Media Release:

Taiwan Railways Administration 'twAAA/twA-1+' Ratings Affirmed; SACP Lowered On Weak Passenger Traffic; Outlook Stable

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Rating Action Overview

- **Taiwan Railways Administration, MOTC** (TRA) is the national conventional railway network operator in Taiwan, with EBITDA of NT$2.91 billion in 2020.
- The negative impact of the COVID-19 pandemic on passenger volume has pressured TRA's revenue and EBITDA margin since 2020. Given that an asset development plans will take years to generate sufficient cash inflow for sustainable and material debt reduction, we have lowered the agency's stand-alone credit profile to 'twbbb' from 'twbbb+'.
- We have affirmed our 'twAAA/twA-1+' issuer credit ratings on TRA, given our continuing view that the agency would receive almost certain timely financial support from the Taiwan government, as needed.
- The stable outlook reflects our view of TRA's critical policy role and integral link to the government.

Rating Action Rationale

Slow progress of asset and land development won't meaningfully improve TRA's cash flow generation over the next two years. TRA owns many land and property assets surrounding its 225 train stations. These assets created over new Taiwan dollar (NT$) 3.8 billion of rental income in 2019 and 2020. Some asset development projects have been ongoing for over ten years due to the complex process to approve such development projects. Although the benefit of land asset development is considerable and likely to improve TRA's debt leverage significantly, the timeline and value remain uncertain. this is because they are subject to market conditions, revenue processes, and slow progress in amending the Railway Act. In addition, the combination of TRA's growing labor costs and a long-term freeze on ticket fares largely offsets the benefits of such plans amid declining passenger volume over the past year. We therefore believe that a substantial reduction in TRA's debt is unlikely over the next two to three years. Accordingly, we have lowered our assessment of TRA's stand-alone credit profile (SACP) to 'twbbb' from 'twbbb+' to reflect the potential delay in improvement of the agency's financial position.

Debt grew materially in 2020-2021 amid weak passenger revenue and TRA's high fixed costs. Passenger volume declined 13.8% year on year in 2020, and a further 27.5% in the first nine months of 2021 due to restrictions on peoples' movements imposed by the government of Taiwan (unsolicited; 'AA/Positive/A-1+' assigned by S&P Global Ratings). In May 2021, the government placed the nation under level 3 restrictions to control the spread of the pandemic. High fixed costs for railway services coupled with continued operating losses have increased TRA's debt accumulation in 2021. The agency's debt increased by 10% to NT$209.8 billion in September 2021 from NT$190.9 billion at the end of 2019. Although Taiwan's vaccination rate has improved rapidly throughout the year, passenger volume for 2022 is unlikely to recover to the pre-pandemic level despite the increased capacity of new rolling stock. Passengers could once again avoid rail travel if confirmed local cases of the pandemic increase and do so aggressively. This interruption to passenger revenue would significantly weaken TRA's cash flow generation and accelerate the agency's debt growth.

Taiwan government will likely strengthen its financial support for TRA to help offset a potential debt increase. The government aims to transform TRA in to a fully-state-owned enterprise in three-years to enhance the agency's operating safety and efficiency. However, this may take longer than planned and is subject to the mutual agreement with labor union of the terms of transformation. To achieve that, the government will increase its support for TRA's pension burden. The government will gradually cover the agency's accumulated losses by NT$3.9 billion annually and subsidize interest derived from pension burden to a value of NT$794 million from 2022. This is just one measure to help prevent the agency from a debt increase when passenger volume returns to the pre-pandemic level.

TRA to maintain an essential role and integral link with the Taiwan government, given the public's daily reliance on TRA's services. The agency's lead market share in public transportation is unlikely to change anytime soon. That's because TRA owns a comprehensive network, conveniently located train stations, and a dominant position on the east coast of Taiwan. This could temper its policy burden in terms of frozen fare rates, discounts for the elderly and disabled, and maintenance of loss-making routes and stations. In addition, the government has agreed to compensate TRA to the tune of NT$0.574 billion-NT$1.053 billion for losses incurred on unprofitable routes and stations in 2021 and 2022.

Outlook

The stable rating outlook on TRA reflects our view that the agency's creditworthiness is equal to that of the Taiwan government. That is because of the agency's critical policy role in managing and operating the nation's conventional rail network on behalf of the government, and our view that TRA's integral link with the government will remain unchanged over the next two years.

A slump in passenger traffic and TRA's ongoing policy burden have weighed on its financial strength, given its very weak cash flow generation and high debt level in 2021. We expect TRA's debt to remain high in 2021-2022, despite a significant government subsidy for its employee pension from 2022 onwards. This is due to the likely slow recovery in passenger traffic, TRA's slow asset development plans, and continuous capital expenditure needs.

Downward scenario

Downgrade risk is very remote over the next two years. That's because any material changes in TRA's policy role and link to the government is unlikely to occur during the period. However, we would lower long-term rating on TRA if:

- S&P Global Ratings lowers its unsolicited long-term issuer credit rating on Taiwan by more than two notches, or
- TRA's policy role or link to the Taiwan government weaken such that we believe there is reduced likelihood of extraordinary government support. Privatization of the rail infrastructure would indicate such a weakening of potential support.

