Media Release:

ECOVE Environment Corp. Assigned 'twA/twA-1' Ratings; Outlook Stable

April 12, 2021

PRIMARY CREDIT ANALYST

David Hsu
Taipei
+886-2-2175-6828
david.hsu@spglobal.com
david.hsu@taiwanratings.com.tw

SECONDARY CONTACT

Anne Kuo, CFA
Taipei
+886-2-2175-6829
anne.kuo@spglobal.com
anne.kuo@taiwanratings.com.tw

Rating Action Overview

- We expect ECOVE's good market position in Taiwan's energy-from-waste (EFW) market, relatively high entry barriers, protection on long-term contracts, and business integration with **CTCI Corp.** group to continue to support ECOVE's competitive position and relatively stable performance. We view ECOVE as a core entity of CTCI group, given it is the group's major profit contributor. ECOVE's limited business scale, renewal risk on some incinerator contracts, and rising financial leverage temper its rating strengths.
- ECOVE's debt leverage is likely to grow due to rising capex over the next two to three years, including in solar energy, other waste treatment businesses, and upgrade projects for Taiwan's major incinerators.
- On April 12, 2021, Taiwan Ratings Corp. assigned its 'twA' long-term and 'twA-1' short-term issuer credit ratings to ECOVE.
- The rating outlook is stable which mainly reflects the stable rating outlook on the parent, CTCI.

Rationale Action Rationale

Good market position, relatively high entry barriers, and long-term contract protection will help ECOVE deliver stable performance. As one of two major incinerator operators in Taiwan, ECOVE has maintain relatively stable performance with limited competition over the past few years, given the high industry barriers for entry. Complex regulatory permits, the operator's long track record, substantial capital expenditure (capex) to build incinerators, as well as investments in proprietary tech, safety standards, and bundled service offerings all contribute to the high barriers. In addition, we view the industry as highly regulated, which hinders potential competitors to enter the market.

In addition, the company's long-term power purchase agreements (PPA) with Taiwan Power Co. (Taipower) and waste management contracts with local governments ensure ECOVE's operating stability, in our view. The PPAs guarantee Taipower will acquire all power generated by ECOVE's EFW incinerators, while local governments also guarantee to provide household waste volume to some of the company's EFW units. Furthermore, unlike other cogeneration operators in Taiwan, EFW operators face limited risk of raw material volatility, since the feedstock, (waste) is guaranteed by local government; therefore, EFW's major costs are from operation, maintenance, and personnel.

Small business scale and contract renewal risks constrain ECOVE's competitive position. Some of ECOVE's seven incinerators are exposed to contract renewal risk because the three of their contracts will expire in 2021. Furthermore, the Taiwan government has initiated an upgrade plan for 12 (soon to be expanded to 17) of the 24 incinerators across Taiwan, which adds to ECOVE's operating risk. Potential rising competition and uncertainty over the terms and returns of the new contracts contribute to the contract renewal risk. Nevertheless, we expect the company to successfully renew the contracts supported by its competitive advantages in terms accumulated experience and know-how. In our view, the market's oligopolistic structure could further consolidate because ECOVE and Onyx Ta-Ho Environmental Services Co. Ltd. (Taho) are the only two capable operators with a good track record and economies of scale.

We expect ECOVE to maintain its relatively small operating scale in Taiwan because the company's business focus is to secure more incinerator upgrade projects over the next two years. This is despite the company's strategy to diversify its business into the treatment of special industrial waste and waste water, as well as renewable energy. In addition, ECOVE's stable EFW operation in Macau since 2009 will continue to provide moderate geographic diversification, in our view. We expect ECOVE to steadily generate revenue of new Taiwan dollar (NT$) 3 billion from its seven incinerators. This will account for 40%-50% of the company's total revenue over the next two to three years, compared to 57% in 2020, as the company continues to expand its business.

ECOVE's debt leverage will grow along with the company's business expansion. ECOVE's ratio of debt to EBITDA will increase to 3x-4x over the next two to three years, compared with a net cash position in previous years. The company will invest actively in solar power generation and special waste treatment, such as for biomass waste and wastewater, along with Taiwan's new energy policy and waste treatment policy. The ratio could increase further if the company participates in more upgrade projects for major incinerators because ECOVE will have to raise its capex significantly for those projects before they generate meaningful EBITDA.

Business integration with CTCI brings mutual benefits to ECOVE and the parent. We also view the business integration with CTCI as a key advantage distinguishing ECOVE from other service providers. We believe CTCI's engineering capability is a strong backup for its environmental services, because CTCI is the most well-known domestic engineering-procurement-construction (EPC) player for environmental projects. Therefore, as the group has better access to fixed assets such as incinerators or water waste disposal sites, ECOVE is well-positioned to secure new contracts.

We assess ECOVE as a core member of CTCI group. This reflects the fact that CTCI owns about 57% of ECOVE and is the single largest shareholder, allowing it control of the company's board of directors. We also believe the group is unlikely to divest of ECOVE because the company accounts for more than 50% of the group operating income despite accounting for much less revenue. ECOVE's stable performance in environmental services plays an important role supporting CTCI's performance stability because the parent's project-based EPC business carries relatively high cyclicality. In addition, we believe ECOVE operates in lines of business or functions that are integral to the group's overall strategy and enhances CTCI's vertical integration

Outlook

The stable outlook on ECOVE reflects the outlook on its parent CTCI, given ECOVE's status as a core subsidiary of the CTCI Corp. The stable outlook also reflects our view that CTCI's stable profitability and recovered cash flow generation from robust revenue growth should help to cap its debt elevation in 2021-2022. We expect CTCI's debt to EBITDA to remain at 2.5x-3.0x over the same period.

