Media Release:

Outlooks On Chang Chun Plastics, Chang Chun Petrochemical Revised To Positive On Improving Financial Strength; Ratings Affirmed

November 4, 2021

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Rationale Action Rationale

- Taiwan-based Chang Chun group, which consists of **Chang Chun Plastics Co. Ltd.** and **Chang Chun Petrochemical Co. Ltd.,** is a specialty chemicals and commodity chemicals manufacturer with a wide range of products and EBITDA of NT$41.7 billion in 2020.
- We revised our rating approach for the two companies to correct a misapplication of our Group Rating Methodology. We now assess the group status of the two companies as highly strategic because of their looser linkage than in a typical group, which indicates a lower likelihood of mutual support. As such, the ratings on the two companies are one notch below their proxy group credit profile (GCP).
- Chang Chun group is likely to maintain relatively strong profitability and cash flow generation over the next few quarters because of favorable market conditions. This could continue to strengthen their credit metrics beyond our base case for the GCP.
- We have revised our rating outlooks on the two companies to positive from stable. This reflects the likelihood that the group will materially improve its debt-to-EBITDA ratio to below 0.5x over the next two years, given the group's strong profitability and debt reduction strategy.
- At the same time, we affirmed our 'twAA-' long-term and 'twA-1+' short-term issuer credit ratings on Chang Chun Plastics and Chang Chun Petrochemical.

Rating Action Rationale

We now view the group status of the two Chang Chun companies' as highly strategic rather than core, indicating a lower likelihood of mutual support. We revised our rating approach for the two companies to use our Principle of Credit Ratings criteria to assess and assign a proxy GCP. This replaces the Group Ratings Methodology we previously applied. We continue to assess the two companies' proxy GCP based on the pro forma consolidated financials of their audited consolidated statements in order to assess the credit quality of the two companies. This is based on our view that the companies will support each other in times of financial stress, given that they share common ownership, integrated operations, common services on administrative affairs, significant coordination in their strategic direction, and shared group name.

However, we now assess each of the two companies as a highly strategic unit rather than our previous assessment of core. As such, the rating on the two companies is one notch below the proxy GCP. This is based on our view that the linkage among the companies is looser than in a typical group because there is no centralized parent or any binding mechanism, such as cross guarantees or pooling of cash, to ensure that support will continue to flow among the entities in times of financial stress. As such, we believe there is no certainty that the companies would provide financial support to each other under any foreseeable circumstances.

Chang Chun group should maintain its relatively strong performance over the next one to two quarters. However, its ability to perform well sustainably over the next two years is uncertain. Chang Chug group's combined revenue increased by nearly 90% year on year for the first half of 2021, with a very strong EBITDA margin at 40.6%. This was mainly due to skyrocketing average selling prices for various products since March 2021. These prices reflected insufficient supply of some key raw materials, mainly in the U.S. and EU, and resulted in early downstream inventory replenishment. Another factor was a low base for the group's sales in the same period of 2020.

Chang Chun group could maintain its very strong performance throughout 2021 as Western economies recover. Extreme weather in the U.S. in the first quarter of 2021 also benefited the group's sales. We now expect the group's revenue to increase by 60%-70% in 2021, mainly driven by a recovery in sales volumes and materially strengthening product prices. The favorable market conditions and Chang Chun group's improving portfolio mix could help the group improve its EBITDA margin at moderately above 30% in 2021, which is much higher than 22.7% in 2020, and higher than our previous base-case scenario for the group.

We believe strong demand for the group's products could normalize over the next two years, which should narrow its currently strong EBITDA margin. Nevertheless, the group's significant expansion in fine chemicals for auto, industrial, medical, electronics, and semiconductor manufacturing in Taiwan, China, and Singapore could help sustain margins. This could partially offset margin pressure due to normalizing product prices when the market recovers to normal levels.

