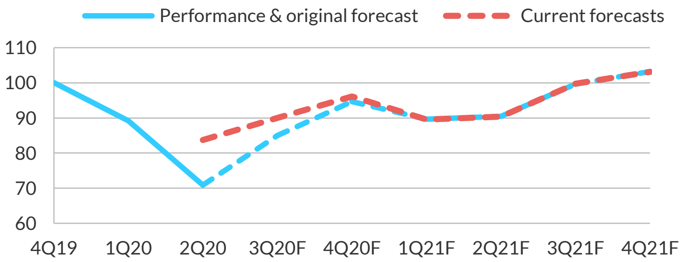
Pandemic Progress Check: Asia-Pacific Consumer Technology

2Q20 Outperforms; Recovery Pace Varies

Asia-Pacific Consumer Technology - Revisions Post 2Q20
(Indicative revenue curve, 4Q19 indexed as 100)



Source: Fitch Ratings

The operating performance of most rated consumer technology companies in 2Q20 has proved better than Fitch Ratings' expectations in May 2020.

The structural shifts in the consumer and business behaviour towards digital transformation and migration to work-from-home practice have benefitted companies manufacturing DRAM/NAND, PCs, printers, laptops, monitors and the related components, which has done more than enough to offset weakness in other electronic products.

Performance has varied among the sub-segments of the consumer technology sectors. The global smartphone market plunged by 17% year-on-year (yoy) in 2Q20, although this was better than our previous forecast. TV shipments remained relatively solid, with a modest decline of around 2% yoy for the top 15 brands, helped by the strong surge in demand in North America and China.

Robust demand from the data centres and technologies that are related to working from home benefitted the memory semiconductor market and led to a strong rise in industry revenue (DRAM by 15.4% yoy and NAND by 6.5% yoy in 2Q20).

However, global automotive sales contracted by 34.4% yoy, which resulted in a severe drop in the corresponding sales of companies manufacturing car batteries and information and communication, infrastructure-industrial products such as capacitors and circuit board materials.

Recovery Pace Diverges

We believe that recovery will be uneven across the technology sub-sectors, depending on the resumption of consumer sentiment in each market. A stronger rebound in demand is likely only after 2021 for most markets.

Companies which have generally high exposure to products with affordable prices and short replacement cycles are likely to see a faster recovery than those with a higher-priced product and longer replacement cycles.

We think Panasonic Corporation (BBB-/Stable) is likely to lag its peers due to larger exposure to automotive-related businesses, including car batteries and infotainment systems which were under pressure even before the pandemic due to weak demand.

On the other hand, companies which are exposed to consumer electronic products such as smartphones, game consoles and home appliances should see a stronger recovery, supported by improvement in consumer sentiment and advancement in technology such as 5G adoption.

Related Research

What Investors Want to Know: Coronavirus Impact on Asia-Pacific Technology (July 2020)

What Investors Want to Know: Asia-Pacific Technology (January 2020)

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Trade Tension, Pandemic Key Sector Risks

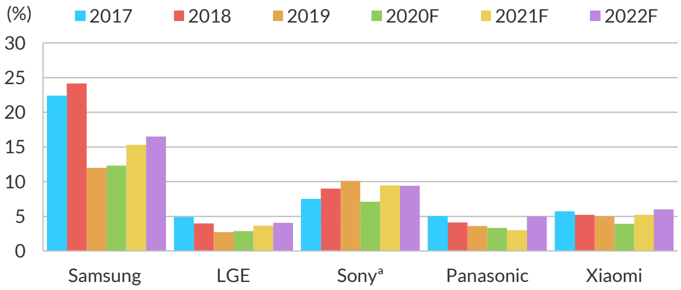
The Outlook distribution among the five consumer tech companies under the Fitch portfolio suggests broadly resilient operating and financial profiles, underpinning an overall moderate impact of the pandemic on credit profiles. The majority of issuers are likely to maintain robust credit profiles throughout the current downturn due to manageable debt levels, sufficient liquidity, and access to diversified funding channels.

However, continued improvement and a revenue pick-up in 2021 will depend to a large extent on consumer and business confidence amid an ongoing lack of visibility over the evolution of the pandemic. In addition, heightened trade tension will spur the shift in the global technology supply chain over time.

Key Credit Sector Consideration

- Scope of post-pandemic recovery will not be homogeneous, as the companies have very different product and service portfolios
- The upcoming US election and policy preferences of the next administration will present greater uncertainties over the direction of US-China disputes, whichever candidate wins the presidency
- China's ambitions to be at the forefront of 5G adoption could accelerate 5G applications, driving the demand for components manufacturing in 2021

EBIT Margin Performance and Forecast



[a] Sony excluded Sony Financial Holdings.
Source: Fitch Ratings, Companies, LG Elecronics proportiontaly consolidates LG

Global Supply Chains and Sales Affected

The pandemic affects the tech industry across all markets due to the complex and highly correlated nature of supply chains around the globe. Consumer electronic products are facing disruptions in the supply of raw material and finished materials as well as critical components because of COVID-19. The closing of overseas manufacturing plants leads to a supply bottleneck, which marked 2Q20 as the weakest for shipments. On the other hand, consumer sentiment is severely dampened, and the shutdown of overseas offline stores affect end-demand.

However, the early recovery in China and some Asian countries like South Korea and Vietnam, where many production facilities are located, has helped many Asia-Pacific tech companies normalise their procurement as well as production, and to benefit from the demand improvement in the respective markets. In other regions, however, exposure to disruptions both in supply and demand remains a threat to operations and financials.

