Media Release:

Yulon Motor Co. Ltd. Upgraded To 'twA-/twA-2' On Deleveraging; Outlook Stable

September 23, 2024

PRIMARY CREDIT ANALYST

Susan Chen
Taipei
+886-2-2175-6817
susan.chen
@spglobal.com
susan.chen
@taiwanratings.com.tw

SECONDARY CONTACT

James Hung, CFA
Taipei
+886-2-2175-6839
james.hung
@spglobal.com
james.hung
@taiwanratings.com.tw

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$) 4.3 billion in 2023.
- We anticipate Yulon Motor will improve its debt leverage over the coming one to two years, supported by a one-off cash inflow and stable cash dividends from **Yulon Finance Corp.** These should help Yulon Motor bring down the debt-to-EBITDA ratio comfortably below 4x over 2024-2025. The disposal of one of its China-based subsidiaries will provide the one-off cash inflow in the second half of 2024.
- This deleveraging could improve Yulon Motor's stand-alone credit profile and accordingly, strengthen Yulon's group credit profile.
- We therefore raised our long-term issuer credit rating on Yulon Motor to 'twA-' from 'twBBB+'. At the same time, we affirmed the short-term rating on the company at 'twA-2'.
- The rating outlook is stable, to reflect our view that Yulon Motor will maintain improved debt leverage over the next one to two years. This is despite a potentially weaker EBITDA margin due to decreasing cash dividends from Yulon Nissan Motor.

Rating Action Rationale

The rating action reflects our view that Yulon Motor will maintain improved debt leverage over the next two years. We see two key factors supporting Yulon Motor to reduce its ratio of debt-to-EBITDA to close to 3.0x in 2024 and 2.5x-3.0x in 2025, from 3.6x in 2023. Firstly, Yulon Motor and its subsidiary, Yulon Finance, plan to divest one of the group's China subsidiaries for a total transaction amount of nearly NT$5.3 billion. We forecast that upon deal completion targeted before the end of 2024, Yulon Motor will receive proceeds of NT$2.89 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 from Yulon Finance of NT$1.0 billion-NT$1.5 billion in 2024 and NT$1.5 billion-NT$2.0 billion in 2025. These cash inflows should help reduce Yulon Motor's adjusted debt to NT$10 billion-NT$13 billion in 2024 and 2025 from NT$15.3 billion at the end of 2023. This is despite our forecast of negative discretionary cash flow for Yulon Motor in 2024, due to working capital outflow for the new car model launch in 2025.

Deleveraging also support an enhanced Yulon group credit profile. We derive the Yulon Motor group credit profile by combining the stand-alone credit profile of Yulon Finance and Yulon Motor (after deconsolidating Yulon Finance). The finance company's solid market position, lower financial risk, and growing profit contribution to the 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. That's because this could enhance Yulon Finance's capital buffer and improve the group's overall debt leverage.

Profitability for Yulon Motor's core auto manufacturing business could improve in 2024-2025, supported by new car launches. The introduction of Luxgen's new 'n7' electric sports utility vehicle could boost Yulon Motor's overall sales volume by 20%-25% in 2024. This would help to counterbalance the constrained sales performance of Nissan-branded domestic vehicles in Taiwan. The new sports utility vehicle should lift Yulon Motor's utilization rate and further underpin its stand-alone operating income, in our view. We see the potential for Yulon's overall sales units to decline by 5%-10% in 2025, given the higher sales base in 2024. Meanwhile, Yulon's Luxgen-branded business could also return to profit after the successful launch of the n7. This is because 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 (before adding cash dividends from equity method investments) will grow by 15%-20% in 2024 before declining by 4%-6% in 2025.

Cash dividends from Yulon Nissan Motor will likely further decline in 2024-2025. Weakened sales and profitability of Nissan-branded cars in China have significantly impaired Yulon Nissan Motor Co. Ltd.'s ability to pay dividends to Yulon Motor. We expect this trend to continue and result in a lower EBITDA margin for Yulon Motor over the next two years. That's because the dividends from Yulon Nissan have historically been the main source of Yulon Motor's cash flow. Yulon Motor received cash dividends from Yulon Nissan of NT$2.7 billion or about 40.6% of Yulon Motor's EBITDA in 2021. Meanwhile, we forecast the cash dividends from Yulon Nissan will decline to NT$0.4 billion-NT$0.5 billion in 2024-2025 from around NT$1.0 billion in 2023, representing just 10%-15% of EBITDA.

Sales of Nissan-branded passenger cars in China declined by 17.7% year on year in 2023, and by 9.5% in the first eight months of 2024. This was mainly due to the brand's inferior market position where it lags in electric vehicle (EV) development and faces severe price competition from local brands. China sales volume is likely to remain sluggish over the next two years amid intense industry competition. As a result, we forecast the declining cash dividends from Yulon Nissan Motor will weaken Yulon Motor's adjusted EBITDA margin to 8.5%-9.0% in 2024-2025 from 10.5% in 2023.

