Media Release:

# Taiwan Smart Electricity & Energy Co. Ltd. Assigned 'twAA+/twA-1+' Issuer Credit Ratings; Outlook Stable

**April 8, 2025**

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## Rating Action Overview

- Taiwan Smart Electricity & Energy Co. Ltd. (TSEE) is a Taiwan-based wholesale power distribution company that will initially specialize in offshore wind power. The company will start generating revenue in 2028 when the wind farms it engages are commissioned.
- We see a high likelihood that the Taiwan government will offer TSEE extraordinary support in the event of the company's financial distress, given our view that the Taiwan government will maintain its control over TSEE due to the company's important role in the government's efforts to achieve a net zero emissions by 2050.
- TSEE can pass through most resource and operational risks for offshore wind power through its long-term fixed-price corporate power purchase agreements (CPPAs) that enable the company to generate stable margins and cash flow. This, together with its asset-light business model and limited working capital needs, could enable TSEE to maintain very strong capital structure.
- We assigned our 'twAA+' long-term and 'twA-1+' short-term issuer credit ratings to TSEE.
- The rating outlook is stable which embeds our view that TSEE will be able to complete its capital injection and secure CPPAs with offshore wind farms and potential clients at terms that are consistent with our assumptions over the next six to 12 months.

## Rating Action Rationale

***TSEE's good pricing power, strong market demand, and long-term fixed-price CPPAs could support stable margins, despite uncertainty about the pricing and terms.*** We believe TSEE's association with the government and the company's strong shareholder mix place it in a good position to secure 25-year CPPAs with offshore wind farms at low costs. We also believe TSEE has strong bargaining power when negotiating offtake agreements with clients at stable margins; this strength is unparalleled by other private renewable distributors.

TSEE plans to sign CPPAs with potential offshore wind farms and clients after the company completes its planned capital injections and expand its board in 2025. However, we believe the uncertainty on pricing and terms of those contracts presents significant downside risk to our current projections.

Our base case assumes TSEE can by the end of 2026 secure one gigawatt (GW) capacity from offshore wind farms that are scheduled to enter operations in 2028-2029, according to the company's plan. Those offshore wind farms under development are facing difficulties in securing long-term offtake contracts with creditworthy counterparties. Those projects carry some project delay risk, given the lack of an efficient supply chain in Taiwan and difficulty in securing debt funding. Uncertainty about the terms and conditions of the CPPAs with offshore wind farms also adds to TSEE's business risk.

Revenue risk will remain before TSEE fully secures sale contracts with its clients. However, we believe the company could secure sufficient demand because of strong demand capacity, given strong demand for green power from major industrial power users, such as chip makers. We believe major Taiwan-based companies, particularly major exporters, will significantly increase their use of green power to fulfill long-term commitments to their shareholders and clients. In addition, power demand from TSEE's industrial shareholders is more than the company's initial plan of 1GW capacity, which largely alleviates demand risk.

Despite TSEE's limited scale, we anticipate the company will have a high market share in the aggregation services of offshore wind power in Taiwan, given high entry barriers in this sector. We do not expect TSEE to experience significant competition from other renewable aggregation services providers, given the high requirement on credit standing and a relatively small renewables market in Taiwan.

***Shareholders' commitment to absorb defaulted capacity and a full passthrough of operational risks from offshore wind farms to clients reduce operational risk.*** TSEE aims to pass through most resource and operational risks from offshore wind farms to its clients in its power sale agreements. These include operating unavailability stemming from natural disasters and maintenance requirements. Nonetheless, TSEE could still experience revenue volatility because of operational interruptions at offshore wind farms. The company's relatively concentrated supplier base could exacerbate such volatility. In addition, it remains uncertain that TSEE can fully achieve its targets in the ongoing negotiations, despite its good bargaining power.

