

Rating Action: Moody's affirms A3 ratings of four Formosa companies; outlook stable

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Hong Kong, June 29, 2021 -- Moody's Investors Service has affirmed the A3 issuer ratings of the four companies that together comprise the Formosa group, namely Formosa Petrochemical Corporation, Formosa Chemicals & Fibre Corporation, Formosa Plastics Corporation, and Nan Ya Plastics Corporation.

The rating outlook remains stable.

"The affirmation of the ratings of the four companies reflects our expectation that the credit profile of the four Formosa companies, on a combined basis, will continue to improve over the next 12-18 months, driven by robust earnings growth and lower adjusted debt amid strong demand supporting the global economic recovery," says Chenyi Lu, a Moody's Vice President and Senior Credit Officer.

"The improving credit profile will provide the group with a strong buffer against volatile business conditions in the chemicals industry," adds Lu.

RATINGS RATIONALE

In assigning the A3 ratings, Moody's has treated each of the four rated companies as an integral part of the group, even though they do not legally constitute a group or fall under any formal group structure.

Accordingly, the ratings reflect the combined strength of the four companies, each of which is assigned the same rating as the group.

The A3 ratings of the four key group companies — Formosa Petrochemical Corporation, Formosa Chemicals & Fibre Corporation, Formosa Plastics Corporation, and Nan Ya Plastics Corporation — reflect their long track records, large operating scales, integrated business models and strong positions in the domestic petrochemical market. The ratings also reflect the group's strong access to funding channels in the domestic market and modest debt leverage.

However, the ratings are constrained by the fact that most of the group's products are commodity petrochemicals, which are exposed to strong industry competition and high cyclicalities. This cyclicalities is partly tempered by the group's diversified product mix and end-markets, and its stringent cost controls.

Moody's expects the group's revenue to increase by 31.4% in 2021 and 6.1% in 2022, driven by: (1) higher average selling prices (ASPs) and strong sales volume growth, including petrochemical, chemical, plastic and electronic products, amid strong demand supporting the improved global economic environment and an increase in oil prices; and (2) new production capacities, such as the new 135K tons meta xylene (MX) and 200K tons purified isopropyl alcohol (PIA) production capacity, which started production in the second quarter (2Q) of 2021; and the new 600K metric tons propylene production capacity, which will start production in 3Q 2021 in Ningbo China.

Moody's also expects the group's adjusted EBITDA margin to improve to 21.1% in 2021 and 17.8% in 2022 from 14.9% in 2020, driven by better product spreads, including petrochemical, chemical, plastics, and electronic products, from higher ASPs amid strong demand, and inventory gains from higher oil prices in 2021. Therefore, Moody's projects the group's adjusted EBITDA will improve to NTD239 billion in 2021 and NTD213 billion in 2022, from NTD128 billion in 2020.

Moody's forecasts the group's adjusted debt will decline to about NTD453 billion as of the end of 2022 from NTD517 billion as of the end of 2020, driven by: (1) an about USD2.0 billion (NTD59 billion) decrease in its guaranteed debt related to Formosa Ha Tinh Steel Corporation (FHS), the steel plant operations of the group, and (2) higher cash flow from operations to pay down its debt, partially offset by capital expenditure to fund its capacity expansion. The strong cash flow from operations will be underpinned by robust earnings growth and prudent working capital management to lower account receivable and inventory days.

FHS will continue to improve its operations and generate meaningful operating cash flows to support its own operations. Therefore, the improvement in FHS' financial profile will strengthen its access to funding, which will lower the contingent liabilities of the four Formosa companies over the next 12-18 months, in view of their provision of guarantees to the steel plant's operations.

Moody's projects the group's adjusted debt/EBITDA will improve to 1.9x-2.1x over the next two years from 2.5x for the 12 months ended March 2021 and 4.0x in 2020, driven by higher earnings and lower adjusted debt. This level of leverage positions the group's ratings well in the A3 rating category.

