Media Release:

Wiwynn Corp. Outlook Revised To Negative From Stable On Rising Debt Leverage At Parent; 'twA/twA-1' Ratings Affirmed

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Rating Action Overview

- Taiwan-based **Wiwynn Corp.** is a subsidiary of Wistron Group, and specializes in providing customized servers for hyper-scale data centers of globally leading cloud service providers. Wiwynn generated EBITDA of NT$11.6 billion in 2020.
- Wiwynn's parent company, Wistron's debt leverage could weaken materially in 2021-2022 due to high capex, sustained cash dividends and working capital outflow for high inventory amid ongoing component shortages.
- The deterioration in Wistron's credit profile could negatively affect the rating on Wiwynn, which is capped at one notch above the Wistron group credit profile on S&P Global Ratings' global rating scale, despite Wiwynn's stable stand-alone credit profile.
- We have revised our outlook on the long-term issuer credit rating to negative from stable. At the same time, we affirmed our 'twA/twA-1' issuer credit ratings on Wiwynn.
- The negative outlook reflects a likely deterioration of the parent company's debt to EBITDA ratio to 5.5x-6.0x in 2021, and the uncertainty surrounding the timing and strength of Wistron's ability to return its debt to EBITDA ratio below 5x on a sustained basis.

Rationale Action Rationale

Wistron's debt leverage could rise materially in 2021. Wistron's inventory has piled-up since the first quarter of 2021 amid global chip supply tightness. This led to around new Taiwan dollar (NT$) 30 billion working capital outflow in the first half of this year, which is likely to last throughout 2021. Based on S&P Global's recent forecast, the demand-supply imbalance for semiconductors will last at least into 2022; in addition, the second half of the year is the traditional peak season for consumer and commercial electronics and requires more working capital to support shipments.

Meanwhile, Wistron's capital expenditures (capex) is likely to increase to NT$14 billion-NT$17 billion in 2021 from around NT$10 billion in 2020, mainly for capacity expansion in Taiwan, South-East Asia and Mexico to reduce the concentration of its production capacity in China. We therefore project Wistron's debt to EBITDA ratio could weaken to 5.5x-6.0x in 2021 from

4.4x in 2020. This is despite the company's improving margin in 2021 after the disposal of part of its manufacturing facilities in China last year.

The degree and time frame for recovery of Wistron's leverage is far from certain. Our base case forecasts that Wistron's debt to EBITDA ratio will gradually recover to below 5x in 2022, driven by strengthening operating cash flow and the company's decreasing capex needs after 2021 once the company completes its current phase of expansion outside of China. In our opinion, Wistron's operating cash flow could significantly improve after supply chain bottlenecks caused by COVID-19 and shortages in components start to ease. Nonetheless, we acknowledge that the remaining uncertainty over the timeline and degree by which Wistron will bring down its debt. A prolonged component shortage, pricing pressures from its key customers, and fading demand from remote working and remote learning could weaken the company's operating performance and operating cash flow. In addition, the cost efficiency of its overseas expansion, such as in India, will take time to achieve the same level as for its existing facilities.

The ratings on Wiwynn are constrained by Wistron's group credit profile. The material weakening in Wistron's credit profile have a negative effect on our ratings on Wiwynn. We continue to assess Wiwynn as an insulated and highly strategic subsidiary of Wistron Group. Our issuer credit rating on Wiwynn is capped at one notch above group credit profile of Wistron on S&P Global Ratings' global rating scale. This reflects our belief in Wistron's strategic need to maintain certain separation from Wiwynn to avoid direct competition in the server market with its major generic server clients. In addition, Wiwynn is independent in its business operation and financial performance, and does not commingle its funds, other assets and cash flow with that of Wistron. However, we do not expect Wistron to fully divest Wiwynn, given the company's significant profit contribution and importance to the group's long-term strategy to develop server business.

Wiwynn's stand-alone credit profile will remain stable over the next two years despite some headwinds. Wiwynn's strong profitability and strong balance sheet could absorb significant working capital outflow, while keeping Wiwynn's ratio of debt to EBITDA at around 1x in 2021, in our opinion. Our base case forecasts Wiwynn will incur around NT$10 billion-NT$12 billion working capital outflow in 2021 because of rising inventory levels. This is despite that Wiwynn's inventory is likely to decline along with easing component shortages in the second half of 2021, reversing part of its NT$17.7 billion working capital outflow in the first half.

There remains uncertainty over the timeframe of any decline in its inventory level. However, we believe Wiwynn's strong balance sheet and operating performance could weather such uncertainty, underpinned by then company's prudent financial management and growing profitability. Strong demand from its key clients' aggressive hyper-scale data center expansion plans will bolster Wiwynn's revenue amid the accelerating shift to cloud services over the next two to three years. Wiwynn's EBITDA margin is likely to sustain at 5.8%-6.2% over the period, thanks to growing economies of scale in its production, as well as the offering of new technology. Moreover, underpinned by its highly customized product and close relationship with its key clients, Wiwynn could pass through most of its rising raw material costs, given recent component shortages.

Outlook

The negative rating outlook reflects the material likelihood that the financial leverage of Wiwynn's parent company, Wistron, could remain weak over 2021-2022. That's due to significant working capital outflow and Wistron's growing capex for capacity expansion. Our base forecast that Wistron's debt to EBITDA ratio will deteriorate to 5.5x-6.0x in 2021 from 4.4x in 2020, before falling slightly below 5x in 2022. However, the uncertain timeframe for the normalization of semiconductor supply-demand imbalance could curb Wistron's ability to restore its cash flow generation and improve its debt to EBITDA ratio to below 5x during the period.

