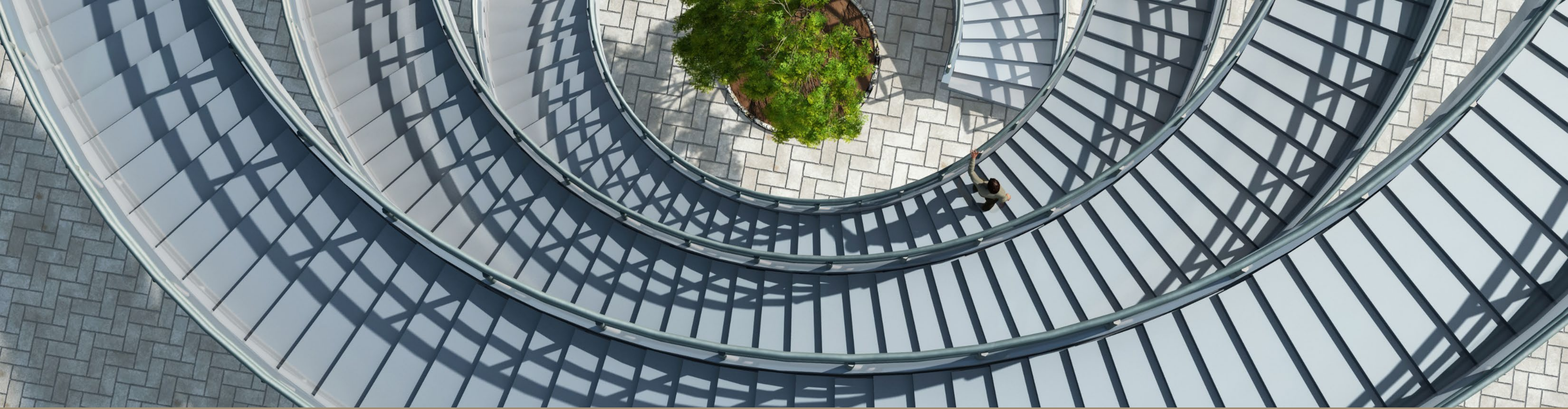


2023 Taiwan Credit Spotlight Corporate Sector Update

Top 50 Firms' EBITDA Generation Could Bottom Out In 2023

S&P Global Ratings

David Hsu, Associate Director

Corporate Ratings

Taiwan Ratings Corp.

September 12, 2023

This report does not constitute a rating action

Top Risks Facing Taiwan Corporates

Top Risks	Risk Level	Risk Trend
Global economic downturn: The global economy risks a hard landing, further depressing aggregate demand and exports	High	Unchanged
China's economy: China's recovery momentum falters substantially in the wake of prolonged weakness in business and household confidence	High	Unchanged
Geopolitics: Geopolitical tensions heighten, worsening trade and investment conditions and reinvigorating inflationary pressures	High	Unchanged
Inflation: Inflation does not ease sufficiently, or even resurges, increasing costs pressures currently faced by borrowers	High	Improving
Financing: Tightening funding access and steepening borrowing costs would worsen the prospects for lower credit issuers	Elevated	Unchanged
Structural Risks		
ESG: Climate change and non-linear energy transition threaten food and energy supply, fanning inflation and social unrest	Elevated	Worsening
Technology: Accelerating technological advancement and mounting cyber attacks to disrupt business models, undermining credit profiles	Elevated	Unchanged

Source: Credit Conditions Asia-Pacific Q3 2023: China Grapples With An Uneven Recovery, published Jun. 27, 2023, by S&P Global Ratings. Note: Risk levels may be classified as moderate, elevated, high, or very high. They are evaluated by considering both the likelihood and systemic impact of such an event occurring over the next one to two years. Typically, these risks are not factored into our base-case rating assumptions unless the risk level is very high. Risk trend reflects our current view about whether the risk level could increase or decrease over the next 12 months.

S&P Global Ratings In APAC Corporate Sector: Improving Outlook Bias Despite Uneven Recovery Across Sectors

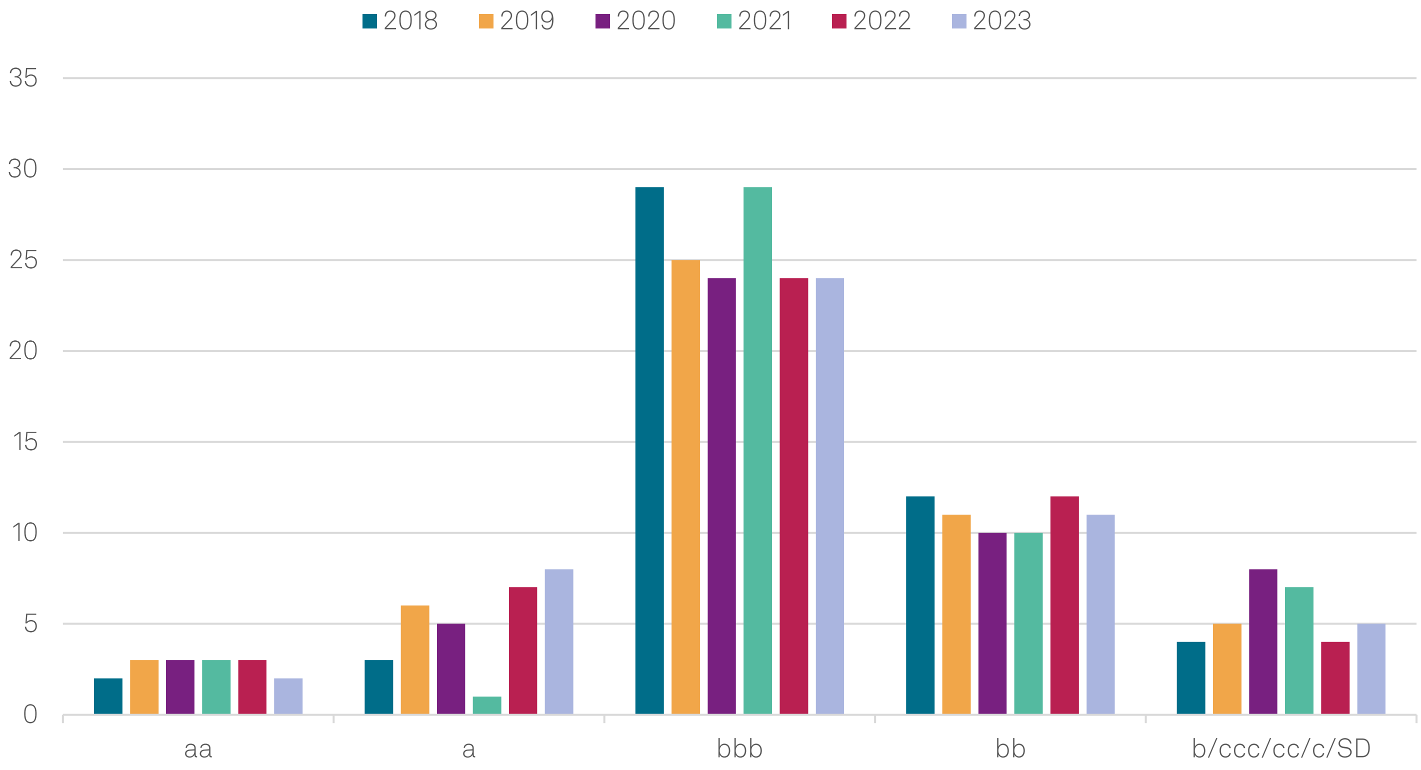
	May 2022	Aug 2022	Oct 2022	Feb 2023	May 2023	Avg rating
Technology	(2%)	0%	(5%)	(10%)	(12%)	BBB
Building materials	(14%)	(8%)	(7%)	(7%)	(13%)	BBB-
Chemicals	0%	3%	0%	0%	(3%)	BBB
Oil & gas	(17%)	(9%)	(4%)	0%	9%	BBB+
Metals & mining	9%	11%	12%	15%	13%	BBB-
Capital goods	(19%)	(11%)	(11%)	(8%)	(6%)	BBB
Consumer products	(11%)	(4%)	(3%)	7%	0%	BBB
Telecommunications	(10%)	(10%)	0%	0%	3%	BBB
Transportation cyclical	(17%)	(17%)	(17%)	(17%)	(17%)	BBB
Auto OEM & suppliers	(3%)	0%	0%	(6%)	(3%)	BBB
Total corporates	(10%)	(7%)	(6%)	(5%)	(4%)	BBB

Source: Asia-Pacific Sector Roundup Q3 2023 – Jun. 28, 2023

- Net rating outlook bias has improved slightly to negative 2% as of end-May, albeit uneven across sectors.
- Of the 21 corporate sectors we cover, six sectors show a deteriorating trend, compared to nine with a positive trend.
- End to pandemic restrictions boosts demand for several consumer service sectors.
- Vulnerabilities abound for sectors more exposed to tepid foreign demand, such as Technology.

