Media Release:

Yulon Motor Co. Ltd. Outlook Revised To Positive From Stable On Improving Profitability; 'twBBB+/twA-2' Ratings Affirmed

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Rating Action Overview

- **Yulon Motor Co. Ltd.'s** stand-alone credit profile could continue to improve and accordingly strengthen the Yulon group credit profile. We believe Yulon Motor could continue to recover its EBITDA to NT$5 billion-NT$6 billion per year over the next two years through ongoing business restructuring of Luxgen and Haitec to curb losses, as well as from a relatively stable cash dividend from Yulon Nissan.
- We have revised our rating outlook on Yulon Motor to positive from stable to reflect our view that Yulon's debt to EBITDA ratio is likely to stay below 4x over 2021-2022. However, the company's debt will increase moderately from the level at the end of 2020, based on our forecast of negative free cash flow for the period.
- At the same time, we affirmed the 'twBBB+' long-term and 'twA-2' short-term issuer credit ratings on the company.

Rationale Action Rationale

Yulon Motor's losses from Luxgen and Haitec have declined significantly and could continue to fall over the next two years. Huachung Automobile Information Technical Center Co. Ltd. (Haitec), a subsidiary of Yulon Motor, will likely continue to limit its operating losses at a low level by downsizing its business. The company is now mainly an investment holding company, with the major asset being Foxtron Vehicle Technologies--a joint venture with Hon Hai Precision Industry Co. Ltd.

Meanwhile, losses on Yulon Motor's own-branded Luxgen business are also likely to stay low, because the company will only pay royalties for new models to the joint venture, if any, rather than sharing development costs with Haitec, as it did previously. We anticipate Yulon Motor will gradually reduce its exposure to Luxgen, which will effectively suppress related losses over the next two years, even with the likelihood of the brand's declining unit sales in Taiwan due to lack of new models.

Yulon Motor's reported operating losses associated Haitec and the Luxgen brand have narrowed to NT$5.8 billion in 2020 and further to NT$200 million in the first half of 2021, from a huge loss of NT$36 billion in 2019.

Relatively stable cash dividend from Yulon Nissan could continue to support Yulon Motor's EBITDA. Yulon Motor's EBITDA relies heavily on the cash dividend payment from Yulon Nissan Motors Co. Ltd., whose performance in turn largely depends on the investment profit from Nissan-branded operations in China. A likely decline in sales of Nissan-branded cars in Taiwan, as well as intense market competition in China could limit the cash dividend Yulon Motor receives at below the level in 2020 over the next two years. However, given Nissan's satisfactory position in China, we factor in a cash dividend of NT$2.6 billion in 2021 and NT$2.4 billion in 2022, compared with NT$3 billion in 2020.

Negative free cash flow could moderately lift Yulon Motor's debt in 2021 and 2022. Yulon Motor is likely to generate negative cash available for debt repayment of NT$1 billion-NT$1.5 billion in 2021, and NT$0.5 billion-NT$ 1 billion in 2022 due to cash outflow from working capital. This includes the construction payment of Yulon City, which is scheduled for opening in late 2022, some tax payables and other payables from Haitec to its suppliers, as well as Yulon Motor's planned capital expenditure and cash dividend payout. These cash outflows could elevate Yulon's adjusted debt to about NT$18.5 billion in 2022, from NT$16.5 billion at the end of 2020.

Our base case assumes Yulon will improve its debt to EBITDA ratio to 3.5x-4x level over 2021 and Y2022, despite likely rising debt leverage. Yulon's annual EBITDA could continue to recover to about NT$5.5 billion annually in 2021 and 2022, from NT$4.1 billion in 2020. We do not anticipate Yulon will incur large losses going forward, particularly related to its Luxgen business. Nor do we expect any large cash outflow or additional debt beyond our base case, such as for additional financial support to Haitec. As a result, we forecast Yulon Motor's ratio of debt to EBITDA to remain at 3.5x-4.0x in 2021-2022 under our base-case. This could support stronger stand-alone credit profile for Yulon Motor, and accordingly lead to a stronger group rating profile.

