Media Release:

Yang Ming Marine Transport Corp. Outlook Revised To Positive From Stable On High Freight Rates; 'twBBB+/twA-2' Ratings Affirmed

September 16, 2021

PRIMARY CREDIT ANALYST

Kaifu Hu
Taipei
+886-2-2175-6814
kaifu.hu
@spglobal.com
kaifu.hu
@taiwanratings.com.tw

SECONDARY CONTACT

Susan Chen
Taipei
+886-2-2175-6817
susan.chen
@spglobal.com
susan.chen
@taiwanratings.com.tw

Rating Action Overview

- **Yang Ming Marine Transport Corp.** is a Taiwan-based container shipping company that generates the bulk of its revenue from long-haul routes. Yang Ming generated funds from operations of new Taiwan dollar (NT$) 33.1 billion in 2020.
- The COVID-19 pandemic has led to lengthy port congestion globally and skyrocketing freight rates, which have in turn strongly enhanced Yang Ming's cash flow generation. We expect this improvement to boost the carrier's performance in 2021.
- Yang Ming has used this strong operating cash flow to reduce its debts, bringing down adjusted debt by 24% to NT$100.9 billion as of the end of June 2021 from NT$133.6 billion at the end of 2020.
- We have revised the outlook on our long-term issuer credit rating on Yang Ming to positive from stable to reflect our view that Yang Ming's strong operating cash flow could help to further reduce its debts and strengthen its overall credit metrics over the next one to two years.
- At the same time, we affirmed our 'twBBB+/twA-2' issuer credit ratings on Yang Ming.

Rationale Action Rationale

Soaring freight rates continue to boost Yang Ming's cash flow generation in 2021. Along with the global spread of the pandemic over the last year, the recent outbreak of the Delta variant of the coronavirus has created further challenges for major ports and logistics services worldwide. It has caused a shortage in vessels and container box supply, which coupled with economic recovery in the major U.S. and Europe markets has significantly elevated freight rates for container shipping services. As a result, the higher freight rates are likely to generate strong cash flow for Yang Ming throughout 2021. Moreover, we believe Yang Ming could generate positive discretionary cash flow to lower its debt in 2022 despite our expectation for freight rates to decline by 40%-50% next year.

Yang Ming has substantially reduced its debts despite capital expenditure needs. The company's strong earnings and cash flows in 2020-2021 should allow it to meet its capital expenditure needs while simultaneously reducing debt. Although Yang Ming plans to increase its freight capacity over the next one or two years through long-term leases and the straight procurement of new vessels, the carrier is likely to improve its capital structure by repaying debt earlier. Having generated strong cash flow from operations of NT$72.7 billion in the first half of 2021, Yang Ming used its cash flow to reduce debt by 24% to NT$100.9 billion as of the end of June 2021, down from NT$133.6 billion at the end of 2020. Given the company aims to improve its capital structure, we believe it is likely that Yang Ming will continue to reduce its debt through strong operating cash flows over the next year. Moreover, the company completed a right issue that raised NT$29.1 billion in July 2021, which has further enhanced the carrier's capability to reduce its debt.

Uncertainty surrounding the time frame of this industry super upcycle and Yang Ming's debt leverage appetite could constrain its credit metrics. After the current wave of strong demand from developed countries fades and global port and inland infrastructure operations gradually return to normal, freight rates will drop substantially. Our base case forecasts the current disruptions facing the shipping industry will gradually resolve in 2022, and freight rates for Yang Ming's major service routes will decrease by 40%-50% in 2022 from their abnormally high level in 2021. Nonetheless, we acknowledge continuing uncertainty over the timeline for this restoration, given the continuing spread of the Delta variant globally. Freight rates could also fall further when most new containership capacity enters service in 2023.

In our view, Yang Ming's financial metrics are highly exposed to the volatile nature of the industry, particularly because the company operates mainly on highly competitive long-haul routes. Containership oversupply, rising competition, or soaring bunker prices could each lead to a quick deterioration in the carrier's profitability and weaken its credit metrics.

Outlook

The positive outlook reflects our view that Yang Ming will likely generate strong cash flow over 2021-2022 which could help to lower its debt. Soaring freight rates under the current favorable market condition of global economic recovery but widespread port congestion supports this view. This is despite Yang Ming's heightened capital expenditure needs and increasing bunker cost over the next one to two years.