Downward scenario

We may lower the long-term issuer credit rating on ECOVE if we lower the long-term rating on the parent or if we believe CTCI's support for ECOVE has weakened. We may lower the long-term rating on CTCI if the company's ratio of debt to EBITDA weakens to above 3x persistently without prospects of recovery. This could happen if:

- CTCI's sustained high working capital requirement results in persistent working capital outflow,
- CTCI incurs large losses from project execution,
- CTCI faces more intensified competition that results in material deterioration in its profit margin, or
- CTCI's debt burden materially rises due to consolidation of debt-heavy build-operate-transfer projects operated by its subsidiaries or significant capital investments.

Upward scenario

We may raise the rating on ECOVE if we raise the rating on the parent. This could occur if:

- CTCI sustainably improves its ratio of debt to EBITDA to close to 1.5x, perhaps if the company reduces its working capital volatility materially and effectively improves its cash conversion cycle, or improves its profit margin further; for instance, through stronger project management with better earnings stability or a rising contribution from higher-margin environmental services business.

Company Description

Founded in 1999 as a key subsidiary of CTCI Corp., ECOVE is one of Taiwan's major environmental services providers, offering investment and development, technical consulting, and operation and maintenance services for domestic and foreign energy-from-waste units. Among Taiwan's 24 major incinerators, ECOVE operates seven (excluding five public incinerators), with daily waste incineration of 6.5K tons, and power generation capacity of 138MW

Our Base-Case Scenario

Macro and industrial assumptions:

- S&P Global Ratings forecast for Taiwan's real GDP to grow by 4.2% in 2021 and 2.7% in 2022.
- Taiwan's incinerator-based waste treatment business to remain stable over the next few years despite planned upgrades to the majority of the 24 incinerators on the island. We view the waste management industry as relatively stable and recession resistant due to the essential nature of the services provided, which is evidenced by the continued growth in waste volume even during the COVID19 pandemic.

Company specific assumptions:

- ECOVE's revenue to grow by 3%-5% in 2021, but could grow materially by 15%-20% in 2022 and 5%-10% in 2023.
- The major growth driver in 2022-2023 will be new projects such as upgrades and operation and maintenance (O&M) of incinerators in Changhua, as well as biomass energy centers in Taoyuan and Changhua.
- ECOVE's active strategy in Taiwan's solar energy generation will also drive the company's sales with an additional 30MW power generating capacity per year. Meanwhile, the company's recycling revenue will also grow along with increased processing volume of waste solvent and waste water.
- The seven incinerators ECOVE operates will maintain stable performance for waste treatment and electricity sales. ECOVE will successfully renew the contracts for these incinerators, including those about to be upgraded.
- Processing volume and related sales of incinerators in Macau and other smaller incinerators for special purposes such as the one in Taoyuan Airport could increase moderately as the impact of the pandemic gradually subsides.
- ECOVE will sustain its cost structure over the next two years at a similar level to that in 2020 level.
- The company's capex is likely to grow materially as ECOVE actively expands its business portfolio to include the O&M of more incinerators, solar energy generation, and recycling business. We assumed NT$1 billion-NT$1.5 billion in 2021 and NT$2 billion-NT$2.5 billion annually in 2022-2023.
- Similar cash conversion cycle over 2021-2022 as in 2020.
- About 90% cash dividend payout ratio in 2021-2022.

Based on the assumptions, we arrive at the following credit measures:

- EBITDA margin of 28.5%-29.5% in 2021-2022, compared with 30.1% in 2020.
- Ratio of debt to EBITDA of 0.5x-1x in 2021, 2x-3x in 2022, and 3x-4x in 2023, compared to 0.1x in 2020.
- Negative free cash flow of NT$1 billion-NT$1.2 billion in 2021 and about NT$2.5 billion per year in 2022-2023.

Liquidity

The short-term issuer credit rating is 'twA-1'. We believe ECOVE has adequate liquidity reflecting a ratio of liquidity sources to liquidity uses of about 1.8x over the 12 months ending December 2021, considering only maintenance capex. We also believe the company will have positive liquidity sources minus uses, even if its EBITDA declined by 15%. In addition, we believe ECOVE has a sound relationship with banks as the core member of the CTCI group, as evidenced by the low interest rate and zero financial covenants on its bank loans. CTCI's high standing in local credit markets also helps ECOVE to access the local credit markets in our view.

Principle liquidity sources:

- Cash and short-term investment: NT$2.2 billion as of the end of 2020.
- Funds from operations: About NT$1.3 billion in 2021.

Principle liquidity uses:

- Debt maturities: NT$0.86 billion in 2021.

- Maintenance capex: About NT$50 million.
- Cash dividend payout: About NT$1 billion.

Related Criteria & Research

Related Criteria

- Criteria | Corporates | Industrials: Key Credit Factors For The Unregulated Power And Gas Industry - March 28, 2014
- General Criteria: Principles Of Credit Ratings - February 16, 2011
- General Criteria: Group Rating Methodology - July 01, 2019
- General Criteria: Country Risk Assessment Methodology And Assumptions - November 19, 2013
- General Criteria: Methodology: Industry Risk - November 19, 2013
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities - November 13, 2012
- Criteria | Corporates | General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers - December 16, 2014
- Criteria | Corporates | General: Corporate Methodology - November 19, 2013
- Criteria | Corporates | General: Corporate Methodology: Ratios And Adjustments - April 01, 2019

Related Research

- Taiwan Ratings' Ratings Definitions – August 10, 2020

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

Ratings List

New Ratings; Outlook Assigned

ECOVE Environment Corp.	
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.