Media Release:

Taiwan Hon Chuan Enterprise Co. Ltd. Upgraded To 'twA/twA-1' On Sustainably Stronger Profitability; Outlook Stable

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Rating Action Overview

- **Taiwan Hon Chuan Enterprise Co. Ltd.** is one of the largest providers of beverage packaging and beverage filling services in Taiwan, China and multiple southeast Asian countries. The company generated EBITDA of new Taiwan dollar (NT$) 5.5billion in 2023.
- We anticipate Hon Chuan will maintain strong growth momentum as its capacity expansion in key markets continues. An increasing revenue contribution from southeast Asian markets and sizable shipments covered by long-term contracts should keep the EBITDA margin at 22%-23% in 2024 and 2025.
- We raised our issuer credit ratings on Hon Chuan to 'twA/twA-1' from 'twA-/twA-2'.
- The stable rating outlook reflects our view that the ratio of FFO to debt could improve over the next one to two years despite possibly higher capex.

Rating Action Rationale

The upgrade action reflects our view that enhanced revenue diversification and a high proportion of long-term contracts could continue to support Hon Chuan's stronger profitability over the next one to two years. We believe the company's capacity expansion overseas will underpin its growing penetration in Southeast Asian markets and enhance its earnings stability. With steady demand throughout the year, higher sales contribution from Southeast Asia could gradually alleviate the influence of seasonal demand variations in China and Taiwan.

In addition, revenue from Southeast Asia markets could continue to carry a higher margin and support Hon Chuan's profitability. That's because the Southeast Asia region offers lower production cost and relatively moderate market competition compared to China.

Over 60% of Hon Chuan's revenue comes from long-term contracts, which include a pricing mechanism to secure profitability. With more predictable shipments throughout the year, the company could more efficiently maintain the utilization rate of its manufacturing sites along with fair cost control. We therefore believe Hon Chuan is well positioned to maintain a higher level of profitability than its global peers. We estimate Hon Chuan's EBITDA margin could rise to 22%-23% over the next two years from 20.9% in 2023.

Hon Chuan could improve its leverage ratio through increasing FFO generation despite high capex needs. Hon Chuan will likely continue its capacity expansion plans over next one to two years to meet rising demand in key markets of Taiwan, China and Southeast Asia. We forecast the company will increase its capital expenditure (capex) to NT$4.4 billion in 2024-2025 compared to NT$3.4 billion in 2023. Its adjusted debt level could remain high due to discretionary cash outflow over the next two years.

Nevertheless, we forecast Hon Chuan's EBITDA generation will increase to NT$6.4 billion in 2024 and NT$6.9 billion in 2025, from NT$5.5 billion in 2023. This will be supported by solid sales growth momentum under its capacity expansion program and sustainable beverage demand. As such, we anticipate the company's ratio of funds from operations (FFO) to debt will improve to 38.8% in 2024 and to 40.6% in 2025, from 35.6% in 2023.

Outlook

The stable rating outlook reflects our view that Hon Chuan will maintain solid growth momentum through continued capacity additions in key markets over the next two years. The company's revenue contribution from long-term contracts should support its stable operating performance over the period. In addition, we believe Hon Chuan's increasing revenue contribution from southeast Asian countries will support its satisfactory profitability. We forecast the ratio of FFO to debt could improve over the next one to two years despite possibly higher capex over the period.

Downside scenario

We could lower the rating on Hon Chuan if:

- The company faces increasing competitive pressure or experiences a sharp increase in material prices without sufficient cost passthrough to its clients which significantly erodes profitability, such that EBITDA margins fall consistently below 17%; or
- The ratio of FFO to debt falls to close to 30% for an extended period without signs of recovery. This could result from rising debt amid more aggressive capex or investment plans, or more friendly shareholder actions than we previously forecast.

Upside scenario

We see a low likelihood that we would upgrade Hon Chuan over the next one to two years. This could occur if:

- The company significantly expands the operating scale and geography as well as client diversification for its packaging business while at the same time enhances its average ratio of return on capital; and
- The company takes a more conservative approach to capacity expansion or materially reduces cash dividend payouts, such that the ratio of FFO to debt improves to consistently above 50%.

