Media Release:

Wan Hai Lines Ltd. Ratings Affirmed At 'twA/twA-1' On High Net Cash Position; Outlook Stable

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Rating Action Overview

- **Wan Hai Lines Ltd.** provides services in intra-Asia, transpacific, and the Middle East. The company generated funds from operations of new Taiwan dollar (NT$) 121.6 billion in 2022.
- Wan Hai Lines Ltd. should be able to absorb the hit from plunging freight rates and maintain a net cash position in 2023-2024. This is because of its enhanced cash position due to strong operating cash flow over the past two years. This is despite still high level of capital expenditure (capex) for capacity expansion.
- Increasing exposure to competitive long-haul routes, as well as Wan Hai's relatively smaller operating scale, could lead to volatility in profitability and higher leverage through business cycles.
- We affirmed our long- and short-term issuer credit ratings on Taiwan-based Wan Hai at 'twA/twA-1'.
- The stable rating outlook reflects our view that Wan Hai 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. Factors that underpinned skyrocketing freight rates over the past two years, including port traffic bottlenecks and pandemic-induced demand for tangible goods, have diminished.

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 amid economic challenges. These risks include inflation, interest rate hikes, and dwindling disposable incomes.

Also, capacity growth of megaships, which are normally deployed on long-haul routes, will likely peak at 10%-20% in 2023-2024. This would further worsen supply and demand imbalances and put a strain on shipping rates. That said, we believe major carriers are likely to remain disciplined in managing supply with measures such as rescheduling, re-routing, and potentially some deferral of new vessel deliveries.

Relatively balanced supply and demand outlook could support more resilient intra-Asia freight rates over the next two years, compared with long-haul routes. We estimate economic growth in the Asia-Pacific region will slightly accelerate in 2023, driven by an end to China's "zero-COVID" policy, as well as a global push by major international brands to lower geopolitical risk by diversifying supply chains away from China to southeast Asia.

We project incremental total capacity growth in smaller-size vessels at 3.8% in 2023, before a likely contraction in 2024. Smaller vessels are under 3,000 twenty-foot equivalent units (TEUs) and are typically deployed on intra-Asia routes.

Wan Hai's operating performance will weaken in 2023. Led by the decrease of both freight rates and lifting volume, Wan Hai's revenue will drop by 55%-60% in 2023 before a recovery in 2024. The plummet of freight rates and heightened ex-fuel operating costs led by inflation will also weaken Wan Hai's EBITDA margin to 20%-23% in 2023-2024 from 53.8% in 2022.

Wan Hai will benefit from relatively stable intra-Asia market, given its leading position in the region. In the first quarter of 2023, intra-Asia contributed about 50% of total revenue for the company. We project a more moderate decline of intra-Asia freight rates by about 40% in 2023, compared with a 60%-70% plunge for Middle East and transpacific lines.

Lifting volume will decline by 2%-3% in 2023 before a rebound of 5%-7% in 2024 due to muted demand in the U.S. China's recovery and still strong demand from emerging markets, such as India, could partly boost the volume.

Improved capital structure could help Wan Hai maintain a net cash position as a buffer against lower operating cash flow. The company built a high cash balance of new Taiwan dollar (NT$) 172 billion as of end of 2022 over the past two years amid a surge in freight rates during that period. This significantly strengthened the carrier's overall capital structure, and should be enough to shield Wan Hai from a steep decline in freight rates.

We forecast Wan Hai's annual operating cash flow could significantly deteriorate to NT$25 billion-NT$30 billion over the next one to two years from NT$137 billion in 2022. Meanwhile, capital expenditure will remain heightened at NT$45 billion-NT$47 billion in 2023 before declining to NT$23 billion-NT$25 billion in 2024. Wan Hai's cash position could provide ample rating headroom over the next two years against lower freight rates, rising investments for strengthening fleet efficiency, as well as for shareholder remuneration.

Wan Hai's increasing exposure to competitive long-haul routes could increase the volatility of its performance and leverage through industry cycles. The company could face intense competition from bigger and more established carriers with more comprehensive service networks, partly through shipping alliances. Wan Hai will still have a much weaker position in the more volatile long-haul container shipping markets despite its aggressive capacity expansion plan involving 18 vessels of 13,000 TEUs each.