Chan Chun group's financial buffer is strengthening but faces uncertainty due to financial policy and capital expenditure plans. Chang Chun group will likely reduce its debt largely through its improving operating cash flow, even with moderately higher capital expenditure (capex) and cash dividend payouts over the next one to two years. However, there's still some uncertainty for the group's financial leverage over the next two to three years given the group’s growth appetite and expanding capex plans.

Given that the two flagship companies of the group are not listed, therefore, they should be able to maintain their disciplined dividend policy without pressure from equity investors. As such, the group's financial headroom for potential market volatility should increase.

In our base case, we factored in new NT$20 billion-NT$25 billion per year capex for the group over 2021-2023, for expansion in copper foil, vinyl acetate-ethylene (VAE) and VAE powder, and electronic chemicals for semiconductors, such as electronic grade hydrogen peroxide and tetramethylammonium hydroxide (TMAH). With some expansion not factored in our base case estimates due to uncertainty, the group is still likely to spend more than what we expect, and this could lead to higher debt levels over the next two to three years.

Nevertheless, incorporating a stronger performance, we now forecast the group's debt-to-EBITDA ratio to close to 0x over the next one to two years, compared with our previous estimate of 0.5x over 2021-2022, and therefore, we raised the proxy GCP to 'twaa' from 'twaa-'.

Outlook

The positive rating outlooks on Chang Chun Plastics and Chang Chun Petrochemical are based on our assessment that the Chang Chun group will likely continue to improve its ratio of debt to EBITDA materially below 0.5x over the next two years. We also believe the group will keep its EBITDA margin at about 30% in 2021 and close to 20% in 2022. Chan Chun group is also likely to sustain its good cash flow generation to support its planned expansion in China, Taiwan, and the U.S., even though the market will likely normalize from 2022 onward.

Upside scenario

We may raise the long-term ratings on the two group companies if the group can keep its ratio of debt to EBITDA materially below 1x while sustaining very low financial leverage through the business cycle. This may be achieved by the following scenarios:

- Chang Chun group continues to improve its financial strength with relatively strong profitability and positive discretionary cash flow to lower its debt level; and
- The group demonstrates its commitment to maintaining a high level of financial buffer through a more conservative financial policy, including its cautious expansion plan and disciplined dividend distribution policy.

Downside scenario

We may revise the rating outlooks back to stable if the Chang Chun group's performance materially deviates from our base case and it fails to improve its debt to EBITDA ratio over the next two years. The likely scenarios for this to occur are:

- The group takes on more aggressive cash dividend payments or expansions that are substantially beyond our base case, or;
- A suddenly reverse market condition or a substantial weakening in the group's market position or cost competitiveness that weakens its profitability and cash flow materially.

Our Base-Case Scenario

- Taiwan's GDP to grow by 5.5% in 2021 and 2.9% in 2022. China's GDP to grow by 8.0% in 2021 and 5.1% in 2022.
- S&P Global assumes Brent crude oil to be around US$65 per barrel for the rest of 2021 and US$60 per barrel for 2022. The higher oil price assumption suggested commodity chemical prices will increase substantially in 2021 compared with levels in 2020.
- Chang Chun group's revenue to grow by 60%-70% in 2021, mainly driven by a recovery in sales volume and materially strengthening product prices. Revenue to decline by 20%-30% in 2022 as the market normalizes.
- The group's sales volume to grow by 5%-10% in 2021 and by low-single-digit percentages in 2022, supported by the group's planned capacity expansion, as well as good demand for part of the group's product lines amid the COVID-19 pandemic, such

as electric chemicals for semiconductors and Bisphenol A-Epoxy resin used for wind power generation.

