Media Release

Far Eastern New Century And Yuan Ding Investment Outlooks Revised To Stable From Negative On Robust EBITDA Recovery; Ratings Affirmed

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Overview

- **Far Eastern New Century Corp.** (FENC) is a major fiber and textile manufacturer in Taiwan, with various investments including **Far EasTone Telecommunications Co. Ltd.** FENC's EBITDA was NT$40 billion in 2020.
- Strong demand for polyethylene terephthalate (PET) and textile products along with narrower losses on purified terephthalic acid (PTA) products could bolster FENC's EBITDA to beyond the pre-pandemic level.
- Improving operating cash flow, payments from 5G network sharing and asset disposals could help fund high capital expenditure and cap debt growth over the next two years.
- Taiwan Ratings Corp. has revised its outlook on the 'twA' long-term issuer credit rating on FENC and its investment holding company, **Yuan Ding Investment Corp.** to stable from negative to reflect the expected improvement in FENC's production business and the resulting improvement in its ratio of debt to EBITDA of around 5x over the next two years.
- At the same time, we affirmed our 'twA' long-term and 'twA-1' issuer credit ratings on the companies.

Rating Action Rationale

Solid demand for PET to sustain the business' high profitability. Strong global demand and a supply shortage for PET in the U.S. will continue to drive export demand and boost margins on FENC's PET sales particularly in the U.S., Taiwan, and Vietnam over the next one to two years. Shifts to PET packaging from aluminum could help grow PET demand in the U.S. by 5%-6% in 2021, prompted by a supply shortage and a sharp price hike for aluminum. The resumption of U.S. domestic travel activity has also spurred demand for packaged drinks.

Demand for recycled PET is also likely to rise rapidly as top global beverage brands pursue aggressive green transitioning for their product packaging. For instance, The Coca-Cola Co. aims to use at least 50% recycled material by 2030 in response to ever-increasing consumer and investor scrutiny over the environmental impact of plastic packaging. Meanwhile, higher quality standards and other entry barriers such as challenging raw material supplies could constrain supply growth and sustain a material price premium and margins for recycled PET relative to virgin PET, in our opinion.

PTA losses to narrow though massive capacity increase will keep the business loss making. We estimate operating losses for FENC's PTA operations at new Taiwan dollar (NT$) 1.8 billion-NT$2.2 billion in 2021, down from NT$3.4 billion in 2020, mostly reflecting inventory gains amid a generally increasing trend in the crude oil price. In addition, a more stable PTA spread in Taiwan along with FENC's lower operating cost for its newly built facilities in Taiwan could offer some cushion against stiff price competition and persistent losses for the company's PTA operations in China.

A quick turnaround in its PTA business in China is unlikely, in our view, because of aggressive capacity additions by Chinese manufacturers in coming years. There could be over 10 million tons of new PTA capacity joining the market in China in 2021, adding about 13% to global capacity. The country could add another 30 million tons of new capacity up to 2025, which could continue to depress product spreads in China in 2021-2024.

A rapid market recovery could help FENC's textile business return to profit. We see a robust recovery in fundamental demand for sports and outdoor wear because consumers are increasingly health and fitness conscious and the improved pandemic condition globally allows consumers to return to in-store shopping and outdoor activities. We see rebounds in outdoor sports and gym activities following the loosening of social distancing measures will help demand recover to the pre-pandemic level. A consumer shift toward more comfortable clothes could also help to drive double-digit revenue growth for FENC's textile business in 2021. We believe that the recent pandemic outbreak in Vietnam and the resultant shortage in labor will have a mild impact on FENC's business activity there because around 80% of its produced yarns use recycled materials and the market is undersupplied.

Far EasTone's EBITDA to rebound on rising 5G penetration. Our base case forecasts that growing average revenue per user (ARPU) and robust growth in the operator's information communication technology business could underpin 2%-4% EBITDA growth in 2021. Consumer adoption of fifth generation (5G) services is moderately higher than our forecast at the beginning of the year. Far EasTone's 5G subscription is likely to reach 1.5 million by the end of 2021, equivalent to about 21% of the service provider's total subscription base. This could support a rebound in the firm's ARPU through higher fees for 5G services.

