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Bulletin:

Formosa Plastics Group Faces Narrow Rating Headroom Amid COVID-19

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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.