Media Release:

Yang Ming Marine Transport Corp. Ratings Affirmed At 'twA-/twA-2' On High Net Cash Position; Outlook Stable

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Rating Action Overview

- Yang Ming Marine Transport Corp. makes the bulk of its revenue from long-haul routes. The company generated funds from operations of new Taiwan dollar (NT$) 193.2 billion in 2022.
- We expect Yang Ming to maintain a net cash position in 2023-2024 to buffer against plunging freight rates, given its enhanced cash position following extraordinarily strong operating cash flow generation over the past two years. This is despite increasing capital expenditure (capex) for fleet replacement over the next two years.
- Yang Ming's key credit metrics are likely to remain highly volatile through business cycles, given its high exposure to the highly competitive long-haul container-shipping market and Yang Ming's limited operating scale compared to that of large global peers.
- We have revised our liquidity assessment for Yang Ming to strong from adequate because of the company's high cash balance. This has no rating impact.
- We have affirmed our issuer credit ratings on Yang Ming at 'twA-/twA-2'.
- The stable rating outlook reflects our view that Yang Ming will continue to maintain a net cash position over the next one to two years.

Rating Action Rationale

Seaborne freight rates will face a substantial correction in 2023 after a boom during the pandemic over the past two years. The factors that underpinned skyrocketing freight rates over the past two years, including the bottleneck of port traffic and pandemic-induced demand for tangible goods, have diminished. We forecast trade volume across main-lane service lines, including transpacific, East Asia to Europe and transatlantic routes, will remain subdued in 2023 before picking up in 2024. We view economic challenges as the main cause of subdued demand over the coming few quarters, including inflation, interest rate hikes and dwindling disposable incomes.

Moreover, the growth of higher capacity megaships on long-haul routes could worsen supply and demand imbalances and place additional strain on shipping rates. Growth in megaships is likely to peak at 10%-20% in 2023-2024. That said, we believe major carriers will remain disciplined when managing supply through rescheduling, re-routing, and even the deferral of some new vessel deliveries.

Yang Ming's operating performance will weaken in 2023. Given current industry conditions, Yang Ming's revenue could drop by 60%-65% in 2023 before a slight recovery in 2024. The average freight rate will likely plunge by 60%-65% in 2023 from the historical high in 2022. Meanwhile, we forecast lifting volume will only grow by 1%-2% over the next year, given muted demand in the U.S. and Europe. Under our base case projection for Yang Ming, the drop in freight rates along with heightened operating costs (excluding fuel) amid inflation, will weaken the carrier's EBITDA margin to 14%-16% over the next one to two years. This compares with 64.5% in 2022.

Improved capital structure should support a net cash position, despite shrinking operating cashflow and rising capex. Booming demand for container shipping in 2021-2022 underpinned strong operating cash flow generation and helped Yang Ming pay down its bank loans. The strong operating cash flow helped Yang Ming accumulate a high cash and short-term investment balance, which reached NT$317.8 billion at the end of 2022. However, operating cash flow is likely to weaken to NT$20 billion-NT$30 billion over the next one to two years, compared with over NT$200 billion annually over the past two years. Meanwhile, based on our projection, Yang Ming's capex needs will likely rise to over NT$10 billion in 2023 and over NT$20 billion in 2024, in addition to a cash dividend payout of about NT$69.8 billion in 2023. The company's enhanced cash position could provide ample rating headroom over the next two years as freight rates normalize, and support rising investments to strengthen fleet efficiency and underpin shareholder remuneration.

High business volatility and capital intensity continue to constrain the ratings. Global container shipping will remain highly volatile due to the standard nature of its services and likely supply-demand imbalances over the next two years. Better market discipline through the formation of shipping alliances could only partly alleviate such volatility, in our view. Yang Ming will likely remain more vulnerable to this volatility than its larger peers due to its relatively weak market position and continuously intense competition in the long-haul market. In addition, in the face of increasingly stringent environmental standards, carriers will need to continuously invest in new and more energy efficient vessels. This will make it difficult for Yang Ming to sustain its improved debt leverage through business cycles.

Outlook

The stable rating outlook reflects our view that Yang Ming will continue to maintain a net cash position over the next one to two years, underpinned by the carrier's enhanced cash position. This is despite a substantial freight rate correction across the container shipping industry and Yang Ming's growing investments in new vessels. The outlook also reflects our view that Yang Ming's role and linkage to the Taiwan government will remain intact and our belief that the company will continue to have good access to Taiwan's banking channels over the next two years.

Downward scenario

We could lower the long-term rating on Yang Ming if:

- The company's competitive position weakens substantially, which could result from a significant decline in the company's market share, or a major deterioration in cost structure and service network relative to larger peers' due to its inadequate fleet; or
- The company's ratio of funds from operations (FFO) to debt falls below 45% for an extended period without a sign of recovery. This could result from either Yang Ming taking on more debt due to overly aggressive capex or cash dividend payments amid prolonged deterioration in

industry conditions, or weakening profitability led by freight rates decline or rising operating costs; or

- In a less likely scenario over the next two years we believe that the company's role and link to the Taiwan government has weakened substantially. This includes a substantial reduction in government ownership or control of Yang Ming's board.

