

Media Release:

Asia Cement Corp. Outlook Revised To Negative From Stable On Weak Profitability; 'twAA-/twA-1+' Ratings Affirmed

September 26, 2023

Rating Action Overview

- Taiwan-based **Asia Cement Corp.** is mainly engaged in the manufacture and distribution of cement in China and Taiwan, generating EBITDA of NT\$17.1 billion in 2022.
- We expect slowing property and infrastructure investments to stagnate cement demand in China and prevent a significant recovery in cement prices and margins, leading to significantly lower profitability for Asia Cement than under our previous projection.
- High capex in combination with persistent pressure on profitability are likely to keep Asia Cement's leverage ratio persistently higher than the current rating indicates.
- We have therefore revised our outlook on the long-term rating on Asia Cement to negative from stable. This reflects rising likelihood that Asia Cement may not be able to lower its ratio of debt to EBITDA to 2x over the next 24 months, due to prolonged weakness in China's cement market as well as high capex.
- At the same time, we affirmed our 'twAA-/twA-1+' issuer credit ratings on Asia Cement.

Rating Action Rationale

Asia Cement's profitability could come substantially below our previous forecast in 2023-2025 due to a weaker economy in China. Slowing economic growth in China and the China government's limited stimulus for reviving the property sector could limit recovery in China's property market over the next two years. The government is likely to shift the focus of its economic model to other areas such as advanced manufacturing to achieve overall growth, thus constraining the long-term prospects for China's property market. This, together with slowing infrastructure investments, is likely to lead China's cement consumption on a gradual downward trend. Under our base case, we project China's cement demand could fall to about 2.0 billion tons a year in 2025 from 2.1 billion tons in 2023.

At the same time, significant capacity additions before 2022 have caused sizeable overcapacity amid slowing demand. Utilization in China has fallen as cement demand declined sharply in 2022. The ratio could stay weak for an extended period, even without significant new capacity additions. We do not expect the retirement of aging capacity to be sufficient to resolve overcapacity in China anytime soon. Enhanced staggered production in the cement industry cannot be sufficient to significantly lift cement prices without a significant improvement in demand, in our view. This

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could constrain margins at a weak level for a long period in China before cement producers can go through substantial capacity reductions. We now forecast profitability from cement produced in China will only improve moderately over 2023-2025 and remain well below the average for 2018-2021.

Asia Cement's businesses outside China are unlikely to fill the profit gap over the next two years.

We forecast the company's cement operations in Taiwan will generate largely flat, albeit still relatively strong, profitability in 2023-2024. Declining coal prices could offset the negative effect on cement pricing and margins from weak demand as domestic investments slow and a weaker property market. The more stable market structure in Taiwan, where Taiwan Cement Corp. and Asia Cement benefit from a high reputation and market share, will also alleviate the impact of imports on pricing, in our view.

Asia Cement's power generation business is also likely to generate lower profits in 2023-2024, amid declining gas prices. Further expansion in its power generation business is unlikely to materialize over the next three to four years. Meanwhile, cash dividends from the company's equity method investment will also decline in 2023-2024. This is mostly due to weaker performance at Far Eastern New Century Corp. and U-Ming Marine Transport Corp. because the slowing recovery in China and high inflation in advanced economies have hit demand for chemicals and other commodities. Accordingly, we forecast Asia Cement's EBITDA is likely to come in significantly below our previous forecast before 2025.

Weaker profitability and high capital spending will prevent significant debt reduction. We expect the company's capital expenditure (capex) to be much higher than under our previous forecast. This will mostly be for the relocation of its two plants in the Hubei province of China at the local government's request due to urban rezoning. In addition, Asia Cement will significantly increase its capex on facility upgrades in Taiwan and China to improve its energy efficiency and build in-house solar power capacity to lower greenhouse gas and pollutant emissions amid growing regulation. This includes a carbon fee that the Taiwan government is likely to impose from 2024. Capex related to the company's environmental protection is likely to remain significant in the long term. Based on Asia Cement's environmental map, the company plans to lower its carbon dioxide emissions per ton by 8% in 2025 and 26% in 2030 versus the level in 2019.

Weaker cash flow from operations, together with rising capex, could limit the company's discretionary operating cash flow to a barely positive level over the next two to three years. As a result, we expect the company's debt to stay relatively flat during 2023-2025, versus our previous forecast of a moderate decline over the period. This is despite our view that Asia Cement could slightly lower its cash dividend payout ratio in view of high capex ahead. We now forecast the company's adjusted debt will stay at new Taiwan dollar (NT\$) 38 billion-NT\$40 billion in 2023-2025. We do not factor in spending on acquisitions because we believe the likelihood for Asia Cement to engage in large scale merger and acquisition activity is very low, given its high capex and unfavorable market conditions.

Uncertainty clouds anticipated improvement in debt leverage. Nonetheless, we still forecast Asia Cement could gradually improve its debt leverage, as measured by the ratio of debt to EBITDA, to about 2x in 2025 through slowly improving EBITDA. The forecast also factors in our expectation that the company will maintain its conservative appetite for financial risk without taking on large acquisitions and investments, as well as maintaining a persistent cash dividend payout ratio. In addition, we do not factor in possible compensation from the local government for Asia Cement's

plant relocation in the Hubei province of China, which could provide additional cash flow for debt reductions.

