Media Release:

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

May 28, 2024

PRIMARY CREDIT ANALYST

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

SECONDARY CONTACT

Raymond Hsu, CFA
Taipei
+886-2-2175-6827
raymond.hsu
@spglobal.com
raymond.hsu
@taiwanratings.com.tw

Rating Action Overview

- **CHIMEI Corp.** is a global leading acrylonitrile butadiene styrene (ABS) resins producer, with a total capacity of 2.4 million tons in Taiwan and China. The company generated EBITDA of new Taiwan dollar (NT$) 4 billion in 2023.
- Extended weak demand for commodity chemical products could continue to constrain CHIMEI's weakening profitability in 2024 and 2025. In addition, the recent capacity expansion in China could intensify competition and pressure CHIMEI's profit enhancement amid the expected recovery period.
- We have therefore revised our rating outlook on CHIMEI to negative from stable.
- At the same time, we affirmed the 'twAA-' long-term and 'twA-1+' short-term issuer credit ratings on the company.

Rating Action Rationale

The outlook revision reflects our view of weak demand will persist and constrain CHIMEI's profitability over the next one to two years. In our view, demand is unlikely to fully recovered in 2024-2025, although mild inventory demand emerges. Chinese property market and high interest and inflation rates in globe have been muting demand for automotive and home appliances related polymers. Destocking of residential properties and sales of home appliances in China could remain slow due to lack of strong consumer confidence to reverse declining sales trend even after the Chinese government released new stimulus measures in 2024.

In addition, global interest and inflation rates have stay high for longer period than our previous base case that weakens consumer sentiment. We believe this could limit CHIMEI's exporting sales and utilization rate in Taiwan and China. As a result, we forecast the company's EBITDA margin could remain thin at single digit level in 2024-2025, down from double digit performance before 2022. We also expect the company's ratio of return on capital to remain below 8%.

Commodity chemical capacity expansion of Chinese chemical firms could pressure CHIMEI's profit improvement in 2024-2026. Chinese chemical firms have been establishing polymers capacity to consume upstream products and increase the integration of manufacturing processes. We believe CHIMEI is likely to benefit from cheaper material given increased supply. However, this could intensify pricing competitions and pressure profit margin during the recovery period. That being said, we forecast the company's EBITDA margin to remain slightly lower at 9.8% and return on capital of 8.2% in 2026 as compared to mid cycle performance of 9%-12% EBITDA margin and above 12% of return on capital.

We believe CHIMEI will take necessary measures to maintain profitability through revamping projects. These are mainly for capacity adjustments with better operating efficiency and product differentiation enhancement via alloyed or chemical recycled products. However, we view the benefit of these measures to takes times to uplift its profitability materially.

Capital expenditure (capex) remains high in 2024 due to capacity expansion in China. CHIMEI's plan is mainly for polycarbonates capacity in China, which sustains its capex high at NT$11 billion-NT$13 billion in 2024. Given our expectation of still-weak operating performance in 2024, the company's cash flow generation is likely to be insufficient to cover its capex and cash dividend distribution. This combined with debt repayment schedule will consume financial buffer of cash on hands largely.

However, the company's capex from 2025 could revise down materially to NT$5 billion-NT$7 billion, mainly for revamping and maintenance projects. This is in line with CHIMEI's strategy to adjust capacity locations and scales for increasing product differentiations and business penetrations in Southeast Asia market with higher growth momentum. We believe this should help the company to raise its net cash level after this downturn period.

Outlook

The negative rating outlook reflects that prolonged weak demand has materially weigh on CHIMEI's profitability, which return on capital could remain below 8% in 2024-2025. In addition, oversupply due to massive capacity expansion in China could intensify competition in Asia Pacific and constrain CHIMEI's profit improvement in possible recovery period of 2025-2026. Nonetheless, CHIMEI's cash on hand should be able to provide buffer of its debt increase. High capex and cash dividend is likely to largely decline in 2025-2026 to ease funding demand.

Downside scenario

We may lower the long-term rating on CHIMEI if:

- Return on capital stays materially below 8% through business cycles without the prospect of recovery, possibly due to failure to enhance contribution of specialty chemical and product differentiation against to peers to generate higher profit margin under oversupply environment, or
- The ratio of debt to EBITDA exceeds 1x, due to a more aggressive expansion strategy or dividend policy.