In addition, TSEE's industrial shareholders have the obligation to assume the capacity defaulted by its clients on a cost-plus basis according to the shareholder agreement. This will largely eliminate business interruptions before new users are secured. Nonetheless, margins could weaken because its shareholders will assume the defaulted capacity at a lower price than regular customers.

TSEE could face contract renewable risk if the company cannot match the durations of its sales contract with the 25-year CPPAs with offshore wind farms. The company seeks to lower the risk through the provision of forward contracts to companies that do not have immediate demand for offshore wind power. In addition, TSEE's good market position could also allow some flexibility for it to be selective in its client acquisitions to minimize the duration mismatch risk.

***TSEE's minimal capital expenditure (capex) and limited working capital needs should support stable free operating cash flow and very low debt leverage.*** TSEE's stable margins together with minimal capex and limited working capital needs will enable the company to generate stable positive free operating cash flow, despite some volatility in revenue. TSEE's working capital needs should be limited and its cash conversion cycle will be short if not negative, given its good bargaining power, particularly with clients.

TSEE will need to provide security over its long-term PPAs with offshore wind farms through cash deposits or letters of credit, based on its credit conditions. However, the company could offset such obligations with security provided by its clients. We also forecast cash proceeds from the upcoming capital injection will be sufficient to absorb potential project delays at TSEE's contracted offshore wind farms without materially altering its leverage after the company starts generating revenue in 2028.

We believe TSEE's planned capital base of new Taiwan dollar (NT$) 1.65 billion will be more than sufficient to meet all operating expenses and working capital needs before the company starts generating revenue in 2028. We also assume TSEE will maintain a prudent dividend policy and pay 65%-70% of its profits as cash dividends to maintain a strong capital structure, which is critical to its business. Accordingly, we forecast TSEE could sustain a net cash position.

***TSEE's important role to facilitate Taiwan's decarbonization and very strong link with the government underpin a high likelihood of extraordinary financial support from the government.*** We believe TSEE will maintain an important role in the government's policy to achieve net zero emissions by 2050. We forecast offshore wind power will play a critical role in the government's decarbonization strategy, contributing more than 40% of renewables by 2030 and more than 60% by 2050.

Taiwan's world-leading offshore wind resources and the limitation on the development of onshore wind and solar power will support offshore power to be the main resource for Taiwan in the long term. However, the difficulty in securing sufficient long-term fixed price CPPAs with highly creditworthy counterparties has significantly hindered the development of offshore wind power in Taiwan. TSEE's government association and strong shareholder base enables the company to fulfill the role, in our view. Uncertainty over Taiwan's energy policy and a limited direct impact of the company's operations on the economy constrain this assessment.

In addition, we forecast the government will maintain its strong influence over TSEE based on government-related entities' 52.5% shareholding after the company completes its planned capital injections in 2025. In addition, the government will exert its influence mainly through four directors out of seven appointed by government-related shareholders in the board post its upcoming capital injection. We believe that the government-related entities will have strong intention to keep, if not increase, their holding because of TSEE's role in the government's energy policy and their large renewables demand. Incoming government-related shareholders, including China Steel Corp., CPC Taiwan Corp., Chunghwa Telecom Co. Ltd. and Taiwan High Speed Rail Corp., are major electricity consumers in Taiwan facing growing pressures to decarbonize.

# Outlook

The stable rating outlook reflects our view that the passthrough nature of TSEE's corporate CPPAs with offshore wind farms and its clients, and shareholders' obligation to assume defaulted contracts will enable TSEE to maintain a net cash position after the commencement of electricity sales in 2028.

We also believe that TSEE could withstand delays in the construction of the offshore wind farms the company engages without negatively affecting its capital structure.

The outlook also reflects our anticipation that the Taiwan government will maintain its very strong link with the company and utilize TSEE as an important vehicle to promote offshore wind power as the key pillar for Taiwan's decarbonization path over the next few years.