Outlook

The stable outlook reflects our view that Yulon Motor's declining debt level could sustain its debt-to-EBITDA ratio at close to 3.0x in 2024 and 2.5x-3.0x in 2025. This is mainly underpinned by a NT$2.89 billion cash inflow following the disposal of one of the group's subsidiaries in China, as well as steady cash dividends from Yulon Finance. This is despite our expectation of Yulon Motor'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, in our view.

Downward scenario

We may lower the long-term rating on Yulon Motor if:

- The EBITDA margin of the company's core car manufacturing business deteriorates to below 4% without a sign of recovery. This could happen if Yulon Motor fails to maintain its car manufacturing utilization rate, possibly led by a material sales decrease of Nissan-branded domestic cars or Luxgen branded cars; or
- The company's debt-to-EBITDA ratio weakens to above 4.0x on a sustainable basis. This could result from weaker profitability of Yulon Motor's core business or an unexpectedly large loss from its Luxgen-related business; or materially lower cash dividends from Yulon Nissan. This could also happen if Yulon Motor assumes a more aggressive property development program that incurs persistently large cash outflow.

Upward scenario

We may raise the long-term rating if Yulon Motor further reduces and maintains its debt-to-EBITDA ratio comfortably and sustainably below 2x. The likely scenarios for this include:

- Further improvement in profitability of the company's core auto manufacturing business profitability led by enhanced plant capacity utilization, or increasing car sales that supports a meaningful revenue and profit contribution from the Luxgen business;
- Recovery in Yulon Nissan's performance to a stronger and sustainable level which increases its cash dividends to Yulon Motor; or
- Yulon Motor continues to lower its debt level through the disposal of its investment assets.

Yulon Motor Co. Ltd. – Taiwan Ratings Corp. Forecast Summary

(Mil. NT$)	2021a	2022a	2023a	2024e	2025f	2026f
Revenue	46,085.6	40,522.5	40,631.3	46,859.7	42,512.8	40,563.8
EBITDA (reported)	2,070.1	2,824.7	2,500.7	2,882.9	2,674.6	2,620.7
Plus/(less): Other	4,473.5	2,021.0	1,756.6	1,125.3	1,090.6	1,048.2
EBITDA	6,543.6	4,845.7	4,257.3	4,008.2	3,765.2	3,669.0
Less: Cash interest paid	(468.7)	(768.2)	(1,065.6)	(456.9)	(419.1)	(414.1)
Less: Cash taxes paid	(192.4)	(294.0)	(204.4)	(521.5)	(474.7)	(466.2)
Funds from operations (FFO)	5,882.5	3,783.5	2,987.3	3,029.8	2,871.4	2,788.7
Cash flow from operations (CFO)	4,081.1	1,780.2	(286.9)	1,323.5	3,219.5	3,228.9
Capital expenditure (capex)	3,581.1	1,764.4	1,770.2	1,000.0	1,300.0	1,300.0
Free operating cash flow (FOCF)	500.0	15.8	(2,057.2)	323.5	1,919.5	1,928.9
Debt (reported)	27,957.7	31,806.7	24,729.1	20,949.1	20,949.1	20,449.1
Plus: Lease liabilities debt	1,518.9	1,223.1	1,193.9	1,165.4	1,137.5	1,110.3

Less: Accessible cash and liquid Investments	(13,343.8)	(12,186.5)	(10,606.4)	(9,888.2)	(11,815.5)	(13,572.6)
Debt	16,132.7	20,843.4	15,316.7	12,226.3	10,271.1	7,986.9
Cash and short-term investments (reported)	14,663.6	13,391.7	11,164.6	10,474.8	12,516.4	14,377.7
Adjusted ratios						
Debt/EBITDA (x)	2.5	4.3	3.6	3.1	2.7	2.2
FFO/debt (%)	36.5	18.2	19.5	24.8	28.0	34.9
Annual revenue growth (%)	(13.0)	(12.1)	0.3	15.3	(9.3)	(4.6)
EBITDA margin (%)	14.2	12.0	10.5	8.6	8.9	9.0
Return on capital (%)	6.7	(10.9)	5.2	4.6	4.3	4.4

All figures are adjusted by Taiwan Ratings Corp., unless stated as reported. Figures of forecast period are based on Taiwan Ratings Corp.'s base case scenario. a--Actual. e--Estimate. f--Forecast. NT$-- new Taiwan dollar. N.M.--Not meaningful.

