

Media Release:

# Walsin Lihwa Corp. Outlook Revised To Negative On Higher Debt Leverage; 'twA-/twA-2' Ratings Affirmed

August 29, 2024

## Rating Action Overview

- **Walsin Lihwa Corp.** is a Taiwan-based stainless steel and wire and cable manufacturer, with EBITDA of new Taiwan dollar (NT\$) 15.8 billion in 2023.
- Weaker operating conditions in the company's nickel and stainless-steel segments could keep Walsin Lihwa's EBITDA margin below our previous expectation of 9%-10% in 2024-2025.
- We forecast Walsin Lihwa's debt for the period could rise to NT\$63 billion-NT\$67 billion due to higher capex and additional investment needs then decline to NT\$60 billion in 2026. Debt leverage is likely to increase to above 4x in 2024 before dropping back to 4x in 2025 and 3.4x in 2026.
- We have revised our outlook on the long-term issuer credit rating on Walsin Lihwa to negative from stable to reflect our view of the rising likelihood that the company will be unable to bring debt leverage below 4x over the next 12-24 months.
- 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 that tougher operating conditions for Walsin Lihwa's nickel and stainless-steel segments coupled with rising capital expenditure (capex) needs could push debt leverage above 4x in 2024.* We expect rising competition in the nickel sector to constrain the EBITDA contribution from this segment amid oversupply and weakened demand.

The nickel price fell to about US\$17,500 in the first half of 2024, from an average of US\$21,000 in 2023. Capacity growth, especially in Indonesia, continues to outpace growth in nickel demand and is unlikely to improve over the next one to two years. This will add pressure to nickel prices and production margins. While global nickel makers have reduced production or closed capacity outside of Indonesia, price competition is likely to continue as more competing capacity comes online.

Indonesian output, including Walsin Lihwa's production facilities there, has a better embedded cost structure supported by higher raw material quality and accessibility than for competing plants in China. In addition, Walsin Lihwa's nickel plant benefits from a relatively better operating structure among plants in Indonesia because of a more comprehensive infrastructure and more stable power supply from their own power plant. However, the company still faces a challenge to fully restore nickel profit over the next two years due to higher downside risk and the sector's volatile operating performance due to continued overcapacity. As a result, we forecast the

### PRIMARY CREDIT ANALYST

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

### SECONDARY CONTACT

**James Hung, CFA**  
Taipei  
+886-2-2175-6839  
james.hung  
@spglobal.com  
james.hung  
@taiwanratings.com.tw

company's EBITDA margin will remain flat at 8.3% in 2024 and to mildly improve to 8.7% in 2025, which is still below our previous forecast of 9%-10% for the period.

**Capital expansion and investment could increase debt in 2024-2025 beyond our previous expectation.** Walsin Lihwa plans to tighten control of its working capital to prevent additional funding needs. This includes reducing businesses that require working capital but make a limited EBITDA contribution, such as bare copper and steel wire rope. Nevertheless, we believe the company will continue to increase spending on mergers, acquisitions, better integration, debottlenecking, product upgrades, and efficiency enhancement.

We forecast Walsin Lihwa's capex will remain relatively high at NT\$11 billion-NT\$12 billion in 2024-2025, which could push up debt in 2024, amid relatively weak operating cash flow generation. This includes the impact of a one-off tax payment of NT\$3 billion for Walsin Lihwa's property division. In addition, planned acquisitions for a stainless-steel company and adjustments to Walsin Lihwa's investment structure in its Indonesia subsidiaries could lead to cash outflow in 2024-2025. Therefore, we forecast adjusted debt will reach NT\$64 billion at the end of 2024 and NT\$66 billion at the end of 2025, up from NT\$51.2 billion in 2023.

**A materially uplift in profitability from recent investments and expansion requires more time.** Some of the company's investments in recent years has lifted the profitability of its wire, cable and stainless-steel segments, which partly offsets the weaker profit from the firm's nickel operations and China market amid a continuing market downturn. However, we believe it will take another one to two years for Walsin Lihwa to see higher returns from its high value-added products and for the full integration of its businesses in Europe. This reflects our view of potential execution risks for the firm's various mergers and prolonged weak stainless-steel demand, especially in China.

**Debt leverage could improve along with a gradual profit recovery from 2025 and significant capex reduction in 2026.** We forecast the ratio of debt to EBITDA will rise to 4.3x in 2024 from 3.2x in 2023, before improving continuously to 4x in 2025 and 3.2x in 2026. That's because after several years of acquisitions and business restructuring, Walsin Lihwa is likely to focus mainly on strengthening profitability. It aims to achieve this through investments in additional capacity, facility upgrades, and procedure optimization. This should bring down capex and investment needs in 2025-2026, in our view.

