Media Release:

Chang Chun Plastics And Chang Chun Petrochemical Upgraded To 'twAA/twA-1+' On Sound Balance Sheet; Outlook Stable

May 30, 2022

Rating Action Overview

- 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.
- We forecast the group will maintain a net cash position through sustainable positive free cash flow despite a likely gradual decline in its profitability from the recent peak amid a weakening demand outlook and global capacity additions.
- We are therefore raising our long-term issuer credit rating on Chang Chun Plastics and Chang Chun Petrochemical to 'twAA' from 'twAA-'. At the same time, we affirmed the short-term issuer credit rating on the companies at 'twA-1+'.
- The rating outlook is stable to reflect our view that the two companies' relatively strong operating cash flow could support their (capex) capital expenditure needs and cash dividend payout, while at the same time sustaining the debt to EBITDA ratio comfortably below 1.0x thorough business cycles.

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Rationale Action Rationale

The group's strong operating cash flow has substantially lowered debt leverage for the group beyond our previous expectation. Chang Chun group's combined revenue increased by nearly 90% year on year in 2021, with a very strong EBITDA margin of 38.5%. This was mostly the result of skyrocketing average selling prices among almost all the group's products. These very high product prices reflected a supply shortage for some key raw materials due to several factors that resulted in downstream inventory replenishment. These factors included a severe winter storm in Texas, COVID restrictions, and several manufacturing accidents among major players.

Meanwhile, the group benefited from strong sales growth momentum from demand for copper foil and various chemicals including bisphenol A and polybutylene terephthalate resin and compound that are used in the manufacture of home appliances, information technology products, and renewable energy. This helped the group generate record high operating cash flow even with a much higher working capital outflow in 2021. Chang Chun group has a net cash position as of the end of 2021 and Debt to EBITDA of 0x, compared with our previous expectation of a debt to EBITDA ratio of 0.3x.

Profitability should moderate over 2022-2023 from the peak in 2021 but remain above the group's historical mid-cycle level. Chang Chun group's profitability is likely to remain above its typical mid-cycle level in 2022-2023, supported by still relatively strong product prices and still-favorable demand and supply conditions for some of the group's product lines. This is despite capacity additions--mostly in Asia--and recovering industry output that was interrupted by extreme weather events in the first half of 2021.

We also believe the Chinese government's more stringent environmental requirements and carbon neutral push will curb chemical production using more polluting processes, particularly coal-based chemicals. This could slightly alleviate the negative effect on the group's profitability of aggressive new additions by integrated chemical producers in China.

In addition, the group's significant expansion in fine chemicals for auto, industrial, medical, electronics, and semiconductor manufacturing in Taiwan, China, Singapore, and the U.S. could help sustain its margins and sightly reduce exposure to the high price volatility of commodity chemicals. Chang Chun group's improving portfolio mix could therefore help to sustain its EBITDA margin at 25%-28% in 2022 and 21%-24% in 2023, which is above the group's historical mid-cycle level of 15%-20%, but lower than the historical high of 38.5% in 2021.

Still-strong operating cash flow should support the group's prudent expansion and cash dividend needs while sustaining its net cash position. Chang Chun group could sustain its net cash position through still-strong operating cash flow even with moderately higher capex and cash dividends paid out over the next two to three years.

The group is likely to keep capex elevated at about new Taiwan dollar (NT$) 25 billion annually in 2022-2023. This will support capacity expansion mainly in copper foil, specialized engineering plastics, and fine chemicals used in the manufacture of semiconductors. The group could also use some capex to convert some of its coal-fired cogeneration units to gas-fired, as well as to support the group's expansion in the U.S. However, we believe the group will maintain a relatively prudent growth strategy and financial management, while at the same time maintaining its cash dividend payout ratio at roughly 50% of net income. These factors should increase the group's financial headroom for potential market volatility and help to sustain its net cash position in 2022-2023.

Outlook

The stable rating outlook on Chang Chun Plastics and Chang Chun Petrochemical reflects our assessment that Chang Chun group can maintain its positive free cash flow and net cash position even with moderately higher capex and cash dividend payouts for 2022-2023. We expect the group's profitability to decline over the next two years from the peak in 2021, given the likelihood of normalizing supply and demand conditions for most of the group's product lines. However, we also forecast the group to maintain far better profitability through business cycles than most of its regional peers, supported by the group's better product diversity and higher exposure to specialty chemicals such as fine chemicals for semiconductor manufacturing.

