

Media Release:

Taiwan Optical Platform Co. Ltd. Assigned 'twBBB+/twA-2' Ratings; Outlook Stable

May 13, 2020

Rating Action Overview

- Taiwan-based TOP is the fifth largest multiple system broadband and cable TV operator in the domestic market with 9.3% market share. TOP's financial leverage increased substantially after its debt-financed expansion in late 2019, and this will also keep its debt to EBITDA at 4.5x-3.5x over the next few years.
- TOP has a dominant position in its key franchise areas of Taiwan's cable TV market as well as adequate operating efficiency, which should support satisfactory profitability and stable cash flow generation over the next two years. These factors partly offset the company's business concentration risk and lower market share compared with that of leading operators.
- We are assigning our 'twBBB+' long-term and 'twA-2' short-term issuer credit ratings to TOP.
- The rating outlook is stable to reflect our expectation that TOP will maintain stable profitability with a satisfactory position in Taiwan's cable TV market, and will gradually pay down its debt over a longer period.

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Rating Action Rationale

TOP is one of the major MSOs in Taiwan, but its market share is relatively small. In our view, **Taiwan Optical Platform Co. Ltd.** (TOP) is likely to remain the fifth largest multiple system operator (MSO) in Taiwan over the next one to two years. The company has effectively enhanced its market share after completion of its expansion plan in the cable TV and broadband services sector in late 2019, with 9.3% share of the domestic market. Although the expansion will close the distance with the island's leading MSOs, TOP remains a relatively small player.

Dominant position in key geographic areas with relatively stable market structure. We believe TOP will maintain a dominant market share in its key franchise areas in middle and southern counties and cities in Taiwan, given established entry barriers. Competition in Taiwan's cable TV market has increased after regulatory changes that allow the entry of more competitors into a single operating area. However, TOP faces limited competition in its respective operating areas, given the operator's established network, customer base, and capital investment that provide meaningful barriers to entry. In addition, we expect TOP to

maintain its market position, given the relatively stable market structure and customers' viewing habits in middle and southern Taiwan.

Sustained ARPU but with limited growth potential. TOP's good operating efficiency, underpinned by its established service network and customer base in its franchised areas with limited competition, enables it to sustain its average revenue per user (ARPU). Accordingly, this allows the company to maintain its satisfactory profitability and stable cash flow generation. This is despite TOP's low growth prospects, in our view, due to stagnant ARPU over the next few quarters and limited subscriber growth especially for its cable TV business.

Growing competition from MOD and other IPTV service. We believe TOP and other cable TV operators face high product substitution risk from Taiwan's leading telecom provider, Chunghwa Telecom Co. Ltd.'s (CHT's) fast-growing MOD (movies-on-demand) platform and other Internet Protocol TV (IPTV)/Over-The-Top (OTT) platforms over the next two years. This is because there are more and more subscribers, particularly of the younger generation, who are willing to watch non-traditional channels rather than local news and local drama channels. However, TOP's ability to offer OTT contents through its new digital set-top box partly offsets this risk.

Weaker position with intense competition in broadband business. TOP's broadband business is likely to face more intense competition and its competitive position in broadband will likely remain weaker than the market leader, CHT, in most of TOP's business areas over the next one to two years. Accordingly, we do not expect TOP's product diversification to improve meaningfully over the same period. This is despite our expectation that TOP's revenue contribution from fiber-to-the-home (FTTH) broadband as well as line and equipment rental business could grow faster because of the company's continuous investment in fiber networks in its service areas.

Dominant position with relatively stable market structure. TOP's credit metrics weakened substantially in late 2019 from its previous net cash position after the company's debt-financed business expansion to acquire two system operators in southern Taiwan. However, given TOP's satisfactory profitability and stable cash flow generation, we expect the company to pay down its debt gradually and keep its debt to EBITDA ratio at 4.5x-3.5x over the following one to two years. TOP's debt to EBITDA ratio was 6.5x as end of 2019 due to pro-rata consolidation of the two acquired operators' profit and loss but the full amount of debts for the related investments.

