Media Release:

Taiwan-Based Shipping Firm Wan Hai Lines Ltd. Outlook Revised To Negative On Weak Global Trade, Rising Debt; Ratings Affirmed

April 14, 2020

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Rating Action Overview

- Taiwan-based container shipper **Wan Hai Lines Ltd.** operates globally but earns the majority of its revenue from intra-Asia routes. Wan Hai had funds from operations (FFO) of NT$7.4 billion in 2019.
- Shrinking international trade due to the global COVID-19 pandemic is likely to weaken Wan Hai's cash flow materially in 2020 and lead to a highly uncertain pace of recovery in 2021.
- These factors combined with significant growth in Wan Hai's planned capex will increase the company's debt significantly in 2020 while at the same time narrowing the rating buffer against potential downside risk caused by COVID-19.
- On April 14, 2020, we revised our rating outlook on Wan Hai to negative from stable. At the same time, we affirmed the 'twA-' long-term and 'twA-2' short-term issuer credit ratings on Wan Hai.
- The negative outlook reflects our view of the elevated risk that Wan Hai may take longer to restore its cash flow than we currently predict and that debt leverage could remain elevated with a ratio of FFO to debt below 45% for a prolonged period.

Rating Action Rationale

Substantial declines in trading volume and freight rates could materially pressure Wan Hai's revenue in 2020. In our view, disruption to people flows and supply chains amid the COVID-19 outbreak could bring a slump in global transportation demand. The strict containment measures imposed by governments around the world could lead to significantly weaker global economic growth and end demand. In our view, Wan Hai is not immune from the significant industry headwinds, despite the company's relatively resilient and strong demand growth on its key intra-Asia routes. The diversification of production facilities away from China to ASEAN--Association of Southeast Asian Nations--countries and robust trade growth in Asia have support stronger demand growth on intra-Asia trade routes. We expect container volume (or lifting volume) carried by Wan Hai to decline by slightly more than 10% in 2020 with particular shrinkage in the second and third quarters. Freight rates will come under pressure if the decline in trade volume worsens oversupply in the industry. Nonetheless, we believe the degree of decline in volume will be much milder for Wan Hai than for its global long-haul peers.

Lower oil prices offer temporary relief for the impact of IMO 2020, but cost pressures could rise substantially soon. Amid multiple industry headwinds, we expect the new regulations on the use of higher-cost low-sulfur fuel oil (under the industry's IMO 2020 agreement) to further pressure Wan Hai's profitability. In our view, the gloomy industry prospects could impair the ability of global container shipping companies to fully pass through to customers the higher costs associated with low-sulfur fuel oil.

Meanwhile, a sharp decline in crude oil prices over the past few weeks and a likely softening price trend over the next one to two quarters could provide some relief to Wan Hai's cost burden, but are unlikely to fully offset the negative effect of weak demand. Additional cost pressures could also arise, further weighing on Wan Hai's cost structure and weakening its margins. We assume crude oil will increase to US$50/barrel (bbl) in 2021 and US$55/bbl in 2022 from US$30/bbl during the rest of 2020, according to S&P Global Ratings forecasts.

Market conditions should stabilize in 2021 but a recovery is far from guaranteed. Under S&P Global Ratings' current baseline assumptions on the global COVID-19 pandemic, we expect the industry to experience the greatest impact from the pandemic in the first two quarters of 2020. This means Wan Hai's operating environment should gradually recover from the third quarter of 2020, before normal operations resume in 2021. Accordingly, we expect Wan Hai's lifting volume to rebound robustly in 2021 when the turbulence caused by the outbreak fades and major economies resume robust economic growth.

Intra-Asia trade is likely to post stronger growth than the global market because of continued supply chain diversification and the lowering trade barriers within the region. This should help Wan Hai to improve its EBITDA substantially by 40%-50% in 2021, after a likely decline of 10%-20% in 2020. Nonetheless, there remains material downside risk, given the uncertainty over how soon governments will bring the spread of COVID-19 under control to allow economic activities to normalize to pre-pandemic levels.