Spectrum sharing, asset disposals, and strengthened profitability could limit a future debt hike. FENC's debt level could decline by NT$2 billion-NT$4 billion in 2021, mainly supported by upcoming payments from Asia Pacific Telecom Co. for 5G network sharing. Far EasTone will receive a net cash inflow of NT$4.5 billion after deducting the telecom operator's planned NT$5 billion capital injection in Asia Pacific Telecom from a promised payment of NT$9.5 billion for partial usage of Far EasTone's 5G bandwidth. Proceeds of NT$3.26 billion from Far EasTone's disposal of its office asset also facilitate a debt reduction.

FENC's debt level could increase slightly in 2022-2023 to support capacity expansion in its production business, working capital needs, as well as Far EasTone's 5G infrastructure investment. FENC has set an ambitious growth target for its recycled PET, given a foreseeable demand increase. The company targets to increase its capacity from 390 thousand metric tons in 2019 to one million tons by 2025. In addition, construction of FENC's partially owned integrated PET project in the United States could also resume in 2022. We believe that the spending on these projects and relatively high cash dividend payments will keep FENC's debt level elevated, despite possible assets disposals and cash inflows from the delivery of the company's residential property project in New Taipei City.

Outlook

The stable rating outlook reflects the material improvement in FENC's production business in 2021 and 2022 and more active debt management. Catalysts include solid demand for PET in the U.S., a supply shortage of recycled PET, and rebounding global demand for textile products. In addition, we expect the company's losses on its PTA business to narrow with some inventory gains amid a generally rising trend in the crude oil price. Accordingly, we forecast FENC's EBITDA generation to increase to NT$45 billion-NT$48 billion in 2021 and 2022. Material cash inflows from asset disposals, cash distributions from its investments, and its property development could help to partly fund its elevated capital expenditure and limit debt growth.

Downward scenario

We may lower the long-term issuer credit rating on FENC if the company's adjusted ratio of debt to EBITDA rises to above 6x, which could result from:

- Deterioration in FENC's profitability due to a prolonged industry downturn in the polyester product chain or worsening oversupply in PTA that devastates the company's profit margin;
- Considerably higher capital expenditure on the company's major businesses than under our base case; or
- FENC's management exhibits a high degree of debt tolerance, as indicated by a lack of active debt management, such as capping debt growth through asset disposals or additional prudency in capital spending.

Upward scenario

We may raise the long-term rating on FENC if the company improves its ratio of debt to EBTIDA to close to 4x on a sustainable basis. This could be led by:

- Sustainable and material improvement in FENC's profitability in its chemical business, possibly led by product mix enhancement with high-margin products, such as recycled-PET constituting a substantial share; or
- A more conservative financial policy regarding capital expenditure and cash dividend or a large-scale asset disposal, such that the company's debt could be lowered substantially.

Our Base-Case Scenario

We project FENC's revenue and EBITDA to increase by 11%-13% and 12%-16%, respectively, in 2021, mainly driven by a demand rebound and operating enhancement in the company's production business. We project another 4%-7% growth in revenue and 0%-4% growth in EBITDA in 2022, mainly reflecting the incremental revenue and profit associated with the company's residential project in New Taipei City. Our base case assumptions for FENC include:

- Taiwan's real GDP to grow 5.6% in 2021 and 2.7% in 2022; China's real GDP to grow 8.3% in 2021 and 5.1% in 2022; and Asia Pacific's real GDP to expand by 7.1% in 2021 and 5.2% in 2022. The higher economic growth rates support higher demand for chemical products.
- S&P Global's assumption for Brent crude oil of around US$65 per barrel (bbl) for the rest of 2021 and US$60 bbl in 2022, suggesting commodity chemical prices will rise in 2021 and soften modestly in 2022.
- We project a 2%-5% revenue growth and 2%-4% EBITDA growth for Far EasTone in 2021 and 2022, reflecting a rebound in ARPU.
- The loss on FENC's PTA business to narrow to NT$1.8 billion-NT$2.5 billion in 2021 and 2022. PTA's cash spread to remain narrow over the next two years, due to China's sizeable new capacity launches.
- Operating profit on polyester business to increase to NT$4.5 billion-NT$5.5 billion in 2021 and 2022, reflecting a relatively high PET margin in the U.S. and increasing contribution from the highly profitable recycled PET. Demand rebound for polyester filament and sustained demand for hygiene products also contribute to strong operating profit.
- Operating profit of its textile business to exceed pre-pandemic levels to NT$0.9 billion-NT$1.1 billion in 2021 and 2022, contributed by a substantial market rebound.
- The completion of a new office building and an uplift of occupancy rates at several other office buildings foster a double-digit increase in operating income for its property development business in 2021. The sale of a residential property project in Banqiao of New Taipei City could increase revenue to NT$11 billion-NT$13 billion and EBITDA to NT$2.5 billion-NT$2.9 billion in 2022. This incorporates a 60% sell-through rate in 2022.
- Working capital outflow of NT$8 billion-NT$10 billion in 2021 and NT$1 billion-NT$2 billion in 2022 for inventory buildup.
- Cash dividend received from equity-method investment to further increase to about NT$5.0 billion in 2021 and remain elevated in 2022, underpinned by solid performance at various invested companies.
- Capital expenditure of NT$25 billion-NT$29 billion in 2021 and NT$28 billion-NT$33 billion in 2022 to support further investment in 5G network infrastructure and capacity expansion in FENC's petrochemical business.
- Far EasTone to receive NT$10 billion-NT$11 billion from APT for sharing two ninths of FET's 3.5GHz spectrum cost and 5G network capital expenditure in 2021.
- Far EasTone to participate in Asia Pacific Telecom's private equity placement for a value of NT$5 billion in 2021, representing a shareholding of 11.58% in the company.
- Asset sales of about NT$3.3 billion in 2021 and NT$1.8 billion-NT$2.2 billion in 2022.
- Cash dividend of NT$7.2 billion in 2021 and NT$8 billion-NT$10 billion in 2022.

