Media Release:

Taiwan-Based Container Carrier Yang Ming Marine Upgraded To ‘twBBB+/twA-2’ On Strong Cash Flow; Outlook Stable

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Rating Action Overview

- Soaring freights rates may substantially boost **Yang Ming Marine Transport Corp.**’s operating performance in 2021, driving up its margins and cash flow position and resulting in significant debt reduction.
- The Taiwan-based shipping company generates the bulk of its revenue from long-haul routes. The company had funds from operations of New Taiwan dollar (NT$) 33.1 billion in 2020.
- On April 29, 2021, we raised the issuer credit ratings on Yang Ming to 'twBBB+/twA-2' from twBBB/twA-2. The outlook is stable.
- The stable outlook reflects our view that Yang Ming can sustain its strong cash flow even as freight rates gradually normalize over the next 12 months.

Rationale Action Rationale

Rising freight rates in Yang Ming's main service routes should boost its margins and cash flows in 2021. While we expect the company's shipping volume to remain flat, port congestion in the world’s main harbors should keep freight rates elevated for the rest of 2021. The rising use of e-commerce and work-from-home models has substantially changed people’s life. An inability to timely offload containers could reduce productivity and undermine the capacity of the container system. We regard this an abnormal situation that should gradually normalize in the second half of 2021. Nonetheless, a significant correction in freight rates is unlikely until 2022.

High freight rates will outweigh elevated operating costs from COVID-19 induced inefficiencies. The prevailing COVID-19 situation has undermined container loading workflow in the U.S. The supply chain of cargo logistics is therefore facing severe delays. In our view, such delays could last for the next one to two quarters, raising unit operating costs. In addition, a cut in oil production by OPEC is likely to partially offset sluggish demand, particularly from India due to current rising confirmed cases, and keep bunker costs at a higher level than in 2020. Nonetheless, we believe the benefit of the abnormally high freight rates outweighs the increasing costs, enabling Yang Ming to generate very strong cash flow.

Industry capacity additions could remain disciplined for regulatory considerations. Although rising demand from e-commerce can bring in strong trade volumes, most container carriers have been cautious in building new vessels and have opted for leasing vessels due to uncertain environmental regulations. Other substitutes of bunkerage, exhaust cleaning to meet stricter regulations, speed controls on vessels, and elimination of unnecessary old vessels may hurt Yang Ming’s operating efficiency. In addition, with major long-haul carriers under three container shipping alliances--2M, Ocean, and THE--capacity additions will be constrained by consensus among alliance members. This will also lead better discipline in addition of market capacity.

Yang Ming’s debt is likely to materially reduce even with still-high capital expenditure in 2021. The company's strong earnings and cash flows in 2020-2021 should allow it to meet its capital expenditure while reducing debt. While Yang Ming plans to increase its capacity over the next one or two years through long-term leases and straight procurement of new vessels, it is expected to improve its capital structure by repaying debt earlier. The company's adequate liquidity increases its capacity to absorb its current obligations. Yang Ming will also likely increase fixed-rate borrowings to lower its funding costs and reduce liquidity risk.

Yang Ming's high business volatility and capital intensity continue to constrain the ratings. We believe the global container shipping industry will remain highly volatile because of its standard nature of services and frequent imbalances between supply and demand. Better market discipline through the formation of shipping alliances are unlikely to fully mitigate such industry volatility, in our view. Yang Ming will likely remain more vulnerable to such volatility than its larger peers due to its weak market position. In addition, the company will need to expand capacity and acquire new and more energy efficient vessels under increasingly stringent environmental standards. This will make it difficult for Yang Ming to sustain its improved debt leverage while improving its market position.

Outlook

The stable outlook reflects our view that Yang Ming can use its strong profitability and cash flow to lower debt over the next 12 months. This will be underpinned by strong freight rates.

The stable outlook also reflects our expectation that Yang Ming's role and linkage to the Taiwan government will remain intact and the company will continue to have good access to Taiwan's banking channels over the next two years.

Downward scenario

We may lower the long-term rating if:

- Yang Ming's competitive position weakens substantially. This could be due to: (1) a significant decline in the company's market share; or (2) a major deterioration in the company's cost structure and service network relative to larger peers' as a result of its inadequate fleet.
- Yang Ming's ratio of FFO to Debt falls below 15% for an extended period. This could result from aggressive debt-funded capital expenditures together with prolonged deterioration in industry conditions.
- We believe the company's role and link to the Taiwan government has weakened substantially, which includes a substantial reduction in government ownership or

control of Yang Ming's board. Nevertheless, we view this scenario as remote over the next 12-24 months.

