Media Release:

Wan Hai Lines Ltd. Upgraded To 'twA/twA-1' On Robust Profitability; Outlook Stable

April 26, 2022

PRIMARY CREDIT ANALYST

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

SECONDARY CONTACT

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

Rating Action Overview

- **Wan Hai Lines Ltd.** provides services in intra-Asia, transpacific, and the Middle East. Elevated freight rates led by still-constrained container ship capacity could keep Wan Hai's profitability much stronger than our previous forecast for 2022-2023.
- Wan Hai's strong operating cash flow, high cash balance, and flexible dividend policy could enable the company to maintain a sufficient financial buffer to fund its aggressive capital expenditure plans while remaining debt free on an adjusted basis over the next two years.
- We have raised our issuer credit ratings on Wan Hai to 'twA/twA-1' from 'twA-/twA-2'.
- The stable outlook reflects our view that Wan Hai's strong profitability could enable the company to maintain positive discretionary cash flow and a net cash position for 2022-2023.

Rating Action Rationale

Heightened freight rates and growing lifting volume should support Wan Hai's revenue over 2022-2023. We now forecast that freight rates could start normalizing in late 2022 at the earliest, from current all-time highs, provided the pandemic's impact on overall supply chains eases. Thereafter, as overall industry capacity gradually comes online and vessels on order start to be delivered from 2023, ocean tariffs might face a correction and subsequently stabilize at profitable levels that are likely above the pre-pandemic base. Container freight rates have been much stronger than our previous forecast in 2021 across most trade lanes due to continued widespread congestion in major maritime ports, disrupted logistics chains, and still-strong demand for tangible goods.

Freight rates are likely to peak in 2022 with a gradual ease in port congestion worldwide and the addition of new vessels. The Shanghai Containerized Freight Rate Index (SCFI) recently declined by 16.6% from its peak at the beginning of this year. This was because of some recent events, including China's COVID-19-related lockdown of the city and the conflict between Russia and Ukraine. However, the index is still about 150% above its level at the beginning of 2021. Wan Hai's blended freight rates also increase sharply by 130%-135% during the same period.

However, we view a sudden plunge of freight rates as less likely, given that capacity management could be more disciplined among major carrier alliances. In addition, increasingly stringent environmental regulations on sulfur and greenhouse gas emissions are likely to partly offset the capacity growth from new containerships over the next two to three years. Accordingly, we project Wan Hai's blended freight rate will increase 50%-55% year on year in 2022 before gradually normalizing.

We also forecast that Wan Hai's capacity additions to transpacific trade routes could generate significant revenue for the company, given still-strong demand for physical goods in the U.S. and high freight rates. We therefore estimate Wan Hai's lifting volume will grow 3.5%-4.5% per year in 2022 and 2023, before decelerating somewhat and largely trailing global GDP growth at 2%-3% in subsequent years.

Despite higher bunker costs and charter hire payments, Wan Hai could maintain an elevated EBITDA margin in 2022-2023. Crude oil prices have spiked recently due to the Russia-Ukraine conflict, together with growing oil demand as the impact from the omicron variant of COVID-19 subsides. We therefore project Wan Hai's bunker cost will increase to US$650-US$700 per ton in 2022-2023 from US$521 per ton in 2021. Nonetheless, the impact on Wan Hai's profitability from rising bunker costs is relatively limited, because the company can pass through the incremental cost through surcharges to clients due to the capacity shortage. The company's charter hire payment will also increase by 35%-40% in 2022 due to a limited supply of vessels on the market. However, we still believe elevated freight rates will sustain Wan Hai's EBITDA margin at 65%-70% in 2022 and 50%-55% in 2023, compared with the pre-pandemic level of below 20%.

Wan Hai's financial buffer should remain significant, with continued strong profitability in 2022-2023, despite aggressive capex. The company's capital expenditure (capex) will continue to remain at a high level over the next two years, given its aggressive plan to build up its self-owned fleet and expand into long-haul service lines. We project the company's capex at new Taiwan dollar (NT$) 45 billion-NT$50 billion in 2022, compared with NT$42.7 billion in 2021, before decreasing to NT$40 billion-NT$42 billion in 2023.

Thanks to improved profitability, Wan Hai generated NT$133 billion in operating cash flow during 2021. We estimate it will generate NT$200 billion-NT$230 billion in operating cash flow in 2022, which substantially outpaces the company's capital needs. In addition, Wan Hai could remain flexible in terms of its dividend policy and the company is likely to reserve sufficient cash for potential fleet expansion, in our view. Wan Hai could maintain at a net cash position in 2022-2023 in our base case. Meanwhile, we forecast the company's return on capital ratio will remain above 100% in 2022 and decline to 30%-35% in 2023.

Wan Hai's increasing exposure to competitive long-haul routes could increase the volatility of its performance and leverage through industry cycles. The company ordered 18 vessels with a capacity of 13,000 twenty-foot equivalent units (TEUs) each, which will be delivered during 2022-2024, mainly for the U.S. market. This underpins Wan Hai's plans to expand into long-haul routes, especially transpacific service lines. American routes accounted for 55% of the carrier's total revenue in 2021. This rose to about 60% in the first quarter of 2022, compared with only 10%-20% historically.

