Media Release

Taiwan Ratings Assigned Taiwan Cement Corp. 'twA+/twA-1' Ratings; Outlook Stable

May 8, 2018

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Overview

- TCC's leading market position in Taiwan, top three market share in focused provinces in southern China, and stable cash flows from Ho Ping Power and Ho Ping Port are key supporting factors for its satisfactory competitive position.
- We expect TCC's limited capital spending on its cement operations and relatively strong profitability in China to sustain its ratio of debt to EBITDA below 3x over the next one to two years despite significant capital expenditure to support its green energy business.
- Valuable land and investment property available for sale provide significant financial flexibility to manage TCC's cash flow volatility from its cement business.
- We are assigning our 'twA+' long-term and 'twA-1' short-term issuer credit ratings on TCC.
- The stable rating outlook reflects our view that TCC will sustain its satisfactory market position in Taiwan and China's cement industry, thereby generating sufficient cash flow to keep its ratio of debt to EBITDA below 3x over the next one to two years despite significant capital expenditures over the period.

Rating Action

Taiwan Ratings Corp. today assigned its 'twA+' long-term and 'twA-1' short-term issuer credit ratings to **Taiwan Cement Corp.** (TCC). The outlook on the long-term rating is stable.

Rationale

The ratings on TCC reflect the company's leading position in Taiwan's cement market, satisfactory market position in focused provinces in Southern China, some diversity into non-cement businesses, and good operating efficiency and intermediate debt leverage. We also expect TCC's valuable land and investment properties available for sale to provide significant financial flexibility to manage cash flow and debt volatility during business cycles. TCC's smaller cement capacity compared with leading peers in China and still-high concentration in China's highly volatile cement industry somewhat offset these strengths. As a result, we believe the company's operating performance will remain more volatile, albeit stabilizing, compared with similar or larger rated peers'.

Founded in 1946, Taiwan Cement is the largest cement company in Taiwan with a capacity of 10.4 million ton and sixth largest in China with a capacity of 65.3 million ton as of the end of 2017. The company has a portfolio of business investments in Taiwan, including power generation, port operation, and chemical and waste management. TCC plans to further diversify its operation through investments in green energy and waste treatment over the next two years.

We expect TCC to maintain its leading market position in Taiwan's oligopoly cement market. The company has held a 34%-37% share over the past three years, consistently ahead of the second largest cement maker, Asia Cement Corp., which had a market share of 25%-28% over the same period. However, we expect TCC's cement revenue to continue to decline over the next 12 months, due to sluggish domestic demand, increased competition from low-priced imports and the government's requirement to lower cement exports. We also expect profit margins to remain under pressure due to rising coal cost without corresponding increases in the selling price. However, we expect TCC's strong branding power and market position in Taiwan's relatively mature cement market and the continuation of anti-dumping taxes on imports from China will somewhat limit the company's margin declines.

In addition, we expect TCC to sustain high capacity utilization and remain a top three cement producer in Guangdong, Guangxi and Guizhou provinces of China. Our view is supported by the company's good operating and technical capability that can fully meet China's increasingly stringent environmental requirements, as well as the company's established distribution network. Nevertheless, we expect TCC's market share to remain limited in other operating provinces, including Sichuan, Chongqing, Hunan, Jiangsu and Liaoning, due to its smaller operating scale in comparison with leading Chinese peers'. We also expect the company to maintain its number six ranking in terms of clinker capacity in China as of the end of 2017. That's because a high degree of market consolidation, lack of feasible acquisition targets, and the government's prohibition on new capacity additions will limit TCC and other cement producers' further capacity expansion.

We anticipate cement performance in China will continue to strengthen in 2018 with a further elevation in average selling price; however, a higher coal price will partly offset the benefits from this. We believe the government's more stringent implementation of environmental protection policy and better industry discipline, reflected in cement producers' tighter control over production volume under a more consolidated industry structure, are critical to cement producers' pricing power. We believe curtailed production from existing players, forced closure of inefficient and high polluting capacities, and government restrictions on new capacity additions will continue to support China's cement prices, despite lingering oversupply in the industry.

We expect higher capital expenditures on renewable energy and waste management over the next three years to increase TCC's debt in 2018. We assume in our base case that the company's capital expenditure will increase to New Taiwan dollar (NT$) 9 billion-NT$10 billion in 2018 and NT$7 billion-NT$8 billion in 2019, up from NT$1.8 billion in 2017. Accordingly, we expect TCC's ratio of debt to EBITDA to increase to 2.4x-2.6x in 2018 from 2.3x in 2017 and decline gradually afterward without assuming new acquisitions for its cement business in China and overseas renewable energy.