Our Base Case Scenario

- Taiwan's real GDP to grow 4.0% in 2024 and 2.1% in 2025. China's real GDP to grow 4.8% in 2024 and 4.6% in 2025. Asia Pacific's real GDP to increase by 4.5% in both 2024 and 2025.
- Revenue to grow by 6.4% in 2024 due to new capacity additions and sustainable demand in Taiwan, China, and Southeast Asia. Hon Chuan's revenue to increase by 8.8% in 2025, supported by continuous capacity expansion.
- Overall gross margin to remain at 32%-32.5% over the next two years, mainly supported by lower material costs in China and an increasing sales contribution from higher-margin markets in Southeast Asia.
- Capex to increase to NT$4.4 billion in 2024 and 2025 compared to NT$3.4 billion in 2023, mainly to speed up capacity expansion in China, Taiwan, and Southeast Asia.
- Cash dividend payout ratio is 60.2% in 2024, which is slightly decrease from 62% in 2023.
- Working capital outflow of NT$0.9 billion in 2024, given the increasing needs to support newly added capacity.
- We apply a surplus cash haircut of 14%, which mainly reflects the discount on Hon Chuan's overseas cash position after withholding tax.

Taiwan Hon Chuan Enterprise Co. Ltd.--Taiwan Ratings Corp. Forecast summary.

Industry sector: Packaging

(Mil. NT$)	2021a	2022a	2023a	2024e	2025f	2026f
Revenue	21,383	24,696	26,409	28,094	30,572	33,908
EBITDA (reported)	5,118	5,112	5,518	6,354	6,903	7,408
EBITDA	5,118	5,112	5,518	6,354	6,903	7,408
Less: Cash interest paid	(115)	(145)	(290)	(297)	(288)	(284)
Less: Cash taxes paid	(427)	(794)	(625)	(616)	(674)	(759)
Funds from operations (FFO)	4,576	4,172	4,603	5,441	5,941	6,365
Cash flow from operations (CFO)	3,592	3,843	5,085	4,624	5,416	5,643
Capital expenditure (capex)	2,136	3,471	3,426	4,400	4,400	4,400
Free operating cash flow (FOCF)	1,456	372	1,660	224	1,016	1,243
Discretionary cash flow (DCF)	378	(902)	231	(1,318)	(642)	(570)
Debt (reported)	15,732	17,083	17,825	17,930	18,572	19,142
Plus: Lease liabilities debt	466	491	447	407	370	337
Less: Accessible cash and liquid Investments	(4,630)	(4,807)	(5,343)	(4,300)	(4,300)	(4,300)
Debt	11,567	12,768	12,929	14,037	14,642	15,178
Cash and short-term investments (reported)	4,952	5,462	6,212	5,000	5,000	5,000
Adjusted ratios						
Debt/EBITDA (x)	2.3	2.5	2.3	2.2	2.1	2.0
FFO/debt (%)	39.6	32.7	35.6	38.8	40.6	41.9
Annual revenue growth (%)	10.5	15.5	6.9	6.4	8.8	10.9
EBITDA margin (%)	23.9	20.7	20.9	22.6	22.6	21.8
Return on capital (%)	11.1	11.2	11.9	11.7	11.8	12.5

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

Liquidity

The short-term rating on Hon Chuan is 'twA-1'. We believe the company has adequate liquidity, reflecting a ratio of liquidity sources to liquidity uses of 1.22x over the next 12 months. We also believe the company will have positive liquidity sources minus uses, even if its EBITDA declined by 15%. The low interest rate on the company's bank loans supports our view of the company's sound relationship with banks. We assess Hon Chuan has generally prudent risk management to ensure continued adequate liquidity. The company's sufficient undrawn bank credit lines and flexibility to increase bank facilities support this view. None of Hon Chuan's debt carry any financial covenants.

Principal liquidity sources:

- Cash and short-term investments of about NT$5.1 billion as of the end of June 30, 2024.
- Undrawn bank lines of NT$4.6 billion maturing beyond June 30, 2025.
- FFO of NT$5.5billion-NT$6 billion annually up to June 30, 2025.

Principle liquidity uses:

- Debt maturities of NT$9.3 billion up to June 30, 2025.
- Working capital outflow of NT$724 million up to June 30, 2025.
- Maintenance capex of NT$1 billion up to June 30, 2025.
- Cash dividend payment of about NT$1.6 billion up to June 30, 2025

Rating Score Snapshot

Taiwan Hon Chuan Enterprise Co. Ltd.		
	To	**From**
Issuer Credit Rating	twA/Stable/twA-1	twA-/Stable/twA-2
Business risk	Fair	Fair
Country risk	Moderately high	Moderately high
Industry risk	Intermediate	Intermediate
Competitive position	Fair	Fair
Financial risk	Intermediate	Intermediate
Cash flow/Leverage	Intermediate	Intermediate
Anchor	twa	twa-
Modifiers		
Diversification/Portfolio effect	Neutral (no impact)	Neutral (no impact)
Capital structure	Neutral (no impact)	Neutral (no impact)
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)	twa	twa-
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

Upgraded

	To	From
Taiwan Hon Chuan Enterprise Co. Ltd.		
Issuer Credit Rating	twA/Stable/twA-1	twA-/Stable/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.