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

- Revenue of NT$229 billion-NT$234 billion in 2021 and NT$241 billion-NT$246 billion in 2022.
- EBITDA margin of 19%-20% in 2021 and 2022.
- Ratio of debt to EBITDA of 4.9x-5.2x in 2021 and 2022.
- Ratio of funds from operations to cash interest coverage of 13x-15x in 2021 and 2022.

Liquidity

The short-term rating on FENC is 'twA-1'. We believe the company has adequate liquidity, which reflects a ratio of liquidity sources to liquidity uses of 1.25x-1.35x over the next 12 months. We also believe the company will have positive liquidity sources minus uses, even if its EBITDA declined by 15%.

We believe the company has a sound relationship with banks as evidenced by the low interest rate on its bank loans. Moreover, we see FENC has a high standing in the credit markets, as demonstrated by a recent NT$9.5 billion five-year 0.67% fixed rate corporate bond in April 2021 and NT$1.2 billion five-year 0.52% fixed rate corporate bond in May 2021.

FENC has generally prudent risk management to ensure continued adequate liquidity, in our view. The company's sufficient undrawn bank credit lines and flexibility to increase bank facilities support this view. We also believe FENC has sufficient headroom without breaching covenant limits due to low interest rates in Taiwan, even if the company's EBITDA dropped by 15%.

Principal liquidity sources:

- Cash and short-term investments of about NT$48.8 billion as of the end of June 2021.
- Funds from operations of NT$40 billion-NT$44 billion over the 12 months ending June 2022.
- Undrawn mid-to-long term bank lines maturing beyond June 2022 of NT$31 billion-NT$35 billion.
- Asset sales of NT$3.0 billion-NT$ 4.0 billion over the 12 months ending June 2022.
- Net cash inflow from Asia Pacific Telecom and others of NT$6.0 billion-NT$8.0 billion over the 12 months ending June 2022.

Principal liquidity uses:

- Debt maturity of NT$71 billion over the 12 months ending June 2022.
- Working capital outflow of NT$4 billion-NT$6 billion over the 12 months ending June 2022.
- Maintenance capital expenditure of about NT$12 billion over the 12 months ending June 2022.
- Cash dividend of NT$14 billion in 2021.

Ratings Score Snapshot

Issuer Credit Rating: twA/Stable/twA-1

Note: The descriptors below are on a global scale.

Business risk: Satisfactory

- Country risk: Intermediate
- Industry risk: Intermediate
- Competitive position: Satisfactory

Financial risk: Aggressive

- Cash flow/Leverage: Aggressive

Anchor: twbbb+

Modifiers

- Diversification/portfolio effect: Neutral (no impact)

- Capital structure: Positive (+1 notch)
- 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

- Group credit profile: twa
- Entity status within group: Core

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
- Criteria | Corporates | Industrials: Key Credit Factors For The Telecommunications And Cable Industry - June 23, 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
Far Eastern New Century Corp.		
Yuan Ding Investment Corp.		
Issuer Credit Rating	twA/Stable/twA-1	twA/Negative/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.