Media Release

Walsin Lihwa Corp. Assigned 'twA-/twA-2' Ratings; Outlook Stable

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Rating Action Overview

- Walsin Lihwa is a Taiwan-based stainless steel and wire and cable manufacturer, with EBITDA of new Taiwan dollar (NT$) 10.5 billion in 2020.
- The company's small operating scale and fewer value-added products than peers constrain its business profile; however, the integration of upstream mining resources and downstream industrial-level cables partly offsets these weaknesses. Walsin Lihwa's profitability is likely to improve and stabilize from the second half of 2021 because of its nickel resources in Indonesia.
- Debt leverage as measured by the ratio of debt to EBITDA, could weaken slightly to 3.3x-3.8x in 2021 due to higher capital expenditure for facilities upgrades and capacity expansion. Nonetheless, strengthening profitability from its nickel resource could improve debt leverage from 2022. Meanwhile, the company's investment property and equity method investments provide additional financial flexibility and enhance the credit profile.
- We have assigned our 'twA-' long-term and 'twA-2' short-term issuer credit ratings to Walsin Lihwa.
- The stable outlook reflects our view that Walsin Lihwa could improve its profitability through its nickel resource in Indonesia, which should prevent the ratio of debt to EBITDA weakening to close to 4x due to high capital expenditure over 2021-2022.

Rating Action Rationale

Small operating scale and limited product offerings constrain its competitive position. The company's production capacity for stainless steel is relatively small compared to regional peers. Limited product offerings with fewer value-added products lead to its profitability from the metals sector relatively thin and volatile, given the highly volatile nature of the steel industry.

Walsin Lihwa's capacity for stainless steel at close to one million tons a year is smaller than its regional peers with comparative annual capacity for Yieh United Steel Corp. of close to three million tons and 1.8 million tons for Guangyang Antai Holdings Ltd. out of its combined annual capacity of five to six million tons. Guangyang Antai's product offerings are also more diversified than Walsin Lihwa's and includes stainless and carbon steel.

Despite its small operating base, Walsin Lihwa is likely to focus on enhancing its operating efficiency and increasing its high value-added products. This strategy could help the company to penetrate the automotive or high-tech sectors, although the required certification process to realize such a plan could take three to five years. Meanwhile, facility upgrades for Walsin Lihwa's plants in China will enable the company to increase production integration and enhance its cost structure.

Multiple businesses lines somewhat alleviate Walsin Lihwa's competitive weakness. In addition to its core stainless steel business, the company is engaged in various business lines including cable and wiring, solar energy related engineering and construction, property investment, and other long-term equity method investments. Non-metal related businesses and investments could help to enhance Walsin Lihwa's EBITDA generation base and lower the volatility of its overall cash flow generation. That's because some of its business areas are stable, such as property leasing. In addition, its industrial cables business could also generate higher and more stable profit, supported by its good reputation of its product quality and long-term business relationship with its major customers. We forecast EBITDA breakdown in 2021 could be about 60% from metals, 10%-15% from cable and wiring (mainly industrial cables), and 6%-10% each from property, engineering and construction, and cash dividend from equity method investments.

Integration of upstream nickel resource should deliver better and more stable profitability. The capacity of Walsin Lihwa's new nickel pig iron processing plant in Indonesia is 36,000 tons annually, which could meet over half the company's nickel demand. Full operation is likely to commence from the second half of 2021. We believe that access to this nickel resource could largely reduce the risk of volatility of the company's material cost for stainless steel products. This should lead to higher and more stable profitability for the company's overall stainless-steel business. Gross profit for the nickel resource could be 3x-4x higher than that of stainless-steel making, because only this specific geographic area of the world can supply the raw materials for nickel production.

Financial leverage to weaken temporarily in 2021, while cash flow volatility should stabilize. Walsin Lihwa's debt leverage (measured by the ratio of debt to EBITDA) could weaken slightly to 3.3x-3.8x in 2021 from 3.1x in 2020 due to higher capital expenditure (capex) to upgrade facilities for stainless steel and wire and cabling production while adding some capacity expansion. Walsin Lihwa's capex plan should peak in 2021 and 2022, with an amount close to NT$10 billion in each year. However, the commencement of its nickel pig iron operations from the second half of 2021 is likely to boost EBITDA generation and improve debt leverage to 2.9x-3.4x in 2022.

