Media Release:

Yulon Motor Co. Ltd. Downgraded To 'twBBB+/twA-2' On Uncertain Timeframe To Recover Financial Strength; Outlook Stable

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Credit Rating Overview

- Yulon's profitability could remain weak, due to Luxgen and Haitec's ongoing business restructuring and the likelihood of a weaker dividend payout from Yulon Nissan over the next one to two years.
- In addition, Yulon's debt leverage has been nearly doubled after its consolidation of Haitec, and the prospects of a significant improvement over the next one to two years are limited. We expect Yulon's debt to EBITDA ratio to stay above 4x over the same period.
- On April. 9, 2020, Taiwan Ratings Corp. lowered its long-term issuer credit rating on Yulon to 'twBBB+' from 'twA-' and affirmed the short-term rating at 'twA-2'.
- The stable outlook reflects our view that Yulon could improve its debt to EBITDA ratio to close to 4x over the next one to two years, through significantly lowering losses at its Luxgen business in China and Taiwan, as well as planned asset disposals. In addition, we do not expect Yulon to incur any material asset impairment over the same period.

Credit Rating Rationale

Weak profitability because operating losses could remain high due to business restructuring for Luxgen and Haitec in 2020.

We expect **Yulon Motor Co. Ltd.'s** operating loss to remain high in 2020 due to expenses associated with the downsizing of the firm's Huachung Automobile Information Technical Center Co. Ltd. (Haitec). However, such operating losses in 2020 are likely to be materially lower than in 2019, when Yulon recorded a large asset impairment and consolidation of Haitec's losses, after Yulon signed a joint venture contract with Hon Hai Precision Industry Co. Ltd. We expect Haitec's operating losses to narrow materially after 2020 because the company will transform into an investment holding company, with the only asset being the joint venture with Hon Hai. Furthermore, losses on Yulon's Luxgen business loss is also likely to narrow going forward, because the company will only pay royalties for new models to the joint venture, rather than sharing development costs with Haitec, as it did previously.

Planned asset sales could help Yulon to lower its debt leverage that has nearly doubled.

The consolidation of Haitec has not only negatively affected Yulon's income statement but also its balance sheet, given the subsidiary's large amount of gross debt and minimal cash on

hand. As a result, Yulon's adjusted debt increased to New Taiwan dollar (NT$) 23 billion at the end of 2019, up from NT$13 billion at the end of the third quarter of 2019. However, Yulon's plan to sell some of its financial assets and industrial land parcels could help the company to moderately lower its debt leverage over next one to two years. However, the timeline remains uncertain, particularly for selling the less liquid land assets amid the currently weak domestic economy.

Weak Chinese auto demand could stifle Yulon's efforts to improve its EBITDA in 2021.

Yulon's EBITDA relies heavily on a cash dividend payout from Yulon Nissan Motors Co. Ltd., whose performance in turn largely depends on the investment profit from Nissan branded operations in China. Yulon Motor's EBITDA could remain weak in 2021, if sales of Nissan branded cars in China weaken in 2020, due to the weaker local economy or the shortage of key materials. This is despite Dongfeng Motor Corp. has resumed sale of Nissan-branded vehicles in China in mid-February, and the spread of COVID-19 in China now seems under control. In addition, Yulon Nissan has increased its holdings in Guangzhou Fengshen Motor Co. Ltd. from 40% to 42.7%, which could be a positive factor for Yulon Nissan's future dividend contribution to Yulon Motor. Guangzhou Fengshen is a joint venture between Yulon Nissan and Dongfeng Motor to manufacture Nissan-branded cars in China.

Our base case assumes Yulon will improve its debt to EBITDA ratio to close to 4x in 2021.

