Media Release:

Walsin Lihwa Corp. Outlook Revised To Positive On Business Restructuring; 'twA-/twA-2' Ratings Affirmed

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PRIMARY CREDIT ANALYST

Irene Lai
Taipei
+886-2-2175-6825
irene.lai
@spglobal.com
irene.lai
@taiwanratings.com.tw

SECONDARY CONTACT

Jin Dong, CFA
Taipei
+886-2-2175-6821
jin.dong
@spglobal.com
jin.dong
@taiwanratings.com.tw

Rating Action Overview

- Walsin Lihwa is a Taiwan-based stainless steel and wire and cable manufacturer, with EBITDA of new Taiwan dollar (NT$) 16.9 billion in 2021.
- Business restructuring should enhance Walsin Lihwa's competitiveness through a focus on core metal businesses with better integration and more comprehensive sales channels.
- Fully operating capacity for nickel pig iron and additional nickel matte processing in 2022-2023 should improve profitability and strengthen the company's credit metrics. We forecast the EBITDA margin to improve to above 12% with the ratio of debt to EBITDA below 3x from 2023.
- We revised our outlook on the long-term issuer credit rating on Walsin Lihwa to positive from stable to reflect our view of likely improvement in the firm's profitability over the next one to two years.
- At the same time, we affirmed our 'twA-/twA-2' issuer credit ratings on the company.

Rating Action Rationale

New nickel matte capacity in Indonesia could improve Walsin Lihwa's profitability significantly. The company's new capacity is likely to be fully operational from 2023. This capacity of 55,000 tons could double Walsin Lihwa's revenue and capacity in the nickel resource sector. EBITDA contribution from this should increase to about 50% in 2022 and to about 65% in 2023, up from 25% in 2021. We forecast the company's EBITDA margin for its nickel resource business to be 4x-5x higher than that for its stainless-steel business. In our projection, expanding nickel processing capacity should uplift Walsin Lihwa's EBITDA margin to above 12% in 2023-2024, up from 10.8% in 2021.

Walsin Lihwa's capex and acquisition plans will enhance its competitive advantages but result in over NT$30 billion cash outflow in 2022. The firm acquired 50.1% of PT. Sunny Metal Industry for US$200 million and plans to invest new Taiwan dollar (NT$) 4.5 billion-NT$5.5 billion to build a nickel matte factory. Different from nickel pig iron, the downstream products of nickel matte are mainly for electric vehicle batteries, which could strengthen the company's competitive advantage through involving in growing electric vehicle market.

Walsin Lihwa is acquiring a 70% stake in Italian stainless-steel company, Cogne Acciai Speciali (CAS) for Euro 225 million. CAS has only about 20%-30% of Walsin Lihwa's stainless steel capacity but it has slightly better profit margin due to more high-end and certificated products.

We believe this acquisition initiative will help to expand Walsin Lihwa's geographic diversity and enhance its product technology by supporting a more flexible business strategy and more comprehensive product offerings across its operating regions. In addition, Walsh Lihwa could create synergy with CAS's technology to upgrade its own stainless steel product portfolio.

Walsin Lihwa also continues to upgrade its own facilities with capital expenditure (capex) potentially amounting to NT$10 billion in 2022. We also recognize the potential competitive benefits brought by the firm's investment in a factory making sub-marine cables for use in offshore wind farm construction. The investment in the factory in Taiwan's southern Kaohsiung City could help diversify Walsin Lihwa's downstream product range and improve its overall profitability. That's because of higher technological entry barriers for this sector, limited available local manufacturers, and the business opportunities granted by the Taiwan government's green energy policy promoting offshore wind energy. We estimate Walsin Lihwa's capex could reach NT$9.0 billion-NT$9.5 billion by 2024.

Walsin Lihwa is making efforts to curb deterioration in its debt. To limit the increase in its debt level from heavy investment plans, the company has completed a capital injection of NT$9 billion in August 2022. In addition, Walsin Lihwa has disposed of part of its solar business in America (Borrego Solar Systems Inc.) which brought in US$260 million-US$270 million cash inflow in July 2022. These initiatives could cover 55%-60% of the company's planned investments this year and slowdown its overall debt increase in 2022. As a result, we expect the company's ratio of debt to EBITDA to be about 3x in 2022 and materially below 3x in 2023-2024.

