Media Release:

Outlook On Yulon Motor Revised To Positive From Stable On Deleveraging; '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$) 3.3 billion in the first nine months in 2023.
- The cash inflow following the disposal settlement of one of Yulon Motor's China subsidiaries in 2H 2024 could help improve the company's debt-to-EBITDA ratio to comfortably below 4x over the next one to two years. This is despite our projection of a lower EBITDA margin amid a substantially decrease in cash dividends from Yulon Nissan.
- We have revised our outlook on the long-term issuer credit rating on Yulon Motor to positive from stable. This reflects our view that the company's deleveraging could help improve its stand-alone credit profile and accordingly strengthen Yulon's group credit profile.
- At the same time, we affirmed our 'twBBB+/twA-2' issuer credit ratings on the company.

Rating Action Rationale

The upward outlook revision reflects our view that Yulon Motor could improve its debt leverage earlier than we had forecast, which could enhance the Yulon group credit profile. We see several factors supporting deleveraging over the next two years, which would strengthen the consolidated Yulon group credit profile. The first of these is the plan by Yulon Motor and its subsidiary, Yulon Finance Corp., to divest one of the group's China subsidiaries for a total transaction amount of nearly NT$5.8 billion. We forecast that upon deal completion which is targeted in 2H 2024, Yulon Motor will receive NT$2.96 billion based on its 51% shareholding in the China subsidiary, Yulon Motor Finance (China) Co. Ltd.

Secondly, we expect Yulon Motor to continue receiving steady cash dividends of NT$1.1 billion-NT$1.3 billion in 2024 and NT$1.5 billion-NT$1.7 billion in 2025 from Yulon Finance. These two cash inflows should help lower Yulon Motor's adjusted debt to NT$11 billion-NT$13 billion in 2024 and 2025 from NT$14 billion-NT$16 billion in 2023. This is despite the projected working capital outflow in 2024 to support the company's car sales growth.

We derive the Yulon Motor group credit profile by combining the stand-alone credit profile of Yulon Motor (after deconsolidating Yulon Finance) and Yulon Finance. The finance company's solid market position, lower financial risk, and growing profit contribution to the whole group partly offset Yulon Motor's higher business and financial risks, in our view. We believe the disposal of the

China subsidiary is positive to the overall group credit profile, because this could enhance Yulon Finance's capital buffer and improve the group's overall debt leverage.

Cash dividends from its equity investment in Yulon Nissan are likely to continue to decline in 2024-2025. The cash dividends from Yulon Nissan Motor Co. Ltd. have historically been the main source of cash flow for Yulon Motor. However, weakened sales and profitability in China could significantly impair Yulon Nissan's ability to pay dividends to Yulon Motor over the next two years. The cash dividends amounted to NT$2.66 billion in 2021, or 40.6% of Yulon Motor's overall EBITDA, but declined to NT$1.29 billion in 2022 (26.6%) and NT$1.04 billion in 2023 (27.2%). Yulon Nissan's net income declined to around NT$0.9 billion (a drop of 54.3%) in the first nine months of 2023 from nearly NT$2.0 billion in the same period of 2022. This indicates that cash dividends from Yulon Nissan are likely to decrease substantially in 2024.

Sales of Nissan-branded cars could rebound in Taiwan in 2024, which would lift Yulon Nissan's operating income. Nonetheless, we see any improvement in Taiwan is unlikely to outweigh the negative impact led by weakening performance in China on Yulon Nissan, given that historically more than 90% of Yulon Nissan's pre-tax income comes from the company's equity investment in China. Sales of Nissan-branded passenger cars declined by 20%-25% in China in 2023 compared with 2022. This was mainly due to the brand's inferior market position where it lags in electric vehicle (EV) development, and faces price competition from local brands, as well as the China government's policy to support local automakers. China sales volume could rebound in 2024-2025 thanks to the introduction of new models, but this growth is likely to be moderate, amid intense industry competition. As a result, we forecast the cash dividends from Yulon Nissan will fall to below NT$0.5 billion annually in 2024 and 2025.

