Media Release:

Wan Hai Lines Ltd. Outlook Revised To Positive From Stable On High Freight Rates; 'twA-/twA-2' Ratings Affirmed

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PRIMARY CREDIT ANALYST

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

SECONDARY CONTACT

Raymond Hsu, CFA
Taipei
+886-2-2175-6827
raymond.hsu
@spglobal.com
raymond.hsu
@taiwanratings.com.tw

Rating Action Overview

- Taiwan-based container shipper **Wan Hai Lines Ltd.** generated most of its revenue from intra-Asia routes with funds from operations of around new Taiwan dollar (NT$) 18 billion in 2020.
- A significant shortage of containership capacity, prolonged port congestions globally, and booming international trade as economies in Europe and the U.S. recover will continue to support high freight rates. This will underpin Wan Hai's strong operating cash flow over the next three to four quarters.
- Wan Hai could use its strong operating cash flow to fund its aggressive capital expenditure plans while maintaining a flexible dividend policy over the next one to two years. This could enable Wan Hai to maintain a sufficient financial buffer for a likely normalization in freight rates in 2022.
- We have therefore revised our outlook on the long-term issuer credit rating to positive from stable to reflect our view that Wan Hai's strong operating flow supported by heightened freight rates could place the carrier in a net cash position in 2021-2022. At the same time, we affirmed our 'twA-/twA-2' issuer credit ratings on Wan Hai.

Rationale Action Rationale

Prolonged disruption to seaborne traffic could support higher freight rates for Wan Hai over the next three to four quarters. Congestion at major international container ports could last into 2022, which along with rising demand for tangible goods could support high freight rates over the next few quarters. Queues at major ports in North America such as Los Angeles and Long Beach, are the longest ever, with improvement unlikely for several months. In addition, the inventory to sales ratio for global retailers remains at a historical low with a long time remaining before retailers can replenish their inventories. Therefore, we have revised upward our growth projection for Wan Hai's average freight rate to 120%-130% in 2021.

Freight rates surged significantly during the second half of 2020 and throughout the first half of 2021. The Shanghai Containerized Freight Rate Index reached US$4,502 per twenty-foot equivalent unit (TEU) at the beginning of September 2021, which is about 1.5x the level at the beginning of 2021. Freight rates on Wan Hai's America routes posted the strongest growth, with around 120% in the second quarter of 2021 compared with the end of 2020, followed by around 100% growth for Middle East routes and 65% growth on intra-Asia routes.

We factor in a 30%-40% decline in average freight rates for Wan Hai in 2022 and a further 20%-25% decline in 2023, which mainly reflects gradually normalizing freight rates once the pandemic is contained and supply chain disruptions are resolved. Nonetheless, Wan Hai is likely to generate substantially higher operating cash flow in 2022 and 2023 than in the years before 2020, given the elevated base in 2021.

Wan Hai's increasing exposure to long-haul routes will benefit its profitability during upcycles, but it could suffer more during downturns because long-haul routes are inherently more volatile than intra-Asia routes. The carrier took advantage of higher freight rates on trans-Pacific routes and increased its service frequency to U.S. west coast routes from March 2021. Wan Hai further expanded routes to the U.S. east coast in June 2021. Revenue from American routes increased to around 40% of the carrier's total revenue in the first half of 2021, compared with 10%-20% historically, leading to an increase in the company's EBITDA margin. However, Wan Hai could face intense competition from other long-haul carriers on these routes once this industry upcycle gradually ends. This would raise the volatility of Wan Hai's profitability, especially if the carrier continues to aggressively expand its long-haul services because the company has not joined any of the three major shipping alliances and possesses a relatively insignificant market share of global long-haul services.

