Research Update:

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

April 29, 2020

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Rating Action Overview

Taiwan Ratings Corp. today affirmed its 'twA+' long-term and 'twA-1' short-term issuer credit ratings on **Taiwan Cement Corp.** The outlook on the long-term rating is stable. The ratings reflect the company's leading position in Taiwan and Southern China's cement markets, business diversity into non-cement industries, and satisfactory operating efficiency.

The rating affirmation also reflects our view that Taiwan Cement's EBITDA is likely to decline moderately in 2020, due to the closedown of construction sites in China in the first quarter to contain the spread of COVID-19. Nonetheless, we believe the company will be able to recover its EBITDA in 2021, underpinned by an expected surge in infrastructure investment by the Chinese government to stabilize the local economy. In addition, disciplined cement output by local producers, and a declining coal price should underpin the company's sales price and product margin in 2020 and 2021.

We believe Taiwan Cement will capably weather the effects of the COVID-19 pandemic, underpinned by the company's diversified operating regions in China and business diversity into non-cement businesses. The stable dividend contribution from the company's power generation business and its stable and growing green energy and waste management business could add to its buffer against market volatility. Overall, we view Taiwan Cement has demonstrated its capability to withstand market volatility in par with those of its peers.

However, Taiwan Cement's high capital expenditure, strong appetite for scale expansion, and aggressive dividend payouts may further increase its debt level. In addition, the company's strong operating cash flow generation over the past two years largely reflected the cement industry upcycle and disciplined output in China. Taiwan Cement's EBITDA could contract sharply if China's cement industry enters a downturn with substantial shrinkage in demand or if the output discipline among cement producers loosens, possibly due to weaker demand. Therefore, the company's credit metrics are subject to a high degree of volatility, in our view.

Outlook

The stable rating outlook reflects our view that Taiwan Cement will sustain its satisfactory position in Taiwan and China's cement markets over the next two years, underpinned by the company's brand recognition, good operating and technical capability that can fully meet China's increasingly stringent environmental requirements, and established distribution network. We expect Taiwan Cement's debt to EBITDA ratio will temporarily rise to between 2.5x-3x in 2020, due to the adverse impact of COVID-19 on its cement business in China, but to recover to 2x-2.5x in 2021, supported by growing infrastructure investment in China. This is despite likely high capital expenditure and cash dividend payout over the period.

Downside Scenario

We may lower the long-term issuer credit rating if:

- the company's ratio of debt to EBITDA deteriorates to above 3.5x for a prolonged period. This could occur if Taiwan Cement adopts a more aggressive business expansion strategy or dividend policy, leading to a substantial increase in debt, or its operating environment deteriorates possibly due to sluggish demand, weakening production discipline, or a substantial increase in key operating costs without a corresponding price reflection.
- its market position in Taiwan or China deteriorates substantially, evidenced by a slide in market share and capacity utilization for a prolonged period

Upside Scenario

We may raise the rating if:

- Taiwan Cement 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.
- The company adopts a more conservative financial policy and lowers its debt level to improve the ratio of debt to EBITDA close to 1.5x on a sustainable basis. A substantial reduction in its cash dividend payout and controlled capital expenditure could lead to such a result.

Ratings Score Snapshot

Issuer Credit Rating: twA+/Stable/twA-1

Note: The descriptors below are on a global scale.

Business risk: Satisfactory

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

Financial risk: Significant

- Cash flow/Leverage: Significant

Anchor: twa

Modifiers

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

Stand-alone credit profile: twa+

Related Criteria

- General Criteria: Group Rating Methodology - July 01, 2019
- Criteria | Corporates | General: Corporate Methodology: Ratios And Adjustments - April 01, 2019
- Understanding Taiwan Ratings' Rating Definitions - June 26, 2018
- Criteria | Corporates | General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers - December 16, 2014
- Criteria | Corporates | Industrials: Key Credit Factors For The Building Materials Industry - December 19, 2013
- General Criteria: Country Risk Assessment Methodology And Assumptions - November 19, 2013
- General Criteria: Methodology: Industry Risk - November 19, 2013
- Criteria | Corporates | General: Corporate Methodology - November 19, 2013
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities - November 13, 2012
- General Criteria: Use Of CreditWatch And Outlooks - September 14, 2009

(Unless otherwise stated, these articles are published on www.taiwanratings.com)

Ratings List

Ratings Affirmed; Outlook	
Taiwan Cement Corp.	
Issuer Credit Rating	twA+/Stable/twA-1