Volatile material costs, economic recession, oversupply risk for nickel matte, and execution risks could challenge the firm's medium-term business prospects. The company's key materials, including coking coal and nickel, have been highly volatile over the past six months. The average price of coking coal in the first half of 2022 was 116% higher than in 2021. Walsin Lihwa could find it difficult to pass on these rising costs fully to its customers. In addition, the London Metal Exchange nickel price in July declined by 25% from the peak in the first quarter of 2022. The highly volatile nickel price will lead to a downward revision in the average selling price of nickel in the resource sector. In addition, macro-economic risks due to inflation and rising interest rates could weigh on demand for its products.

Despite of growing demand in the electric vehicle (EV) market globally has led to stronger demand for nickel matte used in EV batteries, this rising demand could also attract more competitors to join the market and increase or switch their capacity to nickel matte. Accordingly, this could increase oversupply risk. Furthermore, EV battery technology could change and upset demand for nickel matte, as EV firms to firms continue to pursue better efficiency from different materials.

Finally, the success of the firm's capex and acquisition plans for expected return depends on the management team's execution of its business strategies over the next few years to overcome these challenges, which remains to be observed.

Outlook

The positive rating outlook reflects our view that Walsin Lihwa's profitability could improve materially, supported by its expanding nickel resource businesses from 2023. Meanwhile, we expect the company to manage its rising capex and acquisitions through business disposals and capital injections. We therefore estimate the company's ratio of debt to EBITDA could stay below 3x and EBITDA margin could improve to above 12% in 2023-2024. This is despite volatile material costs and slowing demand could limit improvement in profitability.

Upward scenario

We may raise the long-term rating if:

- The company can enhance its EBITDA margin consistently above 12%; and
- At the same time maintain its ratio of debt to EBITDA to be sustainably below 3x.

The company might achieve these scenarios through expansion of its higher margin nickel resource business or an increased proportion of high value-added products, while at the same time funding its capex and cash dividend payout through disciplined financial management.

Downward scenario

We may revise the outlook back to stable if Walsin Liwha's cannot maintain its EBITDA margin sustainably above 12% or if the company's ratio of debt to EBITDA deteriorates to above 3x for an extended period. The likely scenarios for this are:

- A lower return on capex and investment than we currently forecast, such as the result of rising material costs, operating risk in developing countries, or unsuccessful integration with newly acquired companies;
- An industry downturn with contraction in demand and intensifying competition; or
- More aggressive capex or investment plans or insufficient cash inflow from capital injection or business disposal than under our current expectation.

Our Base-Case Scenario

- S&P Global's forecast that Taiwan's GDP growth of 2.8% in 2022, 2.7% in 2023, and 2.6% in 2024, and for China's GDP to expand 3.3% in 2022, 5.4% in 2023, and 4.9% in 2024.
- Weakening GDP growth and softening consumer demand will likely weigh on demand for metals as well as wires and cables over the next two years.
- Our assumption for a copper price of US$8,100/tonne-US$8,300 for 2022 and US$8,400/tonne-US$8,600 for 2023; Indonesia Batubara coal price of US$165/tonne-US$185 for 2022, and US$120/tonne-US$140 for 2023.
- Walsin Lihwa's revenue to decline by 2%-3.5% in 2022 due to the absence of revenue from Borrego which it will dispose of, and a decline in price and sales volume amid slower economic growth. Revenue could rebound by 18%-23% in 2023, supported by new nickel matte capacity and consolidation of the Italian stainless-steel company.
  - Revenue from stainless steel to grow by 0%-2% in 2022 and decline by 8%-12% in 2023, reflecting a price correction since June 2022 and weaker sales volume.
  - Revenue from nickel resource business in 2022 to be 2.6x-2.7x that in 2021, supported by full-year operations of the firm's nickel pig iron factory and grow by 65%-75% again in 2023 amid additional capacity at the new nickel matte factory. Average selling price of nickel products to increase by 5%-7% in 2022 but decline by 15%-17% in 2023.

