Media Release:

Wiwynn Corp. Outlook Revised To Stable From Negative On Parent And Wiwynn Deleveraging; 'twA/twA-1' Ratings Affirmed

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Rating Action Overview

- **Wiwynn Corp.,** a subsidiary of Wistron Group, specializes in providing customized servers for hyper-scale data centers of globally leading cloud service providers. Wiwynn generated EBITDA of NT$18.6 billion in 2022.
- We continue to assess Wiwynn as an insulated and highly strategic subsidiary of Wistron Group; therefore, the ratings currently reflect Wiwynn's SACP and are currently capped at one-notch above the parent group credit profile.
- Improved profitability and inventory destocking, partly at Wiwynn, should enable Wistron to further deleverage in 2023-2024.
- We have therefore revised our outlook on the long-term rating on Wiwynn to stable from negative. This reflects our view that Wiwynn could sustain its strong operating cash flow to support high capex and cash dividends while lowering the ratio of debt to EBITDA to well below 1x in 2023. It also reflects our assessment that Wistron could maintain its debt to EBITDA ratio materially below 5x in 2023-2024 through improving profitability and working capital.
- At the same time, we affirmed our 'twA/twA-1' issuer credit ratings on Wiwynn.

Rating Action Rationale

The outlook revision reflects our view that the parent, Wistron, could continue deleveraging in 2023-2024. Improved profitability and a sharp reduction in inventory after component shortage eased could help Wistron to lower its debt-to-EBITDA ratio to 4.7x-4.9x in 2023 and 4.1x-4.3x in 2024, from 4.9x in 2022. That's despite potentially weaker performance in 2023 amid weak global IT demand. Wistron's revenue is likely to rebound in 2024, amid a recovery in commercial buying for PCs and improving demand for hyperscale data center servers and other applications with long-term prospects, including industrial PCs and auto-electronics. Meanwhile, continuous improvement to the company's product mix with increasing commercial content and the gradual disposal of unprofitable business lines could help Wistron to sustain an improved margin over the next two years.

Wistron's strengthened cash flow could fund the company's higher capital expenditure (capex) needs to support the diversification of its production footprint without preventing Wistron from deleveraging. We forecast capex will remain heightened at new Taiwan dollar (NT$) 12 billion-

NT$14 billion in 2023, mainly to support capacity diversification to Taiwan, South-East Asia and Mexico from China. This will help to meet its clients' demand to mitigate geopolitical risk. In addition, Wistron's cash dividend payout will increase to around NT$7.4 billion in 2023 from NT$6.3 billion in 2022, given the group's better bottom line in 2022.

Wiwynn to resume EBITDA growth after a dip in 2023. Strong demand for hyperscale data center servers could boost Wiwynn's revenue growth in 2024. This likely follows a significant decline in 2023, due to slower expansion by major North American cloud service providers as they gauge the consequences of economic challenges and a likely demand shift to AI applications.

The rapid implementation of AI servers by major cloud service providers could be the key growth driver for Wiwynn from 2024. Wiwynn's close product development with key clients and capability of providing power-efficient and workload-optimized server products could also further expand its client base. In addition, Wiwynn's enhanced scale economy and good technology capability should help to sustain the EBITDA margin at 6.3%-6.5% over the next two years.

Stable operating cash flow generation supports Wiwynn's continued low debt leverage. Destocking after the relief of supply chain disruptions along with EBITDA expansion support Wiwynn's strong operating cash flow generation in 2023. The company's plan to establish its own production capacity globally requires increased working capital and a lengthened supply chain. However, we believe that Wiwynn can manage this risk without a material impact on cash flow. The company's strong cash flow should be sufficient to fund its elevated capex associated with overseas expansion and cash dividends while further lowering its debt in 2023. In turn this should help to maintain the ratio of debt to EBITDA well below 0.5x in 2023-2024.

The ratings on Wiwynn are not currently capped by Wistron's group credit profile. We continue to assess Wiwynn as an insulated and highly strategic subsidiary of Wistron Group. Our issuer credit rating on Wiwynn currently reflects the company's SACP and is capped at one notch above group credit profile of Wistron on S&P Global Ratings' global rating scale. The insulated group status reflects our belief in Wistron's strategic need to maintain some separation from Wiwynn to avoid direct competition in the server market with its major generic server clients. In addition, Wiwynn is independent in its business operation and financial performance, and does not commingle its funds, other assets and cash flow with that of Wistron. However, we do not expect Wistron to fully divest Wiwynn, given the company's significant profit contribution and importance to the group's long-term strategy to develop server business.

