Media Release:

Taipei Financial Center Outlook Revised To Stable From Negative On Recovered Mall Earnings; Ratings Affirmed

March 5, 2021

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Overview

- **Taipei Financial Center Corp.'s** business is divided into retail, office, and observation deck segments, with overall EBITDA of NT$3.3 billion in the year ending September 2020.
- We believe strong domestic consumption over the next one to two years could help the retail segment to largely recover the reduced sales contribution from foreign tourists.
- Stable rental income from the office building and improving mall sales underpin the company's ability to deleverage and further improve its credit metrics.
- On March 5, 2021, we revised our outlook on the long-term issuer credit rating on Taipei Financial Center to stable from negative. At the same time, we affirmed our 'twAA-/twA-1+' issuer credit ratings on the company.

Rating Action Rationale

Strong domestic consumption and agile brand adjustment underpin recovery in 101 shopping center's rental income. A benign COVID-19 outbreak in Taiwan has limited the potential downside risk from the pandemic on domestic consumption power. Meanwhile, the propensity of local consumers to increase their budget for domestic consumption to replace their spending overseas amid travel restrictions could continue to fuel domestic consumption in 2021 and 2022. The replacement effect is particularly significant for luxury goods, given their high sales price. The 101 mall's comprehensive brand selection which has been smoothly adjusted in response to target customers' preferences, add to the shopping center's ability to recover the sales void left by foreign tourists.

In addition, the shopping center is proficient in attracting and retaining affluent Taiwanese through means such as obtaining globally limited-edition products, dedicated services, and targeted marketing campaigns that could secure future sales from high net-worth customers.

Sluggish performance of the observation deck to extend another year. The international tourism market could remain quiet for most of 2021 and the timeline for recovery is still highly uncertain. We now do not expect to see recovery in the observation deck business until at least the fourth quarter of 2021, given the number of inbound tourists is unlikely to rebound significantly before then. This is because of continuing uncertainty over the pace of widespread global vaccinations and the relaxation of quarantine requirements, which are key to the revival of international tourism.

The observation deck's weak performance will continue to constrain Taipei Financial Center's overall performance over the next two years. This segment accounted for 23% and 36% of the company's revenue and operating income, respectively, in 2019.

Resilient performance by the office building and shopping center segments continue to support the company's steady deleveraging, but full EBITDA recovery could take longer. We project Taipei Financial Center's ratio of debt to EBITDA to improve to 6.8x-7.2x in 2021 and 5.9x-6.3x in 2022, from our projection of 7.8x-8.1x in 2020 mainly reflecting declining debt. This incorporates our view that Taipei 101 office building will generate stable rental income while the shopping center could largely recover its sales to pre-COVID-19 levels over the same period. This would enable the company to generate New Taiwan dollar (NT$) 1.3 billion-NT$1.5 billion of positive discretionary cash flow annually over the next two years, in our view. We also expect the management team to maintain a steady dividend policy and a conservative financial policy, such as using excess cash to pay down debt.

EBITDA will take longer to recover fully, because the EBITDA contribution from the observation deck is unlikely to restore to pre-pandemic levels until a full restoration of international travelling activities, which could take several years. We project only a mild recovery of 4%-7% in the company's EBITDA for 2021, stemming from sales recovery at the shopping center and a modest rental increase at the office building. In our view, solid overall demand for office space in Taipei City and limited new office space in the city's high-end Xinyi district over the next one to two years, along with the office building's excellent asset quality could underpin a stable occupancy and rental income over the same period. We project further EBITDA recovery of 6%-9% in 2022, when international tourists start to return. However, the company's 2022 EBITDA generation could still be 18%-23% lower than that in 2019.

Outlook

The stable outlook reflects our view that Taiwan's strong domestic consumption could help 101 shopping center to recover its sales revenue to pre-pandemic levels over the next one to two years. Meanwhile, solid office rental demand and limited new office supply could support stable rental income for the office tower. These factors underpin our view that Taipei Financial Center will generate steady positive discretionary cash flow sufficient to lower its debt level in 2021 as well as the ratio of debt to EBITDA down to below 7.5x. This is despite our view that the company's observation deck business could remain weak due to a likely delayed and protracted recovery in international tourism.

Downward scenario

We may lower the long-term rating on Taipei Financial Center if:

- The company's cash flow generation deteriorates and halts its deleveraging progress, which could push its ratio of debt to EBITDA to above 7.5x for an extended period. This could be due to a substantial weakening in the domestic economy that reduces consumer spending and office space demand. A severe public health event that results in an extended period of weak consumer spending and muted travel activity could also lead to such deterioration; or
- The company takes shareholder friendly action such as increasing its dividend payout ratio, which results in a debt hike that leads to a ratio of debt to EBITDA of 7.5x or above.

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, possibly through more conservative cash dividend payouts, or
- Grows 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. However, the likelihood of such a massive scale expansion is low, in our view.

Our Base Case Scenario

- Office space demand in Taipei to remain solid over the next two years, underpinned by a higher GDP growth and an 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 3%-5% in 2021 and 0.1%-1.1% in 2022, reflecting modest elevation in rental rates and a largely flat occupancy rate.
- We expect consumer spending, particularly on luxury goods, to remain elevated over the next two years, mainly because residents are more likely to make these purchases domestically during the pandemic period.
- We project Taipei 101 shopping center's rental income to recover by 4%-7% in 2021 from the trough in 2020. We expect an increase in domestic consumer spending to largely offset the diminished sales contribution from foreign tourists. We project further income growth of 1%-4% in 2022, reflecting the return of foreign visitors.
- Taipei 101 observation deck's revenue could further decline by 2%-6% in 2021, following a decline of about 80% in 2020. This is based on our assumption that international tourism could remain muted for the year. We expect a robust rebound in tourism activity in 2022, which could double the business's revenue compared with 2021's trough.
- Gross margin and operating expenses for 2021 and 2022 to remain similar to 2020.
- Capital expenditure of NT$135 million-NT$155 million in 2021 and NT$110 million-NT$130 million in 2022.
- 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 67%-70% in 2021 and 2022.
- Ratio of debt to EBITDA of 6.8x-7.2x in 2021 and 5.9x-6.3x in 2022.
- Ratio of debt to Debt+Equity of 52%-55% in 2021 and 50%-53% in 2022.

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 June 30, 2021, which reflects a ratio of liquidity sources to liquidity uses of about 1.3x over the period. We also believe the company will have positive liquidity sources less uses, even if EBITDA declined by 10%.

We 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$616 million as of the end of June 2020.
- Cash funds from operations: NT$2.6 billion-NT$2.8 billion for the 12 months ending June 2021.
- Undrawn bank lines (maturing beyond June 2021): NT$1.2 billion-NT$1.4 billion.

Principal liquidity uses

- Short-term and long-term debt maturity: NT$3.3 billion for the 12 months ending June 2021.
- Maintenance capital expenditure: NT$100 million-NT$150 million for the 12 months ending June 2021.
- Working capital outflow: NT$80 million-NT$120 million for the 12 months ending June 2021.

Ratings Score Snapshot

Issuer Credit Rating: twAA-/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: 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 & Research

Related Criteria

- General Criteria: Group Rating Methodology - July 01, 2019
- Criteria | Corporates | General: Corporate Methodology: Ratios And Adjustments - April 01, 2019
- 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: Principles Of Credit Ratings - February 16, 2011

Related Research

- Taiwan Ratings' Ratings Definitions – August 10, 2020

(Unless otherwise stated, these articles are published on www.taiwanratings.com)

Ratings List

Ratings Affirmed; Outlook Action

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