Nonetheless, significant downside risk to our forecast, which indicates a very limited buffer for the current ratings, persists. The Chinese government's measures to stabilize the economy and property market should be constructive to the stabilization of China's cement market. However, a structural shift in China's economic model and persistent overcapacity in its cement industry could still prevent improvement in profitability from Asia Cement's China operations without active government intervention in the retirement of aging capacity and production control.

Outlook

The negative rating outlook reflects material risk that Asia Cement will not be able to materially improve its debt leverage due to persistently weak performance at its China subsidiary. We measure debt leverage according to the ratio of debt to EBITDA, which is likely to improve to about 2x over the 24 months ending June 30, 2025, from about 2.4x in 2022. A prolonged slump in China's property market and saturated infrastructure investments that weaken cement demand in China are the downside risks to this forecast. Weaker performance by Asia Cement's cement and power generation business in Taiwan than we currently forecast, as well as aggressive investments by the company could also lead to such risk.

Downward scenario

We may lower the rating on Asia Cement if the company is unable to lower its ratio of debt to EBITDA to about 2x over the 24 months ending June 30, 2025, and demonstrate sufficient capacity and intention to keep the ratio below 2x thereafter. This could happen if:

- A prolonged slump in China's property market and slower infrastructure investments suppress cement demand and pricing, keeping cement margins persistently low;
- Profitability from Asia Cement's operations in Taiwan dip more than we assume due to weak economic conditions in Taiwan; or
- The company takes on more aggressive capex and investments for expansion.

Upward scenario

We may revise the outlook back to stable if Asia Cement could lower its ratio of debt to EBITDA to 2x over the 24 months ending June 30, 2025, and demonstrate sufficient capacity and intention to keep the ratio below 2x based on mid-cycle profitability. This may occur if:

- There is significant and sustainable improvement in the company's profitability from its China operations with structural improvement in China's cement market through faster capacity retirements or a strengthened production control mechanism; or
- The company significantly reduces debt by retaining more internal cash flow, i.e., lower shareholder distributions, reduced capex, or the pursuit of external equity funding, though we believe that this is a less likely scenario.

Our Base-Case Scenario

We project 5%-8% revenue decline for Asia Cement in 2023 due to sluggish cement demand and pricing in China. We forecast Asia Cement's revenue to grow marginally in 2024 amid stabilizing cement demand and continued production control that support cement prices in China. Margins could bottom out in 2024 amid lower coal costs and stabilizing cement prices. Our other assumptions are:

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- China's real GDP to grow 4.8% in 2023 and 4.3% in 2024. Recovering consumption and increased infrastructure spending should support GDP growth despite weak property developments and exports. Cement prices should stabilize gradually as the government's support measures should underpin cement demand, while tightened environmental standards and enhanced production control in China could support disciplined output there.
- Taiwan's real GDP to grow 0.5% in 2023 and 3.0% in 2024. We expect cement demand to stay largely flat in Taiwan over the next one to two years, amid slowing property developments and investments along with a slowing global economy and higher domestic interests.
- Revenue from the company's cement business will decline by 11%-13% in China in 2023, reflecting a 13%-15% decline in cement prices and flat sales volume due to a still-weak property market in China, partly offset by stable cement revenues in Taiwan. Asia Cement's cement sales to recover marginally in 2024, mainly because of stabilizing cement demand and pricing in China.
- Revenue from power generation to decline by 15%-20% in 2023 due to declining gas prices but stabilize in 2024. The company's revenues from other businesses to remain stable in 2023-2024.
- Asia Cement's capacity utilization in China will remain slightly below 80% in 2023-2024 compared with 77% in 2022. The company's capacity utilization in Taiwan to remain at 65%-69% over the same period.
- Asia Cement China's EBITDA margin to increase slightly to 16%-17% in 2023 from 15.2% in 2022 and rise further to 19%-21% in 2024.
- EBITDA margin on the domestic cement business will remain stable at 14%-16% in 2023-2024, given a stable domestic market and falling coal costs.
- EBITDA for the company's non-cement business to decline by 13-17% in 2023 and improve marginally in 2024 due to lower gas prices for power generations and weaker market conditions for stainless steel and other smaller business segments.
- Dividend contribution from equity-method investments to fall to NT\$3.1 billion-NT\$3.4 billion in 2023 and further to NT\$2.5 billion-NT\$2.8 billion in 2024 amid weakening performance at Far Eastern New Century, U-Ming Marine, and other smaller investments.
- Capex of NT\$5 billion-NT\$6 billion in 2023, further increasing to NT\$6 billion-NT\$7 billion in 2024. This is mostly related to the relocation of cement plants in China's Hubei province and upgrades to Asia Cement's existing cement plants.
- Cash dividend payment of NT\$8 billion-NT\$9 billion annually in 2023-2024.
- We net 85.2% of Asia Cement's cash and liquid investments with its reported debt in calculating adjusted debt.

