Media Release:

Taiwan-Based Container Carrier Yang Ming Marine Outlook Revised To Negative On Weak Profits; 'twBBB/twA-2' Ratings Affirmed

April 14, 2020

PRIMARY CREDIT ANALYST

Anne Kuo, CFA
Taipei
+886-2-8722-5829
anne.kuo
@spglobal.com
anne.kuo
@taiwanratings.com.tw

SECONDARY CONTACT

David Hsu
Taipei
+886-2-8722-5828
david.hsu
@spglobal.com
david.hsu
@taiwanratings.com.tw

Rating Action Overview

- Taiwan-based shipping company **Yang Ming Marine Transport Corp.** generates the bulk of its revenue from long-haul routes. The company had funds from operations in 2019 of NT$11.3 billion.
- Shrinking international trade could worsen Yang Ming's operating performance materially in 2020 following losses in 2018-2019, while the highly uncertain pace of recovery from the COVID-19 will continue into 2021.
- Yang Ming's persistently weak operating performance and high capex could increasingly weigh on its capital structure and the ratings over the next few quarters, if Yang Ming cannot significantly strengthen its cost competitiveness or if operating conditions fail to improve.
- On April 14, 2020, we revised our rating outlook on the long-term rating to negative from stable. At the same time, we affirmed the 'twBBB/twA-2' issuer credit ratings on Yang Ming and the 'twBBB' issue credit rating on the company's senior unsecured corporate bond.
- The negative outlook reflects the significant difficulty that Yang Ming faces to turnaround in its operations if the COVID-19 pandemic prolongs or worsens, given chronic industry oversupply and Yang Ming's relatively weaker cost structure and efficiency than larger peers'.

Rating Action Rationale

A substantial decline in trading volume could materially pressure Yang Ming's cash flow in 2020. In our view, disruption to people flows and supply chains due to COVID-19 could bring a slump in global demand in 2020. The strict containment measures imposed by governments around the world could lead to significantly weaker global economic growth and lower end demand. Yang Ming is particularly vulnerable to macro changes, given its high exposure to the highly competitive transpacific and Europe long-haul routes. As a result, we expect the volume of trade (lifting volume) carried by Yang Ming to decline by 10%-25% in 2020 with particular shrinkage in the second and third quarters.

Yang Ming's growing exposure to the relatively stable intra-Asia trade routes could lessen the drop in the company's overall lifting volume. Meanwhile, freight rates will come under pressure if the decline in trade volume worsens oversupply in the industry.

Lower oil prices offer temporary relief from the cost impact of IMO2020, but cost pressures could rise substantially soon. Amid multiple industry headwinds, we expect new regulations under the industry's IMO 2020 agreement to further exert pressure on Yang Ming's profitability as it requires the company to use higher-cost low sulfur fuel oil. That's despite the potential financial relief offered by the recent crash in crude oil prices and the narrowing of the price spread between high-sulfur and low-sulfur fuel oils.

In our view, gloomy industry prospects could impair the ability of global container shipping companies to pass through the higher costs for using low-sulfur fuel oil to customers in full. A sharp decline in oil prices in March/April 2020 and likely softening price trend over the next one to two quarters could provide some relief to the company's cost burden, particularly as Yang Ming has only installed equipment to remove Sulphur emissions only about 20% of its vessels. However, the benefit is unlikely to fully offset the negative effect of weak demand, in our view. In addition, other cost pressures could arise and weigh on Yang Ming's costs structure if oil prices stabilize, which would further constrain margins if global trade remains weak. S&P Global Ratings assumes crude oil prices will increase to US$50/barrel (bbl) in 2021 and US$55/bbl in 2022, up from US$30/bbl in 2020.

A prolonged COVID-19 pandemic could dampen Yang Ming's ability to turn around its operating performance after consecutive losses in 2018-2019 and most likely 2020, exposing the ratings to material downward pressure. We believe the odds have turned more negative for Yang Ming to improve its weakened operating performance over the next couple of years. This is because of chronic industry overall supply and the still developing global COVID pandemic that could materially alter the growth trajectory of global trade.

Yang Ming remains more vulnerable to industry downturns than its larger peers due to the carrier's weaker cost structure and operating efficiency, partly as a result of the company's smaller operating scale. However, Yang Ming's cost structure is likely to slightly improve in the next one to two years supported by the growing use of its vessels on specific long- and short-haul routes. Yang Ming management's growing focus on operating efficiency, such as the emphasis on eliminating the imbalances between inbound and outbound traffic, could also the company's enhance revenue and load factor and consequently lower unit operating costs. However, those efforts may not be sufficient to fully offset Yang Ming's scale and fleet disadvantage.

