Media Release:

Taiwan Optical Platform Co. Ltd. Upgraded To 'twA-/twA-2' On Declining Debt Leverage; Outlook Stable

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Rating Action Overview

- **Taiwan Optical Platform Co. Ltd.** provides cable TV and broadband services to households in its franchise areas in central and southern Taiwan. The company had EBITDA of NT$1.93 billion in 2022.
- The company's financial leverage has gradually declined, underpinned by stable cash flow generation and limited capital expenditure. These have supported Taiwan Optical Platform to generate positive discretionary cash flow and reduce its debt accordingly. The ratio of debt to EBITDA has also declined to 3.5x in 2022 from 4.1x in 2020, and we expect continued deleveraging to bring down the ratio to below 3.5x in 2023 and the next few years, despite the company's moderating cable subscription base.
- We have raised our long-term issuer credit rating on Taiwan Optical Platform to 'twA-' from 'twBBB+' and affirming the 'twA-2' short-term issuer credit rating.
- The rating outlook is stable to reflect our expectation that the company will maintain stable profitability with a satisfactory position in Taiwan's cable TV market, while gradually deleveraging over the next few years.

Rating Action Rationale

Positive discretionary cash flow could support further deleveraging, albeit at a slower pace. We forecast Taiwan Optical Platform to generate operating cash flow of around new Taiwan dollar (NT$) 1.3 billion over the next two years, despite slowing cable TV service demand. The positive discretionary cash flow should be sufficient to cover the company's limited capital expenditure (capex) needs and dividend payouts over the same period. In addition, we forecast the company will likely maintain a prudent appetite over new acquisitions, limited to only small transactions, if any. Moreover, a cash inflow of around NT$300 million from the sale of shares in its subsidiary, Shine Trend International Multimedia Technology Co. Ltd. could further support the company's deleveraging. Shin Trend International plans to complete its listing on the over-the-counter market in Taiwan by the end of 2023.

Taiwan Optical Platform's adjusted debt declined to NT$6.7 billion at the end of 2022, down from a peak of NT$8.9 billion at the end of 2019. The debt-to-EBITDA ratio also dropped to 3.5x from 6.5x over the same period. While we believe the company will continue to deleverage, we expect the pace to slow amid decelerating EBITDA generation over the next one to two years. The ratio could further decline to 3.4x in 2023 and 3.3x in 2024.

Declining cable TV business will depress the company's overall EBITDA in 2023-2024, despite improvement in its broadband business. Overall subscriber numbers for cable TV in Taiwan continued to decline in 2022 and represented 51% of total local household, a decline of 1.96% from the end of 2021. The decline comes amid rising competition from similar services, such as over-the-top (OTT) platforms and other on-line content provision services. As with other cable TV providers, Taiwan Optical Platform faces the risk of losing further subscribers, which will pressure the profitability of its TV business over the next few years. However, the company's churn rate is lower than that of its peers in other regions in Taiwan, given the generally older age of its customer base in its franchise areas, who are more inclined to maintain their viewing practice. The company maintained its churn rate at around 0.21% in Q2 2023, which is lower than its peers' rate of around 0.65%.

Taiwan Optical Platform is making efforts to mitigate the downside risk for its cable TV business by strengthening its broadband business through strategic alliances with telecom operators. These have helped to boost the company's revenue and profit contribution from its broadband division over the past two years. However, the company could see the penetration rate of its broadband business reach saturation point over the next few years. That is because its key competitor in this segment, Chunghwa Telecom Co. Ltd., could also take action to retain its market share.

In our view, the increasing profit contribution from broadband business will not be able to fully cover the weakening profitability of its cable TV business, because cable TV remains the largest profit contributor. Its broadband business accounted for only 15.5% of the company's total revenue for the first six months of 2023, while its cable TV service still represented 60% of total revenue at the same time. As a result, we still expect the company's overall EBITDA to continue to decline slightly over the next one to two years.

Outlook

The stable rating outlook reflects our view that Taiwan Optical Platform will maintain a dominant position in its key franchise areas and continue to generate stable profitability and cash flow over the next one to two years. In addition, we believe the company will use its stable operating cash flow to pay down its debt gradually. This should help Taiwan Optical Platform to maintain its ratio of debt to EBITDA below 3.5x in 2023-2024.

Downward scenario

We could lower the rating on Taiwan Optical Platform if:

- The ratio of debt to EBITDA stays constantly above 3.5x. This may happen if 1) its operating performance weakens materially due to a change in regulations, technology evolution, or rising competition risks; 2) the company engages in unexpected large debt-funded acquisitions that lift its financial leverage; or 3) it assumes aggressive shareholder-friendly action such as a much higher cash dividend payout or a share buyback plan; or
- The company's EBITDA deteriorates materially without a sign of recovery, which could result from a faster decline in its cable TV subscriber base than we expected, or the company's broadband business fails to maintain growth as we assumed.

Upward scenario

We view the likelihood of an upgrade is low over the next 12 months. However, we could raise the long-term rating on Taiwan Optical Platform if:

- The company consistently pays down its debt through stable operating performance and cash flow generation and demonstrates prudent debt management that lowers the debt-to-EBITDA ratio comfortably below 2.5x; or
- The company improves its competitive position with a significant market share gain or material improvement in its diversification, such as by expanding its broadband services and line and equipment rental businesses, while maintaining the ratio of debt to EBITDA below 3x.