Downward scenario

We may lower the long-term rating on the two companies if the group's ratio of debt to EBITDA stays above 1.0x for an extended period. The likely scenarios for such a below-expectation performance are:

- a prolonged and deep industry downturn stemming from material oversupply, or a substantial weakening in the group's market position or cost competitiveness that weakens its profitability and cash flow materially; or
- the group takes on more aggressive cash dividend payments or capex that are substantially beyond our base case.

Upward scenario

We view the likelihood of a further upgrade as low over the next two years, given the group's exposure to commodity chemicals and still high business volatility. However, we may raise the rating if:

- the group can further expand its business scale, diversity and integration through a stronger product mix of high-margin specialty products, and stronger manufacturing efficiency. At the same time, the group would need to maintain its debt to EBITDA ratio substantially below 1.0x.

Our Base-Case Scenario

- Taiwan's GDP to increase by 2.8% in 2022 and followed by 2.6% in 2023. China's GDP to decelerate to 4.2% in 2022 but increase to 5.3% in 2023.
- Chemical companies could still largely pass-through rising input costs to sustain favorable margins, given demand remains strong. However, the pass-through ability could be weaker for companies that are more exposed to commodity chemicals facing significant capacity additions in the region.
- We expect Chang Chun group's revenue to decline by about 5% in 2022 and 5%-10% in 2023, mostly driven by generally declining product prices amid normalizing supply and demand conditions.
- The group's sales volume will be largely flat in 2022-2023. Increasing volume in some specialty chemicals and electronics chemicals will be offset by a decline in the oversupply of commodity products, such as Phenol and derivatives.
- The group's blended average selling price will start to normalize from the peak cycle level over the next two years. We assume a 5%-10% decline annually in 2022 and 2023.
- Likely declining prices for most product categories will weaken the group's gross margin to 30%-33% in 2022 and 27%-30% in 2023 as supply and demand conditions turn less favorable.
- We assume capex will remain high at NT$25 billion per year in 2022 and 2023.
- Cash conversion cycle to remain largely unchanged from 2021.
- 50% cash dividend payout, compared with an announced payout ratio of about 40% in 2022.

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

- EBITDA margin of 25%-28% in 2022 and 21%-24% in 2023.
- Positive cash flow for debt repayment of NT11billion-NT$16billion per year.
- Net cash position in 2022 and 2023.

Liquidity

The short-term rating on Chang Chun Group is 'twA-1+'. We believe that the group has strong liquidity to meet its needs over the next 24 months. We believe that the ratio of liquidity sources to uses will be 1.6x-1.7x for the 12 months ended Dec. 31, 2022, and above 1.0x for the next 12 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%. It also reflects our view that the group has a sound business relationship with banks in Taiwan due to its credit standing. We do not believe the group will have any difficulty to renew its short-term debts or establish new bank loan facilities. The group is also capable of absorbing high impact low probability events without financing support, in our view, given its relatively high cash on hand. Furthermore, we believe the group will maintain prudent financial management.

Principal Liquidity Sources:

- Cash and short-term investment of NT$71.4 billion as of the end of 2021.
- Funds from operations of about NT$ 70billion in 2022, and about NT$55 billion in 2023
- Working capital inflow of about NT$8 billion in 2022.

Principal Liquidity Uses:

- Debt maturities of about NT$28.8 billion in 2022.
- Capex of about NT$25 billion annually
- Cash dividend payout of about NT$35 billion in 2022

Ratings Score Snapshot

Issuer Credit Rating: twAA/Stable/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: Positive (+1 notch)

Stand-alone credit profile: The core operating units of the Chang Chun group have not been assigned a 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 - October 10, 2021
- General Criteria: Group Rating Methodology - July 01, 2019
- General Criteria: Methodology For National And Regional Scale Credit Ratings - June 25, 2018
- 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: Ratios And Adjustments - April 01, 2019
- 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

Upgraded

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