## Outlook

The negative outlook reflects our forecast that the ratio of debt to EBITDA could stay at 4.0x-4.3x in 2024-2025. This reflects weaker profit generation due to intensifying price competition for Walsin Lihwa's nickel business amid oversupply at the same time as weaker demand. The firm's expansion appetite remains high, mainly for the construction of a submarine cable plant and regional integration enhancements in Europe and Indonesia. However, prolonged weak steel (stainless-steel) demand, a supply-demand imbalance in Indonesia, and post-acquisition integration risks remain downside risks for the ratings.

### Downward scenario

We may lower the long-term rating on Walsin Lihwa if the ratio of debt to EBITDA fails to improve to below 4x over the next 12-24 months. The likely scenarios for this are:

- A longer industry downturn amid a contraction in demand and intensifying competition;
- More aggressive capex or investment plans than we forecast; or

- Lower return on capex and investments than we forecast, perhaps due to an unsuccessful technology upgrade or development delay for high value-added products. Failure to materialize synergy or to successfully integrate its European acquirees could also lead to the same result.

### Upward scenario

We could revise the outlook back to stable if Walsin Lihwa could bring the debt-to-EBITDA ratio back sustainably below 4x, possibly as the result of:

- Significant improvement in profitability following a demand recovery and better returns from high value-added products, or
- Assumes a more conservative appetite on capex and investments that lead to a material reduction in debt.

## Our Base-Case Scenario

- S&P Global's forecast for Taiwan's GDP to grow 4.0% in 2024, 2.1% in 2025, and 2.4% in 2026, and for China's GDP to rise 4.8% in 2024, 4.6% in 2025, and 4.6% in 2026.
- Our assumption for the copper price of US\$9,300-US\$9,500/ton in 2024 and US\$9,700-US\$9,800/ton in 2025, and the nickel price at US\$16,500-US\$17,500/ton in 2024 and US\$17,000-US\$18,000/ton in 2025.
- Walsin Lihwa's revenue to decrease by 3.5%-6.5% in 2024 due to lower metal prices and the downsized business scale of its solar tech and bare copper businesses. Revenue could increase by 4%-7% in 2025, supported by the acquisition of a stainless-steel business and improving performance of wires and nickel segments.
  - Revenue from stainless steel to remain flat in 2024, as the full-year volume contribution from the acquired entity in the U.K. will offset lower average selling prices (ASP). Revenue could grow by 7%-9% in 2025 due to the merger of Mannesmann Stainless Tubes GmbH (MST).
  - Revenue from nickel resource business to drop by 13%-15% in 2024, reflecting a lower nickel price and temporary volume decline. Revenue could recover by 2.5%-4.5% in 2025 amid gradual recovery in volume and ASP.
  - Revenue from wires and cables to decline by 2.5%-5.5% in 2024 mainly due to reduced copper business but increase by 2.5%-5.5% in 2025 amid higher wire and cables sales volume in Taiwan.
  - Revenue from Walsin Lihwa's solar tech subsidiary, Borrego, could decline by 60%-70% due to the full-year effect after disposal of several of its departments in 2023.
- Gross margins are likely to slightly improve to 12%-14% in 2024 and 2025 from 11.9% in 2023, reflecting better operating efficiency and product mix in wires and cables and stainless-steel sectors. This is despite weaker performance of the firm's nickel business due to oversupply in Indonesia.
- EBITDA contribution from equity investment method companies will decline in 2024 and largely remain flat in 2025 due to conservative cash dividend payouts.
- Ratio of selling, general and administrative expenses to rise to 4.8%-5.5% in 2024-2025, from 4.3% in 2023, due to additional expense from merged subsidiaries in Europe before they materially expand their revenue base.
- Working capital to remain stable as Walsin Lihwa could reduce businesses that require high working capital but make a relatively limited profit contribution.

- Capex of NT\$10 billion-NT\$12 billion in 2024 and 2025 mainly for the construction of a submarine power cable plant in Taiwan and investment in facilities upgrades across all sectors.
- Net cash outflow of NT\$5 billion-NT\$6 billion in 2024 for investments and disposals. The major acquisition will be for German stainless-steel company, MST, to improve production integration in Europe. Potential continuous stainless-steel-related investments of NT\$1.5 billion-NT\$2.5 billion in 2025 and NT\$3.0 billion in 2026.
- Dividend payout of NT\$4.4 billion in 2024 and maintaining a 60% dividend payout ratio in the following two years.
- Surplus cash haircut of 9.6% for 2023 and thereafter.