Credit Quality To Remain Largely Intact In 2023

The most common stand-alone credit profile remains in the 'bbb' category

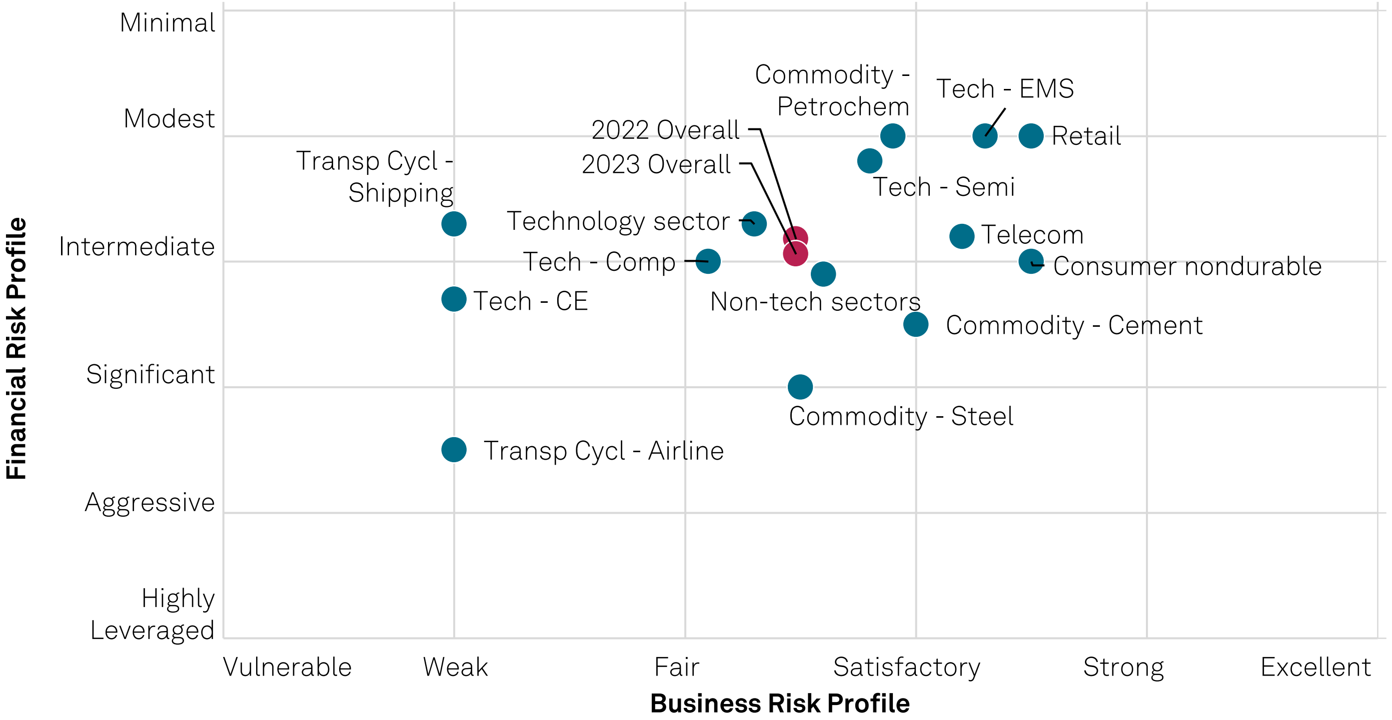


Source: Taiwan Ratings Corp.

- Average creditworthiness has weakened moderately for corporates in Taiwan's technology and retail sectors over the past 12 months.
- We made three downward revisions in creditworthiness this year, compared to 12 upward revisions and one downward revision in 2022.
- The median stand-alone credit profile in 2021 -2023 remains 'bbb', compared to 'bbb-' in 2020.
- Enhanced financial buffers underpin creditworthiness for most top Taiwan companies amid a weak macroeconomic outlook.

Credit Quality To Remain Largely Intact In 2023

Strongest and weakest business and financial risk profiles by sector



Source: Taiwan Ratings Corp. Cycl--Cyclical. CE--Consumer electronics. EMS--Electronic manufacturing services.

- Financial risk profiles (FRP) in Taiwan's technology and retail sectors could weaken moderately in 2023 from the 2022 level.
- Business risk profiles (BRP) in the retail sector could improve just slightly in 2023.
- Tech firms (20 out of the top 50) generally have stronger FRPs to withstand market cyclicality.
- Non-tech firms (30 out of the top 50) generally have stronger BRPs, mainly supported by the dominant local market positions of a few companies.

Rated Corporate Pool: Slower Economic Growth Weighs On Net Rating Bias

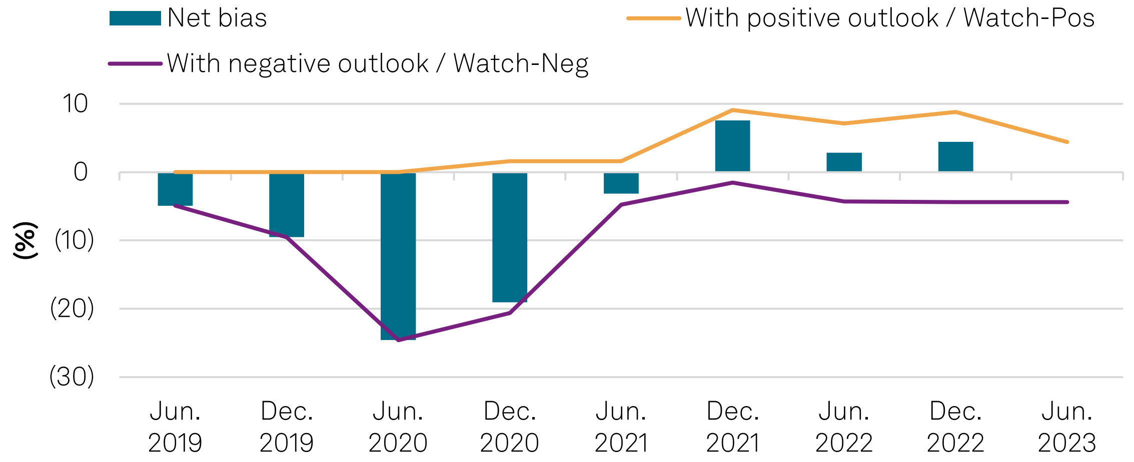
Credit Prospects For Major Sectors

	2022	2023	Note
Technology	Slightly negative	Stable	Slower consumer demand recovery
Chemical	Stable	Stable	Narrowing financial buffer
Steel	Slightly negative	Stable	Weak price but lower cost
Cement	Slightly negative	Slightly negative	Slower China real estate recovery
Shipping	Stable	Stable	Sharp freight rate correction
Airline	Stable	Stable	Solid passenger traffic rebound
Auto & Supplier	Stable	Stable	Stronger 2023 auto market in Taiwan
Telecom	Stable	Stable	Slightly improving profitability

Source: Taiwan Ratings Corp.

