Media Release:

Taiwan Power Co. 'twAAA/twA-1+' Ratings Affirmed; SACP Lowered On Weak Profitability And Rising Debt; Outlook Stable

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Rating Action Overview

- A significant increase in fuel costs and rising green power purchases are likely to result in large operating losses for **Taiwan Power Co.** (Taipower) in 2022 and 2023. This, together with the group's rising capital expenditure to shift its capacity mix and strengthen its power grid network, will lead to a rapid rise in debt beyond our previous forecast.
- Taiwan's government has not yet specified how to compensate Taipower for recent fuel cost-related losses. Nonetheless, we believe any such measures are unlikely to significantly reduce the losses, given the impact of sharp tariff hikes on inflation and the cap on tariffs under the current tariff-setting mechanism.
- We lowered our assessment of Taipower's stand-alone credit profile (SACP) to 'twbbb+' from 'twa-', which has no impact on the issuer credit ratings. This is because we maintained our view that Taipower has an almost certain likelihood of receiving extraordinary support from the Taiwan government due to the company's critical policy role to fulfill power supply for Taiwan's electricity needs.
- We affirmed our 'twAAA/twA-1+' issuer credit ratings on Taipower. We also affirmed our 'twAAA' long-term issue ratings on the company's unsecured common corporate bonds.
- The stable rating outlook on Taipower reflects the outlook on the issue credit rating on Taiwan.

Rationale Action Rationale

We lowered our assessment of Taipower's SACP to reflect the likelihood of large operating losses and a significant rise in debt during 2022 and 2023. The cost of fuel, including natural gas and coal, are likely to stay high over the next 12-18 months. Taiwan's capped electricity tariff adjustment system, if followed, is unlikely to fully cover the increased fuel costs during the same period, given our forecast of an about 100% increase in Taipower's fuel costs in 2022. In addition, we do not anticipate that the government would implement significantly larger tariff hikes than the cap in our base case, given the hit to inflation by such a move. It is currently unclear what measures the government could take to help Taipower mitigate the large losses beyond the existing tariff adjustment scheme.

Energy prices have been rising at a steeper pace in the first half of 2022 due to a recovery in demand from the COVID-19 pandemic and the Russia-Ukraine conflict. Taipower's fuel costs rose 93% year-on-year in the first four months of 2022, resulting in new Taiwan dollar (NT$) 46.9 billion in pre-tax losses during the same period. Taipower's fuel costs are likely to rise further for the rest of the year because CPC Taiwan Co., the major natural gas supplier to Taipower, further raised domestic natural gas prices significantly in May and June 2022. This would significantly deepen Taipower's operating losses for the rest of the year if energy prices do not moderate quickly in the second half of 2022.

The government has not adjusted tariffs since 2018 and Taipower has been able to manage the volatility in fuel prices with tariff stabilization reserves on its balance sheet. The government postponed the review of electricity tariffs in March 2022, but it is likely to conduct the review in the near term, given the sharp rise in energy prices. We forecast that the government will raise the electricity tariff over the next few quarters according to the existing tariff adjustment scheme. However, we believe this will not lead to adjustments in 2022 and 2023 that are sufficient to offset Taipower's losses, given the annual cap on tariff hikes and the lower probability of a quick reversal in international energy prices.

Taipower's capital structure could deteriorate faster than we previously anticipated. The company's debt level will grow substantially faster than we previously forecast due to operating losses and rising capital expenditure (capex) over the next two to three years. Taipower's profitability and cash flow have been under pressure due to rising green power purchases, which will increase to about NT$267 billion in 2026 from NT$41 billion in 2021. Taipower will also increase its capex more than we previously assumed over the next few years. The company will upgrade coal-fired power plants and add new gas-fired capacity to maintain a sufficient reserve margin after the retirement of its existing nuclear power plants. The company will also need to improve the reliability of its power grid network ahead of higher green power contributions and capacity.

Accordingly, we expect the company's debt level to rise significantly faster than we previously forecast and its interest coverage to deteriorate materially over the next two to three years, given weaker profitability and moderately rising interest rates. However, we do not anticipate Taipower's deteriorating capital structure and operating performance will have a material impact on its strong access to capital markets, given our assessment of its critical policy role for Taiwan. Company funding includes access to low interest rates on bank loans and corporate bonds.

The ratings on Taipower remain equalized with that on the government of Taiwan (unsolicited; AA+/Stable/A-1+ assigned by S&P Global Ratings). We believe that Taipower will maintain its critical role in carrying out the government's electricity policy and serving as a critical vehicle to achieve Taiwan's social and economic policy, particularly during crises such as the pandemic. Taipower will maintain its role in the provision of stable and sufficient electricity and Taiwan's transition to renewable energy, in our view, because the company is the sole provider of electricity transmission and distribution services and generates most of the electricity in the country. Due to these reasons, we believe that the government will continue to tightly control and monitor Taipower's operations and financial position to maintain its financial viability.

Outlook

The stable rating outlook on Taipower reflects the stable outlook on the sovereign (unsolicited; AA+/Stable/A-1+ assigned by S&P Global Ratings). The outlook also reflects our view that Taipower's critical role and integral link to the Taiwan government will not change over the next few years because of Taipower's critical mission to provide stable electricity supply at a competitive tariff through the country's isolated power grid. We believe the government's tolerance on electricity supply risk is minimal because the country's technology-heavy economy relies strongly on a stable and cost-competitive power supply.