We expect Yulon's annual EBITDA to recover to NT$4 billion-NT$5 billion after the business restructuring efforts are completed in 2020, and we expect Yulon to lower its debt level by NT$7 billion-NT$8 billion mainly through the execution of its planned asset sales over the next one to two years. We do not expect Yulon to incur large losses going forward, especially related to its Luxgen business. Nor do we expect any large cash outflow or additional debt associated with Yulon's property development in New Taipei City's Xindian district over the new few years. As a result, we believe Yulon's debt to EBITDA ratio will improve to close to 4x under our base-case.

A lower group credit profile for the Yulon Motor group follows our lower assessment of Yulon's SACP.

We have lowered our assessment on Yulon's stand-alone credit profile (SACP) due to the company's weaker financial ratios. As the result, we have also lowered the group credit profile (GCP) of the Yulon Motor group to 'twbbb+' from 'twa-'.

Our Base-Case Scenario

- S&P Global Ratings' real GDP growth assumptions for Taiwan are 0.8% in 2020 and 3.7% for 2021; while for China real GDP growth is forecast at 2.9% in 2020 and 8.4% in 2021. An enormous first-quarter shock in China and shutdowns across the U.S. and Europe guarantee a recession across the Asia-Pacific, in our view.
- COVID-19 will likely lead to very weak car sales in 2020/2021. S&P Global Ratings estimates auto sales in China to decline by 8%-10% in 2020 but recover by 2%-4% in 2021. The impact in Taiwan will be moderately lower. In addition, stronger demand for imported cars could partly offset a likely weak auto market in Taiwan.
- Yulon's revenue to decline by 3%-5% in 2020 and recover by 5% in 2021. This is to reflect sluggish Luxgen sales and the likely negative impact from COVID-19, given Taiwan's

weaker economy and consumer confidence. However, we expect some recovery in 2021, largely driven by new Nissan models.

- Yulon's EBITDA margin will improve in 2020 and 2021, from its very weak condition in 2019, mostly due to asset impairment and the consolidation of Haitec.
  - However, the EBITDA margin in 2020 will remain weak at 2%-4%, due to the ongoing business restructuring of Haitec.
  - We also expect losses on the Luxgen brand to narrow as Yulon changes it business model with much less burden from new model development costs.
  - Nissan sales in China will continue to support Yulon's dividend income and adjusted EBITDA over the next two years. This is despite COVID-19 could lower sales of Nissan branded cars in China in 2020, and subsequently lower Yulon Nissan's dividend payout to Yulon Motor in 2021. We assume the dividend payout in 2021 to be NT$1.8 billion-NT$1.9 billion, compared with NT$2.8 billion in 2020.
- Yulon will scale down its land development project in Xindian over the next few year and ease its working capital needs. We assume about NT$1.5 billion annual cash outflow for this project in 2020 and 2021.
- We expect Yulon to cut capital expenditure over the next few years under its conservative business development strategy. We assume NT$2.0 billion-NT$2.5 billion per year in 2020 and 2021, compared with NT$4.1 billion in 2019.
- We expect Yulon to successfully execute its planned asset sales in 2020 and 2021.
- We assume Yulon to make no cash dividend payout in 2020 and 2021, due to the likely net loss for the company.

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

- EBITDA margin of 2%-4% in 2020 and 7%-8% in 2021, compared with negative 29% in 2019.
- Ratio of debt to EBITDA of above 10x in 2020 and 4x-4.5x in 2021, compared with negative EBITDA in 2019.

Liquidity

The short-term corporate credit rating is 'twA-2'. We now assess Yulon's liquidity as less than adequate compared with adequate previously because we expect the company's ratio of liquidity sources to liquidity uses to be about only 1x over the next 12 months. However, we believe Yulon has fair headroom to manage its liquidity and refinancing risk even if the company experiences moderate performance fluctuations over the next year. This is based on our view that Yulon will continue to maintain sound relationships with banks and a fair credit standing in the local capital market. We also do not expect Yulon to face difficulties rolling over its short-term bank facilities or securing new bank loans. In addition, relatively high cash on hand provides some buffer for the company to withstand market volatility.