Capex is likely to peak in 2020 at a time of weaker cash flow, but could rapidly decline thereafter. Wan Hai began a significant vessel renewal program well before the COVID-19 outbreak began, with deliveries scheduled in 2020-2021. In addition, the company has taken advantage of current low vessel prices and signed an agreement to procure two already operational vessels each with a capacity of 12,000 ton equivalent units (TEUs). As a result, the carrier's capital expenditure (capex) is likely to increase to New Taiwan dollar (NT$) 14 billion-NT$16 billion in 2020, and NT$9 billion-NT$11 billion in 2021, mainly for the acquisition of more vessels.

We expect capex to decline materially in 2022, based on our view that Wan Hai will continue to source around 30% of its capacity from short-term charter hire for its intra-Asia operations and to maintain operational flexibility. Wan Hai has been prudently managing its capacity and maintains a high load factor, which was more than 80% in 2019 and remained strong until the first quarter of 2020. We also expect the company to remain cautious about its expansion in the long-haul market. In particular, we expect the company to focus on niche trade routes such as Asia to South America without acquiring additional mega vessels over the next two to three years, after the acquisition of the two 12,000 TEU vessels.

Shrinking financial buffer with rising debt exposes the ratings to material downside risk amid uncertainty over the impact of COVID-19. Wan Hai's high capex needs and weakened profitability could elevate the company's debt over the next one to two years. Under our baseline assumptions, we project Wan Hai's adjusted debt to increase to about NT$27 billion in 2020 from NT$16.7 billion in 2019, before declining in 2021. Accordingly, Wan Hai's ratio of FFO to debt is likely to decline to 25%-30% in 2020, down from 44.4% in 2019. The ratio is likely to improve to 41%-46% in 2021 and higher beyond 2021 if the company recovers its performance and its capex decreases.

However, the forecast ratio still represents very limited buffer for the ratings to accommodate additional COVID-19 risk if the pandemic prolongs and more severely weakens global trade. In addition, any material deviation from our current capital spending assumptions could also keep Wan Hai's ratio of FFO to debt below 45% for a prolonged period. We view a ratio of 45% to be appropriate for the current rating.

Outlook

The negative outlook reflects material risk that the COVID-19 pandemic could inflict a longer and deeper economic slump than under our current expectation, and prevents Wan Hai from recovering its profitability over the next nine to 18 months. This could in turn lead to higher debt than under our base case and keep the company's ratio of FFO to debt below 45% for a prolonged period if the company does not adjust its capex plan. Our base case assumes that capex will peak in 2020 before declining gradually from 2021 onward. We also assume the ratio of FFO to debt will improve to 41%-46% in 2021 with recovering profitability after falling temporarily to 25%-30% in 2020.

Downward scenario
We may lower the long-term issuer credit rating if we believe that Wan Hai is unlikely to restore its ratio of FFO to debt to above 45% over the next one to two years. This could result from:

- a sustained decline in global trade volume that leads to severe deterioration in profitability for a longer period than we currently expect.
- the company taking on more aggressive debt-funded capex for vessels and not reducing its debt level at our projected pace.

Upward scenario
We may revise the outlook back to stable if we see a clear sign of industry turnaround, such that we believe Wan Hai could restore its cash flow generation and lift the ratio of FFO to debt to above 45% through the current business cycle. Such a result could be achievable if:

- Wan Hai can sustain its good position in the faster growing intra-Asia container shipping market with efficiency and cost competitiveness, and
- the company can reduce its debt through disciplined capex.