Market conditions should stabilize in 2021 but a recovery is far from guaranteed. Our current baseline assumptions on the impact of COVID-19 on trade predict the greatest fallout to occur in the first two quarters of 2020. This means operating conditions should gradually recover from the third quarter of 2020 before Yang Ming can full normalize its operations in 2021. Accordingly, we expect Yang Ming's lifting volume to rebound robustly in 2021, as the turbulence caused by the pandemic fades and major economies resume robust economic growth. This should substantially enhance the company's EBITDA by about 30%-40% in 2021, following a decline of 10%-20% in 2020. Nonetheless, material downside risk remains given the uncertainty over how soon governments will contain the spread of COVID-19 and economic activity can normalize to the pre-outbreak level.

Debt to grow further with capex peaking in 2020 as cash flow remains weak, but liquidity and refinancing risk remain low. Yang Ming has initiated an expansion program to penetrate the intra-Asia market, as it eyes the region's stronger trade volume growth prospects with more balanced demand-supply conditions. As a result, the carrier's capital expenditure (capex) will rise materially to New Taiwan dollar (NT$) 14 billion-NT$16 billion in 2020 for ten 2,800 twenty foot equivalent unit (TEU) vessels to be delivered in 2020 and 2021, before lowering to NT$4 billion-NT$6 billion in 2021. This could add to Yang Ming's debt in 2020 and further weaken the company's capital structure at a time of more stressed cash flow generation.

Nonetheless, we do not expect Yang Ming to encounter material difficulty to fund its capex or refinance its maturing debts over the next 12 months, given the company's very strong link to the Taiwan government. This is despite Yang Ming's breach on covenants for its guaranteed convertible bonds in 2018-2019. The company received waivers from guarantor banks for the breach without any penalty and visible effect on its interest rate or acquisition of new bank lines. In addition, Yang Ming will continue to benefit from favorable borrowing costs and ample liquidity support from state-owned banks in Taiwan. Furthermore, we expect the government to provide necessary capital injections to maintain the viability of Yang Ming's capital structure in stress scenarios such that Yang Ming's shareholder's equity diminishes sharply, based on its previous track record.

Outlook

The negative outlook reflects material risk that Yang Ming's operating performance could remain weak if the company fails to improve its cost competitiveness or if the destructive impact from COVID-19 crushes global trade volume harder and deeper than our baseline assumptions suggest. New regulations under IMO 2020 requiring the use of more expensive low-sulfur-compliant fuel oil could exert further margin pressure on the carrier given the challenge to fully pass on cost inflation through surcharges during industry downturns. In addition, Yang Ming's capital structure could deteriorate significantly with high capex at a time of stressed operating cash flow, if there is no capital support from the government to offset consecutive cash outflows.

Downward scenario

We may lower the long-term rating if:

- Yang Ming's competitive position weakens, evidenced by persistently weak operating performance and negative cash flow. This could be due to the company's failure to enhance its cost structure and service network relative to those of larger peers; a significant decline in the company's market share, leading to diminishing scale economies; or a larger and longer impact of COVID-19 on global trade that worsens oversupply for a prolonged period.
- we believe the company's role and link to the Taiwan government has weakened substantially, which includes a substantial reduction in government ownership or control of Yang Ming's board. The lack of timely funding support from the government to shore up Yang Ming's diminishing equity in times of operating stresses could also be evidence of such deterioration.

- the funds from operations (FFO) cash interest coverage falls below 2x for an extended period, which could result from much weaker market conditions reducing EBITDA or aggressive debt-funded capex materially raising debt.
- the company's access to banking facilities deteriorates due to weakened creditworthiness, although we view the likelihood of this over the next 12 months as minimal.

Upward scenario

We may revise the outlook back to stable if:

- we see a clear sign of a sustainable turnaround in Yang Ming's profitability, such that the carrier could restore its bottom line and cash flow generation in the next one to two years. Thus could result from strengthened cost competitiveness amid recovered market conditions in line with our baseline assumptions, while at the same time the company has adopted a more conservative capital spending to reduce its debt substantially.

