Media Release:

Taipei Financial Center Corp. Outlook Revised To Negative From Stable On Stagnant Tourism; 'twAA-/twA-1+' Ratings Affirmed

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Rating Action Overview

- **Taipei Financial Center Corp.** built and operates the Taipei 101 office building and shopping complex, which is the tallest building and one of the most popular tourist attractions in Taiwan. The company's business is divided into retail, office, and observation deck segments, with overall EBITDA of NT$4.2 billion in 2019.
- The stagnant international tourism market will slash observation deck revenue and tourist spending at 101 shopping center, where diminishing consumer confidence and waning discretionary spending increase the risk of declining sales.
- We expect Taipei Financial Center's credit metrics to deteriorate in 2020, primarily due to a likely plunge in operating cash flow generation at its observation deck and shopping center.
- On April 23, 2020, we revised our outlook on the long-term issuer credit rating on Taipei Financial Center to negative from stable. At the same time, we affirmed our 'twAA-/twA-1+' issuer credit ratings on the company.
- The negative outlook reflects the likely deterioration in Taipei Financial Center's credit metrics in 2020 and the downside risk surrounding the timing and strength of an eventual recovery.

Rating Action Rationale

Observation deck revenue to plummet under a stagnant tourist market. The number of foreign visitors to Taiwan has been close to zero over the past few weeks, due to border control measures and flight bans in place to prevent the spread of COVID-19. Considering the still-soaring number of infected cases and increased travel restrictions worldwide, we expect international travel to remain muted for at least six more months. In addition, the lifting of border controls is likely to be gradual, as governments remain wary of the pandemic reemerging. Moreover, fears over viral infection could further curb the recovery in international travel demand. Therefore, we expect only a modest recovery in international travel by the end of 2020, which underpins our projection of a 70%-80% fall in observation deck visitor numbers and revenue this year.

101 shopping center's sales turnover to plunge due to a lack of tourists and reduced local consumer spending. Even though the COVID-19 pandemic has been well contained domestically and Taiwan's government has not implemented social mobility restrictions, people have consciously reduced their frequency to shop, to limit the risk of getting infected. In addition, the pandemic is eroding overall consumer confidence, with a heavy toll on discretionary spending. We expect a sharp decline in local resident spending at the 101 shopping center, due to the store's collection of mostly top-tier global luxury and fashion brands for which consumption is highly discretionary in nature.

Furthermore, the stagnant tourism market will basically wipe out tourists' sales contribution for at least another six months. Overall, we project 101 shopping center's sales revenue to decline by 31%-35% year on year in 2020. The shopping center's high occupancy, strong tenant mix, and tenants' stable base rent partly offset the aforementioned weaknesses.

Operating cash flow is subject to greater volatility than that of its peers due to reliance on tourists and discretionary spending. We project Taipei Financial Center's EBITDA to decline by 32%-36% in 2020, as a result of the sales slump in the observation deck and shopping mall, which contributed about 36% and 38% of Taipei Financial Center's operating income, respectively, in 2019. We believe the company's office rental will not be affected by the pandemic, because office rental rates are fixed and long-term in nature. In addition, the Taipei 101 building has built up a strong tenant portfolio, consisting of high-profile global tenants and large domestic corporates that can afford an above-average rent. However, the office building's operating income represents just 26% of Taipei Financial Center's overall operating income and offers insufficient cushion against an operating decline at the company's two other businesses. We have therefore lowered our business risk profile assessment for Taipei Financial Center to satisfactory from strong due to the company's higher operating cash flow volatility compared with rated real estate investment trusts (REITs), whose EBITDA fluctuation is generally below 15%.

Recovery trajectory remains highly uncertain, especially for the tourism market. In our base case scenario, we factor in a gradual sales recovery for the shopping center from the third quarter of 2020 and that for the observation deck around the end of 2020. This assumes that the COVID-19 outbreak will be brought under control and border controls are slowly lifted. The company's EBITDA could rebound by 22%-26% in 2021, which will help to improve the ratio of debt to EBITDA to below 7.5x again. Nonetheless, we acknowledge the substantial downside risk to our base-case, residing in the evolution of COVID-19. Cash flow deterioration could go beyond our forecast and recovery could take longer to gain traction if the outbreak prolongs. This could delay the ultimate recovery in people's confidence in travel and consumption, while governments are more likely to adopt an extra-cautious and gradual approach in exiting the various containment measures under such a scenario.