### Upward scenario

We could raise the long-term rating on TSEE if:

- The company can secure long-term fixed price contracts with offshore wind farms and potential clients with favorable pricing and terms, such that we believe TSEE could generate stronger cash flow with lower volatility than we previously forecast for the long term; and
- The company maintains a minimal debt leverage, keeping its ratio of debt to EBITDA consistently below 1.5x.

### Downward scenario.

We could lower the long-term rating on TSEE if:

- The company's debt-to-EBITDA ratio stays materially above 1.5x because of: (1) more aggressive capacity expansion and intense competition that lead to unfavorable pricing and trade terms, resulting in weaker profitability and high capital working capital outflows, or: (2) TSEE adopting a more aggressive financial policy, such as materially increasing its shareholder distributions; or
- TSEE's revenue and margin protection from its power purchase and sale contracts with suppliers and clients are materially weaker than we assume, such as insufficient risk passthrough or a significant mismatch in the duration and trade terms between its purchase and sale contracts.

In a more remote scenario, we could lower the long-term rating on TSEE if the Taiwan government materially reduces its linkage and control with the company, indicating a weaker role in the company's role in the decarbonization strategy. A material decease in government-related entities' holdings in the company together with a loss of control in the board would signal such deterioration.

## Company Description

TSEE was set up by China Steel Corp. in October 2024 to assist the development of offshore wind power in Taiwan, which is critical to the government's net zero goal by 2050. TSEE will engage in offshore wind power distribution. Government-related entities will own 52.5% of the shares in TSEE after the company completes a NT$1.63 billion capital injection by the end of 2025. TSEE plans to complete the signing of purchase agreements with offshore wind farms and sale contracts with its clients by the end of 2026.

## Our Base Case Scenario

- S&P Global Ratings' projection for Taiwan's real GDP to grow 2.1% in 2025 and 2026.
- Taiwan's renewables demand from corporate will grow to 48 billion kilowatt hours (kwh) per year in 2030 from 1.7 billion kwh in 2023, with offshore wind farms generating about 45% of the total volume.
- Our base case forecast that TSEE could secure about 1GW capacity by the end of 2026 from seven offshore wind farms, which will come online in 2028-2029.
- This will enable the company to sell about 700 million kwh electricity in 2028, 2.7 billion kwh in 2029 and about 3.9 billion kwh in 2030.
- Average tariff will stay at NT$5.6-NT$6.0 per kwh through fixed price CPPAs.
- Gross margins will stabilize at 4.5%-4.9% in 2030 and thereafter.

- TSEE's expenses will rise to NT$340 million-NT$360 million in 2028 before falling to NT$170 million-NT$190 million in 2029 and about NT$80 million in 2030 because of costs associated with performance bonds for CPPAs with offshore wind farms.
- TSEE's cash cycle conversion will stay about 30 days.
- The company will have minimal capex.
- TSEE will pay cash dividends of 60%-70% of the previous year's net income.
- We include 100% of TSEE's cash and liquid investments with debt when calculating credit metrics.