However, we believe that Wan Hai has a much weaker position in the long-haul container shipping markets and could face intense competition from other bigger and more established carriers with more comprehensive service networks, partly through shipping alliances. We forecast that the long-haul markets will remain more volatile than the intra-Asia container shipping markets, though market discipline, particularly on capacity expansion, could improve moderately. This would further increase the volatility of Wan Hai's profitability in the long term. In addition, capital spending is likely to rise for further expanding its market share in the long-haul markets where mega vessels with lower unit costs are vital for competing. This could significantly waken the company's credit metrics, particularly during a market downturn.

Outlook

The stable rating outlook on Wan Hai reflects our view that the company's strong operating cash flow and high cash balance on hand could fund its aggressive capex plans while maintaining a net cash position over the next two years. We forecast that strong, albeit gradually decreasing, freight rates will sustain Wan Hai's strong profitability and keep the company's return on capital well above 10% in 2022-2023 due to continued port congestion and still-favorable demand, despite higher operating costs.

Downward scenario

We may lower the long-term issuer credit rating on Wan Hai, if:

- The company's profitability deteriorates materially, as indicated by the ratio of return on capital below 10% on a sustainable basis. This could be caused by less disciplined market conditions leading to oversupply of containerships or rising competition from long-haul competitors that erodes Wan Hai's competitive advantage in intra-Asia; or the company's expansion into the relatively competitive long-haul market materially dampens its profitability; or
- The carrier takes on more aggressive expansion and substantially increases its debt leverage, such that its ratio of funds from operations to debt falls to below 60% for an extended period.

Upward scenario

We see a low likelihood of upgrading Wan Hai over the next 12 months, given high business risk in the global container shipping market and the company's aggressive capex plans for expansion in the more volatile long-haul markets. However, we may raise our rating on the company if:

- Wan Hai substantially enhances its competitive position in the global container shipping market with significantly enlarged scale and market share; and
- The company sustains a very conservative financial policy plan that supports the ration of funds from operations-to-debt above 60% through the business cycle.

Our Base-Case Scenario

We forecast Wan Hai's revenue growth rate to moderate but remain robust at 50%-55% in 2022, reflecting still-healthy demand fundamentals and undersupply caused by disrupted inland logistics and port bottlenecks. Revenue for 2023 will decline by 30%-35%, in our assessment, reflecting lower freight rates amid gradually normalized market conditions in the container shipping industry. Our base-case assumptions are:

- Asia-Pacific real GDP growth to moderate at 5.1% in 2022 and 4.7% in 2023 after an expansion of 6.7% in 2021.
- U.S. real GDP to grow by 3.2% in 2022 and 2.3% in 2023.
- Wan Hai's lifting volume could grow 3.5%-4.5% in 2022 and 2023, reflecting its capacity additions to transpacific lanes and still-strong tangible goods demand around the globe.

- Average freight rate to remain elevated and increase 45%-50% year on year in 2022. Freight rates will decline by 35%-40% in 2023 and further in the following years, after new vessels enter the market.
- Bunker fuel price to increase to US$650-US$700 per ton in 2022 from US$500-US$530 per ton in 2021 due to rising oil prices.
- Charter hire expenses to grow significantly by 35%-40% in 2022, due to the overall shortage of vessels on the market.
- Other costs (including port charges, stevedoring, transshipment, and terminal fees) to grow along with volume over the next two years.
- Capex to remain heightened at NT$48 billion-NT$50 billion in 2022 and NT$40 billion-NT$42 billion in 2023, mainly for the acquisition of newly built and secondhand vessels, as well as new containers.
- Cash dividend payout ratio of 20%-30% in 2022-2023 of previous year's net income.

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

- Return on capital of over 100% in 2022 and 30%-35% in 2023.
- Net cash position in 2022-2023.

Liquidity

The short-term rating on Wan Hai is 'twA-1'. We assess Wan Hai's liquidity as strong. We estimate its ratio of liquidity sources to liquidity uses at 3.5x-4.0x in 2022-2023. We also believe Wan Hai can cope with high-impact low-probability events with limited refinancing, given the company's high cash balance, as well as strong operating cash flow in 2022 and 2023. As of end-2021, Wan Hai had about NT$109 billion in cash and short-term investments. We project the company will generate NT$225 billion-NT$230 billion in operating cash flow in 2022, and NT$130 billion-NT$135 billion in 2023.

In addition, we believe the company's good relationship with Taiwan banks will provide access to financing when needed, as indicated by the low interest rate on Wan Hai's bank loans.

Principal liquidity sources:

- Cash and short-term investments of NT$109.3 billion at the end 2021.
- Funds from operations of NT$230 billion-NT$231 in 2022 and NT$121 billion-NT$122 billion in 2023.

Principal liquidity uses:

- Debt maturity of NT$8 billion in 2022.
- Capex of NT$45 billion-NT$50 billion in 2022 and NT$40 billion-NT$45 billion in 2023.
- Cash dividend payout ratio of 20%-30% of the previous year's net income.

Ratings Score Snapshot

Issuer Credit Rating: twA/Stable/twA-1

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: Strong (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: Environmental, Social, And Governance Principles In Credit Ratings - October 10, 2021
- 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

Upgraded

	To	From
Wan Hai Lines Ltd.		
Issuer Credit Rating	twA/Stable/twA-1	twA-/Positive/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.