Media Release:

Outlook On Taiwan Optical Platform Co. Ltd. Revised To Positive On Lower Debt Leverage; 'twBBB+/twA-2' Ratings Affirmed

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PRIMARY CREDIT ANALYST

Beatrice Chen
Taipei
+886-2-2175-6829
beatrice.chen@spglobal.com
beatrice.chen@taiwanratings.com.tw

SECONDARY CONTACT

David Hsu
Taipei
+886-2-2175-6828
david.hsu@spglobal.com
david.hsu@taiwanratings.com.tw

Rating Action Overview

- **Taiwan Optical Platform Co. Ltd.** provides cable TV and broadband services to households in its franchise areas in central and southern Taiwan. It had EBITDA of NT$1.99 billion in 2021.
- The company, in line with the industry trend, has been experiencing declining subscription base of its cable TV service, despite of enhancing its broadband business.
- The company's financial leverage has gradually decreased thanks to relatively conservative capex and dividend payouts that helped to generate positive discretionary cash flow and lower the company's debt. The ratio of debt to EBITDA improved to 3.6x at the end of 2021 from 4.1x at the end of 2020. It is likely that the ratio could trend down below 3.5x in 2022 and 2023, but with a slowing pace.
- Therefore, we have revised our outlook on the long-term issuer credit rating on Taiwan Optical Platform to positive from stable to reflect our view that the company could deleverage further over the next one to two years.
- At the same time, we affirmed our 'twBBB+' long-term and 'twA-2' short-term issuer credit ratings on the company.

Rating Action Rationale

Positive discretionary cash flow could support further deleveraging, albeit at a slower pace. We forecast the company's capital expenditure (capex) needs to be limited over next two years, given a low likelihood that it will acquire cable operators outside of its franchise areas. In addition, Taiwan Optical Platform has a relatively conservative cash dividend policy with the payout ratio of just 36.1% in 2021. This could sustain positive discretionary cash flow over the next two years and allow the company to lower its adjusted debt further. Adjusted debt declined to new Taiwan dollar (NT$) 7.1 billion as of Dec. 31, 2021, down from NT$8.3 billion a year earlier. The ratio of debt to EBITDA also dropped to 3.6x from 4.1x over the same period. While we believe deleveraging will continue, we see the pace slowing amid decelerating EBITDA generation over the next one to two years.

Declining cable TV subscribers and falling line rental revenue could reduce EBITDA generation, despite improvement in its broadband business. We see Taiwan Optical Platform maintaining its dominant cable TV market share in its key franchise areas in mid and south Taiwan, given the company's first mover advantage and natural monopoly in its service areas. However, its cable TV business is likely to see a further moderate decline over next two years amid rising demand for Internet Protocol TV (IPTV)/Over-The-Top (OTT) platforms. This could result in a decline in revenue over the same period.

In addition, Taiwan Optical Platform has seen a decrease in revenue from its line rental business due to a recent merger among competing telecom operators. This trend will underpin a deceleration in EBITDA generation in 2022 and 2023. The company has adopted strategies to offset this declining revenue trend such as increasing the penetration of its broadband business and expanding into other businesses including shopping channels. However, we still expect to see its overall EBITDA continue to decline over the next one to two years.

Outlook

The positive rating outlook reflects our view that Taiwan Optical Platform will maintain a dominant position in its key franchise areas and continue to generate positive discretionary cash flow to support deleveraging over the next one to two years. However, the company's EBITDA generation will continue to slow due to the gradual loss of its cable TV subscribers. This means it will need one to two years to see ratio of debt to EBITDA come down comfortably and sustainably below 3.5x.

Upward scenario

We could raise the long-term rating on Taiwan Optical Platform if the company:

- Consistently pays down its debt supported by stable operating performance and cash flow generation and demonstrates prudent debt management that lowers the ratio of debt to EBITDA comfortably below 3.5x for an extended period; or
- There is improvement in its competitive position with a significant market share gain or material improvement in business diversification, such as through expansion of its broadband services and smart city project or bid, while at the same time maintaining the ratio of debt to EBITDA below 4x.

Downward scenario

We may revise the outlook back to stable if Taiwan Optical Platform does not lower the ratio of debt to EBITDA sustainably below 3.5x. This may happen if the company:

- Shows material weakening in its performance possibly due to a change in regulation, technology evolution, or rising competition risks;
- Engages in unexpected large debt-funded acquisitions; or
- Assumes aggressive shareholder-friendly action such as a much higher cash dividend payout or a share buyback plan.