The group's liquidity is excellent. On a combined basis, the four companies held NTD150 billion in cash as of the end of March 2021. This cash balance, together with Moody's estimate of around NTD155 billion -- NTD160 billion in operating cash inflow over the next 12 months, will be sufficient to cover the companies' short-term debt of NTD164 billion, committed capital spending and dividend payments over the next 12 months.

The group's liquidity is also supported by the four companies' strong access to domestic funding, given their significant economic contributions and long operating history.

The ratings also factor in the following environmental, social and governance (ESG) considerations.

First, the group is exposed to increasing environmental regulations and safety risks stemming from its refinery, petrochemical and chemical businesses, and its steel plant in Vietnam. In 2016, the Government of Vietnam (Ba3 positive) claimed that FHS had discharged toxic waste, leading to mass fish deaths. FHS paid penalties of around \$500 million to the relevant authority for the alleged breach. Since then, the Formosa group has been working closely with the government on remedial actions and maintaining a record of environmental compliance. Nevertheless, these environmental and safety risks are somewhat mitigated by the group's solid operational and financial capabilities.

Second, the ratings factor in the four companies' good corporate governance track record, as reflected in their good liquidity and disciplined investments.

FACTORS THAT COULD LEAD TO AN UPGRADE OR DOWNGRADE OF THE RATINGS

The stable rating outlook reflects Moody's expectation that the credit profiles of the four companies, on a combined basis, will likely remain strong through the cycle and remain resilient to volatile business conditions in the chemicals industry and the group's investment needs over time.

Upward rating pressure could emerge over time if the group (1) continues to deliver robust earnings and cash flow even in a volatile oil price environment; (2) remains prudent in its investment spending and capital commitments for business expansion; and (3) continues to improve its financial profile, such that its adjusted debt/EBITDA remains below 1.5x on a sustained basis.

The ratings could be downgraded if the group's (1) adjusted EBITDA or operating cash flow weakens materially on a sustained basis; and (2) debt leverage deteriorates, such that its adjusted debt/EBITDA remains above 2.5x-3.0x on a sustained basis because of debt-funded business expansion or a deterioration in its operations.

Moody's rating approach for the four companies on a group basis is based on the following considerations: (1) the four rated companies share business strategies, and have jointly invested in and guaranteed the debt of associated companies, such as FHS; (2) their operations are highly integrated, with each entity housing processes that form part of an overall value chain; (3) the four entities share an intertwined cross-shareholding structure; and (4) there is a long track record of common management control and significant beneficial ownership by their major shareholders.

Consequently, the rating drivers and the combined quantitative financial measurements are applied on a group basis.

The principal methodology used in these ratings was Chemical Industry published in March 2019 and available at https://www.moodys.com/researchdocumentcontentpage.aspx?docid=PBC_1152388. Alternatively, please see the Rating Methodologies page on www.moodys.com for a copy of this methodology.

Incorporated in 1954, Formosa Plastics Corporation manufactures and sells plastic raw materials, chemical fibers, and petrochemical products.

Incorporated in 1958, Nan Ya Plastics Corporation manufactures and sells plastic products, polyester fibers, petrochemical products, and electronic materials.

Incorporated in 1965, Formosa Chemicals & Fibre Corporation produces and sells petrochemical and plastic products, including p-xylene (PX), styrene monomer (SM), acetone, phenol, pure terephthalic acid (PTA), polystyrene (PS), acrylonitrile butadiene styrene (ABS), polypropylene (PP), and polycarbonate (PC) as well as synthetic spun cloth and nylon filaments.

Incorporated in 1992, Formosa Petrochemical Corporation engages in petroleum refining and the integrated manufacture of hydrocarbon products.

REGULATORY DISCLOSURES

For further specification of Moody's key rating assumptions and sensitivity analysis, see the sections Methodology Assumptions and Sensitivity to Assumptions in the disclosure form. Moody's Rating Symbols and Definitions can be found at: https://www.moody.com/researchdocumentcontentpage.aspx?docid=PBC_79004.

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Moody's general principles for assessing environmental, social and governance (ESG) risks in our credit analysis can be found at https://www.moody.com/researchdocumentcontentpage.aspx?docid=PBC_1288435.

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