The company's cash flow generation has been very volatile over the past three years due to the residential property sales business and business volatility related to the stainless-steel market. We do not foresee the sale of additional properties over the next two years, because almost all residential properties in Walsin Centro were sold in 2020. Besides, Walsin Lihwa intends to maintain its current real estate portfolio (shopping mall and office building) for leasing, rather than for sale. Accordingly, we believe cash flow volatility will largely stabilize over the next two years.

Investment property and equity method investments to provide stronger financial flexibility. Walsin Lihwa's investment property portfolio in Taiwan and China, has a book value of NT$17 billion – NT$19 billion, which 50%-55% of it has an appraisal value of NT$33.7 billion as of the end of March 2021. This should help the company to weather unexpected business downturns over the next few years. The company's equity method investment portfolio provides an additional source of financial flexibility, with a book value of NT$34.4 billion as of the end of March 2021. However, we view such equity method investments are strategic and we believe the company will only disposed of these under a very extreme stress event.

Outlook

The stable outlook reflects our forecast that Walsin Lihwa's average ratio of debt to EBITDA could stay at 3x-3.5x over the next two years, despite a temporary decline to 3.3x-3.8x in 2021. The decline reflects rising debt from high capex for facilities upgrades and capacity expansion and a lack of high profits from residential property sales. Nevertheless, the company's EBITDA margin should recover moderately in 2022 to partly offset the risk of rising debt leverage thanks to the contribution of the nickel processing plant in Indonesia.

Downward scenario

We may lower the rating on Walsin Lihwa if the ratio of debt to EBITDA falls close to 4x for an extended period. The likely scenarios for this are:

- More aggressive capex or investment plans than our current expectation,
- an industry downturn with contraction in demand and intensifying competition, or
- lower return on its capex and investment than we forecast, such as the result of an unsuccessful technology upgrade or development delay for its high value-added products.

Upward scenario

The likelihood of a rating upgrade is low over the next one to two years due to high planned capital expenditure over this period and its impact on credit metrics. However, we may raise the rating if the company can sustainably strengthen its profitability through its nickel resource or an increased proportion of high value-added products. Evidence of such an achievement could be:

- the company's EBITDA margin stays above 12% consistently, and
- ratio of debt to EBITDA materially to below 3x through disciplined capex and restrained cash dividend payout.

Our Base-Case Scenario

- S&P Global forecast for Taiwan's economy to expand 5.6% in 2021, 2.7% in 2022, and 2.5% in 2023, and China's to expand 8.3% in 2021, 5.1% in 2022, and 5.0% in 2023. Strong GDP growth should support stainless steel and wiring and cable demand over the next two years.
- S&P Global's forecast for copper price of US$9,000/ton in 2021 and US$8,500/ton in 2022; similarly for the nickel price of US$15,500/ton in 2021 and US$15,000/ton in 2022.
- Walsin Lihwa's revenue to grow 30%-35% in 2021 supported by robust steel price and nickel resource in Indonesia from second half 2021. Revenue could largely remain stable in 2022, reflecting full year operation of nickel resource that mitigates the negative impact of steel price downward revision.

- Revenue from stainless steel and nickel to grow 60%-70% from the new nickel pig iron processing plant and 35%-40% growth in average sales price and 8%-12% volume growth in stainless steel sales in 2021. Stable revenue in 2022 despite 13%-18% decline in average sales price for stainless steel amid increasing regional capacity and lower material prices. However, this could be mitigated by full-year revenue from the new nickel resource.
- Revenue for wiring and cables to grow by double-digit, lifted by higher average sales price amid rising the copper price with sustainable domestic demand for green energy construction and private investments.
- Revenue from property department to drop by over 50% in 2021, given no more residential property sales, but expand 3%-5% in 2022 through rental income from a new office building and recovering performance of its shopping mall.
- Revenue from solar technology to decline up to 5% in 2021, reflecting slower sales progress due to cheaper alternative energy and slower construction capped by material supply. Revenue could recovery up to 5% in 2022, supported by long-term green energy development policies in the U.S. and a more flexible sales strategy to acquire more customers.

