Media Release

Yulon Motor Co. Ltd. Affirmed At 'twA-/twA-2' On Conservative Business Development Plan; Outlook Stable

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Rating Action Overview

- Yulon Motor is likely to maintain its debt-to-EBITDA ratio at 2x-3x over the next two years through its more conservative strategy on new model development for Luxgen cars and the expected material scaling down of the company's real estate development project in New Taipei City.
- Yulon Motor's EBITDA will remain largely unchanged based on our expectation of moderate recovery in sales of Nissan-branded cars in Taiwan as well as the still relatively strong sales of Nissan branded cars in China.
- On Sept. 25, 2019, Taiwan Ratings affirmed its 'twA-' long-term and 'twA-2' short-term issuer credit ratings on Yulon Motors.
- The outlook on the long-term rating is stable to reflect our view of the company's conservative business development plan over the coming two years.

Rating Action Rationale

The rating affirmation reflects our view that **Yulon Motor Co. Ltd.'s** heightened financial risk associated with its Luxgen branded vehicles could substantially decline over the coming one to two years under the company's more conservative strategy to downplay the Luxgen brand, especially in the Chinese market. We therefore expect Yulon Motor to substantially lower its exposure in Luxgen in order to narrow its operating loss and related cash outflow on this brand. It aims to achieve this reduction by slowing down the development of new models, preventing additional large investment, and via additional cost reduction plans.

We also expect to see a reduction in the financial risk related to the company's real estate development in New Taipei City's Xindian district, given the group looks set to take a more conservative approach to this project amid the growing likelihood of a property oversupply in that area. We previously forecast Yulon Motor would experience a high cash outflow for the construction and related development spending during 2019-2023, due to the project's relatively large scale including residential and commercial buildings.

Meanwhile, sales of Nissan branded cars in Taiwan could recover moderately over 2019-2020 in our view, following the launch of new domestic models, such as KICKs and the remodeling of the Sentra. Furthermore, we expect relatively strong demand and the good market position of Nissan vehicles in China to continue to support the brand's sales volume over the next two years. We view Nissan's stillrobust performance in China as the key factor behind joint-venture Yulon Nissan's capability to provide a stable and sizeable cash dividend to Yulon, despite the currently weak auto market in China.

These factors underpin our expectation that Yulon Motor's EBITDA generation could sustain at above New Taiwan dollar (NT$5) billion in 2019-2020. In the meantime, we expect the company's cash outflow could narrow materially and help Yulon Motor to maintain its ratio of debt to EBITDA at 2x-3x over the period. Meanwhile, the satisfactory market position of Nissan branded cars in China, along with Yulon Motor's generally stable auto manufacturing business in Taiwan, and good financial flexibility with large investment properties on hand should continue to support the company's stand-alone credit profile.

The ratings on Yulon Motor are also supported by the strong business position of Yulon's financing arm, **Yulon Finance Corp.,** in Taiwan's auto finance and leasing industry as well as its strong capitalization and prudent capital management. Yulon Finance's solid market position and lower financial risk partly offset Yulon Motor's higher business and financial risks.

Our base-case scenario for Yulon Motor assumes the following:
Industry:

- We expect domestic auto sales to slightly decline to around 420,000 units in 2019, with slight recovery in 2020. Weak domestic demand will be partly offset by still-relatively strong growth in sales of import cars.
- Unit passenger cars sales in China to decline by 10% in 2019 and remain flat in 2020, as the result of China's weakening economy and consumer confidence.

Yulon Motor's company specific assumption:

- Revenue to decline by 10%-15% in 2019 and recover by a low single digit in 2020 with a mild rebound in sales in 2020. This is to reflect sluggish Luxgen sales and a decline in Nissan car sales in Taiwan in 2019. The rebound in sales in 2020 reflects sales recovery following the introduction of new models, particularly by Nissan.
- Working capital outflow to ease significantly, at about NT$5 billion in 2019 and down to NT$2 billion in 2020.
- We expect Yulon Motor's capital expenditures plus additions to long-term investment to decline over the next few years under the company's conservative business and new model development strategy. We assume capital expenditure of NT$3.5 billion-NT$4 billion in 2019 and NT$2.5 billion-NT$3 billion in 2020.
- Cash dividend payout of NT$1 billion-NT$ 1.1 billion per year in 2019-2020.

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

- EBITDA margin at 9%-10% in 2019-2020.
- Ratio of debt to EBITDA at 2x-3x in 2019-2020.

