Media Release:

Taiwan-Based Shipping Firm Wan Hai Lines Ltd. Outlook Revised To Stable On Strong Operating Cash Flow; Ratings Affirmed.

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Rating Action Overview

- Taiwan based container shipper **Wan Hai Lines Ltd.** operates globally but earns the majority of its revenue from intra-Asia routes. Wan Hai generated around New Taiwan dollar (NT$)18 billion funds from operations (FFO) in 2020.
- Booming international trade amid the accelerated recovery in Europe and the U.S. could continue to strain global container shipping capacity and support Wan Hai's very strong cash flow generation over the next three to four quarters.
- Wan Hai could fund its aggressive capex through its strong operating cash flow and still retain sufficient financial buffer for a likely normalization in the shipping market, given the company's flexible dividend policy.
- On April 29, 2021, we revised our rating outlook on Wan Hai to stable from negative. At the same time, we affirmed the 'twA-' long-term and 'twA-2' short-term issuer credit ratings on the company.
- The stable outlook reflects our view that Wan Hai's strong profitability could sustain the company's ratio of FFO to debt well above 45% in 2021-2022, despite the company's plan to increase its capex sharply over the period.

Rationale Action Rationale

Freight rates and growth in trade volume could remain robust in 2021. We expect freight rates to remain heightened at least until the second quarter of 2021 before gradually normalizing. That's because congestion at major ports in North America and strong demand for physical goods continue to strain container shipping capacity. It could take months for port congestion to improve and for supply and demand for container shipping to return to a balance. We project Wan Hai's average freight rate for 2021 to grow by 40%-50% year on year.

Freight rates have surged significantly since the second half of 2020 through the first quarter of 2021. The Shanghai Containerized Freight Rate Index (SCFI) was at US$2,571 per twenty-foot equivalent unit (TEU) at the end of March 2021, which was about two times the level in the same period in 2020. Freight rates for Wan Hai's major service lines, including intra-Asia, Middle East and U.S. west coast (USWC) also posted strong growth, with about 75%-90% growth rate in the first quarter of 2021 compared with the end of 2020.

Wan Hai's lifting volume will also grow materially in 2021, especially for its USWC line, mainly fueled by the U.S. economic stimulus package. Wan Hai has significantly increased weekly services for USWC in response to this strong demand and to benefit from a higher freight rate. The company has achieved this through its highly flexible fleet deployment. We expect Wan Hai's overall lifting volume to grow by 10%-15% in 2021.

Despite higher bunker cost and charter hire payment, Wan Hai could maintain a much higher EBITDA margin in 2021-2022. The company's bunker cost is likely to grow along with recovery in crude oil prices over the next two years. S&P Global has raised its price assumptions for both Brent and West Texas Intermediate (WTI) crude oil for the remainder of 2021 and 2022 by US$10 per barrel (bbl). Hence, we project Wan Hai's bunker cost to increase to US$500-US$550 per ton in 2021-2022 from US$389 per ton in 2020. In addition, the ratio of global idle fleet as a percentage of total fleet reached a record low at below 2% in the first quarter of 2021. That was supported by soaring container freight rates and a shortage of container vessels. This combination of factors has led to surging charter rates across all sizes of containerships. We estimate Wan Hai's charter hire payment to increase by 40%-50% in 2021. However, we still expect soaring freight rates to support growth in Wan Hai's EBITDA margin to 35%-45% in 2021 and 15%-20% in 2022 from 10%-15% historically.

Capex is likely to remain heightened over the next two to three years. Leveraging its stronger operating cash flow in 2020 and 2021, Wan Hai plans to expand its self-owned fleet. That's given the strong market outlook and very high charter hire in the market. The company will acquire newly-built (including eleven 2038 TEU, 4 3036 TEU and 12 3013 TEU vessels) and secondhand vessels (including eleven 4000~7000 TEU vessels), with deliveries scheduled for 2021-2023, as well as new container boxes.

Wan Hai has also booked nine 13,000 TEU vessels in 2021, with deliveries scheduled for 2023-2024, to expand its capability of serving long-haul routes. Hence, the company's capex will significantly increase to around NT$30 billion in 2021 and NT$20billion-NT$23 billion in 2022-2023 from an annual lower than NT$10 billion historically. We project that by the time when all vessels are in position in 2023, Wan Hai's total capacity will grow by more than 30% compared to 2020.

The company is capable of significantly increasing its financial buffer under improved profitability in 2021-2022, but volatility remains for its financial metrics. Wan Hai's operating cash flow could outpace its relatively higher capex requirement and annual dividend distribution in 2021, and further reduce the company's debt level. We expect Wan Hai's adjusted debt to decline to NT$9 billion-NT$10 billion in 2021 from NT$24.9 billion in 2020. Accordingly, Wan Hai's ratio of FFO to debt is likely to materially increase to above 100% in 2021 from 73.2% in 2020. The company' s discretionary cash flow will turn negative in 2022, due to its aggressive capex plan, leading to higher debt of NT$18 billion-NT$19 billion. However, Wan Hai could remain flexibility in terms of its shareholder friendly action and reserve sufficient cash to support its future fleet expansion. Hence, we expect Wan Hai's ratio of FFO to debt to remain at 70%-80% in 2022.

However, we still expect the volatility of the company's financial metrics to be high due to cyclical market conditions, volatile bunker prices, and intense competition, especially after this wave of strong global demand fades and containership supply gradually increases. Additionally, we do not expect Wan Hai's capex to materially decrease over the next three to four years, based on its fleet expansion plan. As such, the ratio of FFO to debt is likely to decline after 2022 and hover at 40%-50% over the long term, in our view. These factors constrain the ratings, despite the company's currently strong credit metrics.

