Bulletin:

# Formosa Plastics Group's Rising Cash Inflows Can Support Stable Debt

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Significant improvement in working capital inflows could help the four major companies of Formosa Plastics group sustain their aggregate debt level over the next 18 months. That's despite continuing volatility in regional operating conditions and input costs.

Demand and supply conditions for the four companies look set to improve from the second half of 2023 and throughout 2024. The four key chemical and oil refining units of the group include Formosa Plastics Corp., Nan Ya Plastics Corp., Formosa Chemicals & Fibre Corp., and Formosa Petrochemical Corp., all rated twAA/Stable/twA-1+. Inventory restocking, rising exports from the region, and recovering consumption in China should support higher chemical prices and improving EBITDA generation later in the period. The China government's package of economic stimulus and policy support for the property sector largely underpin improving demand conditions in this key regional market.

We now expect the four companies to record EBITDA of new Taiwan dollar (NT$) 85 billion-NT$95 billion in 2023, following weak performance in the first half. This is below our previous base case assumption for the group. Nonetheless, EBITDA will likely improve to NT$120 billion-NT$130 billion in 2024, albeit still below the companies' mid-cycle level historically.

Significantly lower EBITDA generation in 2023 could also push the ratio of debt to EBITDA above 3x by the end of the year, up from 2.3x in 2022. We then expect it to fall close to 2x by the end of 2024 and improve further in 2025.

Despite higher leverage, we forecast the four companies will maintain relatively stable overall debt in 2023 and moderately reduce their debt in 2024. This will be supported by lower cash dividend payments with a consistent dividend payout ratio of 70%-80%, and significant working capital inflows. Lower feedstock and product prices along with tighter inventory control amid still-weak market conditions should lead to significant working capital inflows in 2023.

In addition, we expect the four companies will largely maintain their capital expenditure and investments around their annual depreciation and amortization expenses to limit the total debt level. We have not factored capex for the group's chemical project in the U.S. state of Louisiana into our base case for 2023-2024, following the suspension of the project in 2021. In addition, tightening environmental requirements and weak supply and demand dynamics for most commodity chemicals will also make it difficult for the group to pursue other large scale chemical projects. These factors support our forecast of relatively flat total debt of around NT$300 billion in 2023 and slightly lower in 2024, compared with NT$303 billion in 2022.

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