Our Base Case Scenario

- Growth in Taiwan's real GDP of 5.8% in 2021, 2.8% in 2022, and 2.6% in 2023. Nevertheless, we believe that even if GDP growth could enhance peoples' consumption, the fear of COVID-19 and the Taiwan government's prevention measures will constrain improvement in ridership.
- TRA's revenue to decline by 14%-16% in 2021 due to a significant decline in passenger volume. Nonetheless, TRA's revenue should rebound in 2022 with 28.5%-30.5% growth as ridership recovers to close to the level in 2020. The government's NT$1.85 billion subsidy associated with unprofitable routes and interest derived from TRA's pension scheme will support revenue improvement from 2022 as well.
- Seat utilization and passenger revenue to drop significantly in 2021 due to lower demand. We expect seat utilization to greatly recover to 55%-57% in 2022 and 58%-61% in 2023, given the pandemic is now well controlled. The higher capacity of new cars will partly offset this rise.
- Rental income to grow by 0%-2% per year in 2021-2023 due to stagnant market conditions and the lengthy process to complete land asset development.
- Taiwan government to subsidy NT$3.93 billion for TRA's burden of the Labor Retirement Reserve Fund (The Old Fund) to cover accumulated deficits from 2022.
- TRA's operating costs excluding depreciation and amortization to increase 0.5%-2.0% in 2021 and 4.0%-5.0% in 2022, mainly due to salary increase and rising labor costs to support looser working shifts and service enhancement.
- The government's approved expansionary capital expenditure for TRA of NT$24.8 billion for 2021, NT$20.5 billion for 2022, and NT$44.6 billion for 2023, among which NT$20.4 billion, NT$15.6 billion, and NT$40.1 billion, respectively, will be funded by the government.

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

- EBITDA margin of negative 3% to negative 5% in 2021, down from positive 12.2% in 2020, then recover to positive 16%-18% in 2022-2023.
- Ratio of funds from operations to debt of negative 0.5% to negative 1.0% in 2021, down from positive 1.1% in 2020, then recover to positive 1.5%-2.5% in 2022-2023.
- Funds from operations cash interest coverage of negative 0.5x to negative 1.5x in 2021, down from positive 4x in 2020 but improving to positive 6x-8x in 2022-2023.

Liquidity

The short-term rating on TRA is 'twA-1+'. We believe the agency has adequate liquidity based on our view that it will continue to benefit from its status as an essential government related entity, the importance of which is indicated by the ongoing and strong financial support from the Taiwan government.

Based on TRA's track record, when private-owned banks are unwilling to roll over the agency's short-term debt due to very thin margins, state-owned banks will step in and provide additional short-term refinancing needs. Moreover, the government will allocate budgeted funds in sufficient time to help TRA roll over its short-term debt as needed. Therefore, we believe the agency will continue to benefit from preferential access to banking facilities. This is also demonstrated by its strong debt rollover capabilities in the past and the low interest rate on its bank loans and commercial papers. These factors underpin our view that TRA has the ability to achieve a ratio of liquidity sources to uses above 1.2x up to the end of September 2021. TRA has no covenant placed on its debt.

Principal liquidity sources

- Cash and short-term investments of NT$781.9 million at the end of September 2021.
- Ongoing government support (credit lines of government related banks) of NT$185 billion-NT$190 billion up to September 2022.
- Government investment of NT$14 billion-NT$18 billion up to September 2022.

Principal liquidity uses

- Debt maturities of NT$146.2 billion up to September 2022.
- Cash funds from operations of NT$100 million-NT$300 million up to September 2022.
- Working capital outflow of NT$1 billion –NT$2 billion up to September 2022.
- Capital expenditure of NT$20 billion-NT$23 billion up to September 2022.

Ratings Score Snapshot

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

Note: The descriptors below are on a global scale.

Business Risk: Satisfactory

- Country risk: Intermediate
- Industry risk: Low
- Competitive position: Satisfactory

Financial Risk: Aggressive

- Cash flow/Leverage: Aggressive

Anchor: twbbb

Modifiers:

- Diversification/Portfolio effect: Neutral (no impact)
- Capital structure: Neutral (no impact)
- 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: twbbb

- Related government rating: AA
- Likelihood of government support: Almost certain (+8 notches from SACP)

Related Criteria & Research

Related Criteria

- General Criteria: Rating Government-Related Entities: Methodology And Assumptions - March 25, 2015
- General Criteria: Methodology For National And Regional Scale Credit Ratings - June 25, 2018
- General Criteria: Environmental, Social, And Governance Principles In Credit Ratings - October 10, 2021
- General Criteria: Group Rating Methodology - July 01, 2019
- 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: 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: 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

Ratings Affirmed

Taiwan Railways Administration, MOTC	
Issuer Credit Rating	twAAA/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.