**Key metrics**

**Taiwan Smart Electricity & Energy Co. Ltd.--Taiwan Ratings Corp. Forecast Summary**

Industry sector: Unregulated gas and power

| (Mil. NT$) | 2025f | 2026f | 2027f | 2028f | 2029f | 2030f |
|---|---|---|---|---|---|---|
| Revenue | 0 | 0 | 0 | 4,286 | 15,973 | 22,809 |
| EBITDA (reported) | (52) | (59) | (190) | (150) | 569 | 997 |
| EBITDA | (52) | (59) | (190) | (150) | 569 | 997 |
| Less: Cash interest paid | -- | -- | (13) | (24) | (21) | (19) |
| Less: Cash taxes paid | -- | -- | -- | -- | (113) | (198) |
| Funds from operations (FFO) | (52) | (59) | (203) | (174) | 435 | 780 |
| Cash flow from operations (CFO) | (47) | (56) | (186) | (520) | (555) | 206 |
| Free operating cash flow (FOCF) | (47) | (56) | (186) | (520) | (555) | 206 |
| Debt (reported) | -- | -- | 1,000 | 900 | 800 | 700 |
| Less: Accessible cash and liquid Investments | (1,594) | (1,537) | (2,351) | (1,731) | (1,076) | (1,181) |
| Cash and short-term investments (reported) | 1,594 | 1,537 | 2,351 | 1,731 | 1,076 | 1,181 |
| Adjusted ratios | | | | | | |
| Debt/EBITDA (x) | -- | -- | -- | -- | -- | -- |
| FFO/debt (%) | N.M. | N.M. | N.M. | N.M. | N.M. | N.M. |
| Annual revenue growth (%) | N.M. | -- | -- | 428,501.4 | 272.7 | 42.8 |
| EBITDA margin (%) | (5,231.8) | (5,944.1) | (19,036.6) | (3.5) | 3.6 | 4.4 |

All figures are adjusted by Taiwan Ratings Corp., unless stated as reported. Figures for the 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: Strong

The short-term issuer credit rating is 'twA-1+'. We believe TSEE has strong liquidity to meet its needs over the 24 months ending Dec. 31, 2026. This reflects our view that the ratio of liquidity sources to uses will be about 20x over the period.

TSEE could still meet its liquidity needs even if its EBITDA declines by more than 50%. The company can also absorb high-impact low-probability events without refinancing and zero debt. This is despite the company has not yet built any banking relationships.

Principal liquidity sources:

- Cash and short-term investments of about NT$11.5 million as of Dec. 31, 2024.
- Capital injection of NT$1.63 billion in 2025.

Principal liquidity uses:

- Funds from operations of negative NT$50 million in 2025 and negative NT$57 million in 2026.
- Capex of about NT$0.5 million in 2026.

## Environmental, Social, And Governance

Environmental factors have a positive influence on our ratings analysis of TSEE. The company's role in promoting offshore wind power will contribute significantly to Taiwan's decarbonization in the long term. Also, the growing global call to counter climate change will also increase renewable demand from Taiwan's export-oriented economy. This should support TSEE's long-term growth.

Social risk is a neutral factor to the ratings. TSEE will engage in offshore wind power distribution only to corporate users instead of retail consumers. There will be minimal security and health risk to corporate users, the public and TSEE's employees.

We assess TSEE's governance factor as neutral to our credit analysis.

## Ratings Score Snapshot

Issuer Credit Rating: twAA+/Stable/twA-1+

Note: All scores below are in comparison with global obligors

Business risk: Fair

- Country risk: Intermediate
- Industry risk: Moderately high
- Competitive position: Fair

Financial risk: Modest

- Cash flow/Leverage: Modest

Anchor: twa+

Modifiers:

- Diversification/Portfolio effect: Neutral (no impact)
- Capital structure: Neutral (no impact)
- Financial policy: Neutral (no impact)
- Liquidity: Strong (no impact)
- Management and governance: Neutral (no impact)
- Comparable rating analysis: Neutral (no impact)

Stand-alone credit profile: twa+

- Unsolicited sovereign rating on Taiwan: AA+
- Likelihood of government support: High (+3 notches from the SACP)

# Related Criteria & Research

## Related Criteria

- General Criteria: Rating Government-Related Entities: Methodology And Assumptions - March 25, 2015
- General Criteria: Group Rating Methodology - July 01, 2019
- 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
- Criteria | Corporates | General: Corporate Methodology - January 07, 2024
- Criteria | Corporates | General: Sector-Specific Corporate Methodology - April 04, 2024
- 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
- General Criteria: Environmental, Social, And Governance Principles In Credit Ratings - October 10, 2021

## Related Research

- Taiwan Ratings' Ratings Definitions – Nov. 11, 2021

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

# Ratings List

**New Ratings**

| **Taiwan Smart Electricity & Energy Co. Ltd.** | |
|---|---|
| Issuer Credit Rating | 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.