Downward scenario

We could lower the long-term rating on Wiwynn if:

- Wistron's det to EBITDA ratio remains above 5x over the next 12-18 months, which could result from:
  - Wistron's inability to restore its operating cash flow due to prolonged component shortages that lead to more working capital needs than our expectation;
  - Considerably higher capex or investments than under our base case; or
  - Wistron's profitability deteriorates substantially due to a loss of critical customers or more intense pricing competition in the EMS industry, or weaker cost efficiency at its new capacities outside of China.
- In a less likely scenario, Wiwynn's debt to EBITDA ratio deteriorates to above 1.5x for an extended period. This may occur if:
  - Wiwynn's revenue or profitability weaken substantially because intense competition or deteriorating R&D strength relative to that of its peers induces severe pricing pressure from its clients or the loss of key customers; or
  - The company's debt level grows significantly because Wiwynn becomes more aggressive on capex or shareholder friendly actions, or the company's cash conversion cycle lengthens materially under pressure from its clients.

Upward scenario

We could revise the outlook back to stable if:

- Wistron's debt to EBITDA ratio recovers to below 5x on a sustainable basis. This could happen if the imbalance between semiconductor supply and demand resolve and the supply of Wistron's key components normalizes, leading Wistron's inventory back to its historical average. At the same time, Wiwynn keeps its debt to EBITDA ratio below 1.5x.

Our Base-Case Scenario

- S&P Global's forecast for U.S. real GDP to grow by 6.5% in 2021 and 3.1% in 2022, Europe real GDP to grow by 4.2% in 2021 and 4.4% in 2022, and Asia-Pacific real GDP to grow by 7.1% in 2021 and 5.2% in 2022.
- S&P Global's forecast for global IT spending to increase by 9.4% in 2021, mainly reflecting macroeconomic tailwinds and accelerating digital transformation by enterprise and consumers alike.
- Wiwynn's revenue to grow by 5%-10% in 2021 and 20%-25% in 2022, mainly underpinned by leading cloud service providers' aggressive hyper-scale data center expansion plans.

- Gross margin to improve to 8.2%-8.5% in 2021-2022 from a historical 5%-7%, thanks to Wiwynn's growing economies of scale in production and continuous R&D efforts in creating added value to its products.
- Sales, general and administration expense to grow along with revenue in 2021-2022 and R&D to revenue ratio at 1.0%-1.5% over the period.
- Capex to increase to NT$1.2 billion-NT$1.4 billion in 2021-2022 from historical level of below NT$1 billion, mainly to support a new assembly site in Malaysia and equipment additions.
- Equity investment in LiquidStack of NT$280 million in 2021.
- Cash dividend payout ratio in 2021-2022 of about 65% of the previous year's net income.

Liquidity

The short-term rating on Wiwynn is 'twA-1'. We believe that Wiwynn has adequate liquidity to meet its needs over the 12 months ending June 2022. We estimate the ratio of liquidity sources to liquidity will be 1.2x-1.25x over the same period. In addition, we believe Wiwynn can absorb low probability, high-impact events with limited need for refinancing, underpinned by its prudent risk management characterized by limited debt usage, relatively flexible capital expenditure and complete hedging on foreign currency risk, in addition to the company's abundant cash on hand.

We also believe that Wiwynn has strong banking relationship and a generally satisfactory standing in credit market. The company's issuance of five-year corporate bonds in 2020 and 2021 with an interest rate of 0.83% and 0.63%, respectively, underpins our view. Wiwynn's debt carries no financial covenants.

Principal liquidity sources:

- Cash and short-term investments of NT$20.3 billion as of the end of June 2021.
- Funds from operations of NT$9 billion-NT$11 billion over the upcoming 12 months ending June 2022.

Principal liquidity uses: (over the upcoming 12 months ending June 2022)

- Debt maturity of about NT$17 billion.
- Working capital outflow of about NT$3 billion-NT$4 billion.
- Capex of NT$1.2 billion-NT$1.4 billion.
- Cash dividend payout of NT$3.5 billion in a stress scenario.

Ratings Score Snapshot

Issuer Credit Rating: twA/Negative/twA-1
Note: The descriptors below are on a global scale.

Business risk: Fair

- Country risk: Intermediate
- Industry risk: Moderately 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: Fair (no impact)
- Comparable rating analysis: Negative (-1 notch)

Stand-alone credit profile: twA

- Entity status within group: Highly strategic (The issuer credit rating reflects the entity's stand-alone credit profile of 'twa' and is currently not capped by the group credit profile)
- We assess Wiwynn as an insulated and highly strategic subsidiary of Wistron group. The issuer credit rating on Wiwynn can be one notch above the parent group credit profile on S&P Global Ratings' global rating scale if Wiwynn's stand-alone credit profile is one or more notches higher than the group credit profile.

Related Criteria & Research

Related Criteria

- General Criteria: Methodology For National And Regional Scale Credit Ratings - June 25, 2018
- 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

Outlook Revision; Ratings Affirmed

	To	From
Wiwynn Corp.		
Issuer Credit Rating	twA/Negative/twA-1	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.

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