Our Base-Case Scenario

Assumptions

- S&P Global's forecast for Taiwan's real GDP to grow by 4.0% in 2024 and 2.1% in 2025, and China real GDP to grow by 4.8% in 2024 and 4.6% in 2025.
- As economic growth prospects remain clouded in China, the country's domestic light vehicle sales will only increase by 2%-3% annually in 2024-2025, from 5.6% in 2023. The government's support for auto trade-ins coupled with carmakers' promotions could partly underpin sales momentum. EVs will continue to act as the main sales drivers with a growth rate of 15%-20% in 2024-2025. Meanwhile, given the lagging EV model lineups compared to domestic players, Japanese carmakers will continue to face pressure in China's auto market over the next two years.
- For the Taiwan auto market, new car sales are likely to decline by 4%-6% in 2024 after strong growth of 11.3% in 2023. This mainly reflects the release of pent-up auto demand following the recent pandemic as well as the end of supply chain disruption in 2023.
- Yulon Motor's revenue (deconsolidating Yulon Finance) to grow materially by 15%-20% in 2024 but decline by 5%-10% in 2025, given the higher base in 2024. Growth in 2024 will mainly result from the introduction of the Luxgen n7. Sales of Nissan branded cars are likely to remain under pressure due to intense competition.
- Yulon Motor's gross margin to stay at 18.5%-19.5% in 2024-2025, compared with 19.5% in 2023. We believe the company could sustain its utilization rate through a broadened product portfolio and effective control of production costs.
- Yulon Motor's cash dividends received from equity-method investments (including Yulon Nissan and other equity investment companies) could decline to NT$0.7 billion-NT$1.2 billion in 2024-2025 from nearly NT$1.5 billion in 2023. This mainly reflects Yulon Nissan's weakening profitability due to Nissan's continuous market share loss to China competitors.
- Yulon Motor's capital expenditure (capex) at NT$1.0 billion-NT$1.5 billion in 2024-2025. This includes maintenance capex and investments in new energy related businesses.
- Cash inflow of NT$2.89 billion in 2024 following Yulon Motor's disposal of Yulon Motor Finance (China) Co. Ltd.
- Yulon Motor to distribute NT$1.5 billion cash dividends annually in 2024-2025.
- We include the cash dividend from Yulon Finance in our cash flow calculation for Yulon Motor, resulting in cash inflow of NT$1.4 billion-NT$1.7 billion annually in 2024 and 2025.
- We use a haircut ratio of 5.6% to calculate accessible cash.

Liquidity

The short-term issuer credit rating is 'twA-2'. We believe Yulon Motor has adequate liquidity to meet its needs over the 12 months ending June 30, 2025. We base this on our view that the ratio of liquidity sources to liquidity uses will be around 1.3x over the period. Liquidity sources will still exceed uses even if Yulon Motor's EBTIDA were to decline by 15.0%.

We also believe the company has a sound relationship with banks, as shown by its abundant undrawn banking facilities. Yulon Motor's debt does not carry any covenant.

Principal liquidity sources:

- Cash and short-term investments of NT$10.6 billion at the end of June 2024.
- Funds from operations of NT$2.5 billion-NT$3.5 billion in 2024.
- Sales of subsidiary with proceeds of NT$2.89 billion in 2024.

Principal liquidity uses:

- Debt maturity of NT$9.7 billion in the 12 months ending June 30, 2025.
- Working capital outflow of NT$0.5 billion-NT$1.0 billion in the 12 months ending June 30, 2025.
- Capex and investments of NT$1.0 billion-NT$1.2 billion in 2024.
- Cash dividend payout of NT$1.5 billion in 2024.

Rating Score Snapshot

Yulon Motor Co. Ltd.		
	To	From
Issuer Credit Rating	twA-/Stable/twA-2	twBBB+/Positive/twA-2
Business risk	Weak	Weak
Country risk	Intermediate	Intermediate
Industry risk	Moderately high	Moderately high
Competitive position	Weak	Weak
Financial risk	Significant	Aggressive
Cash flow/Leverage	Significant	Aggressive
Anchor	twbbb-	twbb+
Modifiers		
Diversification/Portfolio effect	Neutral (no impact)	Neutral (no impact)
Capital structure	Positive (+1 notch)	Positive (+1 notch)
Financial policy	Neutral (no impact)	Neutral (no impact)
Liquidity	Adequate (no impact)	Adequate (no impact)
Management and governance	Neutral (no impact)	Neutral (no impact)
Comparable ratings analysis	Neutral (no impact)	Neutral (no impact)
Stand-alone credit profile (SACP)	twbbb	twbbb-
Group credit profile	twa-	twbbb+
Entity status within group*	Ultimate parent	
*Therefore, the issuer credit rating equates to the group credit profile. Note: The descriptors are on a global scale.		

Related Criteria & Research

Related Criteria

- Criteria | Corporates | General: Sector-Specific Corporate Methodology - April 04, 2024
- 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 upgraded;

	To	From
Yulon Motor 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.