Upward scenario

We may raise the rating over the next 12-24 months if:

- The company sustains an improved capital structure and conservative financial policy on capex and cash dividend payout that keeps debt from rising significantly, such that the ratio of FFO to debt remains above 60% through business cycles; or
- The company materially increases its profitability through strengthened cost competitiveness and economies of scale.

Our Base-Case Scenario

- S&P Global forecasts Eurozone real GDP to grow by 0.3% in 2023 and 1.0% in 2024; U.S. real GDP to grow by 0.7% in 2023 and 1.2% in 2024; Asia Pacific's real GDP to expand by 4.6% in 2023 and 4.7% in 2024.
- Yang Ming's total lifting volume to grow by a mild 1%-2% in 2023-2024 after 4.5% growth in 2022.
- Yang Ming's average freight rate to decline by 60%-65% in 2023-2024 from the historical peak in 2022.
- Bunker fuel price of US$710-US$720 per ton in 2023-2024. We also assume Yang Ming's unit bunker usage will improve over the next one to two years, supported by the company's younger fleet of vessels and slower sailing speed.
- Operating costs (bunker excluded) per twenty-foot equivalent unit (TEU) to stay elevated due to inflation, but declining slightly, supported by the company's cost management and vessels with better efficiency.
- We project Yang Ming's capex to rise to over NT$10 billion in 2023 from NT$8.5 billion in 2022 and further rise substantially to over NT$20 billion in 2024, mainly for vessel replacement.
- Cash dividend payout amount of NT$69.8 billion in 2023.
- We applied 10.4% haircut ratio for surplus cash adjustment, reflecting Yang Ming's continued use of abundant cash on hand to pay down maturing bank loan over the next two years.

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

- EBITDA margin of 14%-16% in 2023-2024, down from 64.5% in 2022.
- Net cash position in 2023-2024.

Liquidity

The short-term rating on Yang Ming is 'twA-2'. We have revised our assessment of Yang Ming's liquidity to strong from adequate, and we estimate the company's ratio of liquidity sources to liquidity uses at 3.5x-4.5x in 2023-2024. 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 of Dec. 31, 2022, Yang Ming has about NT$317.8billion in cash and short-term investments. We believe

Yang Ming has good access to banks, underpinned by its connection with the Taiwan government. The company does not carry any covenant on its bank loans.

Principal liquidity sources:

- Cash and short-term investments of NT$317.8 billion as of Dec. 31, 2022.
- FFO of NT$15 billion-NT$25 billion annually in 2023 and 2024.

Principal liquidity uses:

- Debt of NT$6.0 billion-NT$6.5 billion maturing in the 12 months ending December. 31, 2023; NT$2.0 billion-NT$2.5 billion in the 12 months ending Dec. 31, 2024.
- Capex of over NT$10 billion in 2023 and over NT$20 billion in 2024.
- Cash dividend payout of NT$69.8 billion in 2023.

Ratings Score Snapshot

Issuer Credit Rating: twA-/Stable/twA-2
Note: The descriptors below are on a global scale.
Business risk: Weak

- Country risk: Low
- Industry risk: High
- Competitive position: Weak

Financial risk: Intermediate

- Cash flow/Leverage: Intermediate

Anchor: twbbb+
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: Negative (-1 notch)

Stand-alone credit profile: twbbb

- Sovereign rating: [unsolicited, rated 'AA+/Stable/A-1+' by S&P Global Ratings]
- Likelihood of government support: Moderately high (+2 notches from SACP)

ESG credit indicators: E-3, S-2, G-2

Related Criteria & Research

Related Criteria

- General Criteria: Environmental, Social, And Governance Principles In Credit Ratings, Sun Oct 10 2021
- General Criteria: Group Rating Methodology, Mon Jul 01 2019
- Criteria | Corporates | General: Corporate Methodology: Ratios And Adjustments, Mon Apr 01 2019
- General Criteria: Methodology For National And Regional Scale Credit Ratings, Mon Jun 25 2018
- General Criteria: Rating Government-Related Entities: Methodology And Assumptions, Wed Mar 25 2015
- Criteria | Corporates | General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Tue Dec 16 2014
- General Criteria: Country Risk Assessment Methodology And Assumptions, Tue Nov 19 2013
- General Criteria: Methodology: Industry Risk, Tue Nov 19 2013
- Criteria | Corporates | General: Corporate Methodology, Tue Nov 19 2013
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities, Tue Nov 13 2012
- General Criteria: Principles Of Credit Ratings, Wed Feb 16 2011

Related Research

- Taiwan Ratings' Ratings Definitions – November 11, 2021

(Unless otherwise stated, these articles are published on www.taiwanratings.com)

Ratings List

Ratings Affirmed

Yang Ming Marine Transport Corp.	
Issuer Credit Rating	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.