Outlook

The negative outlook reflects the material adverse impact of COVID-19 on Taipei Financial Center's revenue and EBITDA generation in 2020. It also represents the downside risk of a prolonged outbreak, which could lengthen the time needed for a restoration in travelling activities and a recovery in consumer spending. We project the company's EBITDA to decline by 32%-36% year on year in 2020, due to a significant decline in ticket revenue at the observation deck and in sales turnover for the 101 shopping center. As a result, Taipei Financial Center's ratio of debt to EBITDA could deteriorate to 8x-9x in 2020.

Our base-case assumes that domestic consumer spending will recover gradually from the third quarter of 2020, and tourist activities will revive at around the end of the year. Taipei Financial Center's EBITDA could subsequently rebound by 22%-26% in 2021. However, we acknowledge substantial downside risk due to a possible prolonged outbreak. Fear of infection could result in a delayed and dampened recovery in consumer spending and travelling activities. This could in turn curb Taipei Financial Center's ability to restore its cash flow generation and to improve its ratio of debt to EBITDA to below 7.5x over the next 12 months.

Downward scenario

We may lower the long-term rating if:

- the company's deteriorated cash flow generation fails to recover over the next 12 months, therefore keeping its ratio of debt to EBITDA at above 7.5x. This could be due to a prolonged COVID-19 outbreak leading to an extended period of muted tourism and weak consumer spending. Taipei 101's significant exposure to the tourism market could hamper its capability to recover its operating performance over the next 12 months under such a scenario, particularly as we believe travel activity is unlikely to rebound earlier than the general economy due to people's fear of being infected.

Upward scenario

We may revise the outlook back to stable if:

- we see a clear recovery in consumer spending and tourist activities, such that Taipei Financial Center improves its ratio of debt to EBITDA to below 7.5x through a rebound in operating cash flow generation. This could be achieved if overseas governments effectively contain the outbreak through various health policy measures over the next 12 months, which helps to promote a swift restoration in consumer confidence and international travel.

Our Base Case Scenario

- Taiwan's GDP to contract by 1.2% in 2020 and rebound by 4.0% in 2021. We expect consumer spending to generally follow the pattern of GDP growth in 2020 and 2021.
- Office space demand in Taipei remains largely unaffected, underpinned by the increasing number of Taiwanese firms expanding their operations in Taiwan to dilute their concentrations in China. We project rental income from Taipei 101 office building to increase by 2%-3% in 2020 and 2021, reflecting elevation in rental rates and stable occupancy of about 96% over the period.
- We project Taipei 101 observation deck's revenue to decline by 70%-80% in 2020, because we do not expect tourists to return before the fourth quarter of this year. We project the company's revenue to rebound by 140%-160% in 2021 with the resumption of international travel.
- We project Taipei 101 shopping center's rental income to decline by 28%-32% in 2020, reflecting severely diminished tourist spending and a significant drop in local consumer spending. We expect the return of tourists and recovery in consumer confidence to help restore the shopping center's rental income by 13%-17% in 2021.

- Operating costs to reduce by new Taiwan dollar (NT$) 150 million-NT$200 million in 2020 for some cost saving initiatives and delay in non-essential hardware upgrades.
- Capital expenditure of NT$250 million-NT$300 million in 2020 and NT$150 million-NT$200 million in 2021.
- 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 these assumptions, we arrive at the following credit measures:

- EBITDA margin of 65%-69% in 2020, and 68%-72% in 2021, down from 73.5% in 2019.
- Ratio of debt to EBITDA of 8x-9x in 2020 and 6x-7x in 2021, compared to a stronger 5.6x in 2019.
- Ratio of Debt to Debt+Equity of 54%-58% in 2020 and 51%-55% in 2021, and more closely resembling the 54.9% in 2019.

Liquidity

The short-term rating on Taipei Financial Center is 'twA-1+'. We believe the company has adequate liquidity to cover its needs over the 12 month period ending December 31, 2020, which reflects a ratio of liquidity sources to liquidity uses of about 1.2x over the period. 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, given the company's limited short-term debt of about NT$350 million as the end of 2019. 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

- Existing cash: about NT$372 million as of the end of December 2019.
- Cash FFO: NT$2.3 billion-NT$2.7 billion in 2020.

Principal liquidity uses

- Short-term and long-term debt maturity: NT$350 million in 2020.
- Maintenance capital expenditure: NT$40 million-NT$60 million in 2020.
- Cash dividend: about NT$2 billion in 2020.

Ratings Score Snapshot

Issuer Credit Rating: twAA-/Negative/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: 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: Group Rating Methodology - July 01, 2019
- Criteria | Corporates | General: Corporate Methodology: Ratios And Adjustments - April 01, 2019
- Understanding Taiwan Ratings' Rating Definitions - 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: Country Risk Assessment Methodology And Assumptions - November 19, 2013
- 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, the above articles are published on www.taiwanratings.com)

Ratings List

Ratings Affirmed; Outlook Action

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