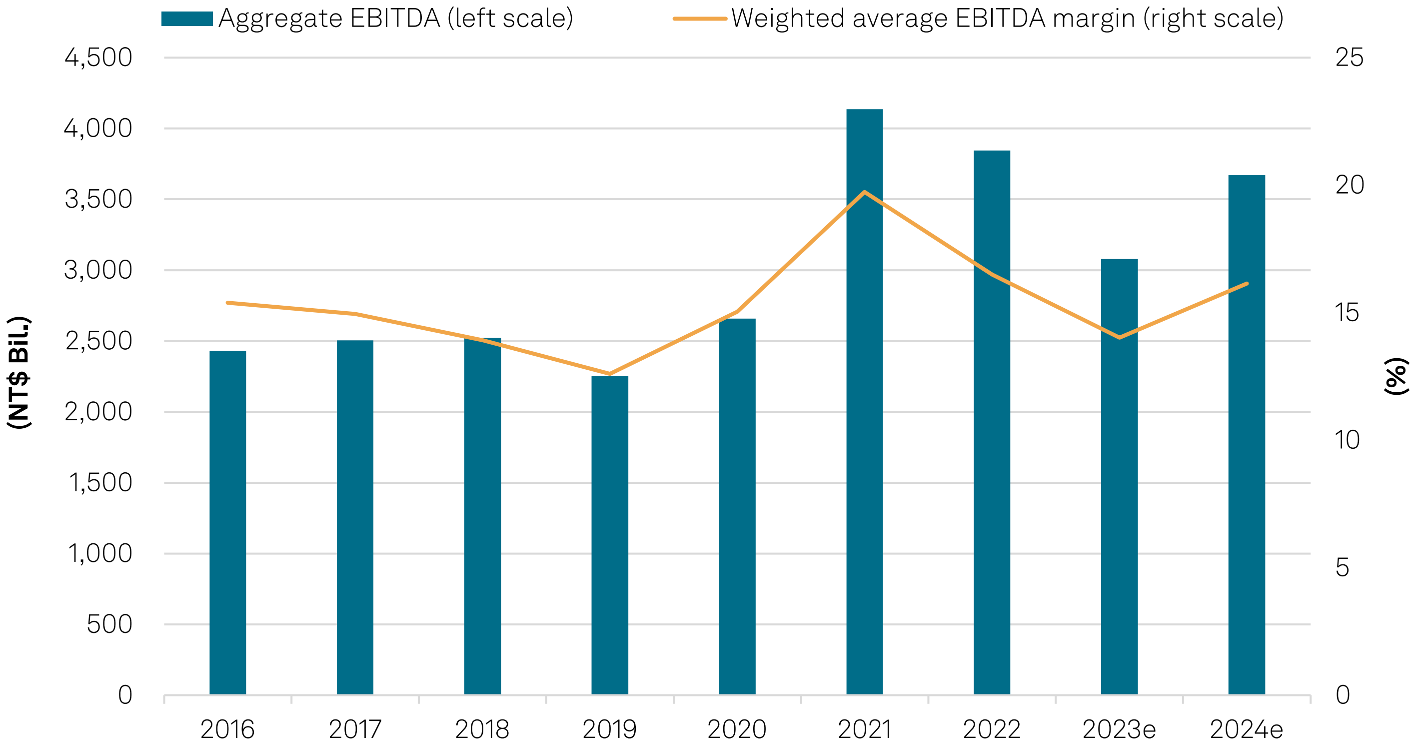
- Weaker market conditions than we previously expected have narrowed rating headroom for some non-tech companies.
- Weaker profitability and continued capital expenditure have also limited corporates' capacity to deleverage, leading to a neutral rating bias.
- This is a slightly unfavorable shift from a marginally positive bias at the start of 2023.

Rating bias of Taiwan Ratings' corporate ratings



EBITDA Generation Could Bottom Out In 2023

EBITDA to continue a downward trend in 2023 after peaking in 2021

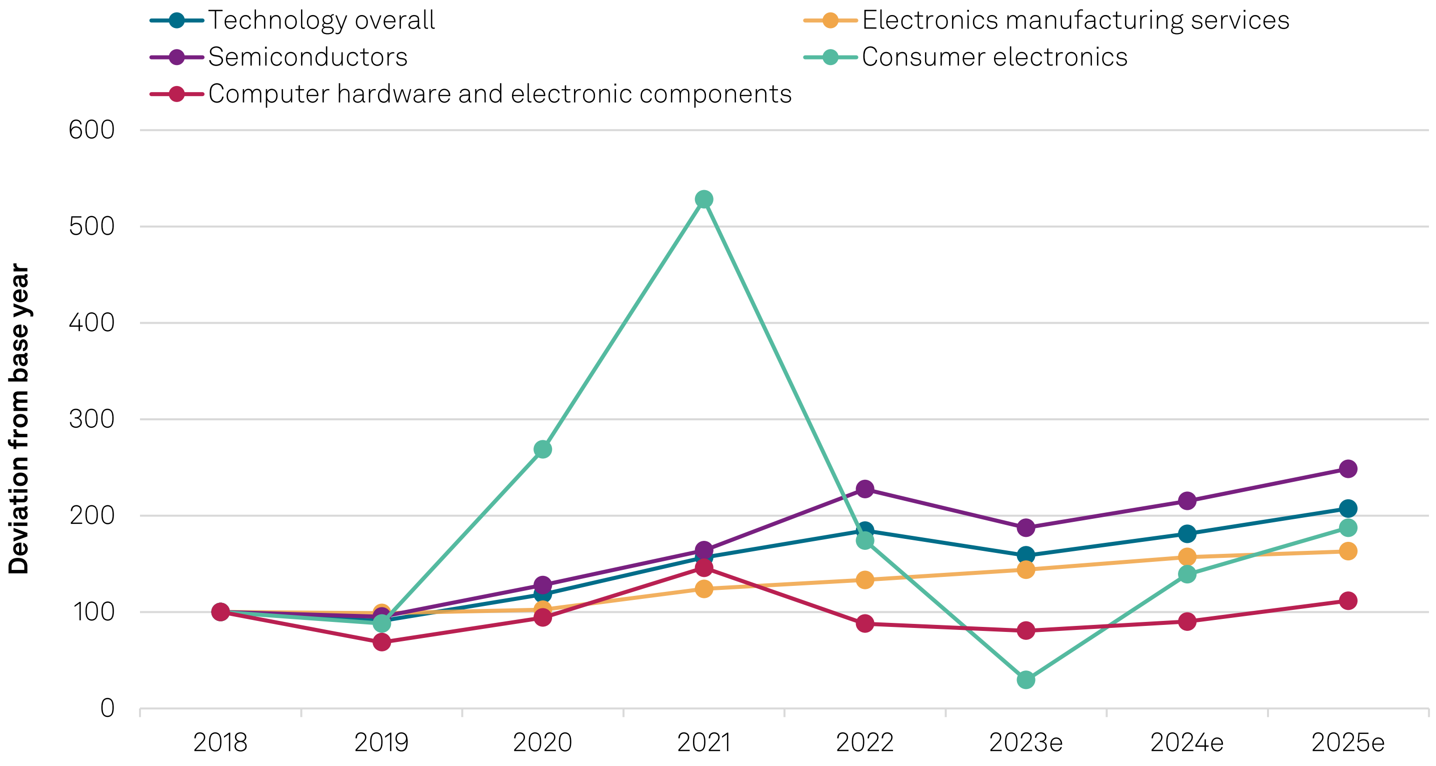


e--Estimate. Source: Industry data, Taiwan Ratings Corp. estimate (e).

- Aggregate EBITDA and EBITDA margin for Taiwan's top 50 corporates could continue to decline in 2023 but remain above the mid-cycle level.
- A likely demand rebound and inventory restocking for both tech and non-tech sectors in the second half of 2023 should support EBITDA generation from 2024 onward.
- Still-weak demand could limit companies' ability to pass through their relatively high costs to downstream clients and consumers.

Taiwan's Tech Sector: EBITDA To Decline In 2023 Amid Weak End Demand, High Inventory Levels

