Media Release:

Taiwan Railways Administration 'twAAA/twA-1+' Ratings Affirmed; SACP Raised On Anticipated Debt Reduction; Outlook Stable

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Rating Action Overview

- **Taiwan Railways Administration, MOTC**, is the national conventional railway network operator in Taiwan, with EBITDA of NT$4.4 billion in 2022.
- To enhance its operating safety and efficiency, the Ministry of Transportation and Communication (MOTC) will transform Taiwan Railway into a state-run corporation from a division of the MOTC formerly. The effective date of transition is Jan. 1, 2024. The government will transfer all of Taiwan Railway's debt into a special purpose fund under the government during the transition. As a result, we expect the rail operator's financial strength to enhance significantly. We have therefore raised the stand-alone credit profile to 'twaa-' from 'twbbb'.
- We have affirmed our 'twAAA/twA-1+' issuer credit ratings on Taiwan Railways, given there is no change in our view that the agency would receive timely financial support from the Taiwan government, despite the corporatization process.
- The stable outlook reflects our view that Taiwan Railway will maintain its critical policy role and integral link to the government.

Rating Action Rationale

Significantly improved financial leverage to boost its post-corporatization stand-alone financial profile. According to the 'Act for Establishment of State-Owned Taiwan Railway Co. Ltd.', Taiwan Railways will transfer all its debt to a special purpose fund during the transition. In addition, we believe the corporatized entity will be freed from its accrued pension liabilities because the Taiwan government has promised to serve as the payment maker under the requirement of the Act. We believe the corporatized entity will greatly benefit from these two factors which will help to enhance its financial risk profile over the next two to three years.

We forecast Taiwan Railways' ratio of funds from operations (FFO) to debt improving to 42.8% in 2024 from 1.3% in 2022. This is despite a likely gradual increase in debt over the next two years amid continued operating losses. We anticipate Taiwan Railways could still face operating losses during the transition period amid likely further squeezing of its operating margin due to rising labor costs. Losses are likely to continue until there is a material rise in revenue contribution from asset development projects or considerable progress in fare rate adjustments.

The corporatization is unlikely to materially strengthen Taiwan Railway's business profile over next one to two years. The rail operator aims to gradually upgrade network safety and improve its operating efficiency post corporatization. However, we believe it is unlikely to meet these goals over the short term, due to probable labor shortages, especially among skillful workers and professionals. The labor shortage will slow Taiwan Railway's plans to accelerate the development of major asset projects and therefore we forecast no enhancement in profitability over the next one to two years. In addition, the operator's highly integrated role with the Taiwan government could continue to prevent Taiwan Rail from meaningfully shortening the review process for major projects including fare rate adjustments. Therefore, we see no material improvement in its business risk profile over the next one to two years.

Taiwan Railways will maintain its critical role and integral link with the Taiwan government, given the public's daily reliance on rail services. According to the 'Act for Establishment of State-owned Taiwan Railways Co. Ltd.', the new railway company will become a 100% government-owned entity. Considering the ongoing national vital position for public transportation, the new company will maintain its critical role and integral link with the government under MOTC's supervision. The operator's leading market share in public transportation is unlikely to change thanks to its comprehensive network, conveniently located train stations, and a dominant position for rail services on the east coast of Taiwan. We foresee the government continuing to subsidize Taiwan Railways' losses incurred on unprofitable routes and stations, as well as for the operator's major capital spending plans.

Outlook

The stable rating outlook on Taiwan Railways reflects our view that the entity's creditworthiness is equal to that of the Taiwan government. This is because of the operator's critical policy role in managing and operating the nation's conventional rail network on behalf of the government, and our view that Taiwan Railways' integral link with the government will remain unchanged over the next two years, despite the corporatization plan.

Downward scenario

Downgrade risk is very remote over the next two years. That's because any material changes in Taiwan Railways' policy role and link to the government are unlikely to occur during the period. However, we would lower the long-term rating on Taiwan Railways if:

- S&P Global Ratings lowers its unsolicited long-term issuer credit rating on the Taiwan government by more than three notches;
- Taiwan Railways' policy role or link to the Taiwan government weakens such that we believe there is a reduced likelihood of extraordinary government support. Reduction of government ownership of Taiwan Railways would indicate such a weakening, although we view the likelihood of this scenario is very remote; or
- Taiwan Railways' stand-alone credit profile comes under pressure due to a decline in government subsidies. This could potentially escalate the operator's debt, although we also view the likelihood of such a revision as low over the next one to two years. A weakening of the company's ratio of FFO to debt to consistently below 30% would indicate such weakening.