Our Base-Case Scenario

- S&P Global Ratings' forecast for U.S. real GDP growth of negative 1.3% in 2020 and positive 3.2% in 2021; Asia Pacific real GDP growth of 2.2% in 2020, rebounding to 6.9% in 2021; and Europe GDP growth of negative 0.5% in 2020 and positive 3.2% in 2021.
- Disruptions to people flows and supply chains due to COVID-19 will bring a slump in transportation demand in the region. We will likely see a significant decline in volume until the health emergency is contained and economic activity normalizes. This could materially pressure ocean carriers' cash flow over the coming few months.
- Yang Ming's shipping volume to drop by 10%-25% in 2020 with a milder decline in the more resilient Intra-Asia market alleviating overall volume shrinkage. This is based on our expectation that the transported volume could fall by 25%-35% over the next one to two quarters with cooling economic growth, disrupted supply chain and halted end demand. We expect the company's shipping volume to fully recover with a robust rebound in 2021.
- Yang Ming's freight rate to be largely flat in 2020 supported by higher fuel surcharges and better industry discipline. We anticipate the carrier's freight rate to resume low-to-mid single digit growth in 2021.
- Bunker fuel price to rise to US$450-US$480/ton in 2020 from US$410-US$430/ton in 2019 reflecting the higher cost of low sulfur oil under IMO 2020 requirements.
- Yang Ming's operating cost to increase at a slower pace than volume, reflecting the company's enhanced cost control measures.
- Capex of NT$14 billion-NT$16 billion in 2020 and NT$4 billion-NT$6 billion in 2021. The higher capex in 2020 is mainly to build ten 2,800TEU vessels to be delivered in 2020 and 2021.
- No surplus cash adjustment is applied because of the company's weak business risk profile.
- Cash dividend in 2020 and 2021 to be nil due to accumulated losses.

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

- Ratio of FFO to debt of 5%-8% in 2020, but to improve to 8%-12% in 2021.
- FFO cash interest coverage of 2.5x-4.5x in 2020 and 5x-7x in 2021.

Liquidity

The short-term rating on Yang Ming is 'twA-2'. We believe the company has less than adequate liquidity sources to cover its needs over the next 12 months ending December 2020, based on our expectation that liquidity sources will only cover 0.8x-1.0x of liquidity uses without refinancing. Nevertheless, we believe good access to banks underpinned by Yang Ming's status as a government related entity can largely offset this refinancing risk.

We do not expect Yang Ming's likely breach on financial covenants for the company's guaranteed convertible bonds in 2020 to have a material effect its access to banking facilities. Yang Ming received waivers after breaching the covenant in its guarantee agreement with banks for its NT$7.6 billion guaranteed mandatory convertible bond in 2019, without a material effect on its interest rates and the addition of new bank loans.

Principal liquidity sources
- Cash and short-term investments: NT$18.2 billion at the end of 2019.
- Cash flow from operations: NT$9.0 billion-NT$10.5 billion in 2020.
- Undrawn bank lines maturing beyond 12 months: about NT$6.9 billion in 2020.

Principal liquidity uses
- Debt maturity: NT$35 billion-NT$40 billion in 2020.
- Maintenance capex: NT$2 billion-NT$3 billion in 2020.

Related Criteria

- General Criteria: Hybrid Capital: Methodology And Assumptions, Mon Jul 01 2019
- General Criteria: Rating Government-Related Entities: Methodology And Assumptions - March 25, 2015
- General Criteria: Group Rating Methodology – July 01, 2019
- General Criteria: Methodology For National And Regional Scale Credit Ratings - June 25, 2018
- Criteria - Corporates - General: Reflecting Subordination Risk In Corporate Issue Ratings - March 28, 2018
- 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 Score Snapshot

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

Business Risk: Weak

- Country risk: Low
- Industry risk: High
- Competitive position: Weak

Financial Risk: Highly leveraged

- Cash flow/Leverage: Highly leveraged

Anchor: twbb

Modifiers

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

Stand-alone credit profile: twbb

Sovereign rating: [unsolicited, rated 'AA-/Stable/A-1+' by S&P Global Ratings]

Likelihood of government support: Moderately high (+3 notches from SACP)

Ratings List

Ratings Affirmed; Outlook Action

	To	From
Yang Ming Marine Transport Corp.		
Issuer Credit Rating	twBBB/Negative/twA-2	twBBB/Stable/twA-2
Senior unsecured corporate bond issue credit rating.	twBBB	

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.