Our base case assumes Wan Hai will focus on generating a profit rather than increasing market share, so it will remain flexible in deploying its fleets between long-haul and intra-Asia routes, which are more profitable for the company. The company's progressive deployment of megaships could also help improve operating efficiency.

However, Wan Hai's credit metrics could significantly weaken if it becomes more aggressive in expanding its market share in long-haul routes without protecting its profit margins, or if it boosts capital spending for mega vessels, which are more efficient for long-haul routes. This would be particularly apparent during a market downturn.

Outlook

The stable rating outlook reflects our view that Wan Hai will continue to maintain a net cash position over the next one to two years, underpinned by its enhanced cash position. This is despite significantly lower freight rates across the container shipping industry and the company's elevated investments to purchase new vessels.

Downward scenario

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

- The company's profitability deteriorates materially due to: (1) the company's expansion into the competitive long-haul market materially dampening its profitability; (2) possible container ship oversupply if the market becomes less disciplined; (3) rising competition from long-haul competitors that erodes Wan Hai's competitive advantage on intra-Asia routes; or
- The carrier takes on a more aggressive capacity expansion and substantially increases its debt leverage, such that its ratio of funds from operations (FFO) to debt falls to below 60% through business cycle.

Upward scenario

We see a low likelihood of upgrading Wan Hai over the next one to two years, given high business risk in the global container shipping market, and the company's aggressive capex plans for the more volatile long-haul markets. That said, 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 maintains a very conservative financial policy plan that supports the ratio of FFO to debt above 60% through the business cycle.

Our Base-Case Scenario

- Asia-Pacific real GDP to expand by 4.6% in 2023 and 4.7% during 2024 after growing 3.9% in 2022; U.S. real GDP to grow by 0.7% in 2023 and 1.2% in 2024.
- Wan Hai's lifting volume to decline 2%-3% in 2023 following a 6.9% decline in 2022. Lifting volume will rebound by 5%-7% in 2024 led by gradual economic recovery around the globe.
- Average freight rates to decline 55%-60% in 2023-2024 from the historical peak in 2022.
- Bunker fuel price to decline to US$710-US$720 per ton in 2023-2024 from US$750-US$800 per ton in 2022, reflecting the general decline in crude oil prices. We also factor in a decline in unit bunker usage as Wan Hai's deployment of newly built megaships in long-haul routes could help improve fuel efficiency.
- Charter hire expenses to decline by 70%-75% in 2023 as Wan Hai plans to lower the contribution of chartered vessels.
- Other ex-bunker costs (including port charges, stevedoring, transshipment, and terminal fees) per TEU to stay elevated due to inflation, though with a declining trend for Wan Hai, which will benefit from continuous vessel replacement.
- Capex to remain heightened at NT$45 billion-NT$50 billion in 2023 and decline to NT$20 billion-NT$25 billion in 2024. This will mainly cover the purchase and down payment for newly built and secondhand vessels, as well as new container boxes.
- Cash dividend payout ratio to decline to 15%-20% of previous year's net income in 2023 from 24.8% in 2022. The ratio will be 25%-30% in 2024. We believe Wan Hai will remain flexible in its dividend policy in order to keep enough cash for a potential industry downturn, and also for potential capital needs in the future.

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

- EBITDA margin of 20%-25% in 2023-2024, down from 53.8% in 2022.
- Net cash position in 2023-2024.

Liquidity

The short-term rating on Wan Hai is 'twA-1'. We assess Wan Hai's liquidity as strong and we estimate the company's ratio of liquidity sources to liquidity uses at 2x-3x in 2023-2024. We also believe Wan Hai can cope with high impact low-probability events with limited refinancing, given the company's high cash balance. As of the end of 2022, Wan Hai had about NT$178 billion in cash and short-term investments. In addition, we believe the company's good relationship with Taiwan banks will provide access to financing when needed.

Principal liquidity sources:

- Cash and short-term investments of NT$178.2 billion as of Dec. 31, 2022.
- FFO of NT$20 billion-NT$30 billion annually in 2023 and 2024.

Principal liquidity uses:

- Debt of NT$6 billion-NT$7 billion maturing during 2023; and NT$15 billion-NT$20 billion in the subsequent 12 months.
- Capex of NT$45 billion-NT$50 billion in 2023 and NT$20 billion-NT$25 billion in 2024.
- Cash dividend payout ratio of 15%-20% of the previous year’s net income in 2023 and 25%-30% in 2024.

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

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

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.

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