Media Release:

Far Eastern New Century Corp. And Yuan Ding Investment Corp. Downgraded To 'twA' On Surging Capital Expenditure; Outlook Stable

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Rating Action Overview

- We expect the surging price of fifth generation (5G) spectrum licenses to result in a significant increase in FENC's financial leverage and heighten its financial risk.
- The necessary investment by FENC's telecommunication subsidiary, Far EasTone, in 5G-related infrastructure and our expectation that the companies are likely to maintain their dividend policies largely unchanged, as well as FENC's capacity expansion plans in the U.S. could push up FENC's debt over the next two years.
- On Jan. 21, 2020, Taiwan Ratings Corp. lowered its long-term issuer credit rating on FENC and its investment holding company, **Yuan Ding Investment Corp.** to 'twA' from 'twA+'. At the same time, we affirmed the short-term ratings on the companies at 'twA-1'.
- The stable outlook incorporates our view that Far EasTone's stable operating cash flow will help to contain the increase in FENC's debt and help the parent to cap the rise in its debt to EBITDA ratio at 5.3x-5.7x over the next two years.

Rating Action Rationale

Expensive 5G license fee will lead to a substantial increase in FENC's debt. Taiwan's overheated 5G spectrum auction has resulted in much higher pricing than we previously anticipated. We now estimate **Far Eastern New Century Corp.'s** (FENC's) telecom subsidiary, **Far EasTone Telecommunications Co. Ltd.**, will spend at least New Taiwan dollar (NT$) 41 billion for a 5G spectrum license in 2020. This compares with our previous assumption of NT$15 billion-NT$20 billion. Accordingly, we project FENC's debt to rise to NT$245 billion-NT$250 billion by the end of 2020, up from NT$196 billion as of September 2019.

FENC's debt is likely to remain elevated over the next two years. We believe FENC's debt will remain high for the next two to three years, given FENC's and Far EasTone's high capex needs and our expectation that the companies are likely to maintain their dividend policies largely unchanged. This is demonstrated by FENC’s intention to expand its capacity in purified terephthalic acid (PTA) and polyethylene terephthalate (PET) production in the United States, through its participation in a joint venture in Corpus Christi. The company also plans to expand its capacity in recycled-PET in Japan. We expect the funding needs of these projects will keep FENC's capital expenditure elevated through 2021.

Meanwhile, Far EasTone is likely to begin investment in its 5G network infrastructure in preparation for the launch of 5G services later in 2020. We estimate the operator's capital spending excluding spectrum license fee to increase to NT$9 billion-NT$12 billion in 2020 and 2021, up from about NT$8 billion in 2019. In addition, we expect FENC and Far EasTone to retain a dividend policy that largely resembles that in previous years. These factors will diminish FENC's debt reduction capability over the next two years, despite the company's growing operating cash flow from its PET business, in addition to the sizeable and stable operating cash flow from its telecom business. We expect FENC's ratio of debt to EBITDA to rise to 5.3x-5.7x in 2020 and 2021, up from about 4.5x in 2019.

Outlook

The stable rating outlook reflects our view that rising cash flow generation from FENC's polyester business, stable cash flow generation from its telecom business, and cautious approach in 5G roll out will help to cap the rise in its adjusted ratio of debt to EBITDA at 5.3x-5.7x over the next two years. This factors in a potential NT$40 billion-NT$50 billion cash outflow by Far EasTone to secure a 5G bandwidth license in 2020.

Downward scenario

We may lower the long-term issuer credit rating on FENC if the company's profitability deteriorates substantially or its capital expenditure significantly exceeds our expectations, such that its adjusted ratio of debt to EBITDA rises above 6x for an extended period. Such a rise could result from industry downturns or higher capital expenditure on the company's major businesses than we earlier predicted. Higher capital spending could include cash outflows for merger and acquisitions and 5G-related investments, such as on spectrum bandwidth and network infrastructure.

Upward scenario

We may raise the long-term rating on FENC if the company improves its ratio of debt to EBTIDA to close to 4.5x on a sustainable basis. Sustainable and material improvement in FENC's profitability and cash flow in its chemical business, as well as prudent capital expenditure and dividend payouts or debt reduction through asset disposals could support such a scenario. It could also occur if FENC substantially enhances the competitive position of its PTA, polyester, and textile businesses by increasing its product diversity and exposure to high-end products without impairing its debt leverage.

Our Base-Case Scenario

We project FENC's revenue and EBITDA to remain largely flat in 2020 and to grow 4%-6% in 2021. The growth in 2021 reflects the contribution from FENC's expansion in petrochemical and polyester businesses in the U.S. Far EasTone's launch of 5G services could also support modest revenue and EBITDA growth. Our base case assumptions for FENC include:

