Media Release:

Walsin Lihwa Corp. Outlook Revised To Stable On Weaker Demand And Profitability; 'twA-/twA-2' Ratings Affirmed

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Rating Action Overview

- **Walsin Lihwa Corp.** is a Taiwan-based stainless steel and wire and cable manufacturer, with EBITDA of new Taiwan dollar (NT$) 15.6 billion in 2022.
- Weak stainless-steel demand constrains Walsin Lihwa's ability to transfer relatively high costs and could keep the EBITDA margin at 8%-9% in 2023-2024. This is materially weaker than our previous expectation of significant growth for the period.
- Debt leverage is likely to improve marginally in 2023-2024 after a material increase in 2022, given that a capital injection in June 2023 has largely offset high capex and acquisition plans in 2023.
- We have revised our outlook on the long-term issuer credit rating on Walsin Lihwa to stable from positive to reflect our view that improvement in the firm's profitability and debt leverage could take longer to achieve than under our previous expectation.
- At the same time, we affirmed our 'twA-/twA-2' issuer credit ratings on the company.

Rating Action Rationale

The outlook revision reflects our view of the weaker profitability of Walsin Lihwa's nickel business, which is materially below our earlier forecast due to high coal cost and weak nickel prices. Softening nickel prices and a doubling in the price of coal over the past year have sharply weakened Walsin Lihwa's margins well beyond our earlier base-case assumptions. We now expect coal prices to remain relatively high over 2023-2024, despite a likely downward trend in Indonesia coal prices over the period. In addition, weakening demand constrains Walsin Lihwa's ability to timely pass-through higher material costs, which could continue to stress nickel's EBITDA margin over the next few quarters. This is despite Walsin Lihwa 's new nickel matte factory will reach full capacity in 2023, enabling the company to sustain revenue and enhance EBITDA in 2023 from a weaker base in 2022.

Weak demand for stainless-steel could also weigh on the EBITDA margin over the next few quarters. Downstream demand mainly relies on the export market which could remain weak amid China's sluggish recovery and high inflation in Europe and the U.S. These factors could narrow margins for stainless-steel sales in China this year. Recent acquisitions in Europe will improve Walsin Lihwa's sales volume for stainless-steel in 2023-2024.The acquiree focuses on higher-end products which could enhance Walsin Lihwa's competitiveness and profitability in the long term, despite some uncertainties over the completion of the merger and integration of the company with Walsin Lihwa.

Consequently, we have lowered our forecast for Walsin Lihwa's EBITDA margin in to 8%-9% in 2023-2024 from 12%-13% under our previous forecast.

A recent capital injection could prevent debt growth despite heightened capex and investments. Walsin Lihwa's debt leverage grew more rapidly in 2022 than under our previous expectation due to weaker profitability and higher capital expenditure (capex) on acquisitions. However, we forecast that proceeds from the new Taiwan dollar (NT$) 12 billion global depositary receipts that Walsin Lihwa issued in June 2023 could help to slightly lower its adjusted debt. This stood at NT$59 billion as of the end of 2022. This improvement together with improving EBITDA generation could lower the company's ratio of debt to EBITDA to about 3.5x by the end of 2023, down from 3.8x at the end of 2022. This is despite Walsin Lihwa could increase capital spending in 2023 to acquire the stainless-steel company in Europe and NT$15 billion-NT$17 billion on expansion in Indonesia, China, and Taiwan.

Refocus on high value-added stainless steel and cable products should enhance long-term profitability amid falling competition. Walsin Lihwa's disposal of its investment in solar installation firm Borrego Solar, should increase focus on the company's core stainless steel and wire and cable businesses. In addition, Walsin Lihwa's decision to downsize its low-margin bare copper wire business and invest in submarine power cable production should significantly enhance the margin on its wire and cable business in the long term. This together with enhanced technology for its stainless products through the acquisitions in Europe should provide a boost to Walsin Lihwa's long-term operating performance. Nonetheless, we do not expect Walsin Lihwa to see material improvement in credit metrics from the new acquisitions over the next one to two years, even by overcoming significant execution risks.

