requires a registered account)

Ratings List

New Ratings

Taipei Financial Center Corp.	
Issuer Credit Rating	twAA-/Stable/twA-1+

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.taiwanratings.com for further information. Complete ratings information is available to subscribers of Rating Research Service at rrs.taiwanratings.com.tw. All ratings affected by this rating action can be found on Taiwan Ratings' public website at www.taiwanratings.com.