- Taiwan's real GDP to grow 2.4% in 2020 and 2.2% in 2021. China's real GDP to grow 5.7% in 2020 and 5.6% in 2021. U.S. GDP to grow 1.9% in 2020 and 1.8% in 2021. Asia Pacific's real GDP to grow 4.7% in 2020 and 4.9% in 2021.
- S&P Global's Brent crude oil price assumption of US$60 per barrel in 2020 and US$55 per barrel in 2021, which suggests commodity chemical prices will remain largely stable compared with levels in 2019. However, product spreads may vary considerably across different production chains.
- Momentum in the domestic telecom industry to be weaker than Taiwan's GDP growth. We project a flat revenue for 2020 and a moderate growth of 1%-3% in 2021, reflecting incremental revenue contributed by new 5G services.
- Output for polyester will increase by 5%-10% annually in 2020 and 2021. Output for PTA will remain stable in 2020 and increase by 12%-17% in 2021. This growth reflects new capacities in PET and PTA in the U.S.
- PTA's cash spread is likely to contract again in 2020 and 2021, due to sizeable new capacity launches in China over the period. This would lead to a contraction in FENC's EBITDA margin from its PTA business.
- The EBITDA margin on FENC's polyester business to strengthen moderately in 2020 and 2021, underpinned by new output from expanded U.S. capacity and growing recycled PET production. The product margin on these products tends to be higher and more stable compared to the rest of the company's polyester products.
- The EBITDA margin on FENC's textile business to recover further in 2020 and 2021 as efficiency at its newly established capacity in Vietnam picks up through training and operational adjustments.
- Stiff competition could continue to pressure Far EasTone's revenue in 2020 and 2021. However, we believe the telecom operator's average revenue per user could receive some uplift through the commercial roll out of new 5G services. We also believe FET will remain disciplined on its handset subsidies; however, the company's sales expense could increase noticeably to promote 5G adoption during the initial launch period.
- Cash dividend received from equity-method investment to remain at an elevated level of NT$3.8 billion-NT$4.3 billion in 2020 and 2021.
- Capital expenditure to increase significantly in 2020 to NT$65 billion-NT$70 billion, due to high spending on the 5G spectrum auction. We project capital spending to remain elevated at NT$26 billion-NT$28 billion in 2021 to support further investment in 5G network infrastructure and capacity expansion in FENC's petrochemical business.
- Working capital outflow of NT$2.5 billion-NT$3.0 billion in 2020 and NT$1.0 billion-NT$1.5 billion in 2021 to support business operation and property construction.
- Cash dividend of NT$5 billion-NT$7 billion in 2020 and 2021.

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

- EBITDA margin of 17%-18% in 2020 and 2021.
- Ratio of debt to EBITDA of 5.3x-5.7x in 2020 and 2021.
- Ratio of funds from operations (FFO) to cash interest coverage of 10x-12x in 2020 and 2021.

Liquidity

The short-term rating on FENC is 'twA-1'. We believe the company has adequate liquidity, which reflects a ratio of liquidity sources to liquidity uses of 1.2x-1.3x over the next 12 months. We also believe the company will have positive liquidity sources minus uses, even if its EBITDA declined by 15%.

In our assessment, FENC can absorb high-impact, low-probability events with limited need for refinancing, given its high cash balance and stable cash flow generation from its telecom business. 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 FENC has a high standing in the credit markets, which is demonstrated by a recent 5-year NT$6 billion corporate bond issuance at a low rate.

FENC has generally prudent risk management to ensure continued adequate liquidity, in our view. The company's sufficient undrawn bank credit lines and flexibility to increase bank facilities support this view. We also believe FENC has sufficient headroom without breaching covenant limits due to low interest rates in Taiwan, even if the company's EBITDA were to drop by 15%.

Principal liquidity sources:

- Cash and short-term investments: about NT$22.7 billion as of the end of September 2019.
- FFO: NT$33 billion-NT$36 billion over the 12 months ending September 2020.
- Undrawn mid-to-long term bank lines maturing beyond September 2020: NT$50 billion-NT$55 billion as of the end of September 2019.
- FET's corporate bond issuance: NT$3.1 billion in December 2019.

Principal liquidity uses:

- Debt maturity of NT$69.5 billion over the 12 months ending September 2020.
- Working capital outflow: NT$1.5 billion-NT$2.0 billion over the 12 months ending September 2020.
- Maintenance capital expenditure: about NT$10 billion over the 12 months ending September 2020.
- Minimum cash dividend: about NT$12 billion over the 12 months ending September 2020.

Related Criteria & Research

Related Criteria

- General Criteria: Group Rating Methodology, Jul 01 2019
- Criteria | Corporates | General: Corporate Methodology: Ratios And Adjustments, Apr 01 2019
- Understanding Taiwan Ratings' Rating Definitions, www.taiwanratings.com, Jun 26 2018
- Criteria | Corporates | General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec 16 2014
- Criteria | Corporates | Industrials: Key Credit Factors For The Telecommunications And Cable Industry, Jun 22 2014
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov 19 2013
- General Criteria: Methodology: Industry Risk, Nov 19 2013
- Criteria | Corporates | General: Corporate Methodology, Nov 19 2013

- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities, Nov 13 2012
- General Criteria: Use Of CreditWatch And Outlooks, Sep 14 2009

Related Research

- FarEasTone Telecommunications Co. Ltd. Downgraded To 'twA+/twA-1' On Surging Capital Expenditure; Outlook Stable, Jan. 21, 2020

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

Ratings List

Downgraded

	To	From
Far Eastern New Century Corp.		
Issuer Credit Rating	twA/Stable/twA-1	twA+/Stable/twA-1
Yuan Ding Investment Corp.		
Issuer Credit Rating	twA/Stable/twA-1	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.