The carrier's aggressive vessel acquisition plans could boost debt. Since our previous review in April, Wan Hai has announced its plan to purchase four vessels with a capacity of 13,000 TEU each and twelve with 3,055 TEU, for a total investment of NT$28 billion-NT$30.3 billion. We believe these incremental vessel purchases, with deliveries scheduled for 2023-2024, are a response to strong market demand and to meet the carrier's expansion plans to its new U.S. East Coast service. Therefore, we forecast Wan Hai's capital expenditure will increase significantly to NT$35 billion-NT$37 billion in 2021, NT$21 billion-NT$23 billion in 2022, and NT$33 billion-NT$35 billion in 2023. This compares with around NT$19 billion in 2020. As a result, the carrier could see its net cash position reverse in 2023.

Wan Hai's improving profitability could increase its financial buffer to cushion against unexpected volatility over the next two years; however, uncertainty over the time frame of this industry's super upcycle and possibly higher debt leverage led by Wan Hai's potential fleet expansion plan could constrain its credit metrics. Despite Wan Hai's more aggressive fleet expansion, the company's robust operating cash flow generation in 2021 and 2022 could still outpace its higher capital needs, supporting the company's need to reduce its debt level over the next one to two years, even after the container shipping industry gradually normalize. In addition, we view that Wan Hai could remain flexible in terms of dividend policy and is likely to reserve sufficient cash for potential fleet expansion. Accordingly, Wan Hai is likely to maintain at net cash position in 2021-2022, and slightly leveraging up afterwards as freight rates progressively shift back to normal in 2023.

Meanwhile, after this wave of strong global demand fades and port and inland infrastructure operations gradually normalize, freight rates will drop substantially. Our base case forecast is for disruptions to the shipping industry to gradually resolve in 2022, and freight rates of all Wan Hai's major service lines will start to decrease by 30%-40% in 2022 and a further 20%-25% in 2023, from the abnormally high level in 2021. Nonetheless, we acknowledge that there remains uncertainty over the timeline as the Delta variant of the coronavirus is still raging around the world, and the expectation for freight rates to plummet, especially when most of the new containership capacity rolls out in 2023. In our view, Wan Hai's financial metrics are highly exposed to the volatile nature of the container shipping industry. Possible oversupply of containerships, rising competition or soaring bunker prices could lead to quick deterioration of Wan Hai's profitability and further worsen its credit metrics.

Outlook

The positive outlook on Wan Hai reflects our view that the company could generate strong operating cash flow that allows the company to maintain a net cash position in 2021-2022 before leveraging up in 2023. Our assessment of recently favorable market conditions supports this view, despite Wan Hai's heightened capital expenditure and likely increasing bunker costs during the period.

Upward scenario

We may raise the long-term issuer credit rating on Wan Hai over the next one to two years if:

- Wan Hai could achieve strong and resilient profitability, as demonstrated by a ratio of return on capital above 10% even after the shipping industry begins to normalize, while keeping the adjusted ratio of funds from operations to debt consistently above 60%. This could be achieved by more disciplined fleet expansion and prudent dividend payouts.

Downward scenario

We may revise the outlook back to stable if Wan Hai fails to sustain its ratio of funds from operations to debt above 60% or return on capital ratio above 10% over the next two years. This could happen if:

- Wan Hai's profitability deteriorates more materially than we current predict, burdened by possible containership oversupply amid less-disciplined market conditions, or rising competition from long-haul competitors that erodes Wan Hai's competitive advantage in intra-Asia; or
- The carrier takes on more aggressive expansion or shareholder friendly action that substantially increases its debt leverage.