Operating income for Yulon Motor's core auto manufacturing business should improve in 2024, supported by new car launches. The facelift of several popular Nissan car models and the introduction of Luxgen's new 'n7' electric sports utility vehicle could boost Yulon Motor's sales volume by 45%-55% in 2024. This should lift the company's utilization rate and further underpin its 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, Yulon Motor will receive full year rental income of NT$400 million-NT$450 million annually in 2024 and 2025 from the group's newly opened shopping mall, Yulon City. We therefore forecast Yulon Motor's reported EBITDA will grow by 25%-30% in 2024 before declining slightly by a low-single digit in 2025. Nonetheless, the plummet in cash dividends from Yulon Motor's equity investments will likely lower the company's adjusted EBITDA margin to 7.5%-8% in 2024-2025 from 9.5%-10% in 2023.

Our base case projects improving debt leverage over the next one to two years. Yulon Motor's deleveraging efforts and prudent investment plans should help lower its debt leverage, despite the company's weakening EBITDA margin. Consequently, we estimate Yulon Motor's debt-to-EBITDA ratio will improve to close to 3.0x in 2024 and further to below 3.0x in 2025 from around 4.0x in 2023. That's if the company executes its asset disposal plan, which will support a stronger stand-alone credit profile for Yulon Motor and strengthen the overall Yulon Motor group rating profile.

Outlook

The positive rating outlook reflects our view that Yulon Motor's likely declining debt level could supports improvement in its debt-to-EBITDA ratio to close to 3.0x in 2024 and below 3.0x in 2025. This is mainly underpinned by NT$2.96 billion cash inflow upon the disposal of one of the group's subsidiaries in China. Stable cash dividends from Yulon Finance along with Yulon Motor's prudent investment strategy should also support the company's deleveraging. This is despite our expectation of the company's weaker EBITDA margin due to a material decline in cash dividends from Yulon Nissan. Improvement in Yulon Motor's core manufacturing profitability could partly underpin its overall EBITDA generation.

Upward scenario

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

- Cash inflow from the sale of Yulon Motor's subsidiary in China could meaningfully reduce Yulon Motor's debt;
- Improvement in profitability led by enhancement in the company's core auto manufacturing business, or the successful launch of EVs that supports meaningful revenue and profit contribution from Luxgen; or
- Recovery in Yulon Nissan's performance to a stronger and sustainable level which increases its cash dividends to Yulon Motor.

Downward scenario

We may revise the outlook back to stable if Yulon Motor's debt-to-EBITDA ratio fails to improve to comfortably below 4.0x on a sustainable basis. The likely scenarios include:

- The sale of the China subsidiary falls through, or Yulon Motor utilizes the transaction proceeds for other investments that will not generate significant cashflow;
- Weaker EBITDA generation than our base case suggests either through a lower profit contribution from Nissan-branded cars sales in Taiwan or persistently low cash dividends from Yulon Nissan;
- Persistently large cash outflow for a more aggressive property development program; or
- An unexpected large loss from its Luxgen-related business.

Our Base-Case Scenario

Assumptions

- S&P Global's forecast for Taiwan real GDP to grow by 3.0% in 2024 and 2.6% in 2025, and China real GDP to grow by 4.6% in 2024 and 4.8% in 2025.
- Considering fragile consumer sentiment under the weakened macroeconomy and no significant government stimulus, China's light vehicle sales to grow by only 0%-2% in 2024. As domestic players are gaining market share amid the rising adoption of EVs in China, the ability to roll out competitive EV products at affordable prices will test the competitiveness of Japanese carmakers in China over the next three to five years.
- Meanwhile, new car sales are likely to decline by a mid-single digit in 2024 after 11.3% growth in 2023. This mainly reflects how pent-up auto demand during the pandemic and supply chain disruptions in 2021-2022 were largely satisfied in 2023.
- Yulon Motor's revenue (deconsolidating Yulon Finance) to grow materially by 30%-35% in 2024. This is mainly boosted by the introduction of a new Luxgen EV model, as well as updates

