Media Release:

Formosa Taffeta Co. Ltd. Ratings Affirmed At 'twA/twA-1'; Outlook Stable

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Rating Action Overview

- Taiwan-based **Formosa Taffeta Co. Ltd.** is a subsidiary of **Formosa Chemicals & Fibre Corp.,** one of the four key companies of the Formosa Plastics group. Formosa Taffeta's businesses include woven fabric, tire cord, and gas station, generating EBITDA of about NT$2.3 billion in 2023.
- We anticipate the EBITDA margin for Formosa Taffeta's core businesses could improve in 2024, mainly underpinned by demand recovery in the woven fabric segment. Nonetheless, the constrained profitability of its tire cord business could partly weaken the company's overall margin and competitive position.
- We see the company's sustainable discretionary cash inflow enhancing its financial risk profile.
- We affirmed our 'twA' long- and 'twA-1' short-term issuer credit rating on Formosa Taffeta.
- The rating outlook is stable, which reflects our view that sustainable operating cash flow generation and prudent capital expenditure and investment plans could sustain the company's debt-to-EBITDA ratio at 2.5x-3.5x in 2024-2025. At the same time, we forecast Formosa Taffeta's EBITDA margin will remain at 7.5%-8.5% over the same period.

Rating Action Rationale

Delayed recovery of its tire cord segment could constrain overall profitability in 2024 and 2025. Slow global economic recovery and still-high inflation in 2024 continue to hinder consumer spending from big ticket purchases, including automobiles, in major economies. This has prolonged an inventory adjustment in the tire sector between 2022 to 2024. In turn, this could cause Formosa Taffeta's tire cord segment to report a material sales decline and operating loss in 2024, the second year in a row. We project the company's revenue from this segment could decline by 10%-15% in 2024 after a substantial 42.1% plummet in 2023.

Nonetheless, we project a sales rebound for this segment of 8%-12% and a turnaround in profit in 2025. This will be supported by the end of downstream destocking and a recovery in demand for bicycle tires. In addition, we believe Formosa Taffeta will continue expanding its product exposure to high-premium products, especially bicycle tires with higher technical barriers, to avoid industry competition. The development of environmentally friendly tire cord could also solidify the company's relationship with large players in the tire industry, such as Cheng Shin Rubber Ind. Co. Ltd.

Furthermore, Formosa Taffeta plans to optimize its capacity in Taiwan and Vietnam to better sustain the utilization rate. At the same time, a more favorable tariff benefit in Vietnam could support increased exports to South-East Asia over the next one to two years, with strong growth momentum. However, we still expect the profit margin for the company's tire cord business to be weaker than its fabric business in 2025, which could constrain Formosa Taffeta's overall profitability.

Weakened tire cord profitability pressures the company's competitive position. We see two factors underpinning higher volatility of profits from the firm's tire cord segment over the next two years. Firstly, the sales momentum of global light vehicles remains soft amid macro uncertainty. This segment typically represents 30%-40% of total tire cord sales volume. We forecast growth for the global light vehicles segment of only 1%-3% in 2025-2026.

Secondly, regional competition, especially for lower-end products from China-based competitors could ignite price competition and further pressure Formosa Taffeta's profitability. We project recovery in the EBITDA margin for the tire cord segment at 4%-5% in 2024 and 8%-9% in 2025, up from 2.1% in 2023. However, this remains below the peer average in the auto supplier sector. We therefore choose a neutral assessment for Formosa Taffeta's comparable rating analysis compared with positive previously, to reflect the relatively inferior market position of its tire cord business.

Improving profitability for woven fabrics supports EBITDA generation in 2024-2025. We project a substantial revenue rebound for Formosa Taffeta's woven fabrics business of 10%-15% in 2024-2025 after a drop of 20.4% in 2023. This will be driven by inventory replenishment at major brand clients in the sports and outdoor wears segment. The woven fabric segment is the company's main profit driver, in our view. Therefore, the improving utilization rate for this segment should offset the loss in the tire core segment and support an increase in the firm's reported EBITDA margin to 7%-8% in 2024-2025 compared with 5.8% in 2023. The reported EBITDA margin excludes cash dividends from equity investments.

In our view, several factors continue to underpin Formosa Taffeta's established relationship with global brands while at the same time help it expand its customer base. These include the company's ability to provide high-functional and environmentally conscious woven fabrics, as well as its diversified production bases in Taiwan, Vietnam, and China. These factors will likely underpin the expansion in the firm's EBITDA over the next two years, in our view.