Our Base Case Scenario

- Taiwan's real GDP to grow 1.2% in 2023, 3.0% in 2024 and 2.6% in 2025.
- Taiwan Railways' revenue to increase by 15.3% in 2023 and by a low single digit in 2024. This is supported by a material improvement in passenger volume and significant additional government subsidies for its policy burden, which comes from subsidies for unprofitable routes.
- Seat utilization to improve to 56% in 2023 and 58% in 2024 from 47.5% in 2022, given the recovery in ridership post-pandemic; however, the higher capacity of new train cars will partly offset this rise.
- Rental income to rise slightly by 2% in 2023 from new Taiwan dollar (NT$) 3.7 billion in 2022. However, this could decline by 10% in 2024 due to the company's asset transfers to a sinking fund.
- The Taiwan government to continue to subsidize Taiwan Railways by NT$3.78 billion in 2023 and NT$3.83 billion in 2024 to cover accumulated deficits in Taiwan Railways' burden for its old pension scheme.
- Taiwan Railways' operating costs (excluding depreciation and amortization) to increase 3% in 2023 from NT$1.27 billion in 2022, due to higher utility expense following the recovery in train frequency. This could further increase by 19.5% in 2024, given the rising labor costs post corporatization.
- The government's approved expansionary capital expenditure (capex) for Taiwan Railways of NT$17.6 billion for 2023 and NT$24.2 billion for 2024, among which NT$14.8 billion and NT$22.6 billion, respectively, will be funded by the government.
  The MOTC agrees to cover old pension scheme by providing a capital injection every year; therefore, we deduct the accrued pension liabilities of NT$52.3 billion from adjusted debt from 2024. However, the company could still need to meet certain payment obligations under its own financial capacity because of the timing mismatch between funding from the government and pension payments. We treat pension obligations which matured within one year as adjusted debt accordingly.

Taiwan Railways Administration --Forecast summary

Industry sector: Railroad transportation

(Mil. TWD)	2021a	2022a	2023e	2024f	2025f	2026f
Revenue	19,576	26,468	30,513	30,982	31,729	32,071
EBITDA (reported)	(1,333)	4,398	7,665	3,796	5,332	5,619
EBITDA	(1,333)	4,398	7,665	3,796	5,332	5,619
Less: Cash interest paid	(568)	(1,633)	(1,311)	(21)	(71)	(71)
Funds from operations (FFO)	(1,901)	2,765	6,354	3,775	5,261	5,548
Cash flow from operations (CFO)	(9,348)	(11,527)	1,033	3,125	2,258	3,276
Capital expenditure (capex)	19,156	26,492	20,795	27,401	43,178	26,887
Free operating cash flow (FOCF)	(28,504)	(38,019)	(19,763)	(24,276)	(40,920)	(23,610)
Discretionary cash flow (DCF)	(28,504)	(38,019)	(19,763)	(24,276)	(40,920)	(23,610)
Debt (reported)	210,657	219,557	219,556	219,556	219,556	219,556
Less: Accessible cash and liquid Investments	(664)	(2,969)	(1,837)	(723)	--	--
Plus/(less): Other	--	--	--	(210,010)	(210,010)	(210,010)
Debt	209,993	216,587	217,720	8,824	9,547	9,547

Adjusted ratios						
Debt/EBITDA (x)	(157.5)	49.2	28.4	2.3	1.8	1.7
FFO/debt (%)	(0.9)	1.3	2.9	42.8	55.1	58.1
DCF/debt (%)	(13.6)	(17.6)	(9.1)	(275.1)	(428.6)	(247.3)
Annual revenue growth (%)	(17.7)	35.2	15.3	1.5	2.4	1.1
EBITDA margin (%)	(6.8)	16.6	25.1	12.3	16.8	17.5

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

Liquidity: Adequate

The short-term rating on Taiwan Railways is 'twA-1+'. We believe the operator has adequate liquidity based on our view that it will continue to benefit from its status as an essential government-related entity.

Given Taiwan Railway's solid relationship with the Taiwan government, state-owned banks will almost certainly step in and provide additional short-term refinancing needs if private-owned banks are unwilling to roll over the entity's short-term debt due to very thin margins. Taiwan Railway also has the capability to roll over its banking facilities and commercial papers at a low interest rate. Moreover, the government will allocate a subsidy to help Taiwan Railways if there is any funding needed. Therefore, we forecast the entity will continue to benefit from preferential access to banking facilities. These factors underpin our view that Taiwan Railways can achieve a ratio of liquidity sources to uses above 1.2x up to the end of September 2024. The operator has no covenant placed on its debts.

Principal liquidity sources:

- Cash and short-term investments of NT$1.076 billion as the end of September 2023.
- Ongoing government support (credit lines of government related banks) of NT$13 billion up to September 2024.
- FFO of NT$2.5 trillion per year over the next 12 months ending September 2024.

Principal liquidity uses:

- Capex of NT$25.75 billion up to September 2024.

Ratings Score Snapshot

Issuer Credit Rating: twAAA/Stable/twA-1+
Note: The descriptors below are on a global scale.

Business Risk: Satisfactory

- Country risk: Intermediate
- Industry risk: Low
- Competitive position: Satisfactory

Financial Risk: Modest

- Cash flow/Leverage: Modest

Anchor: twaa-

Modifiers:
- Diversification/Portfolio effect: Neutral (no impact)
- Capital structure: Neutral (no impact)
- 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: twaa-
- Related government rating: AA+
- Likelihood of government support: Almost certain (+3 notches from SACP)

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
- General Criteria: Rating Government-Related Entities: Methodology And Assumptions - March 25, 2015
- 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 – Nov. 11, 2021

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

Ratings List

Ratings Affirmed

Taiwan Railways Administration, MOTC	
Issuer Credit Rating	twAAA/Stable/twA-1+

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.