Our Base-Case Scenario

We forecast Wan Hai's revenue to grow by a robust 155%-165% in 2021. This reflects the company's strong performance in the first half of 2021, supported by prolonged disruption to seaborne traffic and healthy global demand fundamentals. Revenue could decline by 35%-40% in 2022 and by a further 20%-25% in 2023 as freight rates decline amid gradually normalized market conditions in the container shipping industry. Our base-case assumptions are:

- S&P Global's forecast for Asia Pacific's real GDP to expand by 7.1% in 2021, 5.2% in 2022 and 4.6% in 2023. U.S. real GDP to grow by 6.5% in 2021, 3.1% in 2022, and 1.7% in 2023.
- S&P Global's price assumptions for West Texas Intermediate (WTI) and Brent crude oil are US$60 per barrel and US$65 per barrel, respectively, for the remainder of 2021, US$55 and US$60 for 2022, and US$50 and US$55 for 2023 and beyond.
- Wan Hai's shipping volume to grow by 15%-20% in 2021, underpinned by the global economic recovery and the company's launch of new service lines on its intra-Asia, U.S. West Coast, and U.S. East Coast routes. Volume could decline slightly by 2.5%-3% in 2022, reflecting the higher base in 2021 and gradually decreasing global demand for physical goods. Volume to grow by 1.5%-2.0% in 2023.

- The company's average freight rate to remain high, growing by 120%-130% in 2021 because of a prolonged shortage of container boxes and vessels brought about by continued congestion at major ports around the globe, growing demand, and possible fuel and peak season surcharges. Freight rates could gradually return to normal with a 30%-40% decline in 2022 and a further 20%-25% decline in 2023 from the relatively high freight rate in 2021.
- Bunker fuel price to increase to US$540-US$560 per ton in 2021 and US$490-US$510 per ton in 2022 and 2023, from US$350-US$400 per ton in 2020, to reflect the general rise in crude oil prices.
- Charter hire expenses to grow significantly by 40%-50% in 2021, due to the overall shortage of container vessels. Charter hire expenses to slightly decline by 2%-3% in 2022-2023.
- Other costs such as port charges, stevedoring, transshipment and terminal fees, to grow along with volume over the next two years.
- Capital expenditure will increase materially to NT$35 billion-NT$37 billion in 2021, NT$21 billion-NT$23 billion in 2022, and NT$33 billion-NT$35 billion in 2023, mainly for the acquisition and down payment of new vessels and containers.
- We assume a cash dividend payout of 20% of previous year's net income in 2021 and 40%-50% in 2022-2023. However, Wan Hai could remain flexible in its dividend policy to reserve enough cash for potential future capital needs.

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

- Return on capital of over 100% in 2021, 30%-35% in 2022, and 10%-15% in 2023.
- Net cash position in 2021-2022.
- Ratio of funds from operations to debt of over 100% in 2023.

Liquidity

The short-term rating on Wan Hai is 'twA-2'. We believe that Wan Hai has adequate liquidity to meet its needs over the upcoming 12 months ending June 2022 with a ratio of liquidity sources to liquidity uses of 1.5x-2.0x over the same period. We also believe Wan Hai can 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, Wan Hai has around NT$42 billion in cash and short-term investments. We project Wan Hai will generate NT$75 billion-NT$80 billion operating cash flow over the next 12 months.

In addition, we believe the company's good relationship with Taiwan banks will provide access to financing when needed, as evidenced by the low interest rate on Wan Hai's bank loans. The container carrier also has generally prudent financial risk management to consistently maintain a sufficient financial buffer to withstand market volatility, in our view.

Principal liquidity sources:

- Cash and short-term investments of NT$41.9 billion at the end of June 2021.
- Funds from operations of NT$75 billion-NT$85 billion over the 12 months ending June 2022.

Principal liquidity uses over the 12 months ending June 2022.

- Debt maturing of NT$17.5 billion.
- Capital expenditure of NT$25 billion-NT$30 billion.
- Cash dividend payout of 40%-50% of the previous year's net income.

Ratings Score Snapshot

Issuer Credit Rating: twA-/Positive/twA-2

Note: The descriptors below are on a global scale.

Business Risk: Weak

- Country risk: Intermediate
- Industry risk: 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: Satisfactory (no impact)
- Comparable rating analysis: Neutral (no impact)

Stand-alone credit profile: twa-

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
Wan Hai Lines Ltd.		
Issuer Credit Rating	twA-/Positive/twA-2	twA-/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.