Upward scenario

We may raise the long-term issuer credit rating on Yang Ming if:

- The carrier can further improve its cash flow and profitability and significantly lower its debt, such that its ratio of funds from operations to debt rises substantially and sustainably above 40% over the next one to two years. This could be achieved by adopting a more conservative financial policy that reduces Yang Ming's debt substantially.

Downward scenario

We could revise the outlook back to stable if:

- Yang Ming aggressively raises its fleet expansion plans or aggressively distributes a cash dividend to shareholders which accordingly leads to higher debt when freight rates normalize in the next one to two years, or
- The long-haul market becomes oversupplied due to substantial new vessel deliveries, while demand for services normalizes and leads to plummeting freight rates and a drop in the carrier's cash flow beyond our expectation for 2022-2023.

Our Base-Case Scenario

Yang Ming's revenue could grow robustly by 95%-105% in 2021, which is much higher than our previous assumption of 25-30%. This reflects ongoing concerns over the disruptive impact of the Delta variant on ocean freight logistics. We forecast the carrier's revenue in 2022 could decline by 40%-45%, reflecting a decline in freight rates amid normalizing market conditions. Our base-case assumptions are:

- S&P Global forecasts Asia Pacific's real GDP will expand by 7.1% in 2021 and 5.2% in 2022. U.S. real GDP to grow by 6.5% in 2021 and 3.1% in 2022.
- S&P Global's price assumptions for West Texas Intermediate (WTI) and Brent crude oil of US$60 per barrel and US$65 per barrel, respectively, for the remainder of 2021, and US$55 per barrel and US$60 per barrel for 2022.
- Yang Ming's shipping volume to remain sluggish due to port congestion in the U.S., Europe, and Asia. The fourth quarter of 2021 will continue to see congestion, albeit potentially easing in 2022. Overall shipping volume to decline 4%-10% in 2021 due to COVID-19-induced inefficiency. Volume to gradually rise by a single digit in 2022.
- The company's average freight rate to increase by 140%-150% in 2021, due to the pandemic's impact on logistics, switching consumer behavior toward e-commerce, continuing port congestion, and temporary lockdowns. Upward pressure on freight rates could abate over the next one or two years with Yang Ming's average freight rate declining 40%-50% in 2022.
- Yang Ming's unit operating costs to rise by 24%-30% in 2021 due to increasing level of productivity but decline slightly by a single digit in 2022, given our projection that overall operating performance will slow in 2022.
- Yang Ming's operating leases to rise over the next two years, reflecting the company's ongoing plans on purchasing, chartering, and eliminating vessels in the following years. Currently, the company leases 14 new-build chartered vessels for long-haul services and 10 owned new-build vessels for short haul services. Yang Ming maintains the flexibility of meeting the goal of shipping alliance 'THE Alliance' (Ocean Network Express, Hapag-Lloyd, and Yang Ming Line) and adjusting capacity in terms of overall demand conditions on different routes. Yang Ming's capital expenditure could rise in 2022 because the company plans to spend NT$6.5 billion on self-owned containers.
- Yang Ming will not distribute cash dividends in 2021 due to previous accumulated losses. However, the company could distribute NT$2.5 cash dividend per share in 2022.
- 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 funds from operations to debt of more than 100% in 2021, but to decline to 30%-40% in 2022, and to further decrease to 17%-22% in 2023.
- Ratio of free operating cash flow to debt of more than 100% in 2021, but to decline to 32%-38% in 2022, and to further decrease to 15%-20% in 2023.

Liquidity

The short-term rating on Yang Ming is 'twA-2'. We see Yang Ming has adequate liquidity sources to cover its needs in the next 12 months ending June 2022, based on our forecast that the company's liquidity sources will cover 2.8x of its liquidity uses without refinancing. Yang Ming should be able to 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 June 2021, Yang Ming has around NT$61.5 billion in cash and short-term investments. We believe good access to banks underpinned by Yang Ming's status as a government related entity can largely offset this refinancing risk.

Principal liquidity sources

- Cash and short-term investments of NT$61.5 billion as of the end of June 2021.
- Cash flow from operations of NT$49 billion-NT$53 billion in 2022.

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: Methodology For National And Regional Scale Credit Ratings - June 25, 2018
- General Criteria: Hybrid Capital: Methodology And Assumptions - July 01, 2019
- General Criteria: Group Rating Methodology - July 01, 2019
- Criteria | Corporates | General: Corporate Methodology: Ratios And Adjustments - April 01, 2019
- 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 - 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 Revision

	To	From
Yang Ming Marine Transport Corp.		
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.