Upside scenario

We may revise outlook back to stable if CHIMEI can restore its profitability through better product differentiation and product mix, following the demand recovery over the next two years.

- Return on capital gradually improve to above 8% could be an indicator, and
- At the same time, the ratio of debt to EBITDA remains below 1x with prudent control on the company's expansion strategy and dividend policy.

Our Base Case Scenario

- China's real GDP to slow down to 4.6% in 2024 and 4.8% in 2025. Taiwan's GDP to expand 3.0% in 2024 and 2.6% in 2024. The soften economic rebound in China could constrain demand for chemical products, and the effect of economic stimulus measures of the Chinese government to be tested.
- S&P Global assumes the price of Brent crude oil will stay around US$85 per barrel for the rest of 2024 and revise down by 4%-8% in 2025. This suggests commodity chemical prices will sustain in 2024 and follow the decline trend in 2025. However, individual products could vary considerably depending on their demand-supply balance, especially the pressure from increasing capacities in China.
- CHIMEI's revenue to remain flat in 2024 and increase by 3%-6% in 2025, reflecting fluctuation sales in polycarbonates. We do not expect a boost in revenue due to high uncertainty of demand recovery and intensifying competition in China from increasing capacities.
- Revenue from ABS to increase by 2%-5% in 2024 and 1%-4% in 2025, reflecting ASP changes in 2024 and sales volume growth in 2025. Despite relatively low utilization rate, capacity adjustments with revamping product lines should prevent gross margin to further deteriorate in 2024 and 2025.
- Revenue from polystyrene to increase by 4%-6% in 2024 but lower by 2%-4% in 2025, driven by ASP changes and lightly sales volume increases. As stagnant demand continues to cap utilization rate, improvement in gross margin should be limited.
- Revenue from polycarbonates to decline by 40%-50% in 2024 and fully recover in 2025, reflecting antidumping tax in China from late April 2024 and fully run of additional capacity in China from 2025. Temporarily absence in the China market could be a potential risk for its recovery, but we expect CHIMEI to regain the market through its good quality, product differentiation, and customer relationships. Gross margin to deteriorate in 2024 due to lower utilization rate but to recover in 2025. However, oversupply could stress gross margin in 2025 to lower than 2023 level.
- Revenue from rubber to grow 0%-2% in 2024 and in 2025, reflecting mildly increases in sales volume with price changes. Our view is underpinned by continuous tightened supply should support the high utilization rate. Price for butadiene could be flat in 2024 with limited impact on ASP. Gross margin for rubber could be sustainable over the next one to two years with better position in supply chain.
- Revenue from polymethyl-methacrylate (PMMA) and light-guide plates to remain low in 2024 and 2025, reflecting minimum demand in downturn period. Despite that, the segment should be able to sustain profitable through capacity adjustments.
- Revenue from specialty chemicals could rise by 4%-6% annually in 2024 and 2025, driven by moderately demand recovery in panel and increasing exposure to other semiconductor clients.
- Capex to remain high at NT$11 billion-NT$13 billion in 2024 to support capacity expansion in polycarbonate in China and to revise down to NT$5 billion-NT$7 billion in 2025 for revamping and maintenance projects.
- Working capital to stabilize in 2024 and outflow of NT$0.5 billion-NT$1.0 billion 2025 to support mild inventory buildup for recovery.
- Cash dividend distribution of NT$2.2 billion in 2024 and NT$1.0 billion-NT$1.5 billion in 2025, based on the company's announcement and records.
- A surplus cash haircut of 2.3% for the discount on liquid bond investments.