Our Base-Case Scenario

- Taiwan's real GDP to grow 0.5% in 2023 and 3.0% in 2024. However, given the saturated domestic cable/broadband market with stagnant population and household numbers, growth in both industries is likely to underperform GDP growth.
- Domestic cable TV market will gradually decline due to competition from Multimedia on Demand of Chunghwa Telecom (CHT MOD) and various internet protocol TV (IPTV) and OTT platforms. But market structure should remain relatively stable with limited competition in most operating areas, despite the regulator's additional issuances of operating licenses.
- Domestic broadband market will remain dominated by leading operator, Chunghwa Telecom, although we believe cable broadband operators will gain increasing market share, given their pricing strategy and effective service bundling package.
- Revenue to decrease by 4%-5% in 2023 and remain largely flat in 2024.
  - The subscriber base for cable TV will decline by 0.5%-1.0% annually due to competition from MOD and other OTT providers. The average revenue per user (ARPU) for cable TV is also likely to decline by 1%-4%, given the promotions used to reduce the declining subscriber base.
  - The subscriber base for broadband will grow by 10%-12% in 2023 and 8%-10% in 2024 thanks to bundling sales with telecom providers. ARPU for broadband is likely to increase by 3%-4% in 2023 and 2%-3% in 2024, given higher sales from high-speed FTTH (fiber-to-the-home) services.
  - New businesses such as ICT projects will still take time to generate a meaningful sales and profit contribution.
- Taiwan optical Platform's gross margin will remain flat at 62%-63% in 2023 and gradually increase to 63%-64% in the next few years largely due to the increased contribution and margins from its broadband business as well as the growing sales income from shopping channels.
- Capex will be NT$300 million-NT$350 million per year for 2023-2024 for fiber network deployment and equipment upgrades.
- Cash dividend payout is likely to peak at NT$638 million in 2023 and remain at NT$500 million-NT$550 million annually over 2024-2027 with a payout ratio of 55%-63%.
- Its subsidiary Shine Trend International plans to be listed in October 2023. Taiwan Optical Platform will lower its shareholding in the subsidiary to 65.7% after the IPO from which we factor in around NT$300 million cash inflow in 2023.
- We assume Taiwan Optical Platform will use NT$300 million annually for potential acquisitions in 2024-2025.

Taiwan Optical Platform Co. Ltd.--Forecast summary

Industry sector: Cable TV

(Mil. NT$)	2020a	2021a	2022a	2023e	2024f	2025f
Revenue	4,329	4,280	4,359	4,150	4,146	4,168
EBITDA (reported)	2,047	1,982	1,921	1,796	1,783	1,799
Plus/(less): Other	8	11	6	6	6	6
EBITDA	2,056	1,993	1,927	1,802	1,789	1,805
Less: Cash interest paid	(173)	(181)	(263)	(213)	(195)	(177)
Less: Cash taxes paid	(274)	(296)	(294)	(241)	(240)	(248)
Funds from operations (FFO)	1,610	1,515	1,371	1,348	1,354	1,380
Cash flow from operations (CFO)	2,030	1,207	1,292	1,343	1,340	1,390
Capital expenditure (capex)	247	279	271	341	317	312
Free operating cash flow (FOCF)	1,782	928	1,021	1,003	1,023	1,078
Debt (reported)	10,478	9,315	8,172	7,541	6,873	6,501
Plus: Lease liabilities debt	16	64	61	58	55	52
Less: Accessible cash and liquid Investments	(2,156)	(2,245)	(1,537)	(1,562)	(1,102)	(990)
Debt	8,338	7,135	6,696	6,037	5,825	5,563
Cash and short-term investments (reported)	2,177	2,267	1,552	1,577	1,113	1,000
Adjusted ratios						
Debt/EBITDA (x)	4.1	3.6	3.5	3.4	3.3	3.1
FFO/debt (%)	19.3	21.2	20.5	22.3	23.2	24.8
Annual revenue growth (%)	40.3	(1.1)	1.8	(4.8)	(0.1)	0.5
EBITDA margin (%)	47.5	46.6	44.2	43.4	43.2	43.3

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: Adequate

We assess Taiwan Optical Platform's liquidity as adequate to meet its needs over the 12-months ending June 30, 2024, despite a good ratio of liquidity sources to liquidity uses around 2x over the same period. This is because we believe the company may require some refinancing when encountering low probability high-impact events. This takes into consideration its NT$1.57 billion cash on hand versus its NT$7.81 billion gross debt as of June 30, 2023. In addition, there is no evidence that Taiwan Optical Platform's management will maintain strong liquidity when facing anticipated business setbacks. However, the company will still have sufficient liquidity headroom if the forecasted EBITDA declined by 15%, in our view.

We also believe the company has a sound relationship with banks and could establish new facilities when needed, supported by the completion of a syndication loan of NT$9.66 billion in September 2022. In addition, we believe the company can comfortably meet the financial covenants on its syndication loan, given its stable cash flow generation.

Principal liquidity sources:
- Cash and short-term investment of about NT$1.58 billion as of the end of June 2023.
- Funds from operations of NT$1.3 billion-NT$1.5 billion per year over the next 12 months ending June 2024.

Principal liquidity uses:
- Debt maturity of NT$630 million ending June 2024.
- Capex of NT$300 million-NT$350 million per year over the 12 months ending June 2024.
- Cash dividend payout of NT$550 million-NT$600 million per year over the 12 months ending June 2024.

Ratings Score Snapshot

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

Business Risk: Fair

- Country risk: Intermediate
- Industry risk: Intermediate
- Competitive position: Fair

Financial Risk: Significant

- Cash flow/Leverage: Significant

Anchor: twbbb+

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: Positive (+1 notch)

Stand-alone credit profile: twa-

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

Upgraded

	To	From
Taiwan Optical Platform Co. Ltd.		
Issuer Credit Rating	twA-/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.