

Bulletin:

Formosa Plastics Group Faces Narrow Rating Headroom Amid COVID-19

June 2, 2020

Taiwan Ratings Corp. said today that tough operating conditions leave little rating headroom for the operating performance of Taiwan-based Formosa Plastics group to deviate from our base-case assumptions. That's despite the potential for planned debt reductions and a gradual rebound in oil prices to support the consolidated credit profile of the group's four core companies--**Formosa Plastics Corp., Nan Ya Plastics Corp., Formosa Chemical & Fibre Corp., and Formosa Petrochemical Corp.** The long-term issuer credit rating on the four core companies is 'twAA' with a negative outlook.

Downside risks to product margins will remain high throughout 2020, especially for commodity chemicals, if the pandemic does not subside in the second half of 2020 under our base case. That's despite the likelihood that downstream manufacturers such as Formosa Plastics and Nan Ya Plastics will see spreads improve as demand for their products resumes growth and input costs remain low during the rest of 2020.

Planned overseas expansion projects could push the group's debt leverage higher after 2021. That's if operating cash flow doesn't improve materially to a level similar or higher to that in 2019. We believe the group is likely to ease its debt burden by delaying unnecessary projects until market conditions improve. But failure to control capital expenditure in 2020 and beyond could prevent the group from bringing its debt to EBITDA ratio below 2x, which we view as an adequate level for the current ratings. We also expect the core units to reduce their guarantees on associated company bank loans while also attempting to recover loans made to them, which could lower the group's adjusted debt by as much as New Taiwan dollar (NT\$) 40 billion-NT\$60 billion by the end of 2021.

The slow rebound in oil prices, and a gradual easing of operating restrictions and output cuts as the COVID pandemic eases could lift the core companies' EBITDA. Under our base case, the price of Brent oil will rise to US\$50 a barrel in 2021 from US\$30 a barrel in 2020, which could help the group to bring its debt to EBITDA ratio to around 2x in 2022 compared with above 4x throughout 2020. But with so much uncertainty over operating conditions for the next 6-18 months, this won't be enough to significantly improve the rating headroom for the group.

This report does not constitute a rating action.

Copyright © by Taiwan Ratings Corp. All rights reserved.

PRIMARY CREDIT ANALYST

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

SECONDARY CONTACT

Raymond Hsu, CFA
Taipei
+886-2-8722-5827
raymond.hsu
@spglobal.com
raymond.hsu
@taiwanratings.com.tw

Copyright © 2020 by Taiwan Ratings Corporation (TRC). All rights reserved.

No content (including ratings, credit-related analyses and data, valuations, model, software or other application or output therefrom) or any part thereof (Content) may be modified, reverse engineered, reproduced or distributed in any form by any means, or stored in a database or retrieval system, without the prior written permission of TRC. The Content shall not be used for any unlawful or unauthorized purposes. TRC and any third-party providers, as well as their directors, officers, shareholders, employees or agents (collectively TRC Parties) do not guarantee the accuracy, completeness, timeliness or availability of the Content. TRC Parties are not responsible for any errors or omissions (negligent or otherwise), regardless of the cause, for the results obtained from the use of the Content, or for the security or maintenance of any data input by the user. The Content is provided on an "as is" basis. TRC DISCLAIMS ANY AND ALL EXPRESS OR IMPLIED WARRANTIES, INCLUDING, BUT NOT LIMITED TO, ANY WARRANTIES OF MERCHANTABILITY OR FITNESS FOR A PARTICULAR PURPOSE OR USE, FREEDOM FROM BUGS, SOFTWARE ERRORS OR DEFECTS, THAT THE CONTENT'S FUNCTIONING WILL BE UNINTERRUPTED OR THAT THE CONTENT WILL OPERATE WITH ANY SOFTWARE OR HARDWARE CONFIGURATION. In no event shall TRC be liable to any party for any direct, indirect, incidental, exemplary, compensatory, punitive, special or consequential damages, costs, expenses, legal fees, or losses (including, without limitation, lost income or lost profits and opportunity costs or losses caused by negligence) in connection with any use of the Content even if advised of the possibility of such damages.

Credit-related and other analyses, including ratings, and statements in the Content are statements of opinion as of the date they are expressed and not statements of fact. TRC's opinions, analyses and rating acknowledgment decisions (described below) are not recommendations to purchase, hold, or sell any securities or to make any investment decisions, and do not address the suitability of any security. TRC assumes no obligation to update the Content following publication in any form or format. The Content should not be relied on and is not a substitute for the skill, judgment and experience of the user, its management, employees, advisors and/or clients when making investment and other business decisions. TRC does not act as a fiduciary or an investment advisor except where registered as such. While TRC has obtained information from sources it believes to be reliable, TRC does not perform an audit and undertakes no duty of due diligence or independent verification of any information it receives. Rating-related publications may be published for a variety of reasons that are not necessarily dependent on action by rating committees, including, but not limited to, the publication of a periodic update on a credit rating and related analyses.

To the extent that regulatory authorities allow a rating agency to acknowledge in one jurisdiction a rating issued in another jurisdiction for certain regulatory purposes, TRC reserves the right to assign, withdraw or suspend such acknowledgement at any time and in its sole discretion. TRC disclaims any duty whatsoever arising out of the assignment, withdrawal or suspension of an acknowledgement as well as any liability for any damage alleged to have been suffered on account thereof.

TRC keeps certain activities of its business units separate from each other in order to preserve the independence and objectivity of their respective activities. As a result, certain business units of TRC may have information that is not available to other TRC business units. TRC has established policies and procedures to maintain the confidentiality of certain non-public information received in connection with each analytical process.

TRC receives compensation for its solicited ratings and certain analyses, normally from issuers, originators, arrangers, or underwriters of securities or from obligors. TRC reserves the right to disseminate its opinions and analyses. TRC's public ratings and analyses are made available on its Web sites, www.taiwanratings.com (free of charge), and rrs.taiwanratings.com.tw (subscription), and may be distributed through other means, including via TRC publications and third-party redistributors. Please click [here](#) for any other conflict of interests that may affect the credit rating as requested by the regulator.