Media Release:

Yulon Motor Outlook Revised To Stable From Positive On Constrained Cashflow Generation; 'twBBB+/twA-2' Ratings Affirmed

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Rating Action Overview

- **Yulon Motor Co. Ltd.** is the sole manufacturer of Nissan-branded cars in Taiwan and has its owned car brand, Luxgen. The company generated EBITDA of new Taiwan dollar (NT$) 4.8 billion in 2022.
- A substantially decrease in cash dividends from Yulon Nissan could hinder recovery in Yulon Motor's EBITDA generation over the next one to two years, despite improvement in Yulon Motor's core auto manufacturing profitability.
- We have revised our outlook on the long-term issuer credit rating on Yulon Motor to stable from positive. This reflects our view that it could take longer than we previously expected for the company's debt-to-EBITDA ratio to improve to comfortably below 4x.
- At the same time, we affirmed our 'twBBB+/twA-2' issuer credit ratings on the company.

Rating Action Rationale

The outlook revision reflects our view that Yulon Motor could take longer to deleverage than we previously forecast. Yulon Nissan Motor Co. Ltd.'s main business is to sell Nissan-branded cars in Taiwan and China. Yulon Motor owns a 47.83% share in Yulon Nissan, while Japan-based Nissan Motor Corp. owns 40% as of the end of June 2023. Therefore, Yulon Nissan is not a consolidated entity of Yulon Motor, but instead Yulon Motor receives cash dividends based on Yulon Nissan's profit for the previous year. These cash dividends have historically formed the main cash flow generation source for Yulon Motor and amounted to new Taiwan dollar (NT$) NT$2.66 billion in 2021, which accounted for 40.6% of Yulon Motor's EBITDA. The amount declined to NT$1.28 billion in 2022 (26.6% of Yulon Motor's EBITDA) and further down to NT$1.04 billion in 2023 (29.3%).

In addition, Yulon Nissan's net income was NT$520 million for the first half of 2023, down 50% from NT$1.03 billion in the same period in 2022. This indicates that cash dividends from Yulon Nissan will likely decrease substantially in 2024. We project sales of Nissan-branded passenger cars in China will decline by 20%-25% in full-year 2023. This mainly reflects the brand's inferior market position in China due to the lag of electric vehicle (EV) development, less competitive pricing compared to local brands, and the China government's policy to support local auto brands.

Sales volume could rebound in 2024 thanks to the new model introductions, but growth is likely to remain relatively mild compared to China's overall passenger car market.

Weakened sales and profitability in China could significantly impair Yulon Nissan's ability to pay dividends, because more than 90% of its pre-tax income comes from the company's equity investments in China. As a result, we estimate Yulon Motor's cash dividends from Yulon Nissan could decline to below NT$500 million in 2024.

Operating income for Yulon Motor's core auto manufacturing business should improve in 2024, amid new car launches. The facelift of several popular Nissan car models and the introduction of Luxgen's new electric SUV model, n7, could boost Yulon Motor's sales volume by 30%-35% in 2024. This will follow a low single-digit decline in 2023. Increasing production volume could help lift Yulon Motor's utilization rate and further underpin the company's stand-alone operating income. Losses on Yulon's Luxgen-branded business could also narrow. We base this on our view that the successful launch of the new EV model and the fact that Luxgen only needs to pay royalties for new models to Foxtron Vehicle Technologies rather than sharing the development costs.

In addition, we believe there will be full year rental income from Yulon group's newly opened shopping mall, Yulon City, of NT$400 million-NT$450 million per year in 2024. We forecast Yulon Motor's reported EBITDA will grow 20%-25% in 2024. However, this increase will not be enough to outpace the decrease in Yulon Motor's cash dividends from Yulon Nissan. We project Yulon Motor's adjusted EBITDA will decline to NT$3.2 billion-NT$3.6 billion in 2023-2024, from NT$4.8 billion in 2022. Adjusted EBITDA factors in cash dividends from Yulon Motor's equity investments.

Yulon Motor's debt is likely to decline further in 2023-2024. Yulon Motor raised capital of NT$4.76 billion and disposed preferred shares in its subsidiary, Yulon Finance in 2023. This more than offsets the company's NT$3.7 billion capital injection to its insurance subsidiary in 2023 and should allow Yulon Motor to further pay down debt over the coming one to two years. Yulon Motor made the capital injection to Tokio Marine Newa Insurance Co. Ltd. (TM Newa) after the insurer reported significant claim losses on its pandemic insurance policies. We do not expect further capital injections to the insurer, given that its pandemic insurance policies matured in early 2023.