to several popular Nissan models. Revenue to decline by a mid-single digit in 2025, given the higher base in 2024.
- Yulon Motor's gross margin to stay at an improved 19.5%-20.5% in 2024-2025, compared to below 19% before 2022, thanks to narrowing losses on its Luxgen-related business and improving manufacturing utilization rate.
- Yulon Motor's cash dividends received from equity-method investments (include Yulon Nissan and other equity investment companies) could decline to NT$0.7 billion-NT$0.9 billion in 2024-2025 from NT$1.0 billion-NT$1.4 billion in 2023. This mainly reflects Yulon Nissan's weakening profitability due to Nissan's loss of market share to Chinese competitors.
- Yulon Motor's capex to be NT$1.0 billion-NT$1.5 billion in 2024-2025. This includes the company's maintenance capex and investments in new energy related businesses.
- Cash inflow of NT$2.96 billion in 2024 upon Yulon Motor's disposal of Yulon Motor Finance (China) Co. Ltd.
- Yulon Motor to distribute NT$1.5 billion cash dividends in 2024-2025.
- We include the cash dividend from Yulon Finance in our cash flow calculation for Yulon Motor, resulting in cash flow of NT$1.0 billion-NT$1.4 billion in 2024 and NT$1.5 billion-NT$1.7 billion in 2025.

Yulon Motor Co. Ltd.--Forecast summary

Industry sector: OEMs

(Mil. NT$)	**2020a**	**2021a**	**2022a**	**2023e**	**2024f**	**2025f**
Revenue	52,965	46,086	40,523	39,509	53,161	50,758
EBITDA (reported)	(2,142)	2,070	2,825	2,374	3,081	3,014
Plus/(less): Other	6,223	4,474	2,021	1,438	909	989
EBITDA	4,080	6,544	4,846	3,812	3,990	4,003
Less: Cash interest paid	(1,036)	(469)	(768)	(583)	(506)	(478)
Less: Cash taxes paid	(214)	(192)	(294)	(179)	(296)	(298)
Funds from operations (FFO)	2,830	5,882	3,784	3,051	3,188	3,228
Cash flow from operations (CFO)	8,012	4,081	1,780	879	1,489	3,420
Capital expenditure (capex)	2,923	3,581	1,764	800	1,375	1,220
Free operating cash flow (FOCF)	5,088	500	16	79	114	2,200
Debt (reported)	33,094	27,958	31,807	26,839	24,058	24,058
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)	(12,350)	(12,350)	(14,614)
Debt	16,489	16,133	20,843	15,712	12,931	10,667
Cash and short-term investments (reported)	20,200	14,664	13,392	13,000	13,000	15,383
Adjusted ratios						
Debt/EBITDA (x)	4.0	2.5	4.3	4.1	3.2	2.7
FFO/debt (%)	17.2	36.5	18.2	19.4	24.7	30.3
Annual revenue growth (%)	(8.1)	(13.0)	(12.1)	(2.5)	34.6	(4.5)
EBITDA margin (%)	7.7	14.2	12.0	9.6	7.5	7.9

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 1.4x-1.5x up to Sept. 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$12.9 billion at the end of September 2023.
- Funds from operations of NT$3.0 billion-NT$3.5 billion in 2024.
- Sales of subsidiary of NT$2.96 billion in 2024.

Principal liquidity uses:

- Debt maturity of NT$9.8 billion ending September 2024.
- Capex and investments of NT$1.0 billion-NT$1.5 billion in 2024.
- Cash dividend payout of NT$1.5 billion in 2024.

Rating Score Snapshot

Issuer Credit Rating: twBBB+/Positive/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: Neutral (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

- Criteria | Corporates | General: Corporate Methodology - January 07, 2024
- Criteria | Corporates | General: Methodology: Management And Governance Credit Factors For Corporate Entities - January 07, 2024
- 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
- 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+/Positive/twA-2	twBBB+/Stable/twA-2