Global and regional market focus – Tech sector

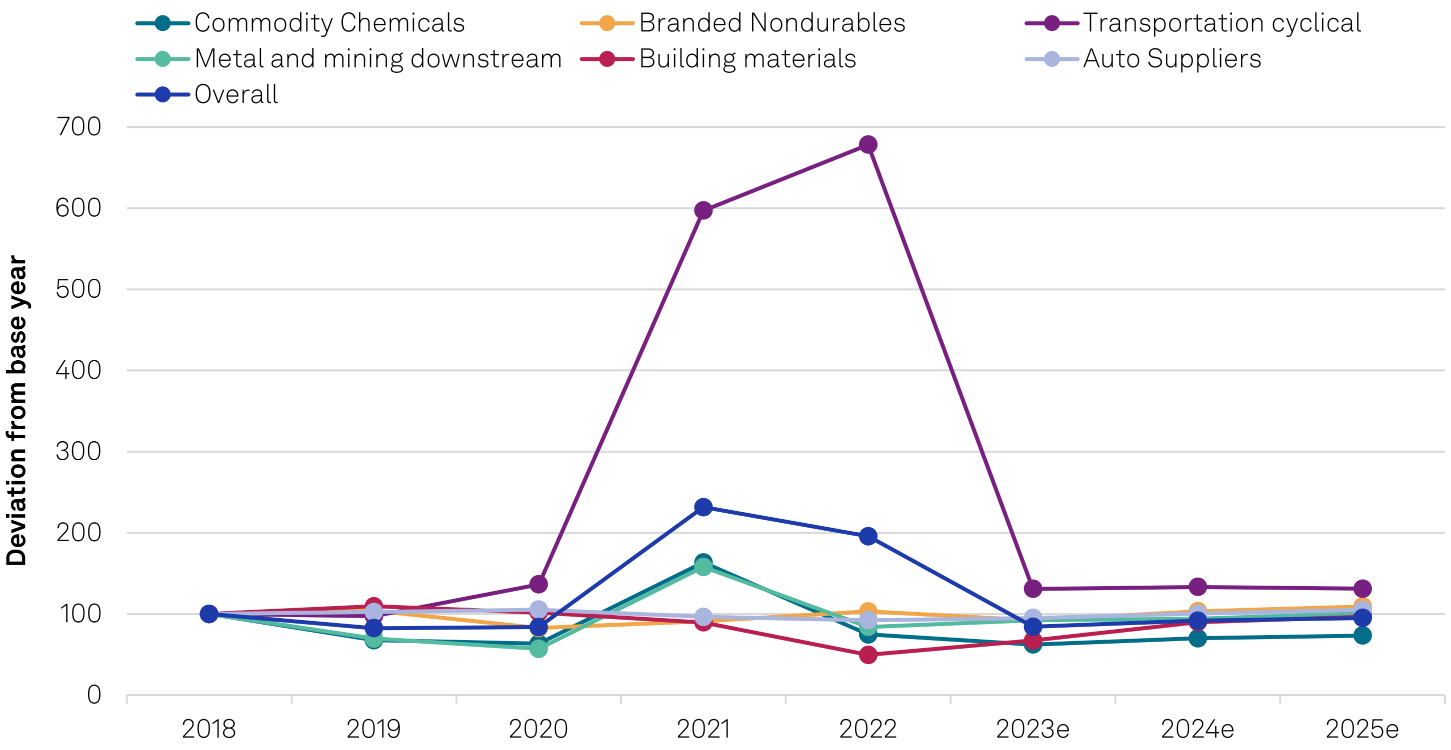


e--Estimate. Source: Industry data, Taiwan Ratings Corp. estimate (e).

- Smartphone, PC, and most consumer electronic sectors face a slow recovery in demand.
- Overall server growth to slow in 2023, despite strong AI server demand.
- The semiconductor sector faces a prolonged inventory correction and weak overall demand.
- Oversupply risk will increase for the semiconductor sector over the next three years, given record investment in capacity.
- 2024 EBITDA to recover to close to 2022 level, supported by development of new technologies, such as cloud, EV and AI.

Taiwan's Non-Tech Sector: Slower China Recovery And The Weak Global Economy Weigh On Profitability

Global and regional market focus – Non-tech sector

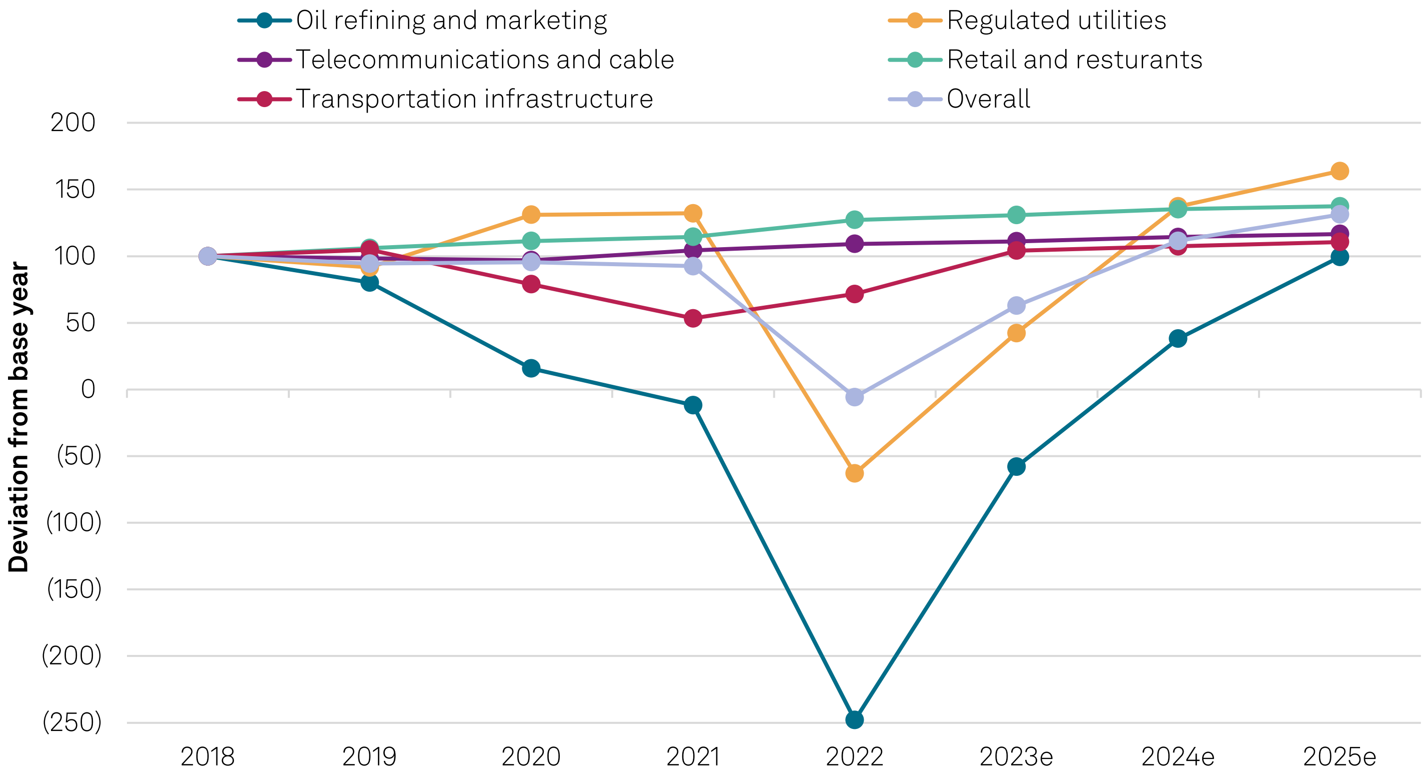


e--Estimate. Source: Industry data, Taiwan Ratings Corp. estimate (e).

- Weaker demand could limit recovery in product spreads and profitability for chemical companies in 2023.
- Recession in China's property market will delay the recovery in cement companies' EBITDA until the second half of 2023.
- Declining material costs enhance steel makers' buffer against weak steel prices.
- The rebound in passenger demand and a lower oil price could slow margin decline for airlines.
- A sharp correction in seaborne freight rates in 2023 to pre-pandemic levels has led to material contraction in EBITDA for container shippers.
- Auto suppliers with less exposure to electric vehicles (EVs) could see slower growth.

Taiwan's Non-Tech Sector: Relatively Stable EBITDA Generation Despite Weak Performance By GREs