Sustainable operating cash flow generation and prudent capex help to enhance the financial risk profile. We acknowledge the support of the company's continuous debt reduction and improving profitability for its core businesses in helping to enhance the debt-to EBITDA ratio to 3.0x-3.5x in 2024 from 3.5x in 2023. We also expect the ratio to improve to around 2.5x in 2025. We forecast possible working capital outflow of NT$0.5 billion-NT$1.0 billion in 2025 to support revenue growth. Nonetheless, EBITDA expansion for the company's core businesses coupled with cash dividends received from its shareholding in Formosa Petrochemical, underpin our projection of operating cash flow generation of NT$2 billion-NT$3 billion in 2024-2025. This amount could outpace Formosa Taffeta's capital expenditure (capex) needs and cash dividend payouts over the same period.

Formosa Taffeta's capex is likely to be limited at below NT$1 billion over the next two years, mainly to support facility maintenance and upgrades, as well as capacity expansion for its fabric production in Vietnam. We see the company incurring capex for the expansion of production bases over the next one to two years, following key customers' demand for more diversified manufacturing sites amid rising geopolitical risks. However, we expect these investments to remain within the company's financial capability and nor induce a material uplift in its debt.

Outlook

The stable rating outlook reflects our view that Formosa Taffeta's debt-to-EBITDA ratio will remain at 2.5x-3.5x in 2024-2025. The company's consistent generation of positive discretionary cash flow could support further debt reduction over the next two years. Meanwhile, we anticipate the profitability of Formosa Taffeta's core businesses will grow in 2024-2025 and help maintain its overall EBITDA margin at 7.5%-8.5% over the period. This will be mainly underpinned by the improving profitability of its woven fabric segment amid recovering downstream demand.

Downward scenario

We may lower the long-term rating on Formosa Taffeta if the company's adjusted ratio of debt to EBITDA rises to above 4x without a sign of recovery. This could result from:

- The EBITDA margin of its tire cord and fabric businesses deteriorates substantially due to dampened downstream demand, volatile raw material prices, rapidly changing market trends, or intensifying competition;
- The company receives materially lower cash dividends from its equity investments than under our base case;
- The company takes on more aggressive capex plans or cash dividend policy; or
- It engages in more aggressive investment in line with the group's investment strategy.

Upward scenario

We could raise the rating on Formosa Taffeta if:

- The company's market position for woven fabric and tire cord improves materially, leading to a meaningful enhancement in profitability. The possible scenarios for this include a substantial increase in demand for its fabric and tire cord businesses, a meaningful customer base expansion, or a significant increase in contribution from the higher value-added products of both businesses. At the same time, the company would need to maintain its debt-to-EBITDA ratio comfortably below 4x and maintain prudent capex and investment plans; or
- The company continues to reduce debt via discretionary cash inflow to improve its debt-to-EBITDA ratio to below 2x comfortably through business cycles.

Formosa Taffeta Co. Ltd. – Taiwan Ratings Corp. Forecast Summary

(Mil. NT$)	2021a	2022a	2023a	2024e	2025f	2026f
Revenue	32,799.0	34,722.7	28,501.5	28,663.3	31,186.9	32,958.2
EBITDA (reported)	2,898.7	2,648.5	1,657.5	1,997.8	2,364.0	2,439.1
Plus/(less): Other	649.5	560.8	595.6	218.9	242.5	250.0
EBITDA	3,548.2	3,209.3	2,253.1	2,216.6	2,606.5	2,689.1
Less: Cash interest paid	(145.3)	(201.4)	(333.9)	(342.1)	(316.6)	(286.3)
Less: Cash taxes paid	(148.9)	(228.9)	(383.0)	(138.6)	(206.5)	(225.6)
Funds from operations (FFO)	3,254.1	2,779.0	1,536.2	1,735.9	2,083.3	2,177.1
Cash flow from operations (CFO)	2,430.8	3,621.2	4,087.2	2,618.2	2,245.6	2,959.1
Capital expenditure (capex)	467.5	849.4	681.9	719.7	515.5	494.5
Free operating cash flow (FOCF)	1,963.3	2,771.8	3,405.3	1,898.5	1,730.1	2,464.6