Outlook

The stable outlook reflects our forecast that Walsin Lihwa could still grow its EBITDA and keep its ratio of debt to EBITDA at about 3.5x in 2023-2024, despite weak market conditions. We forecast that the full commissioning of the company's nickel matte plant in Indonesia will support its overall EBITDA growth despite largely flat overall margins. In addition, NT$12 billion equity funding received in mid-2023 should help to fund Walsin Lihwa's comparatively aggressive capex and investments plans in 2023 while lowering its debt slightly. We also assume capex will decrease after peaking in 2023 and enable Walsin Lihwa to cap its debt increase in 2024. That's despite our expectation the company will continue to seek new acquisitions.

Downward scenario

We may lower the rating on Walsin Lihwa if the ratio of debt to EBITDA falls close to 4x for an extended period. The likely scenarios for this are:

- More aggressive capex or investment plans than under our current expectation;
- An industry downturn with contraction in demand and intensifying competition; or
- Lower return on its capex and investment than we previously forecast, such as the result of an unsuccessful technology upgrade or development delay for its high value-added products.

Upward scenario

The likelihood of an upgrade is low over the next one to two years due to lukewarm demand for stainless steel products and increasing nickel supply. However, we may raise the rating if the company can sustainably strengthen its profitability through its nickel business or increase the proportion of high value-added products. Evidence of such an achievement could be:

- The company enhances the EBITDA margin consistently above 12%; and

- At the same time lowers and maintains the ratio of debt to EBITDA below 3x.

Our Base-Case Scenario

- S&P Global's forecast for Taiwan's GDP growth of 0.5% in 2023, 2.5% in 2024, and 2.6% in 2025, and for China's GDP to expand 5.2% in 2023, 4.7% in 2024, and 4.7% in 2025.
- Weakening GDP growth and softening consumer demand will extend sluggish demand for metals as well as wires and cables in 2023-2024.
- Our assumption for copper price of US$8,100 -US$8,300 per ton for 2023-2024; nickel price of US$20,000-US$21,000 per ton in 2023, and US$17,500-US$18,500 per ton in 2024; Indonesia Batubara coal price of US$190-US$210 per ton for 2023, and US$140-US$160 per ton for 2024.
- Walsin Lihwa's overall revenue to increase by 6%-9% in 2023 supported by capacity additions for nickel processing and stainless steel. Revenue could increase 1%-3% in 2024, supported by rising volume for cables and the full-year consolidation of its acquired stainless-steel subsidiary in the U.K.
- Revenue breakdown: stainless steel to grow by 18%-20% in 2023 and remain flat in 2024, as acquisitions are offset by weaker stainless-steel prices, revenue from nickel resource business to increase by 80%-90% in 2023 from 2022, supported by full-year operations of the firm's nickel matte factory but decrease by 5%-7% in 2024 due to falling prices; revenue from wiring and cables to decline by 18%-20% in 2023, as the company shutdown one of its bare wire facilities of 72,000 tons in Guangdong, China but revenue to recover by 5%-7% in 2024, amid a slight recovery in sales volume of cables with stable prices; and revenue from Borrego could decline 60%-70% along with the progress of its divestment in the firm.
- Gross margins are likely to stay at 11.5%-12.5% in 2023 then improve to 13%-14% in 2024, compared with 12.1% in 2022. This reflects how weak demand in major nickel resource and steel sectors will constrain performance in 2023 albeit this could slightly improve in 2024.
- EBITDA contribution from equity investment method companies will largely decline in 2024, following the downturn in the global high technology industry.
- Ratio of selling, general and administrative expenses to improve to 3.0%-3.5% in 2023-2024 due to expense reduction after department disposal and better economies of scale.
- Working capital inflow of NT$3 billion-NT$4 billion in 2023, mainly due to the reversal of other receivables from a joint venture company.
- Capex of NT$15 billion-NT$17billion in 2023 and NT$8 billion-NT$10 billion for 2024 mainly for facilities upgrades in China, construction of a nickel matte factory in Indonesia, and new capacity for submarine power cable production in Taiwan.
- Acquisitions of NT$9 billion-NT$10 billion in 2023 for stainless-steel companies in Europe and shareholding increase in a nickel subsidiary. Potential annual acquisitions of NT$5 billion in 2024-2025, given Walsin Lihwa's appetite for M&A activity.
- Disposal of investment and capital injection from minority shareholders of NT$7 billion–NT$8 billion in 2023.
- Global depositary receipt (GDR) issuance of NT$12 billion in June 2023.
- NT$6.7 billion dividend payout in 2023. About 35% dividend payout ratio after 2023.