Domestic market focus – Non-tech sector

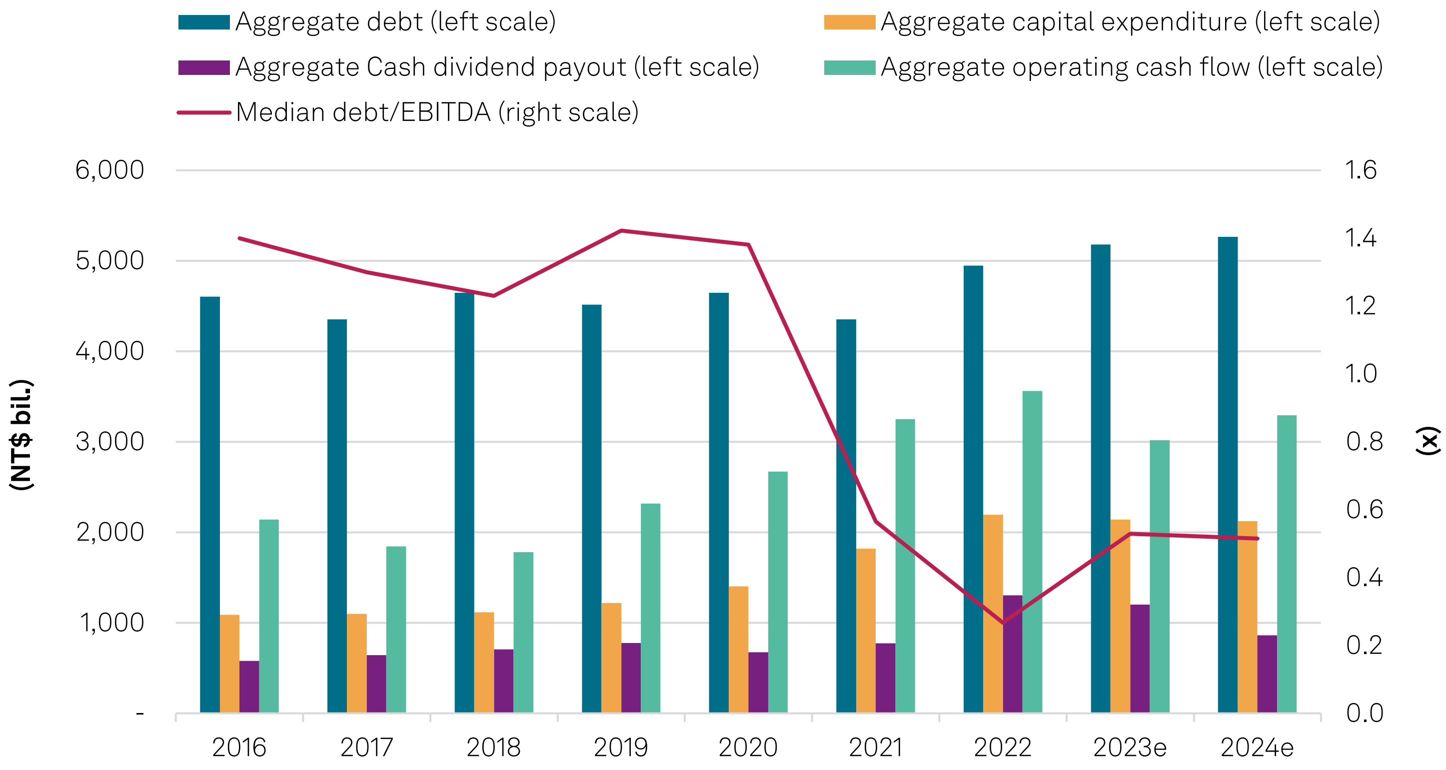


e--Estimate. Source: Industry data, Taiwan Ratings Corp. estimate (e).

- Market consolidation, slow albeit still rising 5G adoption, and conservative 5G data pricing plans are the key drivers for improvement in Telecom operators' average revenue per user and underpins improved profitability.
- Taiwan's continued economic growth should support moderate growth in EBITDA generation for Taiwan's retail sector, including convenience stores and car dealerships.
- The operating performance of government related entities (GREs) should recover in 2023-2024, mainly supported by lower material prices and improving utilization rates post pandemic.

Moderately Higher Debt Levels Despite Capex Cuts

Higher corporate debt is mainly due to weaker operating cash flows



e--Estimate. Source: Industry data and Taiwan Ratings Corp. estimate (e).

- Debt to EBITDA ratio could weaken slightly in 2023 and 2024, from the recent low recorded in 2022.
- Debt levels will rise moderately in 2023-2024 due to weaker operating cashflow and high cash dividend payouts in 2023, despite overall capex cuts.
- Most of the leading corporates in Taiwan have relatively prudent financial policies and avoid aggressive debt-funded acquisitions.

Appendix: Key Sector Updates

S&P Global Ratings

Reinforced Balance Sheets Support Tech Credit Profiles Amid Weak Demand

Cloud services support slightly higher growth in IT spending than GDP in 2023

Overview:

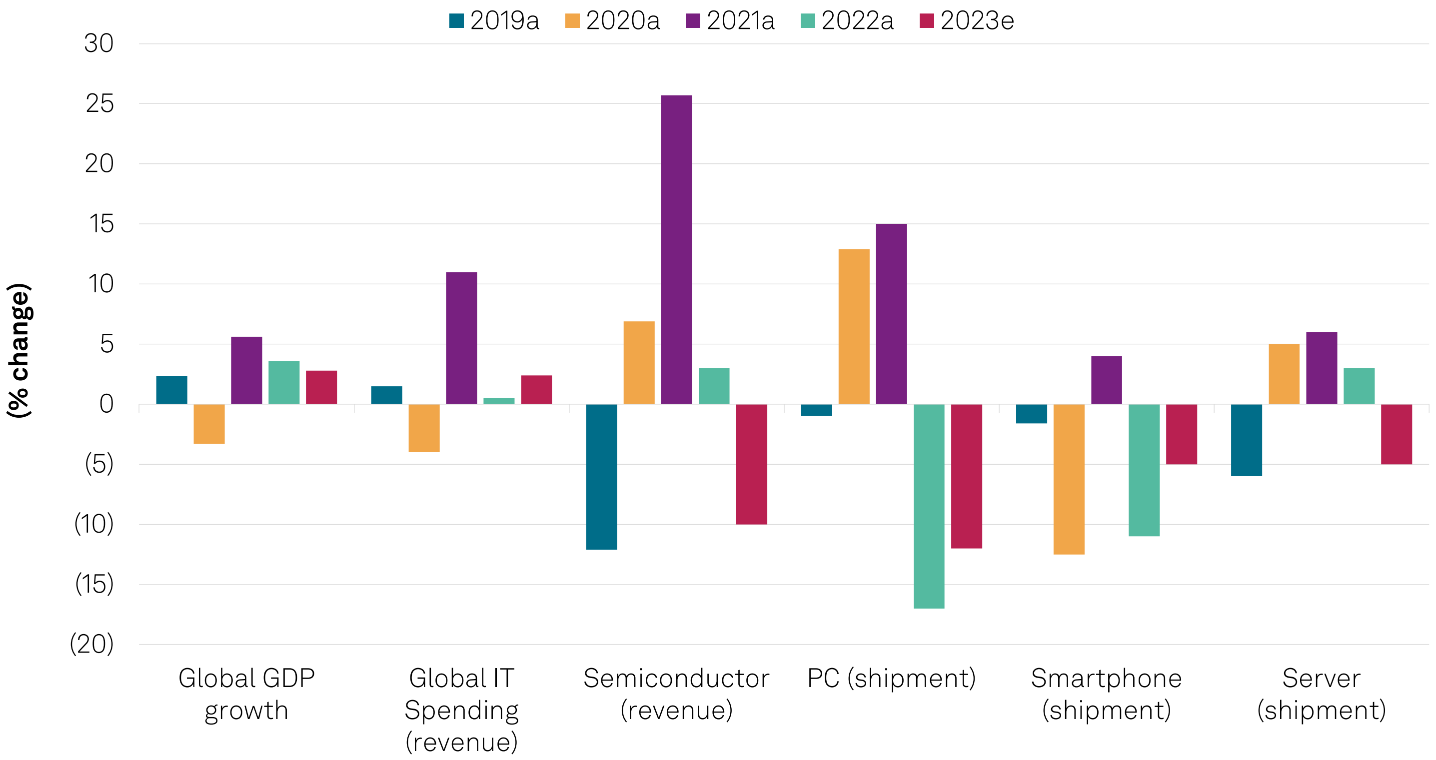
- Most companies have reinforced their balance sheets and are now more resilient against industry downturns and market volatility.

Key risks

- Weaker demand recovery for smartphones, PCs, and consumer electronics.
- Prolonged inventory correction and weak demand for the semiconductor sector; oversupply risk will increase over the next three years, given record new investment.

Mitigants

- Cut in capex and easing working capital needs will support tech firms' credit profiles in 2023.



a--Actual. e--Estimate. Source: Industry data and Taiwan Ratings Corp.

S&P Global Ratings

China’s Reopening Could Fail To Deliver Expected Boost In Chemical Demand

Overview

- Weaker profitability will push up debt leverage over the next 12 months.

