Bulletin:

TSMC Could Sustain Strong Profitability Amid Downstream Inventory Correction

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Taiwan Semiconductor Manufacturing Co. Ltd. (TSMC) is likely to maintain strong profitability over the next 12-24 months. This is despite downstream clients lowering their inventory due to weakening demand in smartphone, personal computers, and other consumer electronics.

We believe TSMC (twAAA/Stable/twA-1+) will maintain very high utilization despite this inventory correction, which could last for a few quarters into 2023. The company could continue to benefit from tight supply for chips, particularly for high-performance computing applications. We expect TSMC's revenue growth in 2022 to be above 30%, supported by higher averaging selling prices and the strengthening U.S. dollar.

TSMC's capital expenditure (capex) could be about US$40 billion this year, at the lower end of its guidance in early 2022, due to equipment delivery issues in both advanced and mature nodes. The lower spending could add buffer for the company's minimal financial risk profile. We previously expected the company to have negative free cash flow in 2022 due to rising capex.

TSMC should also have stronger bargaining power for equipment availability over smaller players. However, further delays on equipment delivery could hinder its capacity ramp up and mass production schedules, bringing downside risk to TSMC's profitability and revenue growth.

We believe TSMC's strong performance will give it a sufficient financial buffer to withstand semiconductor headwinds over the next one to two years. The company's entrenched leadership in advanced and specialty technologies should ensure strong profitability to meet rising capex needs, resulting in positive free cash flow through business cycles. TSMC's prudent shareholder return policy relative to that of its peers could help it to maintain a very strong balance sheet, with a persistent net cash position.

This report does not constitute a rating action.