Media Release:

Unimicron Technology Corp. Upgraded To 'twA+' On Robust Profitability; Outlook Stable

May 27, 2022

Rating Action Overview

- **Unimicron Technology Corp.** is a leading printed circuit board manufacturer with funds from operations (FFO) of new Taiwan dollar (NT$) 21.4 billion in 2021.
- Growing end-market demand for 5G networks, big data servers, and Internet of Things (IoT) are key drivers behind rising demand for products, chiefly ABF carriers, from which it earns the bulk of its revenue. This rising demand will strengthen Unimicron's profitability beyond our previous projection for 2022 and 2023.
- Meanwhile, prepayments from Unimicron's clients and strong profitability could support the company's high capital expenditure (capex) needs with much lower debt leverage in 2022-2023 that we previously assumed.
- We therefore raised our issuer credit ratings on Unimicron to 'twA+/twA-1' from 'twA/twA-1'.
- The rating outlook is stable to reflect our view that Unimicron's strong operating cash flow could help cap the company's debt leverage despite aggressive capex over the next one to two years.

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Rating Action Rationale

Rising application of high-technology solutions in everyday life will drive demand for Unimicron's flip chip substrate lineup and support favorable pricing. We believe the increasing acceptance of high-tech applications by end customers will spur enterprise and retail clients to increase demand for solutions in 5G, data center server, and IoT products among others. This will in turn stimulate demand for Unimicron's flip chip substrate lineup and underpin better pricing for Unimicron's products than we previously predicted. The widening opportunities for the application of such technologies which utilize Unimicron's ABF product should also encourage the company and other manufacturers to invest in products that deliver higher performance and greater reliability and connectivity. Ajinomoto Build-Up Film® (ABF) is used as an insulating material for high-performance semiconductors.

Collaborative business development with key clients could sustain Unimicron's capacity expansion without significantly burdening its debt leverage over the next two years. We estimate Unimicron's operating cash flow will substantially improve over the next one to two years. The company has long-term agreements with its main business clients to receive prepayments over the coming few years. This collaborative model underpins a firm orderbook for Unimicron and can help to offset the financial burden on Unimicron to increase its capacity.

Unimicron's product lines also include high-density interconnect (HDI), printed circuit boards (PCBs) and flexible circuit boards (FCBs), which have relatively weak growth potential amid slowing demand for smartphones and consumer electronics. Nonetheless, we believe the operating cash flow generation from company's ABF carriers will sustain Unimicron's overall profitability over the next few years. The revenue contribution from IC carriers is also likely to rise by a low single digit in 2023 and 2024 from a contribution of 55% at the end of 2021 amid material capacity expansion.

Strong profitability is unlikely to remain once the current industry cycle peaks. We anticipate Unimicron's revenue and margins will strengthen in 2022 compared to 2021; however, the current geopolitical environment and inflationary pressures could hurt demand for Unimicron's products and reduce the company's pricing power, despite the long-term contracts for a significant portion of its capacity additions planned for 2022-2023. The company's growing product concentration in IC carriers made of ABF could exacerbate such volatility along with the influence of demand cycles in the semiconductor sector. This could pressure Unimicron's revenue, operating cash flow and subsequently debt leverage, given that utilization is critical for capital intensive investments.

Outlook

The stable rating outlook reflects our view that Unimicron is likely to maintain its improved profitability over the next one to two years supported by its strengthened position in the advanced IC substrate market and cap the impact of its high capex on leverage over the next same period. We believe strong demand and high utilization for advanced IC substrates could continue to serve as the main revenue driver and support Unimicron's operating cash flow and margin performance over the period. This could in turn enable Unimicron to cap its debt growth and sustain its ratio of debt to EBITDA ratio below 1.5x over the next one to two years, despite a sharp growth in capex over the same period.

Downward scenario

We may lower the long-term issuer credit rating on Unimicron if:

- The company's ratio of debt to EBITDA rises consistently above 2.0x. More aggressive debt-funded capex beyond our base case assumption without measures such as prepayments and long-term contract from clients to mitigate the cash flow impact, or weaker cash flow than we currently expect possibly due to weak end-market demand or a relatively low return on new investments could lead to such an increase in debt leverage, or
- The company's EBITDA margin weakens to below 12% for an extended period. Potential factors resulting in such a downside scenario include a slowdown in demand, low production yield rate or utilization, or heightened pricing pressure from its top customers amid intensifying competition.

Upward scenario

The likelihood of an upgrade is remote over the next 12 months, due to the company's relatively aggressive capex plan, intense market competition, and a weaker demand outlook for smartphones and consumer electronics. However, we may raise the long-term rating if:

- The company can further enhance its technology competitiveness and improve its business scale, thus improving its profitability materially and generating sustainable positive free operating cash flow. An EBITDA margin sustaining above 20% even during downcycles could indicate such improvement; and

- At the same time, Unimicron can sustain its debt to EBITDA below 1.5x on a consistent basis.

