Media Release:

Ratings On Cathay No. 1 REIT Raised To 'twA/twA-1' On Improving Revenue Diversification; Outlook Stable

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Rating Action Overview

- **Cathay Number One Real Estate Investment Trust** (Cathay No.1 REIT) owns three properties include Sheraton Taipei Hotel Building, Taipei Ximen Building, and Taipei Chunghwa Building. The reconstruction of Taipei Chunghwa Building has ended and the new building's hotel segment began operations in August 2023.
- We view the addition of the new hotel operator has improved the trust's revenue diversification, given hotel tenant of Taipei Chunghwa Building has a long-term lease contract with fixed base rent that will represent a substantial portion of the building's rental income. We project the annual rental income from the building will contribute 20%-22% of the REIT's total revenue in 2024-2025, which lowers the relative contribution from Sheraton Hotel to 65%-70% of the trust's total revenue from over 80% previously.
- Accordingly, we have raised our long-term and short-term issuer credit ratings on Cathay No.1 REIT to 'twA/twA-1' from 'twA-/twA-2'.
- The rating outlook is stable to reflect our view that the trust's satisfactory asset quality and the long-term fixed base rent of key tenants can support stable profitability for the trust while helping keep the ratio of debt to EBITDA below 9.5x over the next one to two years.

Rating Action Rationale

Fixed rental income from Taipei Chunghwa Building will help improve the trust's revenue concentration. Prior to the reopening of Taipei Chunghwa Building, the REIT had very high reliance on the rental income from Sheraton Hotel, which represented 88% of the trust's rental income in the first six months of 2023. Taipei Chunghwa Building has a large hotel tenant that began operations in August 2023, occupying floors 6 to 28. The first four floors of the new building will be retail spaces. We project the annual rental income from the new building could contribute 20%-22% of the REIT's total revenue in 2024-2025 and in turn lower the revenue contribution from Sheraton Hotel to 65%-70% over the next two years.

Strong recovery in international tourism and robust domestic demand underpin the tenants' performance. International tourism has recovered strongly since the reopening of Taiwan's border in October 2022. This has underpinned strong growth in the sales revenue of tourist hotels in Taipei. Furthermore, we believe the different customer segmentation of the REIT's hotels will also support the satisfactory performance of its hotel tenants. At the same time, robust domestic consumption has boosted sales in the retail sector including food services. We believe food and beverage services will continue to represent over 60% of Sheraton's total sales revenue in 2024-2025.

Satisfactory asset quality and long-term fixed base rent will support the trust's stable profitability and credit metrics. The good condition of the new building and the favorable location of the REIT's properties should also support the tenants' rental affordability. Most of the REIT's properties, including Taipei Chunghwa Building, are in Taipei's Ximen district, which remains the favored location for foreign tourists. In addition, the trust's key tenants all carry long-term fixed base rental agreements, which provide a solid foundation for the trust's stable profitability. Accordingly, we see the trust maintaining its ratio of debt to EBITDA at 4.2x in 2023 and 3.6x in 2024.

Outlook

The stable rating outlook reflects our view that the trust's satisfactory asset quality and the long-term fixed base rent of the trust's key tenants can support stable profitability over the next one to two years. The outlook also reflects our view that the trust will maintain a ratio of debt to EBITDA below 9.5x over the same period.

Downward scenario

We could lower the rating on Cathay No.1 if the REIT's debt-to-EBITDA ratio increases to more than 9.5x for an extended period, possibly due to:

- Aggressive debt-financed property acquisitions where the new properties are unable to significantly strengthen the trust's diversification in asset type or the asset quality of the new properties is below that of the trust's current properties; or
- Tenants' weakened performance or key tenant turnover leads to material rental income disruption, possibly due to a prolonged recovery in Taipei's tourism market.

Upward scenario

We could raise the rating if:

- The trust materially enhances its diversification in asset type while maintaining its satisfactory asset quality through debt-funded acquisition; and
- At the same time, maintains the ratio of debt to EBITDA below 9.5x.

Our Base-Case Scenario

- Taiwan real GDP growth of 1.2% in 2023 and 3.0% in 2024.
- Cathay No.1 REIT's rental income to grow by 10%-11% in 2023, reflecting the opening of a new hotel in Taipei Chunghwa Building in H2 2023. Revenue to grow by 16%-17% in 2024, once the trust receives full-year rental income from Taipei Chunghwa Building and schedules the increase in Sheraton Hotel's high base-rent.
- Variable rent collected from the operating revenue of Sheraton to increase by 45%-55% in 2023, underpinned by strong domestic demand and the return of foreign tourists. We expect the variable rent in 2024-2025 to restore to close to the level in 2019, albeit still-lower than the annual base-rent.
- Rental income from Taipei Ximen Building to increase by 4%-5% in 2023 following a scheduled rental adjustment. No variable rent collected in 2023 based on the building's sales revenue in 2022. For 2023-2025, we anticipate sales revenue for the building will gradually restore to 85%-95% of the level in 2019 and reach the variable-rent threshold, supported by strong recovery of international tourism.