Principal Liquidity Sources

- Cash and short-term investments: NT$31.6 billion at the end of 2019.
- Cash flow from operations: about NT$1 billion in the 12 months up to the end of 2020.
- Undrawn long-term bank facilities: NT$1 billion at the end of 2019.

Principal Liquidity Uses

- Debt maturity: NT$33 billion in the 12 months up to the end of 2020.
- Maintenance capital expenditure: NT$0.5 billion in the 12 months up to the end of 2020.

No immediate refinancing risk despite less than adequate liquidity.

Our assessment of less than adequate liquidity for Yulon is mainly due to the company's higher short-term borrowing after the consolidation of Haitec. However, we do not expect Yulon to experience refinancing risk in the near-term, even after the company reported a large loss in 2019 as a result of asset impairment costs and the consolidation of Haitec. In addition, Yulon can dispose of the investment properties on its balance sheet to provide a sufficient financial buffer and additional financial flexibility for the company to weather market volatility and absorb the impact from losses on its Luxgen business. As a result, we have revised our assessment of Yulon's comparative rating analysis to positive from neutral.

Outlook

The rating outlook is stable, based on our expectation that Yulon could improve its debt to EBITDA ratio to close to 4x over the next one to two years, through significantly lowering the losses on its Luxgen business in China and Taiwan, as well as through planned asset disposals. In addition, we do not expect Yulon to incur any material asset impairment during the period. This is despite our expectation of a weaker ratio for Yulon in 2020, largely due to Yulon's consolidation of Haitec and related costs and expenses from the business restructuring of Haitec.

Downward scenario

We may further lower the long-term rating on Yulon if the company's EBITDA generation is weaker than our current expectation, such that its debt to EBITDA ratio rises consistently above 5x. This could result from either: 1) much weaker sales for Nissan branded car in China than we expected, particularly in 2020, thereby lowering the investment income for Yulon Nissan and the company's cash dividend payout to Yulon; or 2) any unexpected loss from business restructuring on Haitec and Luxgen going forward. The debt to EBITDA ratio might also rise above 5x if Yulon cannot deliver its planned asset sales to lower its debt level over the next two years, or if Yulon incurs a larger cash outflow than we currently forecast such as for its property development in Xindian.

Upward scenario

We may raise the rating if Yulon can keep its debt to EBITDA ratio comfortably and sustainably below 4x. To achieve this scenario, Yulon may need to improve its profitability and generate positive cash flow to lower its debt, through enhancing its core auto manufacturing business or a better performance from Yulon Nissan.

Rating Scores Snapshot

Issuer Credit Ratings: twBBB+/Stable/twA-2
Note: All scores below are in comparison with global obligors.

Business risk: Weak

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

Financial risk: Aggressive

- Cash flow/Leverage: Aggressive

Anchor: twbb+

Modifiers
- Diversification/Portfolio effect: Neutral (no impact)
- Capital structure: Positive (+1 notch)
- Liquidity: Less than adequate (-1 notch)
- Financial policy: Neutral (no impact)
- Management and governance: Fair (no impact)
- Comparable rating analysis: Positive (+1 notch)

Stand-alone credit profile: twbbb-
- Group credit profile: twbbb+
- Entity status within group: Ultimate parent (therefore the issuer credit rating equates to the group credit profile)

Related Criteria

- General Criteria: Group Rating Methodology - July 01, 2019
- Understanding Taiwan Ratings' Rating Definitions, www.taiwanratings.com - June 26, 2018
- 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
- General Criteria: Country Risk Assessment Methodology And Assumptions - November 19, 2013
- General Criteria: Use Of CreditWatch And Outlooks - September 14, 2009

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Ratings List

Rating Downgraded

	To	From
Yulon Motor Corp.		
Issuer Credit Rating	twBBB+/Stable/twA-2	twA-/Stable/twA-2

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