Asia Cement Corp.--Forecast summary

Industry sector: Building materials

| (Mil. NT\$) | 2020a | 2021a | 2022a | 2023e | 2024f | 2025f |
|--------------------------|--------------|--------------|--------------|--------------|--------------|--------------|
| Revenue | 78,241 | 89,655 | 90,341 | 84,293 | 84,874 | 85,571 |
| EBITDA (reported) | 24,618 | 22,616 | 13,341 | 12,999 | 14,492 | 15,774 |
| Plus/(less): Other | 3,152 | 2,681 | 3,711 | 3,208 | 2,641 | 2,842 |
| EBITDA | 27,770 | 25,297 | 17,052 | 16,207 | 17,133 | 18,616 |
| Less: Cash interest paid | (1,214) | (1,181) | (1,295) | (2,057) | (1,884) | (1,667) |
| Less: Cash taxes paid | (5,483) | (5,059) | (3,719) | (2,441) | (2,728) | (2,981) |

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| | | | | | | |
|--|----------|----------|----------|----------|----------|----------|
| Funds from operations (FFO) | 21,073 | 19,057 | 12,038 | 11,708 | 12,520 | 13,967 |
| Cash flow from operations (CFO) | 29,277 | 17,433 | 16,304 | 15,180 | 15,019 | 16,465 |
| Capital expenditure (capex) | 9,965 | 3,250 | 2,673 | 5,759 | 6,791 | 6,791 |
| Free operating cash flow (FOCF) | 19,312 | 14,183 | 13,631 | 9,421 | 8,227 | 9,674 |
| Debt (reported) | 99,581 | 106,802 | 112,974 | 105,948 | 105,858 | 105,276 |
| Plus: Lease liabilities debt | 1,381 | 1,272 | 1,563 | 1,563 | 1,563 | 1,563 |
| Less: Accessible cash and liquid Investments | (54,212) | (67,178) | (73,501) | (68,160) | (68,160) | (68,160) |
| Debt | 46,750 | 40,896 | 41,036 | 39,351 | 39,261 | 38,680 |
| Cash and short-term investments (reported) | 61,605 | 76,339 | 86,269 | 80,000 | 80,000 | 80,000 |
| Adjusted ratios | | | | | | |
| Debt/EBITDA (x) | 1.7 | 1.6 | 2.4 | 2.4 | 2.3 | 2.1 |
| FFO/debt (%) | 45.1 | 46.6 | 29.3 | 29.8 | 31.9 | 36.1 |
| Annual revenue growth (%) | (12.4) | 14.6 | 0.8 | (6.7) | 0.7 | 0.8 |
| EBITDA margin (%) | 35.5 | 28.2 | 18.9 | 19.2 | 20.2 | 21.8 |

All figures are adjusted by Taiwan Ratings Corp., unless stated as reported. a--Actual. e--Estimate. f--Forecast. NT\$-- new Taiwan dollar. N.M.--Not meaningful.

Liquidity

The short-term issuer credit rating is 'twA-1+'. We believe Asia Cement has strong liquidity to meet its needs over the 24 months ended June 30, 2025, reflecting our view that its ratio of liquidity sources to liquidity uses will be 1.5-1.8x over the 12 months ended June 30, 2024, and 1.6x-2x for the following 12 months. We also believe that liquidity sources will continue to exceed uses even if Asia Cement's EBITDA were to decline by 30%.

In addition, we believe the company has a sound relationship with banks and a generally high standing in the credit market in Taiwan, supported by the company's membership of the Far Eastern New Century group. The company's five-year corporate bonds issued at a low fixed rate of 1.6% in 2023 also underpins our view. There are no financial covenants associated with Asia Cement's or its subsidiaries' debt as of the end of June 2023.

Principal liquidity sources:

- Cash and short-term investments of NT\$95.6 billion at the end of June 2023.
- Funds from operations of NT\$14 billion-NT\$18 billion annually over the 24 months ending June 2025.
- Undrawn bank lines maturing beyond June 2024 of NT\$14.5 billion.

Principal liquidity uses:

- Debt maturities of NT\$66.2 billion over the 12 months ending June 2024 and NT\$10 billion-NT\$15 billion over the 12 months ended June 2025.
- Capex and investments of NT\$5 billion-NT\$7 billion annually over the next 24 months ending June 2025.
- Cash dividends of 70%-75% of the previous year's net income in 2023-2024.

Ratings Score Snapshot

Issuer Credit Rating: twAA-/Negative/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: Intermediate

- Cash flow/Leverage: Intermediate

Anchor: twA+

Modifiers

- Diversification/portfolio effect: Neutral (no impact)
- Capital structure: Positive (+1 notch)
- Financial policy: Neutral (no impact)
- Liquidity: Strong (no impact)
- Management and governance: Satisfactory (no impact)
- Comparable rating analysis: Neutral (no impact)

Stand-alone credit profile: twAA-

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

Outlook Revision; Ratings Affirmed

| | To | From |
|--------------------------|-----------------------|---------------------|
| Asia Cement Corp. | | |
| Issuer Credit Rating | twAA-/Negative/twA-1+ | twAA-/Stable/twA-1+ |

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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.

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