CHIMEI Corp.– Forecast summary

Industry sector: Chemical

(Mil. NT$)	2021a	2022a	2023a	2024e	2025f	2026f
Revenue	178,671.7	153,538.5	124,821.6	124,474.7	129,170.5	137,875.5
EBITDA (reported)	39,710.5	9,859.9	3,597.8	4,659.0	7,942.6	13,508.0
Plus/(less): Other	64.5	861.0	398.5	17.3	17.3	17.3
EBITDA	39,775.0	10,720.9	3,996.3	4,676.4	7,960.0	13,525.4
Less: Cash interest paid	(366.7)	(486.9)	(647.5)	(555.9)	(378.4)	(202.0)
Less: Cash taxes paid	(7,704.1)	(6,206.4)	(1,112.7)	--	--	(781.2)
Funds from operations (FFO)	31,704.2	4,027.6	2,236.0	4,120.5	7,581.6	12,542.1
Cash flow from operations (CFO)	25,964.5	8,896.4	2,048.5	4,981.1	7,575.4	12,016.8
Capital expenditure (capex)	11,789.9	9,283.8	12,417.9	11,976.9	5,976.9	5,976.9
Free operating cash flow (FOCF)	14,174.5	(387.4)	(10,369.4)	(6,995.8)	1,598.5	6,039.9
Dividends	7,152.4	10,709.4	5,385.0	2,155.8	1,346.3	1,346.3
Discretionary cash flow (DCF)	6,819.4	(11,159.5)	(15,795.7)	(9,151.6)	252.3	4,693.6
Debt (reported)	16,232.1	23,988.9	19,391.3	14,720.3	10,518.3	4,922.4
Plus: Lease liabilities debt	263.6	182.4	971.4	971.4	971.4	971.4
Less: Accessible cash and liquid Investments	(52,778.0)	(50,184.8)	(31,364.3)	(17,859.6)	(14,000.8)	(13,119.3)
Debt	--	--	--	--	--	--
Cash and short-term investments (reported)	56,750.6	52,221.4	32,102.7	18,280.1	14,330.4	13,428.1
Adjusted ratios						
Debt/EBITDA (x)	--	--	--	--	--	--
FFO/debt (%)	N.M.	N.M.	N.M.	N.M.	N.M.	N.M.
Annual revenue growth (%)	52.4	(14.1)	(18.7)	(0.3)	3.8	6.7
EBITDA margin (%)	22.3	7.0	3.2	3.8	6.2	9.8
Return on capital (%)	37.2	5.9	(0.5)	(0.3)	2.6	8.2

All figures are adjusted by Taiwan Ratings Corp., unless stated as reported. a--Actual. e--Estimate. f--Forecast. NM—not meaningful. NT$--new Taiwan dollar.

Liquidity: Strong

The short-term rating on CHIMEI is 'twA-1+'. We believe the company has strong liquidity based on our projection of its net cash position and we forecast the ratio of liquidity sources to liquidity uses of 1.8x in 2024 and 2x in 2025. We see CHIMEI has sufficient liquidity sources to cover its liquidity uses, even if forecasted EBITDA declines by 50%. In addition, CHIMEI has well-established banking relationship and a high credit standing in the capital market, in our view. Moreover, we believe CHIMEI can absorb low probability high impact events with limited need for refinancing, underpinned by its high cash balance and low debt usage.

Principal liquidity sources:

- Cash and short-term investments of about NT$32.1 billion as of the end of 2023.
- Funds from operations of NT$3 billion-NT$7 billion in 2024 and NT$6 billion-NT$10 billion in 2025.

Principle liquidity uses:

- Short-term debt maturity of about NT$6.3 billion in 2024 and syndicated loan maturity of NT$4.2 billion in 2025.

- Working capital outflow of NT$0.5 billion-NT$2.0 billion in 2025.
- Capex of NT$11 billion-NT$13 billion in 2024 and NT$5 billion-NT$7 billion in 2025.
- Cash dividend payout of NT$2.2 billion in 2024 and NT$1 billion-NT2 billion in 2025.

Related Criteria & Research

Related Criteria

- Criteria | Corporates | General: Sector-Specific Corporate Methodology - April 04, 2024
- Criteria | Corporates | General: Corporate Methodology - January 07, 2024
- Criteria | Corporates | General: Methodology: Management And Governance Credit Factors For Corporate Entities - January 07, 2024
- 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
- 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; Outlook Action

	To	From
CHIMEI Corp.		
Issuer Credit Rating	twAA-/Negative/twA-1+	twAA-/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.