Media Release:

# Formosa Taffeta Co. Ltd. Ratings Affirmed At 'twA/twA-1' On Debt Reduction Plan; Outlook Stable

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## Rating Action Overview

- Taiwan-based **Formosa Taffeta Co. Ltd.** (FTC) is a subsidiary of **Formosa Plastics Corp.** group (FP group). With businesses including fabric, gas station, and tire cord, FTC had revenue of NT$37 billion in 2019.
- We believe that weaker demand for woven fabric due to the stagnant economic recovery has weakened FTC's capacity utilization. As a result, we forecast FTC's EBITDA margin to be lower than 8% in 2020 and to remain weak at around 8% in 2021-2022.
- However, FTC's debt could decline significantly over 2021-2022 due to its reducing guarantee on the FP group's steel mill in Vietnam. Accordingly, we expect FTC's ratio of funds from operations (FFO) to debt to recover to materially above 12% over the same period.
- On October 23, 2020, we affirmed our 'twA/twA-1' issuer credit ratings on FTC.
- The stable outlook reflects the company's slow but recovering profitability and improving on debt leverage that could sustain its ratio of FFO to debt above 12% from 2021.

## Rationale Action Rationale

**Weakened competitive position due to lower capacity utilization amid COVID-19 has resulted in weakening profitability.**

The company's revenue has declined by 24% in first three quarters of 2020 as a result of slower demand due to COVID-19. Over 80% FTC's revenue from its fabric business is generated from sports and outdoor products, which are one of the weakest sales among apparels due to the diminishing demand for outside activities amid COVID-19. FTC's woven fabric's capacity utilization declined significantly during the middle of 2020, and we expect a low likelihood for its utilization rates to recover over the next one to two years to the higher level in the previous years. This also reflects our view that demand for woven fabrics will remain soft. Accordingly, FTC's profitability has come under pressure with its EBITDA margin declining to less than 8% in 2020 under our estimate.

**Declining guarantee on the FP group's steel mill in Vietnam helps to mitigate the risk of FTC's profitability weakening further.**

In line with other FP group members, we expect FTC to gradually reduce its debt guarantee for the group's steel mill in Vietnam (Formosa Ha-Tinh (Cayman) Ltd.), because the steel mill will be able to refinance its debt without the shareholders' guarantee from 2021. This will allow FTC to reduce its debt level significantly. In combination with the company's prudent capital expenditure (capex) and investment plans, we expect FTC's ratio of FFO to debt to improve to 15%-20% in 2021-2022 from 9%-11% in 2020.

**Cash dividend from Formosa Petrochemical Corp. (FPCC) is a positive credit factor.**

We view FTC's investment in FPCC as a positive credit factor. The company owns a 3.8% stake in FPCC and it received a cash dividend from FPCC of about New Taiwan dollar (NT$) 1.2 billion in 2020. This is a substantial cash dividend compared with NT$2 billion-NT$3 billion EBITDA from FTC's core businesses each year. We believe the sizable cash dividend from FPCC is sustainable and will support FTC's capex and investments plans and prevent a significant increase in its debt.

## Outlook

The stable outlook reflects our view that FTC's ratio of FFO to debt will improve to sustainably above 12% from 2021. We believe FTC will significantly reduce its guarantee on FP group's steel company in Vietnam from 2021 in line with that of its group members, which will help to mitigate the risk of FTC's EBITDA margin weakening in 2020-2022 due to prolonged weak demand amid COVID-19.

### Downward scenario

We may lower the long-term rating if FTC's ratio of FFO to debt declines materially below 12% for an extended period from 2021, which could indicate a deterioration in its business or financial strength This could result from:

- the EBITDA margin of its fabric and tire cord businesses deteriorates materially due to slower demand recovery, rapidly changing market trends, intensifying competition, or FTC receives less dividend income from equity investments than in our expectation, or
- FTC's cash inflow cannot support its dividend payout, capex, or potential equity investment in the group's expansion projects in the U.S., which leads to rising debt, despite its reducing guarantee for the group's steel mill in Vietnam.

### Upward scenario

We view the likelihood of an upgrade is low over the next one to two years. However, we could raise the long-term rating on FTC if the ratio of FFO to debt improves to above 20% on a sustainable basis. The likely scenarios are:

- FTC's profitability improves as a result of demand recovery for its fabric business or a significant increase in demand for higher-value fabrics and tire cord products, or
- its debt reduction is faster than our current expectation as a result of faster reduction of its guarantee on the group's steel mill in Vietnam, or any significant asset disposals.