  - Revenue from wiring and cables to decline by 18%-20% in 2022, because of softening sales volume for bare copper along with declining average selling price. Revenue to recover by 10%-12% in 2023, amid a recovery in copper price and sustainable domestic demand.
- Gross margins are likely to improve to 15%-16.5% in 2022 and 2023, up from 14.5% in 2021. This reflects a higher margin from the nickel resource segment that could mitigate the decline in margin from other segments and thinner margins at CAS.
- Ratio of selling, general and administrative expenses expanses to remain stable in 2022 but improve to 3%-3.5% in 2023 because of better economies of scale.
- Working capital outflow of NT$4 billion-NT$6 billion in 2022 and NT$1 billion-NT$2 billion in 2023, mainly due to slower inventory turnover.
- Capex of NT$14 billion-NT$16 billion in 2022 and NT$5 billion-NT$7 billion for 2023 mainly for facilities upgrades in China and Taiwan, a new nickel matte factory in Indonesia, and new capacity expansion for stainless steel production.
- Cash outflow of EU$225 million for share acquisitions for overseas stainless steel and US$250 million-US$300 million for nickel and coal companies in 2022.Cash outflow of NT$4 billion-NT$5 billion for other share acquisitions in 2023.
- Cash inflow from part of solar-tech business unit disposal of NT$7.5 billion-NT$8 billion in 2022.
- Capital injection of NT$9 billion in 2022.
- NT$5.5 billion dividend payout in 2022. About 45% dividend payout ratio after 2022.

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

- EBITDA margin of 11%-12% in 2022 and 12%-13% in 2023, up from 10.8% in 2021.
- Debt to EBITDA of 2.8x-3.3x in 2022 and 2.3x-2.8x in 2023, up from 2.4x in 2021.

Liquidity

The short-term issuer credit rating is 'twA-2'. We believe the company has adequate liquidity, which reflects a ratio of liquidity sources to liquidity uses of about 1.2x for the 12 months ending March 2023. We also believe the company will have positive liquidity sources minus uses, even if its EBITDA declined by 15%.

In addition, Walsin Lihwa has a solid relationship with banks in our view, as evidenced by the low interest rate on its bank loans. This view is also supported by the company's satisfactory standing in the credit markets, given its good market position. We also believe the company has generally prudent risk management to ensure continued adequate liquidity, which is indicated by its recent capital injection plan. In addition, Walsin Lihwa's sufficient undrawn bank credit lines and flexibility to increase bank facilities support this view. The company's bank loans carry some financial covenants, but we believe Walsin Lihwa will meet these with sufficient headroom over the next one to two years.

Principal liquidity sources

- Cash and short-term investments of NT$14 billion at the end of March 2022.
- Funds from operations of NT$15 billion-NT$16 billion up to March 2023.
- Committed mid-term bank lines of NT$18 billion-NT$19 billion up to March 2023.
- Share issuance of NT$9 billion up to March 2023.
- Business disposal of NT$7 billion-NT$8 billion up to March 2023.

Principal liquidity uses

- Long-term debt amortization plus short-term debt maturity of NT$22.9 billion up to March 2023.
- Working capital outflow of NT$3.5 billion-NT$4.5 billion up to March 2023
- Maintenance capex of NT$1 billion-NT$1.5 billion up to March 2023.
- Shareholding acquisition for four projects in Indonesia and Italy of NT$19 billion-NT$20 billion up to March 2023.
- Cash dividend of NT$5.5 billion up to March 2022.

Rating Score Snapshot

Issuer Credit Rating: twA-/Positive/twA-2
Note: All scores are in comparison with global obligors.

Business risk: Fair
- Country risk: Intermediate
- Industry risk: Moderately high
- Competitive position: Fair

Financial risk: Significant
- Cash flow/Leverage: Significant

Anchor: twbbb+

Modifiers
- Diversification/Portfolio effect: Neutral (No impact)
- Capital structure: Positive (+1 notch)
- 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: twa-

ESG credit indicators: E-3, S-2, G-2

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
- 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 – November 11, 2021

(Unless otherwise stated, these articles are published on www.taiwanratings.com)

Ratings List

Ratings Affirmed; Outlook Revision

	To	From
Walsin Lihwa Corp.		
Issuer Credit Rating	twA-/Positive/twA-2	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.