Walsin Lihwa Corp. – Forecast summary

Industry sector: Metal and mining

(Mil. NT$)	2020a	2021a	2022a	2023e	2024f	2025f
Revenue	112,547	156,665	180,401	193,315	195,888	199,640
EBITDA (reported)	9,826	16,176	13,950	15,321	16,688	19,415
Plus/(less): Other	687	809	1,633	1,513	693	414
EBITDA	10,513	16,985	15,583	16,834	17,381	19,829
Less: Cash interest paid	(535)	(492)	(740)	(1,256)	(1,217)	(1,055)
Less: Cash taxes paid	(2,156)	(1,255)	(2,732)	(5,980)	(1,330)	(1,367)
Funds from operations (FFO)	7,822	15,239	12,111	9,599	14,833	17,407
Cash flow from operations (CFO)	7,173	1,303	13,903	13,752	15,355	17,172
Capital expenditure (capex)	8,816	6,415	15,499	16,583	9,392	7,400
Free operating cash flow (FOCF)	(1,643)	(5,113)	(1,596)	(2,831)	5,962	9,772
Debt (reported)	44,553	50,712	74,764	78,876	71,262	62,784
Plus: Lease liabilities debt	350	315	2,555	2,555	2,555	2,555
Less: Accessible cash and liquid Investments	(12,061)	(9,758)	(18,049)	(22,606)	(13,996)	(8,045)
Plus/(less): Other	137	150	152	912	912	912
Debt	32,979	41,419	59,422	59,737	60,733	58,207
Cash and short-term investments (reported)	13,342	10,493	19,428	24,320	15,052	8,646
Adjusted ratios						
Debt/EBITDA (x)	3.1	2.4	3.8	3.5	3.5	2.9
FFO/debt (%)	23.7	36.8	20.4	16.1	24.4	29.9
Annual revenue growth (%)	(16.5)	39.2	15.2	7.2	1.3	1.9
EBITDA margin (%)	9.3	10.8	8.6	8.7	8.9	9.9

All figures are adjusted by Taiwan Ratings Corp., unless stated as reported. a--Actual. e--Estimate. f--Forecast. NT$-- new Taiwan dollar.

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 1.36x for the 12 months ending March 2024. 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 indicated 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 GDR issuance. 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$8.4 billion at the end of March 2023.
- Funds from operations of NT$11 billion-NT$13 billion up to March 2024.
- Committed mid-term bank lines of NT$21 billion-NT$23 billion up to March 2024.
- GDR issuance of NT$12 billion in June 2023.
- Working capital inflow: NT$1 billion-NT$3 billion up to March 2024.

Principal liquidity uses

- Long-term debt amortization plus short-term debt maturity of NT$18.6 billion up to March 2024.
- Capex of NT$13 billion-NT$15 billion up to March 2024.
- Net outflow of NT$1 billion-NT$3 billion for investment activities for the 12 months ended March 31, 2024.
- Cash dividend of NT$6.7 billion up to March 2023.

Rating Score Snapshot

Issuer Credit Rating: twA-/Stable/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-

Related Criteria & Research

Related Criteria

- General Criteria: National And Regional Scale Credit Ratings Methodology - June 08, 2023
- 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-/Stable/twA-2	twA-/Positive/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.