- The group's blended average selling price (ASP) will stay at a relatively high level in 2021 and decline moderately in 2022. Supply shortage of some key raw materials and demand from downstream inventory replenishment will support the high ASP in 2021.
- The good supply and demand market condition for part of the group's business lines such as phenol and derivatives and butanediol/tetrahydrofuran should support the group's good gross margin at very high level throughout 2021, despite higher input costs.
- Capex will be higher at NT$25 billion in 2021 to support the group's expansion plan. This is partly to reflect some delayed capex in 2020. We also assume NT$20 billion capex per year over the following few years.
- Cash conversion cycle remains unchanged.
- Cash dividend payout ratio will be lower at about 40% of previous year's net income.

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

- EBITDA margin of 30%-33% in 2021 and 18%-20% in 2022, versus 22.7% in 2020.
- Ratio of debt to EBITDA of 0.4x-0.2x in 2021 and 0.2x-0x in 2022, versus 0.7x in 2020.

Liquidity

The short-term ratings on the two key companies of Chang Chun group are 'twA-1+'. We assess the ratio of liquidity sources to uses at 1.7x- 1.8x for the 12 months ending June 30, 2022, and still at above 1.5x over the next 12-24 months. The liquidity profile incorporates our view that liquidity sources will continue to exceed uses even if the group's EBITDA were to decline by 30%. This also reflects our view that the group has a sound business relationship with banks in Taiwan due to its credit standing. We do not foresee the group will experience difficulties renewing its short-term debts or establishing new bank loan facilities. Chang Chun group can absorb high-impact, low-probability events with limited refinancing given its high cash balance and improving cash flow. We also believe the company will maintain prudent financial management to sustain its strong liquidity.

Principal liquidity sources

- Cash and short-term investment: NT$48 billion as of the end of June 2021.
- Funds from operations of NT$55 billion-NT$60 billion over the 12 months ending June 30, 2022.

Principal liquidity uses

- Debt maturities of about NT$20 billion in the next 12 months ending June 30, 2022.
- Capex of NT$20 billion-NT$25 billion annually over the next 24 months.
- Working capital outflow of NT$5 billion-NT$10 billion in the next 12 months ending June 30, 2022.
- Cash dividend payout of about NT$8 billion in the next 12 months.

Ratings Score Snapshot

Issuer Credit Rating: twAA-/Positive/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: Modest

- Cash flow/Leverage: Modest

Anchor: twaa

Modifiers

- Diversification/Portfolio effect: Neutral (no impact)
- Capital structure: Neutral (no impact)
- Liquidity: Strong (no impact)
- Financial policy: Neutral (no impact)
- Management and governance: Satisfactory (no impact)
- Comparable rating analysis: Neutral (no impact)

Stand-alone credit profile: The operating units of the Chang Chun group have not been assigned an SACP.

- Group credit profile: twaa
- Entity status within group: Highly Strategic

Related Criteria & Research

Related Criteria

- General Criteria: Environmental, Social, And Governance Principles In Credit Ratings, Sun Oct 10 2021
- General Criteria: Group Rating Methodology, Mon Jul 01 2019
- Criteria | Corporates | General: Corporate Methodology: Ratios And Adjustments, Mon Apr 01 2019
- General Criteria: Methodology For National And Regional Scale Credit Ratings, Mon Jun 25 2018
- Criteria | Corporates | General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issu-ers, Tue Dec 16 2014
- General Criteria: Country Risk Assessment Methodology And Assumptions, Tue Nov 19 2013
- General Criteria: Methodology: Industry Risk, Tue Nov 19 2013
- Criteria | Corporates | General: Corporate Methodology, Tue Nov 19 2013
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities, Tue Nov 13 2012
- General Criteria: Principles Of Credit Ratings, Wed Feb 16 2011

Related Research

- Taiwan Ratings' Ratings Definitions – August 10, 2020

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

Ratings List

Outlook Revision; Ratings Affirmed

	To	From
Chang Chun Plastics Co. Ltd.		
Issuer Credit Rating	twAA-/Positive/twA-1+	twAA-/Stable/twA-1+
Chang Chun Petrochemical Co. Ltd.		
Issuer Credit Rating	twAA-/Positive/twA-1+	twAA-/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.