Taiwan Ratings' key assumptions for TOP over the coming two years are:

- Given the wider global spread of COVID-19 will lead to a prolonged economic fallout, we project Taiwan's real GDP growth to be negative 1.2% in 2020, and rebound by positive 4.0% in 2021.
- However, we do not expect the COVID-19 outbreak to impact the domestic demand for cable and broadband, as they are essential services for local people in daily life. Nonetheless, given the saturated domestic cable/broadband market with stagnant population growth and household numbers, the growth for both industries is likely to be below GDP growth in the long run.
- Taiwan's cable TV market will decline gradually due to competition from MOD and various IPTV and OTT platforms; however, the market structure will remain relatively stable with limited competition in most operating areas, despite the regulator's additional issuances of operating licenses.

- CHT will continue to dominate Taiwan's broadband market. However, cable broadband operators are likely to gain market share because of their pricing strategies and service-bundling packages.
- Our base-case scenario for TOP indicates 45%-50% sales growth in 2020 as a result of the business acquisition. We also assume low-single-digit growth for the company from 2021.
 - The subscriber base for cable TV will decline by low single digits due to competition from MOD and other OTT providers but the ARPU for cable TV is likely to remain unchanged.
 - The subscriber base for broadband is likely to remain mostly unchanged, but ARPU for broadband is likely to recover over the next few years thanks to higher sales from high-speed users based using TOP's FTTH services.
- TOP's capex will be New Taiwan dollar NT\$300 million-NT\$350 million for 2020-2021. About 75% of this expenditure is for TOP's fiber network deployment in middle-to-northern Taiwan with the rest for equipment and set-up box upgrades.
- Cash dividend payout is likely to remain at NT\$ 600 million per annum over next few years.

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

- EBITDA margin to improve to 45%-50% in 2021 from about 45% in early 2020 due to the better margins of its newly acquired businesses.
- Ratio of debt to EBITDA at 4.5x-3.5x over the next few years.

Outlook

The stable outlook reflects our expectation that TOP will maintain stable profitability and cash flow in Taiwan's cable TV market. In addition, we believe the company will gradually pay down its debt using positive free cash flow. As a result, TOP is likely to maintain its debt to EBITDA at 4.5x-3.5x range over the next few years.

Downward scenario

The long-term rating could come under pressure if:

- TOP's debt to EBITDA stays constantly above 4x post acquisition, which could happen if 1) TOP's performance weakens materially due to a change in regulation, evolution of technology, or rising competition risks, 2) the company engages in any unexpected large debt-funded acquisition that lift its financial leverage, or 3) TOP assumes an aggressive shareholder-friendly action such as a much higher cash dividend payout than we expected or share buyback plan.

Upward scenario

We could upgrade TOP if:

- the company gradually pays down its post-acquisition debt and maintains its debt to EBITDA ratio comfortably below 3x. We may also consider an upgrade if the company could improve its competitive position further with a significant market share gain or material improvement in its diversification, such as by expanding its broadband and line and equipment rental businesses, while maintaining its ratio of debt to EBITDA below 4x.

Liquidity

The short-term rating on TOP is 'twA-2'. We believe the company has adequate liquidity to meet its needs over the next 12 months based on our view that TOP's ratio of liquidity sources to liquidity uses will be about 2x for the upcoming 12 months, but will weaken substantially due to debt repayment. However, we believe TOP's liquidity sources will likely continue to exceed uses, even if EBITDA were to decline by 15%. We also believe TOP has sufficient financial covenant buffer and could absorb, with limited refinancing, high impact, low-probability events over next 12 months. In addition, the company has a generally satisfactory standing in credit markets, thanks to its stable cable TV business.

Principal liquidity sources

- Existing cash and short term investment: about NT\$2.1 billion as of the end of December 2019.
- Cash FFO: About NT\$900 million in 2020.

Principal liquidity uses

- Short-term and long-term debt maturity: NT\$570 million in 2020.
- Capex: NT\$350 million in 2020.
- Cash dividend: about NT\$490 million in 2020.

Related Criteria

- Understanding Taiwan Ratings' Rating Definitions - June 26, 2018
- General Criteria: Group Rating Methodology - July 01, 2019
- Criteria | Corporates | General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers - December 16, 2014
- Criteria | Corporates | Industrials: Key Credit Factors For The Telecommunications And Cable Industry - June 22, 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
- Criteria | Corporates | General: Corporate Methodology: Ratios And Adjustments - April 01, 2019
- 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.taiwanratings.com)

Ratings List

New Ratings

Taiwan Optical Platform Co. Ltd.

Issuer Credit Rating

twBBB+/Stable/twA-2

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