Bulletin:

TSMC's High Growth, Rising Margins Will Help It Absorb Higher Capital Expenditure

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PRIMARY CREDIT ANALYST

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

SECONDARY CONTACT

Raymond Hsu, CFA
Taipei
+886-2-2175-6827
raymond.hsu
@spglobal.com
raymond.hsu
@taiwanratings.com.tw

Taiwan Ratings Corp. said today that **Taiwan Semiconductor Manufacturing Co. Ltd.** (TSMC; twAAA/Stable/twA-1+) has sufficient financial headroom to support higher capital expenditure over the next 24 months. This will likely prevent material deterioration in TSMC's debt leverage over the same period.

The company announced plans to increase its capital expenditure for 2021-2023 to US$100 billion to capture high growth in leading and specialty technology nodes, enhance its geographic footprint, and expand new business lines. We had previously forecast a much lower level of capital expenditure for the period. Nonetheless, we believe TSMC's EBIDTA margin will also increase over the period, which could absorb much of the proposed rise in capital expenditure.

The current up-cycle in the semiconductor industry will continue to benefit TSMC through at least 2022, given still-strong demand from significant global investments in 5G networks, high performance computing, and electrical vehicles. The continued popularity of work from home amid the ongoing pandemic along with its clients' response to geopolitical risks add to demand for TSMC's products. We now forecast this demand will boost TSMC's revenue by 14%-18% annually in 2021 and 2022, which is substantially higher than our previous forecast of 5%-10% annually. We also forecast the EBITDA margin will climb to 67.5%-69.5% in 2021-2022, from 67.3% in 2020.

The company is likely to continue to raise its average selling prices over the rest of 2021, and likely 2022, supported by robust demand and a growing revenue contribution from demand for chips using 5 nanometer process technology. TSMC will also keep its utilization at a high level of 93%-95% over the next two years, even as it ramps up capacity for its most advanced technology nodes. In addition, we do not believe that a likely softening in COVID-19 related demand for PCs and networking equipment in 2022 will materially weaken TSMC's revenue amid still-strong demand from 5G mobile communications, internet of things and cloud computing.

The proposed capital expenditure could lead to negative discretionary cash flow of new Taiwan dollar (NT$) 50 billion-NT$150 billion annually in 2021-2023. However, our base case forecasts that TSMC will remain debt free on an adjusted basis over the period, given the strengthening operating cash flow and ample cash on hand.