In our view, TCC's financial risk is partly offset by the financial flexibility arising from its valuable investment properties and lands in urban areas. These allow it to manage uneven cash flow stemming from relatively volatile cement business. The company owns investment properties and publically listed stocks with a market value of NT$14.85 billion and NT$3.45 billion, respectively, as of the end of 2017. In addition, TCC has two pieces of land available for sale, with total fair value of NT$20 billion to NT$23 billion as of the end of May 2017. We believe that the company can dispose of part of the land assets, its investment properties, and equity holdings available for sale if needed to enhance its financial risk profile by one category. We therefore notch up the company's standalone credit profile (SACP) by one notch accordingly.

We believe TCC's profitability and cash flow will remain relatively more volatile than its peers' of similar and larger scale due to TCC's higher concentration in China's volatile cement industry, which will account for 70%-75% of TCC's EBITDA and its relatively limited scale. This is despite TCC's moderate business diversity into non-cement businesses, including power generation, port operation, chemical and waste management in Taiwan. Cash flow from Ho-Ping Power, Ho-Ping port and Taiwan Prosperity Chemical accounted for 15%, 7% and 3% of TCC's EBITDA in 2017. The risk of high profitability volatility and risk of credit metrics deterioration amid industry downturn is captured in our negative comparable rating analysis and therefore we lower TCC's SACP by one notch.

We deconsolidate Ho-Ping Power (HPC) from TCC's consolidated financial statements and include HPC's cash dividend to TCC as EBITDA in deriving TCC's credit metrics. We view TCC does not have control over HPC, despite TCC owns 60% of HPC, due to the existence of a significant minority shareholder, OneEnergy. OneEnergy controls 40% of HPC's shares and holds five out 13 board seats. TCC needs to seek OneEnergy's approval on all material decisions such as cash dividend payout. In addition, HPC has financial independence and does not pledge or commingle cash flows for the benefit of TCC or its subsidiaries. As a result, we believe that even if TCC encounter severe setbacks, the relative strength of HPC would remain nearly intact and therefore its financial conditions is delinked from TCC.

Taiwan Ratings' base-case scenario for TCC indicates 7%-10% revenue growth in 2018 and 0.5%-2% in 2019. We expect the company's gross margin to remain flat over the next two years. Our assumptions for the base-case scenario are:

- China's real GDP to grow 6.5% in 2018 and 6.3% in 2019. We expect the growth in China's cement production to be flat or drop slightly in 2018 and 2019 owing to slow economic activity, given a high correlation with the fixed-asset investment growth rate, which we expect to moderate over next two years.
- Taiwan's real GDP to grow 2.7% in 2018 and 2.6% in 2019. We expect Taiwan's cement demand to be flat in 2018 and 2019, owning to the mature cement market and still-sluggish housing market.
- TCC's cement revenue will increase by 6%-8% in 2018 and remain flat in 2019, reflecting growth in cement revenue in China. We anticipate the growth to be driven by elevation in average selling price (ASP).
- TCC's blended ASP in China to increase by 7%-9% in 2018 and remain flat in 2019. We believe government and cement producers' effort in controlling production and a more concentrated market structure will continue to support cement selling price at a relatively high level over the next two years.
- TCC's cement selling price in Taiwan to remain largely flat over the next two years, reflecting mature and stable market structure.
- TCC's capacity utilization in China to be above 90%. We expect its capacity utilization in Taiwan to decline by 1% each year over the next 2 years, reflecting reduction in export volume.
- Cement gross margin in China to remain flat in 2018 and 2019. We anticipate the benefit of higher ASP is offset by higher coal cost. We expect cement gross margin in Taiwan to slightly weaken over the same period due to higher coal costs, which is not reflected in cement selling price.
- TCC's non-cement revenue and gross profit to increase by 15%-19% in 2018 and 4%-6% in 2019, mainly reflecting performance improvement in Prosperity Chemical.
- Ho-Ping Power's dividend contribution to TCC to decline to NT$1.5 billion-NT$2 billion in 2018 and 2019, due to higher coal cost, which is not yet reflected in its power selling price.
- Capital expenditure will increase to NT$9 billion-NT$10 billion in 2018 and NT$7 billion-NT$8 billion in 2019. The higher capital expenditure is to support green energy projects in Taiwan and waste management projects in China.
- Dividend payout of 43%-47% in 2018 and 2019.
- We net 75% of TCC's cash and liquid investments with debt.
- We deconsolidate Ho-Ping Power and include its cash dividend to TCC as EBITDA in deriving our financial forecasts for TCC. This is because we view HPC as an insulated subsidiary.