Outlook

The stable outlook reflects our expectation that Wiwynn's parent company, Wistron, could continue to lower its debt leverage over the next one to two years. Wistron's improved working capital movement after the ease of supply chain disruption and strengthened profitability help the company to keep its debt to EBITDA ratio below 5x in 2023-2024.

Meanwhile, the outlook also reflects our view that Wiwynn will continue to expand its EBITDA in 2024 after a temporal decline in 2023 and maintain its debt-to-EBITDA ratio below 0.5x over the next one to two years. In addition, under our base case for Wiwynn, we believe the company's plan to increase its self-owned capacity will not materially increase its debt over the next two years.

Downward scenario

We may lower the rating on Wiwynn if:

- The company's debt to EBITDA ratio deteriorates to above 1.5x for an extended period. This could happen if Wiwynn becomes more aggressive on capex for building self-owned capacity than our base case suggests, or the company's cash conversion cycle lengthens, leading to significant debt-funded operating cash flow to support revenue growth and diversified production bases; or
- Wiwynn's profitability, as measured by return on capital, falls to near 12%, signaling a material deterioration in the company's revenue or profitability. This could happen if intense competition or deteriorating R&D strength relative to that of its peers induces severe pricing pressure from its clients or the loss of key customers.

We may also lower the rating on Wiwynn if Wistron's creditworthiness deteriorates materially. This may occur if:

- Wistron's profitability deteriorates substantially due to the loss of critical customers or more intense pricing competition in the electronics manufacturing services (EMS) industry; or
- Wistron's capex, investments, or working capital needs rise significantly above our previous forecast, such that its debt-to-EBITDA ratio deteriorates to above 5x for an extended period.

Upward scenario

We may raise the long-term rating on Wiwynn if we raise Wiwynn's stand-alone credit profile while at the same time Wistron's creditworthiness improves materially. This may occur if:

- Wistron substantially improves its market position in the EMS industry and significantly expands its operating scale, or
- Wistron's debt-to-EBITDA ratio improves to below 3x for an extended period, underpinned by its improving profitability as well as more prudent capex, working capital management, and cash dividends, while at the same time, Wiwynn expands its operating scale substantially through diversifying its customer base so that cash flow stability can improve, or Wiwynn materially strengthens its profitability by constantly developing new products faster than its peers.

Our Base-Case Scenario

- S&P Global's forecast for U.S. real GDP to grow by 1.7% in 2023 and 1.3% in 2024, Eurozone real GDP to grow by 0.6% in 2023 and 0.9% in 2024, and APAC real GDP to grow 4.5% in 2023 and 2024.
- After nearly two years of robust global IT spending throughout the pandemic, 2022 IT spending slowed considerably and will continue to remain moderate in 2023, with 2.2% growth, based on S&P Global's forecast. Server shipments (including both generic and hyperscale data center servers) are projected to decline by 5% in 2023, given enterprises and major cloud service providers in North America have turned cautious in their IT spending budgets amid a global economic slowdown. Nonetheless, we still expect secular growth in the server market, underpinned by the growing adoption of cloud, edge computing and data analytics.
- We project Wiwynn's revenue to decline by 15%-20% in 2023 after robust growth of 52% in 2022, due to the deceleration of spending by the company's hyperscale clients. Revenue to rebound by around the same extent in 2024 amid rising installations of AI servers and resumed growth of cloud demand.

- Gross margin to improve to 8.5%-8.7% in 2023-2024 from 8.4% in 2022, amid falling raw material prices, as well as the company's ability to constantly provide tailor-made hyperscale data center servers.
- Sales, goods and administration expense to grow along with revenue in 2023-2024 with R&D-to-revenue ratio at 1.2%-1.4% over the period.
- Capex to increase to NT$6 billion-NT$7 billion in 2023 and NT$4 billion-NT$5 billion in 2024 from NT$1.5 billion in 2022, mainly for building new capacity in Malaysia, Mexico and Taiwan.
- Dividend payout ratio of 60%-65% of the previous year's net income in 2023-2024.