- The trust has collected fixed base rent from the hotel segment in Taipei Chunghwa Building since August 2023. Rental income from the building could grow by 160%-170% in 2024 and 10%-12% in 2025 with full-year rental collection and a further improved vacancy rate for retail floors. We expect the building's retail spaces to become fully occupied by the end of 2024.
- Operating costs in 2023 to increase by 25%-26% annually, considering the house tax, land value tax, and related operating expenses incurred for Taipei Chunghwa Building. It also reflects the increased trustee fee and management fee due to asset value appreciation and elevated maintenance reserve ratio. In 2024-2025, annual operating cost will increase by 12%-13% and 8%-10%, respectively, mainly reflecting the increased tax burden and increased maintenance expense due to the trust's expanded revenue base.
- New Taiwan dollar (NT$) 60 million-NT$70 million of maintenance spending for Sheraton Hotel in 2023. We project there will be NT$70 million-NT$75 million of working capital outflow annually in relation to the maintenance projects of Sheraton Hotel over the next one to two years.
- Total costs associated with the reconstruction of Chunghwa Building are NT$500 million-NT$550 million in 2023. We expect the trust to refinance its maturing borrowings related to urban renewal within the next 6 months.
- We assume a 2.1%-2.3% interest rate on bank borrowings.
- We do not factor in potential asset acquisitions in our base case for 2024-2025.

Cathay Number One Real Estate Investment Trust--Forecast summary

(Mil. NT$)	2021a	2022a	2023e	2024f	2025f
Revenue	678.5	740.4	815.5	950.1	980.9
EBITDA (reported)	515.9	563.5	592.8	699.9	706.9
EBITDA	515.9	563.5	592.8	699.9	706.9
Less: Cash interest paid	(13.3)	(20.4)	(50.6)	(56.6)	(57.9)
Funds from operations (FFO)	502.5	543.1	542.2	643.3	648.9
Cash flow from operations (CFO)	328.8	455.1	54.4	569.8	575.4
Capital expenditure (capex)	(12.7)	(17.1)	--	--	--
Free operating cash flow (FOCF)	341.6	472.1	54.4	569.8	575.4
Debt (reported)	1,106.3	2,076.7	2,577.2	2,551.8	2,621.9
Less: Accessible cash and liquid Investments	(123.4)	(76.5)	(66.0)	(66.0)	(66.0)
Debt	982.9	2,000.2	2,511.2	2,485.8	2,555.9
Cash and short-term investments (reported)	143.4	99.6	100.0	100.0	100.0
Adjusted ratios					
Debt/EBITDA (x)	1.9	3.6	4.2	3.6	3.6
Debt/debt and equity (%)	3.6	6.7	8.3	8.2	8.4
Annual revenue growth (%)	8.8	9.1	10.1	16.5	3.2
EBITDA margin (%)	76.0	76.1	72.7	73.7	72.1

All figures are adjusted by Taiwan Ratings Corp., unless stated as reported. a--Actual. e--Estimate. f--Forecast.

Liquidity

The short-term corporate credit rating is 'twA-1', given the long-term issuer credit rating and our assessment of Cathay No.1 REIT's liquidity as adequate. The trust faces refinancing of its long-term debt that matures in June 2024. We assess the refinancing risk for this to be very low considering the trust's unpledged property, which includes high value properties that also generate a stable cash flow.

We estimate the trust's ratio of liquidity sources to liquidity uses will be 1.24x over the next year, and we believe that liquidity sources will continue to exceed uses even if the trust's EBITDA were to decline by 10%. We assess the trust has generally prudent risk management, supported by its 25% maximum debt to asset ratio. The trust's relationship with Taiwan banks is solid, in our view, underpinned by the REIT's unpledged high-quality assets, which can provide additional financial flexibility for funding if needed. Moreover, the trust has no financial covenants on its debt.

Principal liquidity sources

- Cash and short-term investments of NT$329 million as of Sept. 30, 2023.
- FFO of NT$600 million-NT$650 million for the 12 months ending Sept. 30, 2024.
- Undrawn bank lines of NT$3.0 billion-NT$3.5 billion available for the 12 months ending Sept. 30, 2024.

Principal liquidity uses

- Debt maturities of NT$2.6 billion for the 12 months ending Sept. 30, 2024.
- Cash dividend of NT$500 million-NT$600 million for the 12 months ending Sept. 30, 2024.
- Working capital outflow of NT$50 million-NT$70 million for the 12 months ending Sept. 30, 2024.

Ratings Score Snapshot

Issuer Credit Rating: twA/Stable/twA-1

Note: The descriptors below are on a global scale.

Business risk: Fair

- Country risk: Intermediate
- Industry risk: Low
- Competitive position: Fair

Financial risk: Modest

- Cash flow/Leverage: Modest

Anchor: twa+

Modifiers

- Diversification/portfolio effect: Neutral (no impact)
- Capital structure: Neutral (no impact)
- Financial policy: Negative (-1 notch)
- Liquidity: Adequate (no impact)
- Management and governance: Satisfactory (no impact)
- Comparable rating analysis: Neutral (no impact)

Stand-alone credit profile: twa

Related Criteria & Research

Related Criteria

- General Criteria: National And Regional Scale Credit Ratings Methodology - June 08, 2023
- General Criteria: Environmental, Social, And Governance Principles In Credit Ratings - October 10, 2021
- 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 – Nov. 11, 2021

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

Ratings List

Upgraded

	To	From
Cathay Number One Real Estate Investment Trust		
Issuer Credit Rating	twA/Stable/twA-1	twA-/Stable/twA-2

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.