- Gross margins before depreciation and amortization could soften to 10%-12% in 2021-2022, down from 13.3% in 2020. This reflects no more high profit from residential property sales but improving profit from product mix changes and support from the nickel processing business could partly offset this drop.
- Ratio of selling, general and administrative expenses to overall expenses of 3.5%-4.0% in 2021-2022, down from 4.5% in 2020, thanks to better economies of scale from the new nickel business unit.
- Capex of NT$9 billion-NT$11 billion in 2021 and NT$8 billion-NT$10 billion for 2022 mainly for the new nickel processing plant in Indonesia, facility upgrades in China and Taiwan, and capacity expansion for stainless steel.
- Working capital outflow of NT$2 billion-NT$3 billion in 2021 and NT$1 billion-NT$2 billion in 2022, mainly to construct the office building of Walsin Centro in Nanjing, China.
- NT$3.1 billion dividend payout in 2021 and about 45% dividend payout ratio after 2021.

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

- EBITDA margin of 6.5%-8.5% in 2021 and 8.0%-9.5% in 2022.
- Debt to EBITDA of 3.3x-3.8x in 2021 and 2.9x-3.4x in 2022.
- EBITDA interest coverage of 19x-21x in 2021 and 23.5x-26.5x in 2022.

Liquidity

The short-term issuer credit rating is 'twA-2'. We believe the company has adequate liquidity reflecting a ratio of liquidity sources to liquidity uses of about 1.2x over the next 12 months ending March 2022. We also believe the company will have positive liquidity sources minus uses, even if its EBITDA declined by 15%.

In addition, we believe Walsin Lihwa has a solid relationship with banks, as evidenced by the low interest rate on its bank loans. This view is also supported by the company's satisfactory standing in the credit markets, given its good market position. In our view, the company has generally prudent risk management to ensure continued adequate liquidity. This view is supported by its sufficient undrawn bank credit lines and flexibility to increase bank facilities. Walsin Lihwa's bank loans carry some financial covenants but we believe the company will meet these with sufficient headroom over the next one to two years.

Principal Liquidity Sources

- Cash and short-term investments of NT$14.2 billion at the end of March 2021.
- Undrawn bank lines of NT$1.5 billion-NT$2.5 billion up to March 2022.
- Funds from operations of NT$9 billion-NT$10 billion up to March 2022.
- Committed mid-term bank lines of NT$11 billion-NT$12 billion up to March 2022.

Principal Liquidity Uses

- Long-term debt amortization plus short-term debt maturity of NT$16.4 billion up to March 2022.
- Working capital outflow of NT$1.5 billion-NT$2.5 billion up to March 2022
- Capex of NT$9 billion-NT$10 billion up to March 2022.
- Cash dividend of NT$3.1 billion up to March 2022.

Rating Score Snapshot

Issuer Credit Rating: twA-/Stable/twA-2
Note: All scores are in comparison with global obligors.

Business risk: Fair
- Country risk: Intermediate
- Industry risk: Moderately high
- Competitive position: Fair

Financial risk: Significant
- Cash flow/Leverage: Significant

Anchor: twbbb+

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

Stand-alone credit profile: twa-

Related Criteria & Research

Related Criteria

- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities - November 13, 2012
- Criteria | Corporates | General: Corporate Methodology - November 19, 2013
- Criteria | Corporates | General: Corporate Methodology: Ratios And Adjustments - April 01, 2019
- Criteria | Corporates | General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers - December 16, 2014
- General Criteria: Methodology: Industry Risk - November 19, 2013
- General Criteria: Country Risk Assessment Methodology And Assumptions - November 19, 2013
- General Criteria: Group Rating Methodology - July 01, 2019
- General Criteria: Methodology For National And Regional Scale Credit Ratings - June 25, 2018
- General Criteria: Principles Of Credit Ratings - February 16, 2011

Related Research

- Taiwan Ratings' Ratings Definitions – August 10, 2020

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

Ratings List

New Ratings

Walsin Lihwa Corp.	
Issuer Credit Rating	twA-/Stable/twA-2

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.