**Walsin Lihwa Corp. – Taiwan Ratings Corp. Forecast summary**

**Industry sector: Metal and mining**

<b>(Mil. NT\$)</b>	<b>2021a</b>	<b>2022a</b>	<b>2023a</b>	<b>2024e</b>	<b>2025f</b>	<b>2026f</b>
Revenue	156,665	180,401	189,840	180,063	190,352	196,001
EBITDA (reported)	16,176	13,950	14,449	14,569	15,977	17,101
Plus/(less): Other	809	1,633	1,375	412	551	596
EBITDA	16,985	15,583	15,824	14,981	16,528	17,697
Less: Cash interest paid	(492)	(740)	(1,926)	(2,174)	(2,261)	(2,162)
Less: Cash taxes paid	(1,255)	(2,732)	(1,690)	(4,794)	(1,184)	(1,381)
Funds from operations (FFO)	15,239	12,111	12,208	8,013	13,083	14,154
Cash flow from operations (CFO)	1,303	13,903	22,755	8,988	14,024	18,120
Capital expenditure (capex)	6,415	15,499	16,512	11,826	11,472	5,887
Free operating cash flow (FOCF)	(5,113)	(1,596)	6,242	(2,838)	2,552	12,233
Debt (reported)	50,712	74,764	64,517	71,299	73,710	67,766
Plus: Lease liabilities debt	315	2,555	3,023	3,114	3,114	3,114
Less: Accessible cash and liquid investments	(9,758)	(18,049)	(16,456)	(10,848)	(10,848)	(10,848)
Plus/(less): Other	150	152	144	144	144	144
Debt	41,419	59,422	51,229	63,709	66,120	60,176
Cash and short-term investments (reported)	10,493	19,428	18,203	12,000	12,000	12,000
<b>Adjusted ratios</b>						
Debt/EBITDA (x)	2.4	3.8	3.2	4.3	4.0	3.4
FFO/debt (%)	36.8	20.4	23.8	12.6	19.8	23.4
Annual revenue growth (%)	39.2	15.2	5.2	(5.1)	5.7	3.0
EBITDA margin (%)	10.8	8.6	8.3	8.3	8.7	9.0

All figures are adjusted by Taiwan Ratings Corp., unless stated as reported. Figures of forecast period are based on Taiwan Ratings Corp.'s base case scenario. a--Actual. e--Estimate. f--Forecast. NT\$-- new Taiwan dollar. N.M.--Not meaningful.

## 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 1.6x for the 12 months ending June 2025. We also believe the company will have positive liquidity sources minus uses, even if its EBITDA declined by 15%.

In addition, we view Walsin Lihwa has a solid relationship with banks, 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 global depositary rights issuance. Walsin Lihwa's sufficient undrawn bank credit lines and flexibility to increase bank facilities further support this view. The company's bank loans carry some financial covenants; however, 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\$13.1 billion at the end of June 2024.
- Funds from operations of NT\$10 billion-NT\$13 billion up to June 2025.
- Committed mid-term bank lines of NT\$35 billion-NT\$38 billion up to June 2025.

### Principal liquidity uses

- Long-term debt amortization plus short-term debt maturity of NT\$18.2 billion up to June 2025.
- Capex of NT\$10.5 billion-NT\$12.5 billion up to June 2025.
- Net out flow of NT\$4 billion-NT\$5 billion for investment activities for the 12 months ended June 30, 2025.
- Cash dividend of NT\$4.4 billion up to June 2024.

## Rating Score Snapshot

Issuer Credit Rating: twA-/Negative/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: Neutral (No impact)
- Comparable rating analysis: Neutral (No impact)

Stand-alone credit profile: twa-

## 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 – November 11, 2021

(Unless otherwise stated, these articles are published on [www.taiwanratings.com](http://www.taiwanratings.com))

## Ratings List

### Ratings Affirmed; Outlook Revision

	To	From
<b>Walsin Lihwa Corp.</b>		
Issuer Credit Rating	twA-/Negative/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](http://www.taiwanratings.com) for further information. Complete ratings information is available to subscribers of Rating Research Service at [rrs.taiwanratings.com.tw](http://rrs.taiwanratings.com.tw). All ratings affected by this rating action can be found on Taiwan Ratings' public website at [www.taiwanratings.com](http://www.taiwanratings.com).

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