The company's working capital needs will decline now that construction of Yulon City is complete. This, along with stable EBITDA generation (excluding the cash dividends from Yulon Nissan) should support Yulon Motor's operating cash flow generation over the next one to two years. Steady annual cash dividends from Yulon Finance of NT$1.0 billion-NT$1.4 billion will also support Yulon Motor's deleveraging efforts, in our view. We forecast the company's adjusted debt will decrease to NT$14 billion-NT$16 billion in 2023-2024, from NT$20.8 billion in 2022.

Our base case projects debt to EBITDA will remain at 4.4x-4.7x in 2023-2024. Yulon Motor's deleveraging efforts and prudent investment plans should prevent further deterioration in its debt leverage, despite weakening cash flow generation. Consequently, we estimate Yulon Motor will maintain its debt-to-EBITDA ratio at 4.4x-4.7x over the next two years, which is in line with our ratings on the company.

Outlook

The stable rating outlook reflects our view that Yulon Motor can sustain its debt to EBITDA ratio at 4.4x-4.7x in 2023-2024. We expect the company's EBITDA to continue to decline over the next one to two years, due to the material decline in cash dividends from Yulon Nissan. Improvement in Yulon Motor's core manufacturing profitability could partly underpin its overall EBITDA generation.

Moreover, steady operating cash flow generation, stable cash dividends from Yulon Finance, along with Yulon Motor's prudent investment strategy should prevent an increase in Yulon Motor's debt.

Downward scenario

We may lower the long-term rating on Yulon Motor if the company's debt-to-EBITDA ratio weakens to above 5x on a sustainable basis. This could result from:

- Weaker EBITDA generation than our base case suggests, led by a lower profit contribution from Nissan-branded cars sales in Taiwan amid intense competition; or substantial performance deterioration in Nissan-branded cars in China that results in persistently low cash dividends from Yulon Nissan;
- Persistently large cash outflow for a more aggressive property development; or
- An unexpected large loss from Luxgen-related business.

Upward scenario

We may raise the long-term rating if Yulon Motor comfortably and sustainably maintains its debt-to-EBITDA ratio below 4x. The likely scenarios for this include:

- Improvement in profitability led by enhancement in its core auto manufacturing business possibly through the launch of new and more competitive models, or the successful launch of EVs that supports meaningful revenue and profit contribution from Luxgen;
- Recovery to a stronger and sustainable performance by Yulon Nissan, which underpins Yulon Motor's cash dividends received;
- Yulon Motor continues to lower its overall debt through positive discretionary cash flow generation to repay debts, or through the potential disposal of investment assets.

Our Base-Case Scenario

Assumptions

- S&P Global's forecast for Taiwan real GDP to grow by 0.5% in 2023 and 2.5% in 2024 and China real GDP to grow by 5.2% in 2023 and 4.7% in 2024.
- We project light vehicle sales in China to grow by low-single digit over the next two years and EV models from local brands to continue to lead the growth. Meanwhile, growth of Taiwan domestic new car sales is likely to outpace that of GDP in 2023 at 5%-8%, underpinned by pent-up demand in 2021-2022 amid the pandemic and supply chain disruptions. New car sales will slow down in 2024 as previously pent-up demand is gradually satisfied.
- Yulon Motor's revenue (deconsolidating Yulon Finance) to decline by 8%-12% in 2023 before growing materially by 20%-25% in 2024. The decline in 2023 is mainly led by weak sales performance of Nissan-branded cars in China. Updates to existing models and the introduction of new models will boost the company's sales in 2024.
- Yulon Motor's gross margin to stay at an improved 19.5%-20.5% in 2023 and 2024, compared to below 19% before 2022, thanks to the narrowing losses on Luxgen-related business and improving manufacturing utilization rate.
- Sales, general and administrative expense to grow along with revenue, reflecting the increase in promotional expenses amid a competitive domestic auto market.
- Yulon's cash dividend received from equity-method investment could decline to NT$1.0 billion-NT$1.4 billion in 2023 and further to NT$0.6 billion-NT$0.8 billion 2024 from NT$2.0 billion in 2022. This mainly reflects Nissan's weakening profitability due to Nissan's loss of market share to Chinese competitors.
- Yulon Motor's capital expenditure to remain high at NT$2.5 billion-NT$3.0 billion in 2023 to support the construction of Yulon City and equipment maintenance. Capex will decline to

NT$1.0 billion-NT$1.5 billion in 2024. This includes the company's investments in new energy related businesses of NT$1.0 billion per year.

- Cash injection to TM Newa of NT$3.5 billion-NT$4.0 billion in 2023.
- Yulon Motor to raise capital of NT$4.76 billion in 2023.
- Asset disposals amounting to NT$0.8 billion-NT$1.0 billion in 2023. Meanwhile, Yulon Motor together with its subsidiaries will dispose of holdings of Yulon Finance's preferred shares, amounting to NT$2.2 billion.
- Yulon Motor to pay NT$1.0 billion cash dividend in 2023 and NT$1.5 billion in 2024.
- We include cash dividend paid by Yulon Finance into Yulon's cash flow calculation, with annual amount of NT$1.0 billion-NT$1.4 billion in 2023-2024.
- We use haircut ratio of 5% to calculate accessible cash.