Limited Impact from Resurgence of Coronavirus

Our base-case scenario assumes a gradual improvement in the global economy towards 2021, and does not take into consideration widespread recurring lockdowns. Even if the spread of coronavirus is prolonged beyond our expectations, we think the impact on credit profiles is likely to be limited. This is because the tech companies also benefit from stay-at-home trends and digital transformation which spur the usage of technology and related products.

Containment Delays Manageable

Issuers faced many pandemic-related challenges, including supply-chain disruptions, distribution delays and shifts in consumer demand. However, we envisage the consumer tech companies will remain resilient even with a longer-than-expected containment of the pandemic. They already have adapted operations to contain these disruptions, and have showed resilience in their financial results.

A temporary shutdown of production facilities is not a major issue, given weakening demand beyond output loss, which creates healthy inventory levels when recovery arrives. The companies have streamlined production processes and continue to implement cost-cutting measures. Some have also strengthened e-commerce distribution channels and tilted away from the traditional offline sales.

All the companies in our portfolio are rated above investment grade, underpinned by their competitive positions (particularly in the high-end segment), sufficient scale, extensive product portfolio and geographic diversification. We believe such strong business traits will continue to provide a sufficient buffer to weather the downturn without seriously hurting credit profiles.

Adequate Rating Headroom

The need to maintain high capex and R&D spend in order to keep up with competition continues to put pressure on the ability to generate cash However, we expect the companies will maintain positive free cash flow (FCF) with healthy margins on the back of a focus on profitable growth after the pandemic. The strategy of improving the product mix towards the premium segment also supports operating profitability.

Among the consumer tech issuers, we view Panasonic as the most vulnerable to a prolonged spread of the pandemic. We expect that a substantial decline in sales as the coronavirus spreads will continue to weigh on operating results which are already weak. Worse-than-expected operating performance driven by delayed recovery in the car battery business, continuously subdued household-related business in the domestic market and consumer electronics sales, could push Panasonic's FFO leverage above 3.0x for a sustained period, together with a weaker-than-expected operating margin which is below 3.5%, leading to a downgrade in Panasonic's rating to below investment grade.

Appendix: APAC Consumer Technology – Coronavirus Impact & Revised Forecasts

5 Rated Corporates – Outlook Distribution

Outlook Distribution

Source:Fitch Ratings

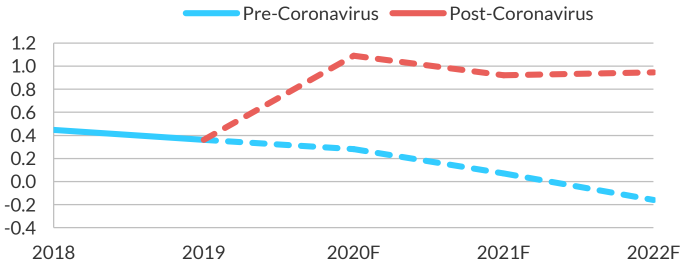
Coronavirus Related Rating Actions to Date

Rating Actions

Source:Fitch Ratings

APAC Consumer Technology: Median Leverage

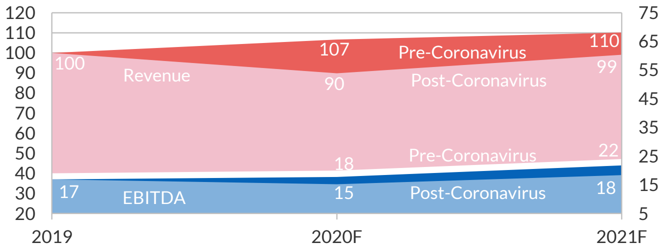
FFO adjusted net leverage



Source: Fitch Ratings

APAC Consumer Technology: Revenue & EBITDA

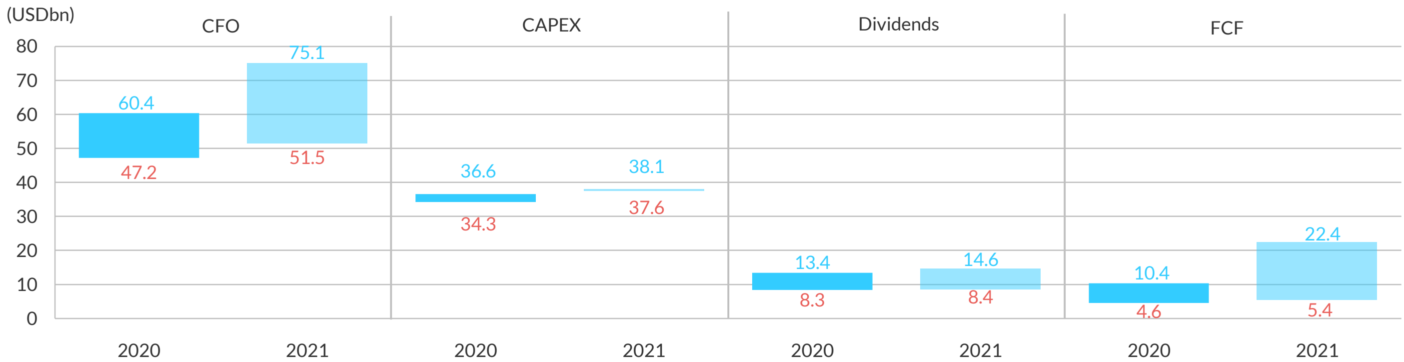
(Sector averages. revenue indexed from 2019 at 100; EBITDA indexed from 2019 at 2019's EBITDA margin)



Source: Fitch Ratings

APAC Consumer Technology: Pre- vs. Post-Coronavirus Cash Flow Forecasts

Sector aggregate forecasts, blue figure is pre-coranavirus and the red figure is post



Source: Fitch Ratings