Our Base-Case Scenario

- Taiwan's real GDP to grow 2.2% in 2022 and 1.5% in 2023. However, given the saturated domestic cable/broadband market with stagnant population and household numbers, growth for both industries is likely to underperform GDP growth.
- Domestic cable TV market to gradually decline due to competition from Multimedia on Demand of Chunghwa Telecom (CHT MOD) and various IPTV and OTT platform. But the market structure should remain relatively stable with limited competition in most operating areas.
- Domestic broadband market will remain dominated by leading operator, Chunghwa Telecom, although we believe cable broadband operators will gain increasing market share because of their pricing strategy and effective service bundling package.
- Revenue to increase by 0%-3% in 2022 but then decrease by 1%-4% in 2023 based on our view that:
    - The subscriber base for cable TV could decline by 1%-2% annually amid competition from CHT MOD and other OTT providers. The average revenue per user (ARPU) for cable TV could also decline by 1%-2%, given the promotion to contend declining subscriber base.
    - The subscriber base for broadband will grow by 8%-12% in 2022 and 4%-8% in 2023 thanks to the bundling sales with telecom providers. The ARPU for broadband is likely to increase by 4%-8% in 2022 and 0%-4% in 2023 thanks to high-speed users based using its fiber-to-the-home (FTTH) services.
    - New businesses such as information and communications technology projects will take time to generate meaningful sales and profit contribution.
- Taiwan Optical Platform's gross margin will decline to 60%-62% in 2022 from 63.7% in 2021 largely due to promotions as well as the falling subscriber base in its cable business.
- Taiwan Optical Platform's capital expenditures will be around New Taiwan dollar (NT$) 300 million per year for 2022-2023 for fiber network deployment and equipment upgrades.
- Cash dividend payout is likely to remain at NT$550 million-NT$650 million per annum over next few years with payout ratio of 50%-60%.

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

- EBITDA margin of 42%-44% in 2022 and 2023, down from 46.6% in 2021.
- Ratio of debt to EBITDA to improve slightly to 3.3x-3.5x in 2022 and 2023, from 3.6x in 2021.

Liquidity: Adequate

We assess Taiwan Optical Platform's liquidity as adequate to meet its needs over the 12-months ending June 30, 2023. That's despite a good ratio of liquidity sources to liquidity uses above 2x over the period. This is because we believe the company may need some refinancing when it encounters low probability high-impact events, considering its NT$2.46 billion cash on hand and NT$8.69 billion gross debt as of June 30, 2022. In addition, there is no evidence that Taiwan Optical Platform's management will maintain strong liquidity when facing anticipated business setbacks. However, we believe the company will still have sufficient liquidity headroom if the forecasted EBITDA declined by 15%. We also believe the company has a sound relationship with banks and could establish new facilities when needed, as indicated by the recent completion of a syndication loan with facility of NT$10.18 billion in September 2022. In addition, we assess Taiwan Optical Platform can comfortably meet the financial covenants on this syndication loan, given the company's stable profitability and cash flow generation.

Principal liquidity sources

- Cash and short-term investment of about NT$2.46 billion as of June 30, 2022.
- Funds from operations of NT$1.2 billion-NT$1.5 billion per year over the 12 months ending June 30, 2023.

Principal liquidity uses:

- Debt maturity of NT$660 million ending June 30, 2023.
- Capex of NT$300 million for the 12 months ending June 30, 2023.
- Cash dividend payout of NT$550 million–NT$650 million over the 12 months ending June 30, 2023.

Ratings Score Snapshot

Issuer Credit Rating: twBBB+/Positive/twA-2
Note: The descriptors below are on a global scale.

Business Risk: Fair

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

Financial Risk: Significant

- Cash flow/Leverage: Significant

Anchor: twbbb+

Modifiers

- Diversification/Portfolio effect: Neutral (no impact)
- Capital structure: Neutral (no impact)
- Financial policy: Neutral (no impact)
- Liquidity: Adequate (no impact)
- Management and governance: Fair (no impact)
- Comparable rating analysis: Neutral (no impact)

Stand-alone credit profile: twbbb+

ESG credit indicators: E-2, S-2, G-2

Related Criteria & Research

Related Criteria

- Criteria | Corporates | General: Corporate Methodology - November 19, 2013
- 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: Group Rating Methodology - July 01, 2019
- General Criteria: Methodology For National And Regional Scale Credit Ratings - June 25, 2018
- General Criteria: Country Risk Assessment Methodology And Assumptions - November 19, 2013
- General Criteria: Methodology: Industry Risk - November 19, 2013
- General Criteria: Principles Of Credit Ratings - February 16, 2011

- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities - November 13, 2012
- General Criteria: Environmental, Social, And Governance Principles In Credit Ratings - October 10, 2021

Related Research

- Taiwan Ratings' Ratings Definitions –November 11, 2021

(Unless otherwise stated, these articles are published on www.standardandpoors.com, access to which requires a registered account)

Ratings List

Ratings Affirmed; Outlook Revision

	To	From
Taiwan Optical Platform 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.