Liquidity

The short-term corporate credit rating is 'twA-1'. We believe Taiwan Cement has adequate liquidity to meet its needs over the next twelve months, which reflects our view that the ratio of liquidity sources to liquidity uses will be 1.2x-1.4x over the next 12 months, and that liquidity sources will continue to exceed uses even if Taiwan Cement's EBITDA were to decline by 15%. We also believe the company has a sound relationship with banks and a generally high standing in the credit market in Taiwan, evidenced by its capability in obtaining low-cost funding through banks and capital market. We also expect the company and its subsidiaries to meet financial covenants over the next two years with sufficient headroom, underpinned by the company's satisfactory cash flow generation expected over the same period.

Principle Liquidity Sources

- Cash and short-term investments: NT49.8 billion as the end of 2017.
- Funds from operations: NT$14 billion-NT$15 billion in 2018.

Principle Liquidity Uses

- Debt maturities: NT$40 billion-NT$41 billion in 2018.
- Maintenance capital expenditure: NT$2.6 billion-NT$2.7 billion in 2018.
- Working capital outflow: NT$3 billion-NT$4 billion in 2018.
- Cash dividend: NT$3 billion- NT$4 billion in 2018.

Outlook

The stable rating outlook reflects our view that TCC will sustain its satisfactory market position in Taiwan and China's cement industry, underpinned by its brand recognition, good operating and technical capability that can fully meet China's increasingly stringent environmental requirements, and established distribution network over the next one to two to years. The stable outlook also reflects our view that TCC's cement business in China will strengthen in 2018 under a rising selling price. As a result, we expect the company can comfortably maintain its ratio of debt to EBITDA below 3x even with a significant increase in capital expenditures.

Downward scenario

We may lower the rating if TCC pursues business growth more aggressive than our expectation and causes a substantial deterioration in its ratio of debt to EBITDA to over 3x for a prolonged period of time. Possible scenarios include: 1) a higher growth appetite for renewable energy that results in higher-than-expected capital expenditure or 2) substantial capital expenditure needs arise from property development projects in Kaohsiung and Taipei. We may also lower our ratings on TCC if its market position in Taiwan or China deteriorates substantially, evidenced by a slide in market share and capacity utilization for a prolonged period.

Upward scenario

We believe that the likelihood of an upgrade over the next 12 months is limited, considering TCC's rising debt for high capital expenditures and remaining cyclicality in China's cement industry. However, we may raise the rating if TCC can demonstrate higher stability in profitability and cash flow throughout industry cycles, possibly achieved by further business diversification, while maintaining its ratio of debt to EBITDA close to 2x. We may also raise the rating if TCC adopts a more conservative financial policy and lower its debt level to improve its ratio of debt to EBITDA close to 1.5x on a sustainable basis.

Rating Score Snapshot

Issuer Credit Ratings: twA+/Stable/twA-1
Note: All score are in comparison with global obligors.
Business risk: Satisfactory

- Country risk: Moderately high
- Industry risk: Intermediate
- Competitive position: Satisfactory

Financial risk: Intermediate

- Cash flow/Leverage: Intermediate

Anchor: twa+

Modifiers

- Diversification/Portfolio effect: Neutral (no impact)
- Capital structure: Positive (+1 notch)
- Liquidity: Adequate (no impact)
- Financial policy: Neutral (no impact)
- Management and governance: Satisfactory (no impact)
- Comparable rating analysis: Negative (-1 notch)

Stand-alone credit profile: twa+

Related Criteria

- Understanding Taiwan Ratings' Rating Definitions, www.taiwanratings.com - November 18, 2014
- General Criteria: Use Of CreditWatch And Outlooks - September 14, 2009
- General Criteria: Group Rating Methodology - November 19, 2013
- Criteria - Corporates - Industrials: Key Credit Factors For The Building Materials Industry - December 19, 2013
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities And Insurers - November 13, 2012
- General Criteria: Methodology: Industry Risk - November 19, 2013
- General Criteria: Country Risk Assessment Methodology And Assumptions - November 19, 2013
- Criteria - Corporates - General: Corporate Methodology - November 19, 2013
- Criteria - Corporates - General: Corporate Methodology: Ratios And Adjustments - November 19, 2013
- Criteria - Corporates - General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers - December 16, 2014

(Unless otherwise stated, these articles are published on www.standardandpoors.com, access to which requires a registered account)

Ratings List

Ratings Assigned

	To	From
Taiwan Cement Corp.		
Issuer Credit Ratings	twA+/Stable/twA-1	NR

NR—Not rated.