Discretionary cash flow (DCF)	278.7	1,125.8	935.0	1,056.2	861.6	1,601.7
Debt (reported)	13,559.4	14,241.1	12,651.6	11,390.7	10,829.1	9,227.4
Plus: Lease liabilities debt	811.3	894.5	916.8	939.6	962.9	986.9
Less: Accessible cash and liquid Investments	(4,496.0)	(5,906.1)	(5,584.2)	(5,520.0)	(5,520.0)	(5,400.0)
Plus/(less): Other	2,209.6	--	--	--	--	--
Debt	12,084.3	9,229.5	7,984.1	6,810.3	6,272.1	4,814.3
Cash and short-term investments (reported)	5,023.5	6,599.0	6,204.7	6,000.0	6,000.0	6,000.0
Adjusted ratios						
Debt/EBITDA (x)	3.4	2.9	3.5	3.1	2.4	1.8
FFO/debt (%)	26.9	30.1	19.2	25.5	33.2	45.2
Annual revenue growth (%)	14.0	5.9	(17.9)	0.6	8.8	5.7
EBITDA margin (%)	10.8	9.2	7.9	7.7	8.4	8.2
Return on capital (%)	3.3	5.6	1.4	1.7	2.3	2.4

All figures are adjusted by Taiwan Ratings Corp., unless stated as reported. Figures for the forecast period are based on Taiwan Ratings Corp.'s base-case scenario. a--Actual. e--Estimate. f--Forecast. NT$-- new Taiwan dollar.

Our Base-Case Scenario

Assumptions

- S&P Global's forecast for world real GDP growth at 3.2% in 2024, 3.1% in 2025 and 3.3% in 2026.
- Formosa Taffeta's revenue to grow only marginally in 2024, mainly dragged down by the still-sluggish performance of tire cord segment. Meanwhile, the fabric segment will act as the company's main growth driver over the next two years, underpinned by recovering demand for sports and outdoor wears. Overall revenue will show more meaningful growth of 5%-10% in 2025.
- Gross profit margin to improve to 14.5%-15.5% in 2024-2025 from 13.7% in 2023, supported by the company's recovering utilization rate.
- Cash dividends received from equity investments to decline to NT$200 million-NT$300 million in 2024-2025 from NT$596 million in 2023.
- We project NT$0.5 billion-NT$1.0 billion working capital outflow in 2025 to support strong revenue growth.
- Capex and investment of NT$0.5 billion-NT$1.0 billion in 2024-2025, mainly for capacity expansion of its fabric production base in Vietnam and for equipment maintenance, upgrades, and replacement with energy-saving equipment. This amount also partly contributes to the company's potential capacity expansion in South-East Asia over the period.
- Cash dividends payout of NT$842 million in 2024.
- We factor in NT$500 million-NT$800 million cash dividends received from Formosa Petrochemical into operating cash flow in 2024-2025.

Liquidity

The short-term issuer credit rating is 'twA-1'. We believe Formosa Taffeta has adequate liquidity to meet its needs over the 12 months ending June 2025, which reflects a ratio of liquidity sources to liquidity uses of around 1.5x over the same period. In addition, we see the company's liquidity sources will continue to exceed uses, even if EBITDA was to decline by 15%.

Formosa Taffeta has sound relationship with banks, in our view, supported by the company's satisfactory standing in credit markets. That's because of its position as a subsidiary of one the four key Formosa group companies. In our view, Formosa Taffeta has generally prudent risk management to ensure continued adequate liquidity based on the company's flexibility to increase bank facilities. There are some covenants in the company's bank loan, but we believe it is unlikely to breach these even if forecast EBITDA to decline by 15%.

Principal liquidity sources:

- Cash and short-term investments of NT$6.8 billion at the end of June 2024.
- Funds from operations of NT$1.5 billion-NT$2.0 billion in 2024.

Principal liquidity uses:

- Debt maturity of NT$4.4 billion in the 12 months ending June 30, 2025.
- Working capital outflow of NT$300 million-NT$700 million in the 12 months ending June 30, 2025.
- Capex and investments of NT$0.5 billion-NT$1.0 billion in in the 12 months ending June 30, 2025.
- Cash dividend payout of NT$842 million in 2024.

Rating Score Snapshot

Formosa Taffeta Co. Ltd.		
	To	From
Issuer Credit Rating	twA/Stable/twA-1	twA/Stable/twA-1
Business risk	Fair	Fair
Country risk	Intermediate	Intermediate
Industry risk	Moderately high	Moderately high
Competitive position	Fair	Fair
Financial risk	Significant	Aggressive
Cash flow/Leverage	Significant	Aggressive
Anchor	twbbb+	twbbb
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)	Positive (+1 notch)
Stand-alone credit profile (SACP)	twbbb+	twbbb+
*Group credit profile: twaa * Entity status within group: Moderately strategic (+2 notches from SACP)		

Related Criteria & Research

Related Criteria

- General Criteria: Group Rating Methodology - July 01, 2019
- 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
- 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;

Formosa Taffeta Co. Ltd.	
Issuer Credit Rating	twA/Stable/twA-1

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.