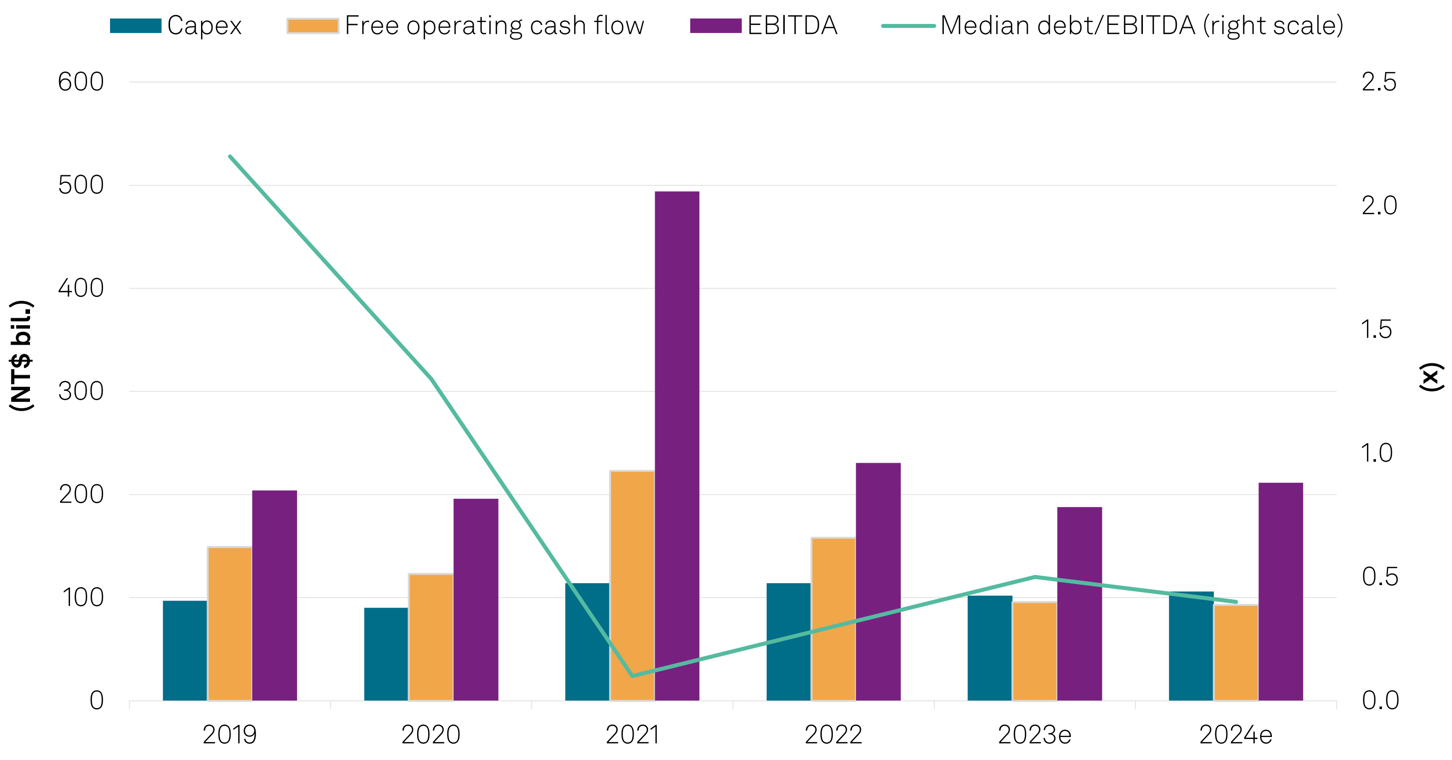
Key risks

- A slower economic recovery in China could dampen demand growth for the rest of 2023.
- Weaker demand could hurt the ability of commodity chemical companies to pass-through product costs and limit their recovery in product spreads.

Mitigants

- Financial buffers, albeit narrowing, will remain sufficient in 2023 before rebounding in 2024.

EBITDA is unlikely to grow strongly over the next 12 months



Note: Capex, free operating cash and EBITDA are the sum for rated Taiwanese chemical companies. e--Estimate. Source: Company data, Taiwan Ratings.

Solid Rebound In Passenger Traffic To Slightly Lift Airlines' Profitability

Overview

- The rebound in passenger demand and a lower oil price could slow margin decline and support adequate cash flow protection for airlines.

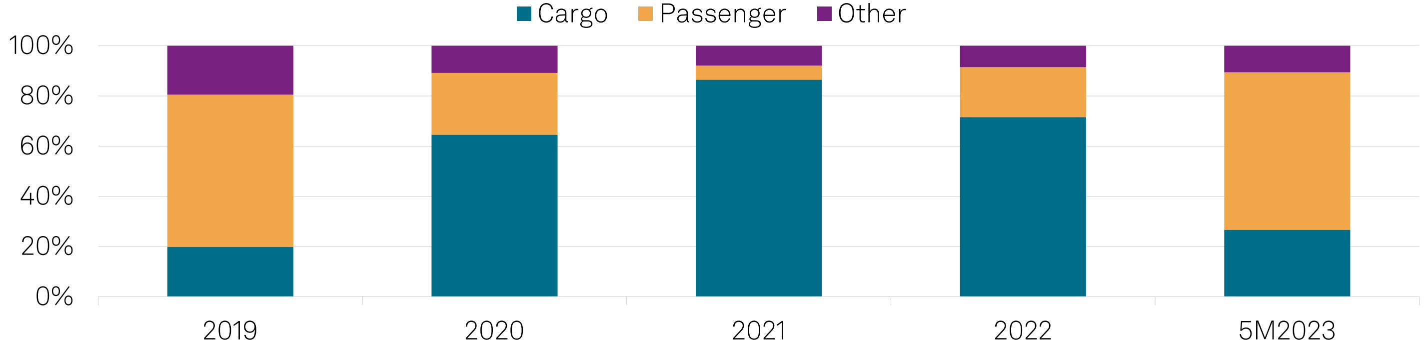
Key risks

- Air cargo to face headwind from the slowing global economy and restoration in belly cargo space.
- Volatile fuel prices, high spending on fleet replacement, and increasingly stringent carbon emission standards.

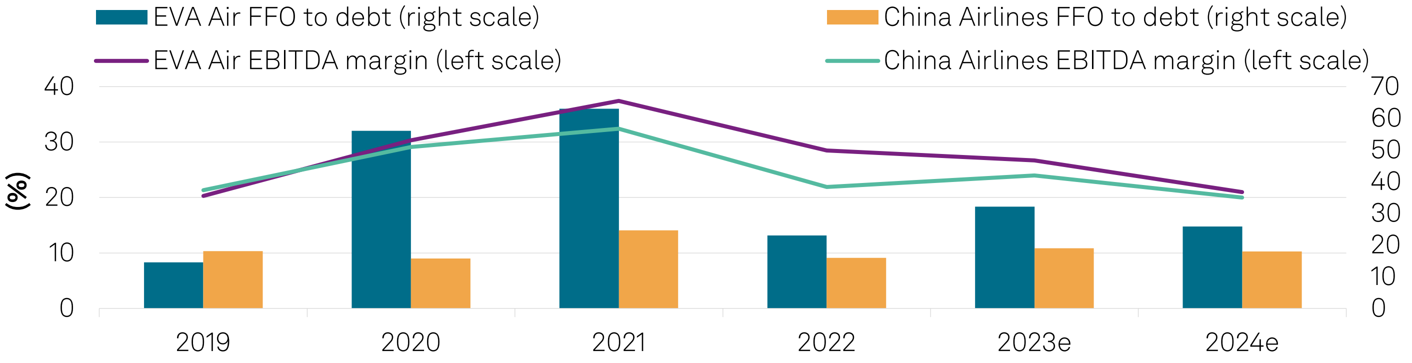
Mitigants

- Rising passenger volume in 2023 could be stronger than under our previous expectation, despite muted traffic on routes to China.

Accelerating passenger recovery could fully offset the impact of declining cargo demand in 2023 (contribution to overall revenue)



China Airlines' margin to return to the pre-pandemic level in 2023



e--Estimate. Source: Company data; Taiwan Ratings Corp.

High Net Cash Positions Shield Container Carriers From Plunging Freight Rates

Overview

- A sharp correction in seaborne freight rates in 2023 led to material EBITDA contraction.

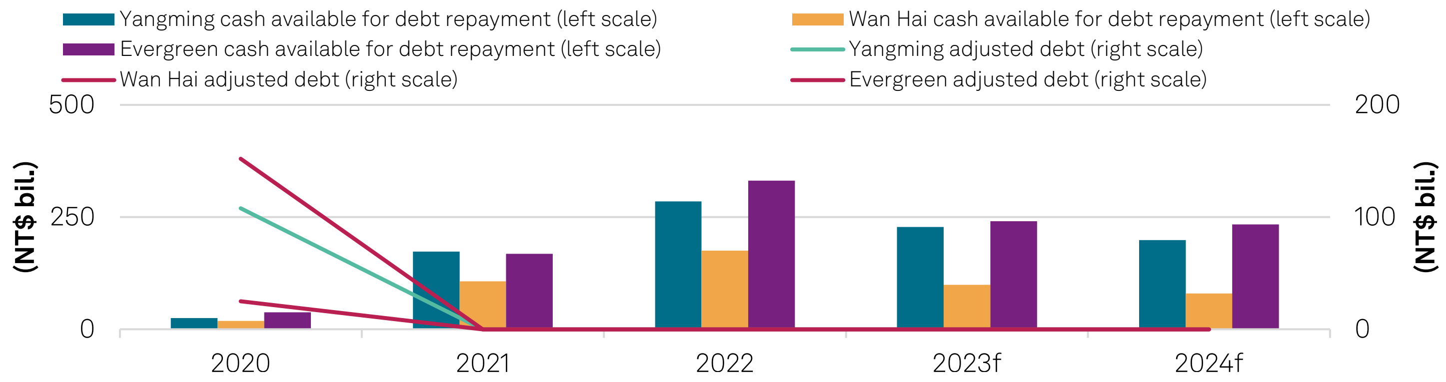
Key risks

- Growth of long-haul megaships in 2023-2024 could worsen supply/demand imbalances and place additional strain on freight rates.
- China's subdued exports could constrain freight rates in 2023.

