Media Release:

# Taoyuan International Airport Corp. Affirmed At 'twAAA/twA-1+' With Stable Outlook; SACP Revised Down To 'twaa-'

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## Overview

- We expect significantly lower aircraft and passenger volume will produce a double digit decline in Taoyuan Airport's full-year revenue and EBITDA margin in 2020 and weakens its stand-alone credit profile (SACP). Debt leverage will deteriorate.
- We continue to see an extremely high likelihood of timely financial support for the company from the Taiwan government.
- On March 20, 2020, Taiwan Ratings Corp. affirmed its 'twAAA/twA-1+' issuer credit ratings on Taoyuan Airport.
- The stable outlook reflects the stable outlook on the unsolicited issuer credit ratings on the government of Taiwan assigned by S&P Global Ratings and our view of Taoyuan Airport's very important policy role and integral link to the Taiwan government.

## Rating Action Rationale

*Shrinking flight and passenger volume will significantly constrain **Taoyuan International Airport Corp.'s** (Taoyuan Airport's) cash flow generation in 2020.*
In February 2020, passenger numbers through Taoyuan Airport declined 47% year on year. As fear surrounding COVID-19 grows, we expect the number of passengers and aircraft movement to remain very low over the next few months. This reflects the diminishing passenger demand for all but essential air travel. Air travel restrictions by major foreign governments has also hit air traffic severely.

*Concessions and rent revenue will also fall sharply in 2020.*
As passenger numbers decline, consumption in duty free stores and restaurants is also set to weaken significantly. Therefore, we expect revenue from concessions within the airport to fall 40%-50%. Meanwhile, the tentative closing of stores and restaurants with potential tenant turnover and rental rate reductions will bring further challenges to sustain rental revenue in full-year 2020.

*The ratio of FFO to debt could weaken to 13%-16% in 2020 and 10%-13% in 2021-2022, given the uncertain recovery and upcoming huge capex on Terminal 3.*
Our current forecast indicates that Taoyuan Airport will see weak cash flow generation over the next two to three years. The company's funds from operations (FFO) in 2020 is likely to be 50%-55% of that in 2019, mainly reflecting the slump in passenger numbers. Although we expect the airport's business to recover gradually in 2021-2022, its debt will significantly increase along with the construction of Terminal 3. Capital expenditure (capex) will likely keep the ratio of FFO to debt below 13% in 2022. We expect the ratio to be below 9% when the construction of the new terminal is completed and within the proposed total budget of New Taiwan dollar (NT$) 78.9 billion. However, Taoyuan Airport's SACP may come under pressure if the budget increases materially due to cost overruns or the terminal's redesign before the recovery of air travel demand.

We have revised down our assessment of Taoyuan Airport's SACP to 'twaa-' from 'twaa' to reflect the airport's weakening cash flow generation.

*Taoyuan Airport's very important role and integral link with the government of Taiwan continues to support the credit rating.*
Despite the impact of COVID-19, we are maintaining our assessment on the company's role and link to the government, given that the airport is the main air hub for Taiwan and is a wholly owned state enterprise.

# Outlook

The stable outlook on Taoyuan Airport reflects the stable outlook on the unsolicited issuer credit ratings assigned by S&P Global Ratings on the government of Taiwan. The outlook also reflects our view that Taoyuan Airport's very important role and integral link to the Taiwan government will not change over the next one to two years, even in the current weak demand for air travel. This is because of the company's very important role to provide essential infrastructure and services.

### Downward scenario

We may lower the rating on Taoyuan Airport if S&P Global Ratings lowers its ratings on the Taiwan government. We may also lower the rating if government support for the company diminishes because of a change in the government's strategies or priorities, thus weakening the importance of the airport's role or the company's link to the Taiwan government.

# Our Base-Case Scenario

- Passenger volume to decline by about 40% in 2020 with over 50% decline in passengers in the first half and a gradual recovery in the second half as passengers avoid the peak outbreak period. Passenger volume to recover by 25%-35% in 2021 and by a further 10%-20% in 2022 as global travel restrictions are removed.
- Aircraft movement to decline by about 30% in 2020 as demand declines but to recover by 12%-18% in 2021 and 8%-13% in 2022.
- Low passenger volume and softer consumption will slash concession revenue along a similar curve as passenger volume over the same period.

- Gross margin to decline to 45%-50% in 2020 from 62.3% in 2019, given the limited savings from variable costs, because the airport incurs substantial costs to maintain its full day service. We expect the company's gross margin to recovery to 55%-60% in 2021-2022 along the same path as revenue growth.
- Capex of NT$6 billion–NT$7 billion in 2020 for ongoing projects including preparations for the construction of Terminal 3. Capex to increase to about NT$20 billion in 2021-2022, with over 50% scheduled for the construction of the third terminal.
- 65% distribution ratio of the current year's earnings.

Based on these assumptions, we arrive the following credit measure:

- EBITDA margin of 65%-68% in 2020, and 70%-73% in 2021-2022, down from 75.2% in 2019.
- Ratio of FFO to debt to fall to 13%-16% in 2020 and 10%-13% in 2021-2022, down from 29.3% in 2019.
- FFO cash interest coverage ratio to fall to 2.5x-3x in 2020 and 3.1x-3.5x in 2021-2022, down from 4.4x in 2019.

# Liquidity

The short-term issuer credit rating is 'twA-1+'. We believe the company has adequate liquidity to meet its needs up to the end of 2020, with a ratio of liquidity sources to liquidity uses of 1.6x-2.0x during the period. However, the company's upcoming capex constrains our liquidity assessment against a higher result. The liquidity assessment reflects our view that liquidity sources will continue to exceed uses, even if Taoyuan Airport's EBITDA were to decline by 15%.

We believe that the company can absorb high-impact, low-probability events, with limited need for refinancing, given its sufficient cash on hand. In our view, Taoyuan Airport has high standing in credit markets and sound relationships with banks in Taiwan as a 100% government owned enterprise, as demonstrated by its credit lines with lower interest rate. Taoyuan Airport carries no debt except for its operating lease commitment as of the end of 2019.

### Principal liquidity sources

- Cash and short-term investments: about NT$10.4 billion at the end of 2019.
- Cash flow from operations: NT$4.5 billion-NT$5 billion up to the end of 2020.

### Principal liquidity uses

- Capital expenditure: NT$6 billion-NT$7 billion up to the end of 2020.
- Dividend: NT$1 billion-NT$2 billion up to the end of 2020.

## Ratings Score Snapshot

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

Business risk: Excellent

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

Financial risk: Significant

- Cash flow/leverage: Significant

Anchor: twaa

Modifiers

- Diversification/portfolio effect: Neutral (no impact)
- Capital structure: Neutral (no impact)
- Financial policy: Negative (-1 notch)
- Liquidity: Adequate (no impact)
- Management and governance: Satisfactory (no impact)
- Comparable rating analysis: Neutral (no impact)

Stand-alone credit profile: twaa-

- Related government rating: AA-
- Likelihood of government support: Extremely high (+3 notches from SACP)

## 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: Corporate Methodology: Ratios And Adjustments - April 01, 2019
- Understanding Taiwan Ratings' Rating Definitions, www.taiwanratings.com - June 26, 2018
- Criteria | Corporates | General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers - December 16, 2014
- Criteria | Corporates | Industrials: Key Credit Factors For The Transportation Infrastructure Industry - November 19, 2013
- 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: Use Of CreditWatch And Outlooks - September 14, 2009

(Unless otherwise stated, these articles are published on www.standardandpoors.com, access to which requires a registered account)

# