Research Update:

Taiwan Cogeneration Corp. Ratings Affirmed At 'twA-/twA-2'; Outlook Stable

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Rating Action Rationale

Taiwan Ratings Corp. today affirmed its 'twA-' long-term and 'twA-2' short-term issuer credit ratings on **Taiwan Cogeneration Corp.** (Taiwan Cogen). The outlook on the long-term rating is stable. The ratings on Taiwan Cogen are mainly supported by the company's low-risk business model involving Taiwan Cogen's four invested gas-fired independent power plants (IPPs). Minimum guaranteed hours and full cost-pass-through terms in the power purchase agreements between the IPPs and Taiwan Power Co. nearly eliminate risks associated with demand and price changes in natural gas. Nonetheless, the IPPs' cash dividend contribution to Taiwan Cogen could decline in 2022-2024 to support their capacity expansions.

In our view, Taiwan Cogen's growing renewable energy business could enhance the company's earnings stability over the next three to five years. These strengths are mitigated by Taiwan Cogen's less-stable cogeneration business, particularly given the prevailing high coal price. In addition, the company's high capital expenditure (capex) needs driven by planned capacity expansion in renewable energy will lead to a deterioration in Taiwan Cogen's credit metrics over the next two years.

Outlook

The stable rating outlook mainly reflects our expectation that Taiwan Cogen's ratio of funds from operations (FFO) to debt could recover to above 12% in 2023 from likely below 12% in 2022 given the potential for a narrower loss from the company's cogeneration business and an increasing contribution from its renewable power business. The ratio of FFO to debt could weaken temporarily in 2022 under our estimates, due to a reduction in the cash dividend Taiwan Cogen receives from IPPs along with the cogen business' limited capability to pass on the prevailing high coal price to its clients. The outlook also reflects the management team's intention to manage its leverage, as indicated by Taiwan Cogen's plan to control its debt leverage through equity injections in 2023 and 2024.

Downward scenario

We may lower the long-term rating on Taiwan Cogen if:

- The ratio of FFO to debt deteriorates to below 12% without the prospect of improvement, possibly due to aggressive capex without a corresponding capital injection that results in higher debt than we currently project, or Taiwan Cogen has a substantial operating loss, possibly due to a persistently high coal price that is not passed on through the sales price to reflect the cost increase;

- Taiwan Cogen's liquidity position deteriorates from the current adequate level, possibly due to a significant debt maturity without a sufficient long-term refinancing plan in place; or
- Volatility in the company's EBITDA increases. This may occur if the cash flow contribution from Taiwan Cogen's power generation business declines substantially due to a severe mechanical incident without sufficient insurance coverage, or if the company undertakes engineering and construction projects that incur large losses.

Upward scenario

We view the likelihood of an upgrade as remote over the next two years; however, we may raise the rating on Taiwan Cogen if:

- The company takes a more conservative approach in its capacity expansion or reduces its cash dividend payout materially, such that the ratio of FFO to debt improves to consistently above 25%.

Related Criteria & Research

Related Criteria

- 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
- Criteria | Corporates | Industrials: Key Credit Factors For The Unregulated Power And Gas Industry - March 28, 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 Cogeneration 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.