Mitigants

- Materially lower operating cash flow and elevated capex won't materially weaken carriers' debt leverage in 2023-2024, given their very high cash balances on hand.
- A relatively balanced supply and demand outlook could underpin resilient intra-Asia freight rates over the next two years.

High cash balance could help maintain carriers' improved capital structure



Container shipping supply growth could outpace demand growth in 2023-2024

		2022	2023f	2024f
Drewry	Supply	4.2%	4.7%	6.3%
	Demand	0.5%	1.0%	3.1%
Alphaliner	Supply	4.1%	8.3%	8.9%
	Demand	0.1%	1.4%	2.2%
Clarksons	Supply	4.0%	6.9%	5.8%
	Demand	(5.0%)	2.1%	3.3%

f--Forecast. Yangming--Yang Ming Marine Transport Corp. Wan Hai--Wan Hai Lines Ltd. Evergreen--Evergreen Marine Corp. Source: Alphaliner Monthly Monitor, April 2023; Drewry Container Forecaster New Monthly Supplement, April 2023; Clarksons Container Intelligence 2Q 2023.

Cement Companies Need A Recovery In China To Stabilize Credit Outlooks

Overview

- Recession in China's property market has kept the spread between cement and coal prices weak, delaying the recovery in cement companies' EBITDA until the second half of 2023.
- Enhanced staggered production cannot fully offset the impact of weak demand, thereby suppressing margins despite falling coal prices.

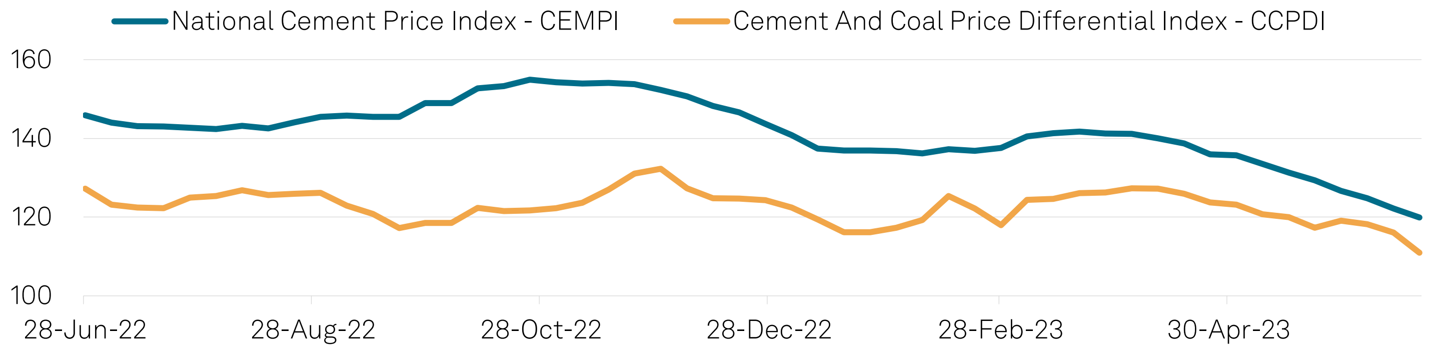
Key risks

- An extended deep recession in China's property market.

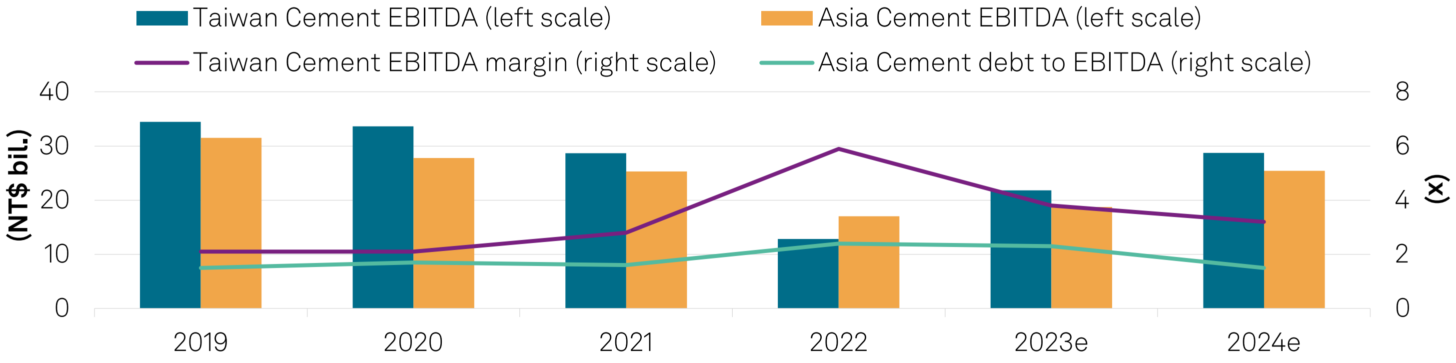
Mitigants

- China's tighter environmental standards and stricter rules for capacity replacement could retire aged capacity, albeit at a slow pace.

Cement prices fell faster than coal prices in China in the second quarter of 2023



Sluggish demand could keep cement companies' credit metrics weak in 2023



e--estimate. Source: Company data; Taiwan Rating forecasts.

S&P Global Ratings

Lower Material Prices Could Support Moderate Rebound In Profit Margin For Steel Makers

Overview

- Industry outlook has stabilized because declining material costs enhance the buffer for steel makers to cope with weak steel prices.

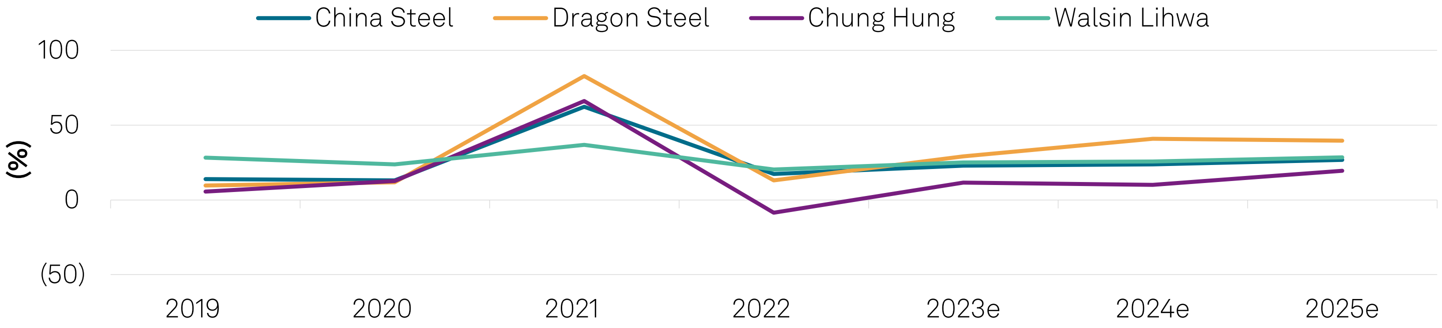
Key risks

- Steel prices could continue to trend downward, reflecting declining material prices.
- Demand is unlikely to grow materially over the next few quarters, capping significant improvement in steel makers' profitability.