Liquidity

The short-term issuer credit rating is 'twA-2'. We believe Yulon Motor has adequate liquidity to meet its needs over the next 12 months. Our view of the company's liquidity profile incorporates our assessment that the ratio of liquidity sources to liquidity uses will be 1.2x-1.3x over the next 12 months and that liquidity sources will continue to exceed uses even if Yulon Motor's EBTIDA were to decline by 15%. The liquidity assessment also reflects our view that the company has generally prudent risk management, and a satisfactory standing in credit markets, evidenced by the issuance of a NT$5.3 billion bond at a low interest rate in late 2018. Yulon Motor's debt does not carry any covenants.

Principle Liquidity Sources:

- Cash and short-term investments: NT$34.6 billion at the end of June 2019.
- Cash flow from operations: about NT$3.5 billion in the 12 months ending June 2020.

Principle Liquidity Uses

- Debt maturity: NT$23 billion-NT$24 billion in the 12 months ending June 2020.
- Working capital outflow: NT$3 billion-NT$4 billion in the 12 months ending June 2020.

- Committed and maintenance capital expenditure: NT$2 billion-NT$2.5 billion in the 12 months ending June 2020.

Outlook

The stable outlook reflects the following expectations:

- the sales of Nissan-branded cars in Taiwan could recover moderately after the launch of new domestically made cars, leading to a mild recovery in Yulon Motor's EBITDA;
- still relatively strong sales of Nissan-branded cars in China will continue to underpin Yulon Nissan's capability to contribute a significant and stable cash dividend to Yulon Motor; and
- Yulon Motor's more conservative plan on the development of new Luxgen models, expected significantly scaled-down real estate development project in Taiwan, and other cost-saving plans could help the company to sustain its debt to EBITDA at 2x-3x over next two years.

In addition, the stable outlook reflects our view that Yulon Finance's growing contribution to the Yulon group, strong capitalization, and prudent capital management will partly offset Yulon Motor's higher financial risk associated with the Luxgen brand.

Downward scenario

We may lower the long-term rating on Yulon Motor if the company's ratio of debt to EBITDA exceeds 4x on a sustainable basis. The possible scenarios for this include higher losses on its Luxgen business that we currently expect, large cash outflows to support Luxgen's development, no change in the original property development plan that raises Yulon Motor's cash outflow significantly, or any large cash outflow associated with the rapidly declining scale of Luxgen brand's operations in Taiwan and China.

Upward scenario

The likelihood to raise the rating is lower over the next year, because of the challenges we believe Yulon Motor faces to sustain its profitability while at the same time lower its debt leverage through its loss cutting and business restructuring plan for the Luxgen brand. However, we may raise the rating on Yulon Motor if the company's ratio of debt to EBITDA consistently improves to below 2x. We may also raise the rating if Yulon Finance's capitalization improves substantially.

Rating Score Snapshot

Issuer Credit Rating: twA-/Stable/twA-2
Note: All scores are in comparison with global obligors and are based on Yulon Motor after deconsolidating Yulon Finance.

Business risk: Weak
- Country risk: Moderately high
- Industry risk: Moderately high
- Competitive position: Weak

Financial risk: Significant
- Cash flow/Leverage: Significant

Anchor: twbbb-

Modifiers
- Diversification/Portfolio effect: Neutral (no impact)
- Capital structure: Positive (+1 notch)
- Liquidity: Adequate (no impact)
- Financial policy: Neutral (no impact)
- Management and governance: Fair (no impact)

- Comparable rating analysis: Neutral (no impact)

Stand-alone credit profile: twbbb

- Group credit profile: twa-
- Entity status within group: Ultimate parent

Related Criteria

- General Criteria: Group Rating Methodology - July 01, 2019
- 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 | Industrials: Key Credit Factors For The Auto And Commercial Vehicle Manufacturing Industry - November 19, 2013
- Criteria | Financial Institutions | General: Nonbank Financial Institutions Rating Methodology - December 09, 2014
- Criteria | Corporates | General: Corporate Methodology: Ratios And Adjustments - April 01, 2019
- Criteria | Corporates | General: Corporate Methodology - November 19, 2013
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities - November 13, 2012
- Understanding Taiwan Ratings' Rating Definitions, www.taiwanratings.com - June 26, 2018
- General Criteria: Country Risk Assessment Methodology And Assumptions - November 19, 2013
- 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

Yulon Motor Co. Ltd.	
Issuer Credit Ratings	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.