Media Release

Millerful No. 1 Real Estate Investment Trust Ratings Affirmed At 'twA+/twA-1' After New Acquisitions; Outlook Stable

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Rating Action Overview

- Millerful No.1 REIT will adjust its property portfolio by acquiring a logistics center and a boutique hotel instead of the Songlin building under our original assumption.
- Since the size of the new properties is similar to that of Songlin building, and the asset quality is in line with our previous expectation, there is no impact on the trust's business risk assessment.
- We believe the trust will acquire the two new properties through borrowing and cash on hand, leading to an increase in its ratio of debt to EBITDA to 10x-11x in 2019, which will decline to about 9x in 2020 after receipt of a full year's rental. Therefore, our financial risk assessment for the REITs is also unchanged.
- Taiwan Ratings Corp. today affirmed its 'twA+' long-term and 'twA-1' short-term issuer credit ratings on Millerful No.1 REIT.
- The rating outlook is stable to reflect our expectation that the trust can generate relatively stable operating cash flow supported by its satisfactory asset quality and maintain a ratio of debt to EBITDA below 11x over the next two years.

Rating Action Rationale

The rating affirmation reflects our view that **Millerful No.1 Real Estate Investment Trust's** (Millerful No.1 REIT's) announcement that it will acquire two new properties will have no significant impact on our assessment of the trust's satisfactory asset quality and diversification or financial leverage. We continue to expect the trust to generate relatively stable operating cash flow and maintain its ratio of debt to EBITDA below 11x over the next two years. The affirmation also reflects our view that Millerful No.1 REIT will maintain a prudent financial policy and keep its ratio of debt to asset comfortably below 35% over the same period.

Based on the new portfolio, we expect the trust's debt leverage to weaken in 2019 but then improve in 2020 following receipt of the first full year of rental income. This also reflects our view that the two new properties in the new portfolio--a logistics center in the northern city of Taoyuan and a boutique hotel in central Taiwan's Lukang Township--will generate stronger rental income than Songlin building used in our previous assumption for the portfolio. The rental contract for the logistics center will secure at least seven-year's rental income at a fixed rate even if the tenant terminates the contract earlier. Meanwhile, the contract with the operator of the boutique hotel (Union House) secures long-term rental income with an upward rental adjustment during the rental period.

The logistic center follows the global design standard of its end-tenant and could provide efficient network for logistic services. As a newly constructed steel structure, the maintenance needs for the property are therefore likely to be low. In addition, the location of the center offers convenient access to main transportation lines. Nevertheless, given the main customers of logistics services are from the retail sector, we view the volatility of the retail industry in Taiwan to be a potential risk factor for this property.

Meanwhile, the hotel in Lukang is a 20-year old building, albeit renovated in 2017 for the opening of Union House. The hotel with 62 rooms has obtained 'Small Luxury Hotel of the World' certification which testifies to the quality of its infrastructure and services. We see a low likelihood of new competitor establishing operations in the same area because the regulation's governing the hospitality industry have revised down the height limit for properties in Lukang township. Nevertheless, we see industry risk as relatively high for the hotel segment because of the significant difference between peak and low season demand, partly offset by the demand from corporate clients of nearby Zhangbin Industrial Zone.

In our view, the portfolio's satisfactory asset quality underpins the trust's competitive position and its ability to attract creditworthy tenants. However, we expect the trust's operating cash flow to be more volatile than that of its domestic office-rental-based peers, due to the trust's mall-based operation. In our base case, we assume Millerful No.1 REIT's asset portfolio is composed of Taimall (floors one to four), a family oriented shopping mall in Taoyuan, part of the Metropolitan International Center and NASA office buildings (both in Taipei City), a logistic center in Taoyuan, and Union House in Lukang, and shares in overseas REITs. We expect the REIT's mall, office, logistics center, hotel business, and dividend income to contribute 56%, 12%, 8%, 1% and 23%, respectively, of EBITDA in 2019.

We believe the trust will acquire the two new properties through borrowing and cash on hand; as a result, its ratio of debt to EBITDA will increase to 10x-11x in 2019, but decline to about 9x in 2020 following receipt of rental income for one full year. Going forward, we expect the trust to use its debt leverage to enhance its return while maintaining its debt-to-asset ratio below 35%, as per local regulations.