## Our Base Case Scenario

- S&P global anticipates world real GDP growth at negative 3.8% in 2020, positive 5.2% in 2021, and positive 3.6% in 2022; China's real GDP growth at 2.1% in 2020, 6.8% in 2021, and 4.8% in 2022; and Taiwan's real GDP growth at 1% in 2020, 3% in 2021, and 2.6% in 2022.
- Demand for woven fabrics remains slow in late 2020 and early 2021 due to the prolonged impact of COVID-19. We expect a demand recovery from mid-2021. Sales of tire cord will improve from late 2020, following the mild recovery in the auto market, particularly in China.
- FTC's revenue to decline by 20%-25% in 2020, then recover by 10%-15% in 2021 and 6%-9% in 2022. This reflects a demand interruption in 2020 but a likely recovery from mid-2021 if governments worldwide can control the damage from the pandemic.
    - Sales momentum of woven fabrics is likely to slow down due to the temporary closure of the branded stores globally and cancellation or delay of big sport events in 2020, but to recover mildly in 2021, following a light recovery in consumption activities by loosening measures on people movement.
    - We expect a 25%-30% decline in sales in tire cord in 2020, mainly due to a weakening auto market. Despite good progress in product certification, FTC's effectiveness in raising its product average selling price to delay to late 2020. Sales to recover by 20%-25% in 2021, with recovering demand for cars and stronger demand for bicycles and off-road vehicles.
    - Due to a slump in the oil price in second quarter of 2020, revenue from the gas station sector could decline by 18%-22% in 2020. After that, the revenue is likely to grow by 8%-13% in 2021, as we expect the oil price to remain stable after the price recovery in the second half of 2020.
- We forecast the ratio of FTC's operating cost and expenses to revenue to decrease 0.8%-1% in 2020 due to additional investment profit, partly offset by unfavorable exchange rates. The ratio is likely to decline 0.3%-0.7% in 2021 amid an improving utilization rate when the demand for woven fabrics and tire-cord picks up gradually.
- NT$1 billion-NT$1.5 billion capex per year in 2020 and afterward. This is mainly to support maintenance and upgrades for woven fabrics and tire cord business in Vietnam in 2020 and thereafter.
- NT$4.2 billion dividend payout in 2020 according to FTC's announcement. An 80% dividend payout ratio after 2020, which is a similar to the level before 2020.
- NT$450 million-NT$700 million investment in 2021-2022 for the parent group's investments in the U.S.
- The company will continue to provide guarantee on Formosa Ha Tinh (Cayman) Ltd.'s debt proportional to its ownership in 2020-2022, but the amount will materially diminish in 2021-2022, following the refinancing schedule without the requirement of a guarantee.

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

- EBITDA margin of 7.5%-8% in 2020, and 7.7%-8.2% in 2021-2022.
- Ratio of FFO to debt of 10%-12% in 2020, 14%-16% in 2021, and 17%-19% in 2022.
- FFO cash interest coverage of 8x-9x in 2020, 9x-11x in 2021-2022.

# Liquidity

The short-term issuer credit rating is 'twA-1'. We believe that FTC has adequate liquidity to meet its needs over the 12 months ending June 2021, reflecting a ratio of liquidity sources to liquidity uses will be around 1.4x over the same period and our view that the company's liquidity sources will continue to exceed uses, even if FTC's EBITDA were to decline by 15%. We also believe the company can absorb high-impact, low-probability events, with limited need of refinancing because its cash on hand and cash flow generation are sufficient for the repayment of short-term debt.

We also believe FTC has sound relationship with banks as evidenced by the low interest rate on its bank loans and diversified funding sources. This view is also supported by the company's satisfactory standing in the credit markets, as a member of the FP group. In our view, the company has generally prudent risk management to ensure continued adequate liquidity. This view is supported by the company's sufficient undrawn bank credit lines and flexibility to increase bank facilities. FTC's bank loans carry some financial covenants but we believe the company will meet these financial covenants with sufficient headroom over the next one to two years.

Principal Liquidity Sources:

- Cash and short-term investments: NT$3.8 billion at the end of June 2020.
- Undrawn bank lines: NT$6.5 billion-NT$7.5 billion up to June 2021
- Funds from operations: NT$3 billion-NT$3.5 billion up to June 2021.
- Working capital inflows: NT$100 million-NT$300 million up to June 2021.

Principal Liquidity uses:

- Long-term debt amortization plus short-term debt maturity: NT$4.0 billion-NT$4.5 billion up to June 2021.
- Capex: NT$1 billion-NT$1.5 billion up to June 2021.
- Cash outflow for investment: NT$200 million-NT$400 million up to June 2021.
- Cash dividend: NT$4.2 billion up to June 2021.

# Related Criteria & Research

## Related Criteria

- General Criteria: Group Rating Methodology - July 01, 2019
- Criteria | Corporates | General: Corporate Methodology: Ratios And Adjustments - April 01, 2019
- Criteria | Corporates | General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers - December 16, 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: Principles Of Credit Ratings - February 16, 2011

## Related Research

- Taiwan Ratings' Ratings Definitions – August 10, 2020

(Unless otherwise stated, these articles are published on www.taiwanratings.com)

# Ratings List

| Ratings Affirmed; | |
|---|---|
| **Formosa Taffeta Co. Ltd.** | |
| Issuer Credit Rating | twA/Stable/twA-1 |

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.