Yulon Motor Co. Ltd. – Forecast summary

Industry sector: Automotive - OEM's

(Mil. NT$)	2020a	2021a	2022a	2023e	2024f	2025f
Revenue	52,965	46,086	40,523	36,007	45,124	44,921
EBITDA (reported)	(2,142)	2,070	2,825	2,104	2,546	2,591
Plus/(less): Other	6,223	4,474	2,021	1,438	817	823
EBITDA	4,080	6,544	4,846	3,542	3,364	3,415
Less: Cash interest paid	(1,036)	(469)	(768)	(604)	(571)	(567)
Less: Cash taxes paid	(214)	(192)	(294)	(145)	(200)	(208)
Funds from operations (FFO)	2,830	5,882	3,784	2,793	2,593	2,640
Cash flow from operations (CFO)	8,012	4,081	1,780	2,913	2,067	2,712
Capital expenditure (capex)	2,923	3,581	1,764	2,902	1,375	1,220
Free operating cash flow (FOCF)	5,088	500	16	11	692	1,492
Debt (reported)	33,094	27,958	31,807	28,908	28,506	28,506
Plus: Lease liabilities debt	1,777	1,519	1,223	1,223	1,223	1,223
Less: Accessible cash and liquid Investments	(18,382)	(13,344)	(12,186)	(14,250)	(14,250)	(15,841)
Debt	16,489	16,133	20,843	15,881	15,479	13,888
Cash and short-term investments (reported)	20,200	14,664	13,392	15,000	15,000	16,675
Adjusted ratios						
Debt/EBITDA (x)	4.0	2.5	4.3	4.5	4.6	4.1
FFO/debt (%)	17.2	36.5	18.2	17.6	16.8	19.0
Annual revenue growth (%)	(8.1)	(13.0)	(12.1)	(11.1)	25.3	(0.5)
EBITDA margin (%)	7.7	14.2	12.0	9.8	7.5	7.6

All figures are adjusted by Taiwan Ratings Corp., unless stated as reported. a--Actual. e--Estimate. f--Forecast. NT$-- new Taiwan dollar.

Liquidity

The short-term issuer credit rating is 'twA-2'. We believe Yulon Motor has adequate liquidity to meet its needs over the next 12 months. We base this on our view that the ratio of liquidity sources to liquidity uses will be 1.3x-1.4x over the 12 months up to June 30, 2024, with liquidity sources continuing to exceed uses even if Yulon Motor's EBTIDA were to decline by 15%.

The liquidity assessment also reflects our view that the company can absorb high-impact, low-probability events, with limited need for refinancing. This is supported by Yulon's relatively high cash on hand, which provides some buffer for the company to withstand market volatility. Moreover, a supportive banking environment in Taiwan with ample liquidity should allow the company to renew short-term debts or establish new bank loan facilities. Yulon Motor's debt does not carry any covenant.

Principal liquidity sources:

- Cash and short-term investments of NT$22.8 billion at the end of June 2023.
- Funds from operations of NT$2.5 billion-NT$3.5 billion in the 12 months ending June 2024.
- Sales of asset and preferred shares of NT$2.8 billion-NT$3.2 billion in 2023.
- Share issuance of NT$4.76 billion in 2023.

Principal liquidity uses:

- Debt maturity of NT$18.4 billion in the 12 months ending June 2023.
- Capital expenditure and investments of NT$2.5 billion-NT$3.0 billion in 2023.
- Capital injection to equity investment company of NT$3.5 billion-NT$4.0 billion in 2023.
- Cash dividend payout of NT$1 billion in 2023.

Rating Score Snapshot

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

- Country risk: Intermediate
- Industry risk: Moderately high
- Competitive position: Weak

Financial risk: Aggressive

- Cash flow/Leverage: Aggressive

Anchor: twbb+
Modifiers

- Diversification/Portfolio effect: Neutral (no impact)
- Capital structure: Positive (+1 notch)
- Liquidity: Adequate (no impact)
- Financial policy: Neutral (no impact)
- Management and governance: Fair (no impact)
- Comparable rating analysis: Neutral (no impact)

Stand-alone credit profile: twbbb-

- Group credit profile: twbbb+
- Entity status within group: Ultimate parent (therefore the issuer credit rating equates to 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

Ratings Affirmed; Outlook Action

	To	From
Yulon Motor Co. Ltd.		
Issuer Credit Rating	twBBB+/Stable/twA-2	twBBB+/Positive/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.