Wiwynn Corp.--Forecast summary

Industry sector: Technology hardware

(Mil. NT$)	2020a	2021a	2022a	2023e	2024f	2025f
Revenue	186,928	192,626	292,876	237,500	284,900	325,725
EBITDA (reported)	11,632	11,935	18,596	14,888	18,145	20,745
EBITDA	11,632	11,935	18,596	14,888	18,145	20,745
Less: Cash interest paid	(303)	(334)	(886)	(567)	(492)	(275)
Less: Cash taxes paid	(1,659)	(2,709)	(2,345)	(3,040)	(3,690)	(4,245)
Funds from operations (FFO)	9,671	8,892	15,365	11,281	13,962	16,225
Cash flow from operations (CFO)	10,703	(27,271)	30,079	25,691	11,001	12,448
Capital expenditure (capex)	553	511	1,466	7,039	5,000	1,000
Free operating cash flow (FOCF)	10,150	(27,782)	28,613	18,652	6,001	11,448
Debt (reported)	10,360	30,716	9,448	10,950	6,950	2,225
Plus: Lease liabilities debt	380	671	1,013	1,044	1,148	1,263
Less: Accessible cash and liquid Investments	(22,706)	(22,219)	(25,812)	(17,117)	(13,516)	(11,592)
Plus/(less): Other	12,129	25,152	25,851	7,000	7,000	7,000
Debt	164	34,319	10,501	1,876	1,582	--
Cash and short-term investments (reported)	23,169	22,673	26,232	17,290	13,652	11,709
Adjusted ratios						
Debt/EBITDA (x)	0.0	2.9	0.6	0.1	0.1	--
FFO/debt (%)	5,913.8	25.9	146.3	601.3	882.5	N.M.
Annual revenue growth (%)	14.3	3.0	52.0	(18.9)	20.0	14.3
EBITDA margin (%)	6.2	6.2	6.3	6.3	6.4	6.4

All figures are adjusted by Taiwan Ratings Corp., unless stated as reported. a--Actual. e--Estimate. f--Forecast. NT$-- new Taiwan dollar. N.M.--Not meaningful.

Liquidity

The short-term rating on Wiwynn is 'twA-1'. We believe that Wiwynn has adequate liquidity to meet its needs over the 12 months ending June 2024, with a ratio of liquidity sources to liquidity uses at around 1.3x for the period. We believe that Wiwynn's liquidity sources will still exceed liquidity uses even if its EBITDA was to drop by 15%. Wiwynn has prudent risk management as characterized by its high cash on hand, complete hedging on foreign currency risk, and high insurance coverage on inventory.

We also believe that Wiwynn has strong banking relationships and a generally satisfactory standing in credit market. Along with a supportive banking environment in Taiwan with ample liquidity, the company should be able to renew short-term debts or establish new bank loan facilities. Wiwynn's debt carries no financial covenants.

Principal liquidity sources:

- Cash and short-term investments of NT$27 billion as of the end of June 2023.
- Funds from operations of NT$12.5 billion-NT$13.5 billion over the 12 months ending June 2024.

Principal liquidity uses:

- Debt maturities of about $12.4 billion over the 12 months ending June 2024.
- Capex of NT$6 billion-NT$7 billion in 2023.
- Cash dividend payout of 60%-65% of the previous year's net income in 2023.

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: 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: Adequate (no impact)
- Management and governance: Fair (no impact)
- Comparable rating analysis: Negative (-1 notch)

Stand-alone credit profile: twA

- Entity status within group: Highly strategic (The issuer credit rating reflects the entity's stand-alone credit profile of 'twa' and is currently not capped by the group credit profile)
- We assess Wiwynn as an insulated and highly strategic subsidiary of Wistron group. The issuer credit rating on Wiwynn can be one notch above the parent group credit profile on S&P

Global Ratings' global rating scale if Wiwynn's stand-alone credit profile is one or more notches higher than the group credit profile.

Related Criteria & Research

Related Criteria

- General Criteria: National And Regional Scale Credit Ratings Methodology - June 08, 2023
- 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 – November 11, 2021

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

Ratings List

Outlook Revision; Ratings Affirmed

	To	From
Wiwynn Corp.		
Issuer Credit Rating	twA/Stable/twA-1	twA/Negative/twA-1