Our base case assumes:

- Millerful No.1 REIT’s investment portfolio includes the lower four floors of Taimall, selected units in Metropolitan building, selected floors of the NASA office building, a logistics center, Union House, and New Taiwan dollar (NT$) 2.5 billion worth of shares in overseas and domestic REITs.
- Almost of all of the trust's buildings will remain fully occupied over the next two years.
- Taimall's rental income to increase by 1%-3% in 2020, driven by the renovation of its outside space to attract more customers to visit. We expect rental levels at NASA and Metropolitan buildings, the logistic center, and Union House to remain flat over the next two years.
- Blended dividend yield on overseas and domestic REITs of 5%-6% over the next two years.
- The REIT's operating expense ratio will remain at 13%-15% of revenue over the next two years.
- The trust will incur very limited maintenance expenses because of its properties' good condition and the agreement that the tenants will be responsible for the major maintenance of the logistic center and Union House.
- Interest rate of 1.4%-1.5%.
- 100% dividend payout.

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

- EBITDA margin of 86%-88% in 2019 and 2020.
- Ratio of adjusted debt to EBITDA of 10x-11x in 2019 and 8.5x-9.5x in 2020.
- Ratio of adjusted debt to capital of 27%-29% in 2019 and 2020.

Liquidity: Adequate

The short-term credit rating on Millerful No.1 REIT is 'twA-1'. We believe the trust has adequate liquidity to meet its needs over the next 12 months, given that the trust owns substantial unencumbered assets, which can be a critical source of financial flexibility. We expect the ratio of liquidity sources to liquidity uses will be above 1.2x in 2019. We also believe the trust has the ability to cope with high-impact low-probability events without refinancing. In addition, we consider Millerful No.1 REIT has generally prudent risk management as evidenced by its stated maximum debt leverage and Taiwan's tight regulation on REITs. Moreover, we consider Millerful No.1 REIT has a solid relationship with Taiwan banks and a generally high standing in Taiwan's credit market, backed by its properties of satisfactory quality.

Principal Liquidity Sources

- Cash and short-term investments: NT$3.1 billion at the end of 2018.
- Undrawn bank lines: NT$5.7 billion.
- Cash flow from operations: NT$400 million-NT$440 million at the end of 2019.
- Substantial Unencumbered asset.

Principal Liquidity Uses

- Distribution to unit holders: NT$110 million-NT$150 million in 2019.
- Working capital outflow: NT$74 million in 2019.
- Capital expenditure: NT$5.5 billion-NT$5.7 billion in 2019.
- Acquisition: NT$2.1 billion-NT$2.3 billion in 2019.
- Distribution to unit holders: NT$110 million-NT$130 million in 2019.

Outlook

The stable outlook reflects our expectation that Millerful No.1 REIT can maintain satisfactory asset quality and diversified asset and tenant mix to support its credit quality and relatively stable operating cash flow generation over the next 24 months. The stable outlook also reflects our expectation that the trust's ratio of debt/EBITDA will remain under 11x even if the REIT acquires new properties and increases its ratio of debt to assets to close to 35%.

Downward scenario

We may lower the long-term rating on Millerful No.1 REIT if the trust's ratio of debt to EBITDA increases to above 11x for an extended period. Such deterioration could result from aggressive debt-funded property acquisitions accompanied by high tenant turnover or unexpected sluggishness in the general economy that substantially weakens the asset portfolio's performance.

We may lower the rating if the REIT's competitive position deteriorates or the volatility of its profitability far exceeds our expectation, possibly due to a higher level of competition or higher performance volatility associated with Taimall. In addition and despite the very low likelihood, we could lower the rating if the proposed acquisition of the logistics center and Union House do not materialize in contrast to our base case assumption and the trust has no intention to acquire other properties, which would lead to higher asset concentration risk.

Upward scenario

Though the likelihood is relatively low over the next one to two years, we may raise the long-term rating if Millerful No.1 REIT could reduce the volatility of its profitability and further diversify its cash flow sources, while keeping the ratio of debt/EBITDA comfortably below 11x even if leverage increases to 35% of total assets. This could happen if the trust can: 1) materially strengthen EBITDA diversification through portfolio adjustment and 2) maintain its current EBITDA margin through economic downturns and manage cost swings associated with Taimall.

Rating Score Snapshot

Issuer Credit Ratings	**twA+ /Stable/twA-1**
Note: The descriptors below are on a global scale.	
Business Risk	**Satisfactory**
Country risk	Intermediate
Industry risk	Low
Competitive position:	Satisfactory
Financial Risk	**Significant**
Cash flow/Leverage	Significant
Anchor	**twa+**
Modifiers	
Diversification/Portfolio effect:	Neutral (no impact)
Capital structure:	Neutral (no impact)
Financial policy:	Neutral (no impact)
Liquidity	Adequate (no impact)
Management and governance	Fair (no impact)
Comparable rating analysis	Neutral (no impact)
Stand-alone credit profile:	**twa+**

Related Criteria

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

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

Ratings List

Ratings Affirmed	
Millerful Number One Real Estate Investment Trust	
Issuer Credit Rating	twA+/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.