Upward scenario

The likelihood of an upgrade over the next 12 months is limited because we believe Yang Ming's fleet upgrade will keep the company's debt leverage high. Nevertheless, we may raise the rating if:

- Yang Ming can further improve its cash flow and profitability, or substantially lower its debt, such that its ratio of FFO to debt rises substantially above 40% on a sustainable basis. Such a result may indicate a strengthened cost competitiveness and scale economy, or that the company has adopted a more conservative financial policy that reduces its debt substantially.

Our Base-Case Scenario

We forecast Yang Ming's revenue will grow robustly by 20%-30% in 2021, mainly underpinned by strong growth in shipping volume and freight rates. Revenue for 2022 could decline by 6%-12%%, reflecting declining freight rates amid gradually normalized market conditions in the container shipping industry. Our base-case assumptions are:

- S&P Global Ratings forecast for Asia-Pacific real GDP to expand by 7.3% in 2021, mainly reflecting stronger trade and manufacturing amid the recovery from COVID-19. Asia-Pacific real GDP to grow 4.9%. in 2022. Meanwhile, S&P Global Ratings forecasts U.S. real GDP to grow by 6.5% in 2021 and 3.1% in 2022.
- In our expectation, Yang Ming's shipping volume will remain sluggish due to the port congestion in the U.S. and Asia. We expect the second and third quarters in 2021 to continue to see congestion, which could ease a bit toward the end of the year. The overall volume in 2021 will go down by 4%-10% due to COVID-19-induced inefficiency. Volume should grow relatively strongly by 10%-13% in 2022.
- The freight rates, on the other hands, will remain abnormally high this year. Port congestion in Los Angeles-Long Beach will result in cargo delays and continue to drive up freight rates in the third and fourth quarters in 2021. We project a 42%-50% increase in freight rates in 2021. The freight rates for all main service routes will also remain high this year but decline 16%-22% in 2022.
- We expect Yang Ming's unit operating costs will rise in 2021 due to cargo delays and insufficient productivity. The overall level will go up by 20%-25%% in 2021. We incorporate S&P Global Ratings' projection of substantially rising bunker prices. This is congruent with the recent market condition in brent crude oil prices and WTI crude oil futures. We believe the effect of the production cut from OPEC on oil pricing will outweigh the current uncertain demand from rising confirmed cases in India and Japan.
- Yang Ming's operating leases for the next two years to go up, reflecting the company's ongoing plans on purchasing, chartering, and eliminating vessels for the following years. Currently, the company leases 14 new-built chartered vessels for long-haul services and 10 new-built owned vessels for short haul. Yang Ming maintains the flexibility of meeting the alliance's goal and adjusting capacity in terms of overall demand conditions in different routes. In 2022, the capex could rise as the company intends to spend NT$6.5 billion on self-owned containers. The current owned percentage in container is about 30%.

- Yang Ming to not issue cash dividends in 2021 as it has to cover its existing loss and regulatory capital requirement first. We expect the company to issue NT$2.5 cash dividend per share in 2022. The total amount will be about NT$8.7 billion. Total cash dividend in 2023 may decline to NT$1.6 billion as we project margins and cash flow will slow down as the market gradually returns to normal.
- We have applied no surplus cash adjustment because of the company's weak business risk profile.

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

- Ratio of FFO to debt of 35%-42% in 2021, but to decrease to 18%-23% in 2022.
- FOCF to debt of 30%-36% in 2021, but to drop to 8%-12% in 2022.

Liquidity

The short-term rating on Yang Ming is 'twA-2'. We believe Yang Ming has adequate liquidity sources to cover its needs in 2021. We expect liquidity sources will cover 1.40x – 1.60x of liquidity uses without refinancing. Furthermore, we expect Yang Ming to restructure its capital structures and increase fixed-rate loan borrowings by effectively utilizing its current strong cash position. The company's good access to banks underpinned by its status as a government related entity should help it to easily gain access to bank facilities and reduce its refinancing risk.

Principal Liquidity Sources

- Cash and short-term investments of NT$28.2 billion at the end of 2020.
- Cash flow from operations of NT$40 billion-NT$44 billion in 2021.
- Undrawn bank lines maturing beyond 12 months of about NT$12.8 billion in 2021.

Principal Liquidity Uses

- Debt maturity of NT$35 billion-NT$40 billion in 2021.
- Current operating lease of NT$10 billion-NT$13 billion in 2021.

Related Criteria & Research

Related Criteria

- General Criteria: Hybrid Capital: Methodology And Assumptions, Mon Jul 01 2019
- 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
- General Criteria: Rating Government-Related Entities: Methodology And Assumptions - March 25, 2015
- 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 And Insurers - November 13, 2012
- General Criteria: Principles Of Credit Ratings, Wed Feb 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 Upgraded

	To	From
Yang Ming Marine Transport Corp.		
Issuer Credit Rating	twBBB+/Stable/twA-2	twBBB/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.