Our Base-Case Scenario

- S&P Global Ratings' forecast for Asia Pacific real GDP growth of 2.2% in 2020, significantly down from 4.7% in 2019, but to rebound to 6.9% in 2021; U.S. real GDP growth of negative 1.3% in 2020 and positive 3.2% in 2021.
- Disruptions to people flows and supply chains due to COVID-19 will severely diminish transportation demand in the region. Trade volume is likely to fall significantly until the pandemic is contained and economic activity normalizes. This could materially pressure ocean carriers' cash flow in the coming few months.
- Wan Hai's shipping volume to drop by 8%-13% in 2020, based on our expectation that transported volume could fall by 20%-30% in the next one to two quarters amid cooling economic growth, a disrupted supply chain, and stalled end demand. We expect the company's shipping volume to fully recover with a robust rebound in 2021.
- Wan Hai's freight rate to be largely flat in 2020, supported by higher fuel surcharges and better industry discipline. We anticipate the freight rate will resume low-to-mid single digit growth in 2021.
- Bunker fuel price to rise to US$450-US$500/ton in 2020 from US$410-US$430/ton in 2019, reflecting the higher cost of low-sulfur oil under IMO 2020.
- Unit operating expense (excluding bunker costs) to decline by a low-single digit in 2020-2021 with continued network optimization.
- Capex of NT$14 billion-NT$16 billion in 2020 and NT$9 billion-NT$11 billion in 2021, including vessel replacement costs, the acquisition of two used 12,000 TEU vessels, container box replacement costs, and maintenance.
- Cash dividend to lower to about 50% in 2020 and 2021 (similar to the payout ratio in 2018) to reserve cash for higher capex plans over the next one to two years.

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

- Return on capital of 6%-9% in 2020, and 9%-12% in 2021.
- Ratio of FFO to debt to fall to 25%-30% in 2020 from 44.4% in 2019, but recover to 41%-46% in 2021.
- Ratio of free operating cash flow to debt of negative 28% to negative 33% in 2020 due to significant capex, but to recover to positive 3%-8% in 2021.

Liquidity

The short-term rating on Wan Hai is 'twA-2'. We have revised our liquidity assessment for Wan Hai to adequate from strong, given the planned significant increase in the company's capex over the next one to two years. We believe that Wan Hai has adequate liquidity to meet its needs over the next 12 months, with a ratio of liquidity sources to liquidity uses of 1.4x-1.6x in 2020. We also believe Wan Hai has the ability to cope with high-impact, low-probability events with limited refinancing, given its high cash balance on hand.

We also believe the company's good relationship with Taiwan banks and generally high standing in Taiwan's credit markets will provide access to financing, as evidenced by the low interest rate on Wan Hai's bank loans. The carrier also has generally prudent financial risk management to consistently maintain a sufficient financial buffer that helps the company to withstand market volatility, in our view. Wan Hai does not have any loans carrying covenants as of the end of 2019.

Principal Liquidity Sources:

- Cash and short-term investments: NT$ 19.6 billion at the end of 2019.
- Cash flow from operations: NT$5.5 billion-NT$7.0 billion in 2020.
- Undrawn bank lines maturing beyond end of 2020: About NT$7.4 billion in 2020.

Principal Liquidity Uses:

- Debt maturity: NT$3.5 billion-NT$4.5 billion in 2020.
- Capex: NT$14 billion-NT$16 billion in 2020.
- Cash dividend: NT$1.7 billion-NT$1.9 billion in 2020.

Ratings Snapshot

Issuer Credit Rating: twA-/Negative/twA-2
Note: The descriptors below are on a global scale.

Business Risk: Weak

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

Financial Risk: Intermediate

- Cash flow/Leverage: Intermediate

Anchor: twbbb+

Modifiers

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

Stand-alone credit profile: twa-

Related Criteria

- General Criteria: Group Rating Methodology – July 01, 2019
- Criteria | Corporates | General: Corporate Methodology: Ratios And Adjustments - April 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
- Criteria | Corporates | Industrials: Key Credit Factors For The Transportation Cyclical Industry - February 12, 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: 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; Outlook Action

	To	From
Wan Hai Lines Ltd.		
Issuer Credit Rating	twA-/Negative/twA-2	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.