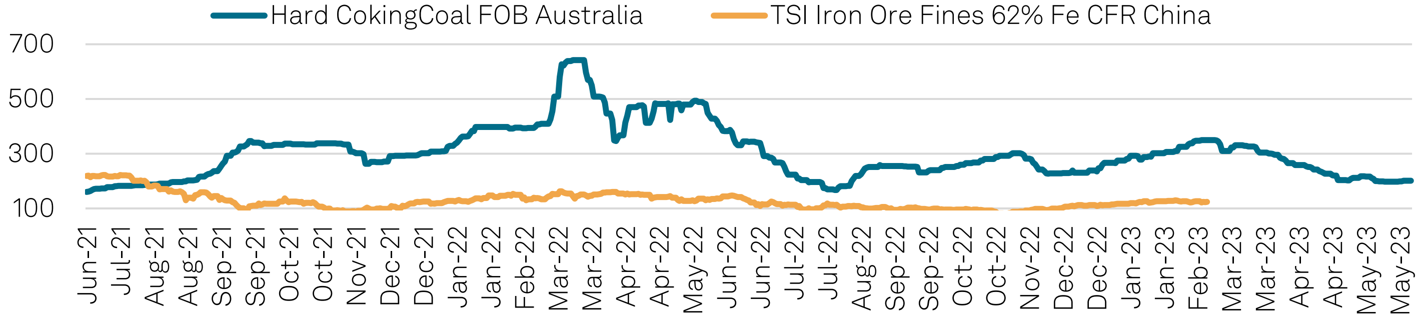
Mitigants

- Sales volume could recover mildly after bottoming out for a prolonged time. We also see some bright spots in demand, such as the growing electric vehicle market.

Softer improvement in FFO to debt than under our previous expectation, but with no impact on credit strength



Declining coking coal prices support some recovery in profitability



e--Estimate. Source: Company data; Taiwan Ratings Corp. and S&P Global Commodity Insights.

Easing Chip Shortage To Lift Business Outlook For Auto And Auto Suppliers

Overview

- Easing chip shortage and removal of pandemic restrictions could lift light vehicle sales.
- Taiwan's auto market could see high single digit growth in 2023, given pent-up domestic demand.

Risks

- Auto suppliers with more exposure in China could see growth at a slower pace.
- A rapid shift to electric vehicles could hurt auto and auto suppliers that lag in investment in this field.

Mitigants

- Slower-than-expected deployment of charging infrastructure in Taiwan places all auto manufacturers at the same starting point in the electric vehicle race.

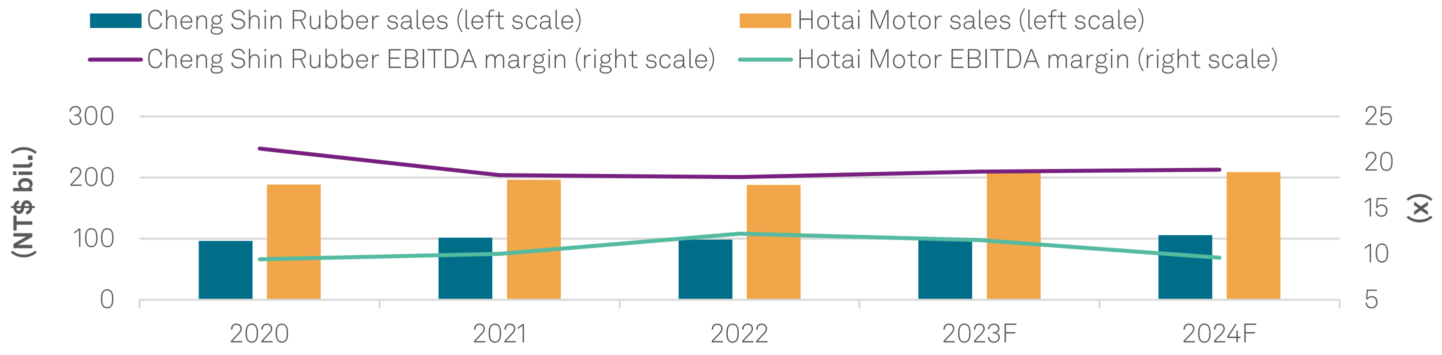
S&P Global Ratings Forecasts Chinese Auto Sales Could Disappoint In 2023

	Mil. units	% year-on-year change		
	2022a		2023f	2024f
U.S.	13.9	(7.9)	5-7	5-7
China	24.1	(0.9)	0-2	2-4
Europe	14.9	(11.2)	3-5	3-6
Rest of the World	20.0	(8.3)	4-6	4-7

Electrification Scenario--Share Of BEV And PHEV As % Of Total Sales

	2019a	2020a	2022a	2025f
U.S.	2.0	2.0	7	18-23
China	4.7	5.5	27	35-40
Europe	2.7	10.0	22	>30
Global	2.5	4.4	13	17-22

Growth momentum is back on track and supports stable rating outlooks



a--Actual. f--Forecast. BEV--Battery electric vehicles. PHEV--Plug-in hybrid vehicles. Source: Taiwan Ratings, Global Auto Sales Forecasts: Macro Risks Demand Pricing And Production Discipline, published by S&P Global Ratings on Apr. 18, 2023.

Low Sensitivity To The Slowing Economy Underpins Telecom Sector's Stable Rating Outlook

Overview

- Telecom operators' profitability can better weather the slowing economy.
- Quite strong operating cash flow, prudent capital spending to sustain financial buffers.

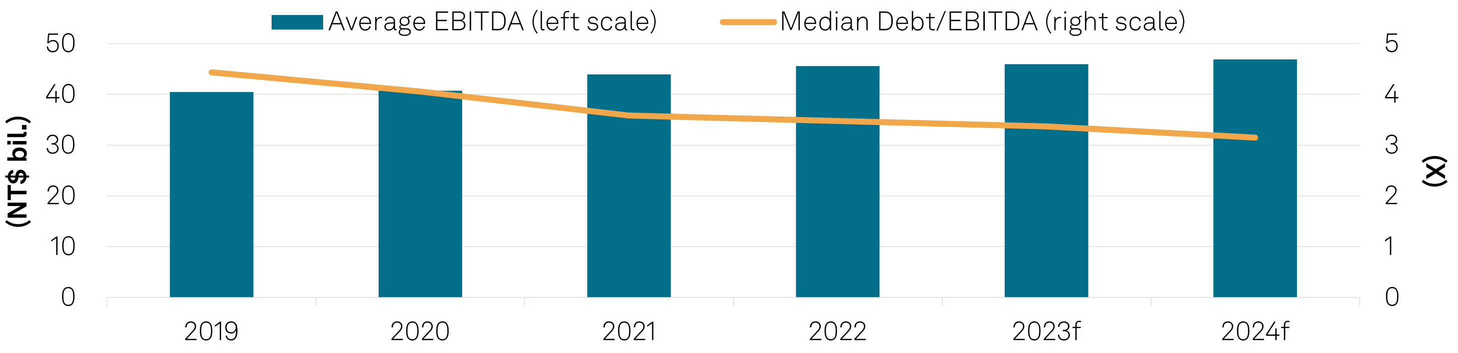
Key risks

- Slower 5G adoption; More aggressive data plans; Higher spending for new licenses.

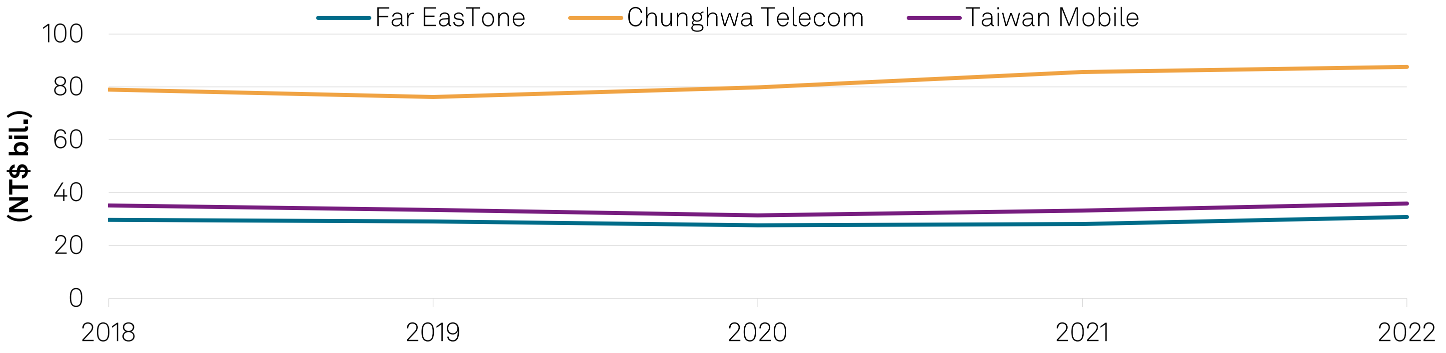
Mitigants

- Conservative 5G plans and increasing adoption rates improve average revenue per user, supporting improved profitability.
- Improved capital structure and cash flow could support private 5G network building and enhance the service for enterprise customers without a material negative effect on operators' financial positions.

Leverage has declined amid continuously improving profitability



EBITDA generation remains sustainable for major telecom operators



f--Forecast. Source: Company data and Taiwan Ratings Corp.

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