Outlook

The stable outlook reflects our view that Wan Hai will improve its profitability significantly over the next two years, underpinned by rising freight rates and growing lifting volume, despite a possible increase in fuel cost. This reflects the overall favorable market conditions in the shipping industry led by the global economic recovery from the COVID-19 pandemic, as well as disciplined industry supply control. Through strengthened operating cash flow and flexible shareholder friendly action, Wan Hai could improve its ratio of FFO to debt to above 100% in 2021 and 70%-80% in 2022. This is despite the company's heightened capex, mainly for fleet expansion, over the same period.

Downward scenario

We may lower the long-term issuer credit rating on Wan Hai, if:

- the company's profitability deteriorates materially, burdened by possible oversupply of containerships led by less disciplined market conditions, or rising competition from long-haul competitors that erodes its competitive advantage in intra-Asia, or
- the carrier takes on more aggressive expansion and substantially increases its debt leverage, such that its ratio of FFO to debt falls to below 45% for an extended period.

Upward scenario

We may raise the rating on Wan Hai, if:

- the company could achieve strong and resilient profitability, as demonstrated by a ratio of return on capital above 10% throughout industry cycles, while keeping the adjusted ratio of FFO to debt consistently above 60%. This could be achieved by further expansion in niche networks that can help the company to counter margin pressure, while at the same time lower its debt level through constrained capex.

Our Base-Case Scenario

We forecast Wan Hai's revenue to grow robustly by 60%-65% in 2021, mainly underpinned by strong growth in shipping volume and freight rates. Revenue for 2022 could decline by 30%-35%, reflecting declining freight rates amid gradually normalized market conditions in the container shipping industry. Our base-case assumptions are:

- S&P Global forecast for APAC real GDP to expand by 7.3% in 2021, mainly reflecting stronger trade and manufacturing amid the recovery from COVID-19. APAC real GDP to grow 4.9%. in 2022. Meanwhile, S&P Global forecasts U.S. real GDP to grow by 6.5% in 2021 and 3.1% in 2022.
- Wan Hai's shipping volume to grow by 10%-15% in 2021, underpinned by global economic recovery as well as the company's launch of new service lines on its intra-Asia and U.S. west coast routes. Volume should grow relatively moderately by 2%-3% in 2022.
- The company's average freight rate to remain high, growing by a further 40%-50% in 2021, due to shortage of container boxes and vessels led by continued congestion at major ports in the U.S., growing demand, and possible fuel surcharges. Market discipline is likely to remain over the next one to two years. Freight rates could gradually return to normal with a 30%-35% decline in 2022 from relatively high freight rate in 2021.

- Bunker fuel price to increase to US$500-US$550 per ton in 2021-2022 from US$350-US$400 per ton in 2020, reflecting the general rise in crude oil prices.
- Charter hire expense is likely to grow significantly by 40%-50% in 2021, due to the overall shortage of containers and vessels.
- Other costs (including port charges, stevedoring, transshipment and terminal fees) to grow along with volume over the next two years.
- Capex will increase significantly to NT$29 billion-NT$31 billion in 2021 and NT$20 billion-NT$23 billion in 2022, mainly for the acquisition of 36 new vessels, 11 used vessels, and new containers.
- Cash dividend payout ratio to decline to 15%-20% in 2021-2022 from around 50% in 2020, in order to reserve cash for the company's more aggressive capex plan over the same period.

Liquidity

The short-term rating on Wan Hai is 'twA-2'. We believe the company has adequate liquidity to meet its needs over the next 12 months, with a ratio of liquidity sources to liquidity uses of 1.5x-1.7x in 2021. We also believe Wan Hai can cope with high-impact low-probability events with limited refinancing, given the company's high cash balance on hand, as well as relatively strong operating cash flow in 2021. As of the end of 2020, Wan Hai has around NT$20 billion in cash and short-term investments. We project Wan Hai will generate NT$40 billion-NT$50 billion operating cash flow in 2021.

In addition, we believe the company's good relationship with Taiwan banks will provide access to financing when needed, as evidenced by the low interest rate on Wan Hai's bank loans. The carrier also has generally prudent financial risk management to consistently maintain sufficient financial buffer to withstand market volatility, in our view.

Principal Liquidity Sources:

- Cash and short-term investments: NT$ 20.6 billion at the end of 2020.
- Cash flow from operations: NT$40 billion-NT$50 billion in 2021.

Principal Liquidity Sources:

- Debt maturity: NT$9.5 billion-NT$10.0 billion in 2021.
- Capex: NT$28 billion-NT$32 billion in 2021.
- Cash dividend: NT$2.0 billion-NT$2.5 billion in 2021.

Ratings Score Snapshot

Issuer Credit Rating: twA-/Stable/twA-2

Note: The descriptors below are on a global scale.

Business Risk: Weak

- Country risk: Intermediate
- Industry risk: High
- Competitive position: Fair

Financial Risk: Modest

- Cash flow/Leverage: Modest

Anchor: twa-

Modifiers:

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

Stand-alone credit profile: twa-

Related Criteria & Research

Related Criteria

- General Criteria: Group Rating Methodology - July 01, 2019
- Criteria | Corporates | General: Corporate Methodology: Ratios And Adjustments - April 01, 2019
- General Criteria: Methodology For National And Regional Scale Credit Ratings - June 25, 2018
- 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; Outlook Action

	To	From
Wan Hai Lines Ltd.		
Issuer Credit Rating	twA-/Stable/twA-2	twA-/Negative/twA-2

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.