Our Base-Case Scenario

Assumptions

- S&P's real GDP growth projection for Taiwan of 5.6% in 2021 and 2.7% in 2022 and for China of 8.3% in 2021 and 5.1% in 2022.
- We anticipate 5%-9% growth for light vehicle sales in China in 2021. China's economic recovery and supportive government policies underpin such growth, likely offsetting disruptions from auto-chip supply.
- The global automotive chip shortage, uncertainty over seaborne shipments, and domestic pandemic restrictions could reduce auto sales in Taiwan by 5%-10% in 2021 before recovery in 2022.
- Yulon Motor's revenue to decline by 7%-8% in 2021 and recover by 1%-3% in 2022, reflecting a likely decline in unit sales for Yulon Nissan due to a lack of new models, as well as lower sales for Nissan-branded cars in China amid intense competition. However, revenue to see some recovery in 2022, mainly driven by the introduction of new Nissan models in Taiwan.
- Yulon Motor's gross margin to improve thanks to its narrowed losses on its Luxgen brand and a lower operating loss from Haitec.
- Nissan sales in China will continue to support Yulon Motor's dividend income and EBITDA over the next two years but the cash dividend could be lower in 2022, given a likely weaker recovery for Nissan cars than the industry average in China.

- Yulon Motor's capital expenditure to decline over the next few years under its conservative business and new model development strategy. We assume NT$2 billion per year in 2021 and 2022.
- Working capital outflow of about NT$3.5 billion in 2021, and NT$1.5 billion -NT$2 billion in 2022, from cash outflow of construction cost for Yulon City, as well as other payables such as for taxes.
- Yulon Motor to pay NT$1 billion cash dividend in 2021 and NT$1.5 billion in 2022.

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

- EBITDA margin of 10%-11% in 2021 and 2022, from 7.7% in 2020.
- Ratio of debt to EBITDA of about 3.5x in 2021 and 2022, compared with 4x as of the end of 2020.

Liquidity

The short-term issuer credit rating is 'twA-2'. We believe Yulon Motor has adequate liquidity to meet its needs over the next 12 months. Our view of the company's liquidity profile incorporates our assessment that the ratio of liquidity sources to liquidity uses will be 1.4x-1.5x over the next 12 months up to June 2022, and that liquidity sources will continue to exceed uses even if Yulon Motor's EBTIDA were to decline by 15%.

The liquidity assessment also reflects our view that the company can absorb high-impact, low-probability events, with limited need for refinancing, supported by its relatively high cash on hand, which provides some buffer for the company to withstand market volatility. Yulon Motor also has a satisfactory standing in credit markets, as evidenced by the bond issuance of a NT$5.3 billion bond at a low interest rate in 2018 and stable bond prices so far. Yulon Motor's debt does not carry any covenants

Principal Liquidity Sources

- Cash and short-term investments of NT$16.9 billion at the end of June 2021.
- Cash flow from operations of NT$4.5 billion-NT$5 billion in the 12 months ending June 2021.

Principal Liquidity Sources

- Debt maturity of NT$7.5 billion in the 12 months ending June 2022.
- Expected working capital outflow of about NT$3.5 billion in the 12 months ending June 2022.
- Capital expenditure of NT$2 billion in the 12 months ending June 2022.
- Cash dividend of NT$1 billion in the 12 months ending June 2022.

Outlook

The positive rating outlook reflects our expectation that Yulon is likely to improve its stand-alone credit profile and correspondingly the overall group credit profile, by keeping its debt to EBITDA ratio below 4x over the next two years. This assumes the company can successfully curb losses on Luxgen and other businesses and that the cash dividend from Yulon Nissan will continue support Yulon Motor's EBITDA generation over the period. However, cash outflow from working capital, construction costs for Yulon City, capital expenditure, and cash dividends will moderately raise Yulon's financial leverage and could prevent the company from holding its debt to EBITDA ratio below 4x over the next two years.

The positive rating outlook also reflects our view that Yulon Finance can maintain its current credit profile over the next two years.

Upward scenario

We may raise the long-term rating if Yulon Motor can keep its debt to EBITDA ratio comfortably and sustainably below 4x. The likely scenarios to sustainably improve its cash flow generation include:

- enhancing its core auto manufacturing business;
- a better performance from Yulon Nissan;
- no material losses from Luxgen and Haitec.

Downward scenario

We may revise the outlook back to stable if Yulon Motor fails to keep its debt to EBITDA ratio below 4x over the next one to two years. This could result from:

- much weaker sales for Nissan branded cars in China in 2021-2022 than we currently expect, resulting in lower investment income from Yulon Nissan,
- unexpected large loss from business restructuring on Haitec and Luxgen; or
- Higher cash outflow from property development, working capital needs, or financial support to other group related entities than we currently forecast.

Related Criteria & Research

Related Criteria

- Criteria | Financial Institutions | General: Nonbank Financial Institutions Rating Methodology - December 09, 2014
- 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

	To	From
Yulon Motor Co. Ltd.		
Issuer Credit Rating	twBBB+/Positive/twA-2	twBBB+/Stable/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.