Our assessment on Taipower's SACP reflects our view that tariff hikes will enable the company to gradually restore its profitability and credit metrics. However, significant downside risk to our base case remains. In addition, the company has strong access to capital markets in Taiwan to sustain its operations without any refinancing risk over the next two years, despite likely sizable operating losses during 2022-2023.

Downward scenario

We could lower the long-term rating on Taipower if the following scenarios occur:

- S&P Global Ratings lowers its unsolicited issuer credit ratings on Taiwan by more than four notches.
- Although unlikely over the next two to three years, we could also lower the rating if we believe that Taipower's importance to or relationship with the Taiwan government has weakened materially. Such a scenario could reflect more aggressive market liberalization that breaks Taipower's monopoly in power transmission, distribution and retailing, or a significant reduction in government ownership.

Our Base-Case Scenario

- Taiwan's GDP to grow 2.8% in 2022 and 2.6% in 2023, with power demand to grow by 1%-2%) in 2022.
- The current tariff adjustment scheme to remain in effect for 2022-2024 and the return on tariff basis to be 5%, given accumulated losses on Taipower's balance sheet.
- Average tariff to increase by about 3% in 2022 and 6% in 2023, based on the adjustment mechanism to reflect rising fuel costs and rapid increases in green power purchases.
- In aggregate, Taipower's revenues to grow 4%-5% in 2022 and 6%-8% in 2023.
- Fuel costs, including those of independent power producers, to increase by about 100% in 2022 but decline about 40% in 2023. Purchases of green power to increase to about NT$90 billion in 2022 and NT$107 billion in 2023, from NT$41 billion in 2021.
- Other operating and maintenance costs to grow by a 1%-3% each year in 2022-2023.
- Taipower's capex to increase to NT$190 billion-NT$200 billion in 2022 and NT$225 billion-NT$235 billion in 2023, mainly for new gas-fired power plants and renewable energy to replace retiring coal-fired and nuclear power plants, as well as improving network reliability.
- No cash dividends throughout the projection period.
- The blended interest rate on Taipower's debt to rise 20-30 basis points over the next two years.

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

- Ratio of funds from operations to debt to be negative in 2022 and 1%-3% in 2023.
- Negative EBITDA margin of be 5%-10% in 2022, before turning slightly positive in 2023.

Liquidity

The short-term rating on Taipower is 'twA-1+', reflecting the long-term issuer credit rating and our assessment of Taipower's liquidity is adequate. Our view reflects primarily the following factors:

- We believe that Taipower currently has sufficient cash flow to meet its needs, factoring in maintenance capex and ongoing government support in the form of the company's favorable access to local capital markets.
- The ratio of liquidity sources to uses will be about 1.1x-1.2x for 2022.
- Liquidity sources will continue to exceed uses even if Taipower's EBITDA were to decline by 10%
- The company has a sound business relationship with banks based on very low interest rates on its bank loans and unsecured corporate bonds. We do not expect Taipower to encounter difficulties in renewing its short-term debt or establishing new bank loan facilities, given its strong credit standing, underpinned by its status as one of the most important state-owned enterprises in Taiwan.
- The company's debt does not carry any financial covenants.

Principal liquidity sources:

- Cash and short-term investment of NT$1.9 billion as of the end of 2021; and
- Ongoing government support, in the form of state bank facilities and domestic bond issuance of about NT$570 billion to cover refinancing needs in 2022.

Principal liquidity uses:

- Debt maturities of NT$352 billion in 2022;
- Negative funds from operations of NT$120 billion-NT$140 billion in 2022;
- Maintenance capex of about NT$22 billion in 2022; and
- No cash dividend payout in 2022.

Ratings Score Snapshot

Taiwan Power Co.--Ratings Score Snapshot		
	To	From
Issuer Credit Rating	**twAAA/Stable/twA-1+**	**twAAA/Stable/twA-1+**
Business risk profile	**Strong**	**Strong**
Country risk	Intermediate	Intermediate
Industry risk	Very low	Very low
Competitive position	Satisfactory	Satisfactory
Financial risk profile	**Highly leveraged**	**Aggressive**
Cash flow/leverage	Highly leveraged	Aggressive
Anchor	twbbb+	twa-
Modifiers		
Diversification/Portfolio effect	Neutral (no impact)	Neutral (no impact)
Capital structure	Neutral (no impact)	Neutral (no impact)
Liquidity	Adequate (no impact)	Adequate (no impact)
Financial policy	Neutral (no impact)	Neutral (no impact)
Management and governance	Satisfactory (no impact)	Satisfactory (no impact)
Comparable rating analysis	Neutral (no impact)	Neutral (no impact)
Stand-alone credit profile	**twbbb+**	**twa-**
Government rating	AA+	AA+
Likelihood of government support	Almost certain (+7)	Almost certain (+6)

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
- Criteria | Corporates | General: Reflecting Subordination Risk In Corporate Issue Ratings - March 28, 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 | Utilities: Key Credit Factors For The Regulated Utilities Industry - November 19, 2013
- 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 Power Co.	
Issuer Credit Rating	twAAA/Stable/twA-1+
Unsecure common corporate bond	twAAA

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.