Our Base-Case Scenario

- S&P Global Ratings' projected growth in US real GDP of 2.4% in 2022, 2.0% in 2023 and 2.1% in 2024; China's GDP growth of 4.2% in 2022, 5.3% in 2023 and 5.2% in 2024.
- IT spending will continue to outpace GDP growth in 2022. After expanding by more than 10% in 2021, lobal IT spending to still grow, albeit at a more modest 6.3% in 2022. This beats our global GDP forecast of 4.3% and represents increasing demand for cloud services, acceleration of enterprise spending, and adoption of new technologies.
- Semiconductor shortage to persist through 2022 and ease in 2023. Emerging technologies such as cloud, AI and IoT will enter the steeper part of the adoption curve in 2022 and partly offset weaker demand for smartphones and consumer electronics. However, moderately slowing demand growth and significant capacity additions should significantly ease supply constraints in 2023.
- Taiwan Ratings' base-case scenario for Unimicron indicates 30%-37% revenue growth in 2022 and 18%-25% in 2023, which is slightly stronger than the industry average due to a stronger outlook for IC substrate sales.
  - For IC carriers, we expect 37%-46% growth in 2022 and 17%-24% in 2023 with significant capacity additions and favorable pricing,
  - Mild revenue momentum for HDI of a mid-single digit growth in 2022-2023 due to weaker smartphone demand, and
  - Revenue of conventional PCBs will maintain its growth momentum in 2022, driven by continued market penetration.
- Unimicron's EBITDA margin will improve to 23%-28% in 2022-2023, up from 21.8% in 2021 which mainly reflects Unimicron's strong revenue contribution from the ABF carrier business sector. Strong pricing and long-term contracts with the company's main customers support pricing during the period.
- Capex to rise to NT$43.5 billion in 2022 but decline to NT$32 billion-NT$37 billion in 2023. More than 80% of Unimicron's total capex will go toward its ABF carrier expansion plan.
- About NT$20 billion working capital inflow due to prepayments from its clients in 2022.
- Dividend payout of close to 40% in 2022 and about 45% in 2022.
- Amortization of contract liability at NT$1.6 billion-NT$2.2 billion in 2022 and rising significantly in 2023.

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

- EBITDA margin will improve to 23%-28% in 2022-2023, exceeding the level in 2021.
- Debt to EBITDA of 0x in 2022 and 0x-0.5x in 2023.
- Negative free operating cash flow in 2022-2023.

Liquidity

The short-term rating on Unimicron is 'twA-1'. We believe the company has strong liquidity reflecting a ratio of liquidity sources to liquidity uses at 2.0x-2.4x for the 12 months ending March 2023 and 1.9x-2.2x for the next 12 months. We also believe the company will have positive liquidity sources minus uses, even if the forecasted EBITDA declined by 30%.

In our view, Unimicron has sufficient headroom without breaching covenant limits due to low interest rates in Taiwan. We also believe the company has generally prudent risk management to ensure continued adequate liquidity based on its good track record. Unimicron is also likely to absorb high-impact and low-probability events with limited needs for refinancing considering its high cash balance and improving operating cash flow. Furthermore, we believe the company has sound bank relationships as indicated by its ample bank lines and low interest rates.

Principal Liquidity Sources:

- Cash and short-term investment of about NT$46 billion as of the end of March 2022.
- Fund from operations of NT$24 billion-NT$34 billion over the 12-month period ending March 2023.
- Working capital inflow of NT$9 billion–NT$14 billion over the 12-month period ending March 2023.
- Undrawn long-term bank facilities of NT$33 billion-NT$34 billion up to the end of March 2023.

Principal Liquidity Uses:

- Long-term debt due in one year plus short-term debt of NT$13 billion-NT$15 billion over the 12 months up to March 2023.
- Capex of NT$39.0 billion-NT$43.5 billion for the 12 months ending March 2023.
- Cash dividend payout of NT$5 billion in 2022.

Ratings Score Snapshot

Issuer Credit Rating: twA+/Stable/twA-1

Note: The descriptors below are on a global scale.

Business risk: Fair

- Country risk: Intermediate
- Industry risk: Moderately high
- Competitive position: Fair

Financial risk: Intermediate

- Cash flow/Leverage: Intermediate

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: Fair (no impact)
- Comparable rating analysis: Positive (+1 notches)

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
Unimicron Technology Corp.		
Issuer Credit Rating	twA+/Stable/twA-1	twA/Stable/twA-1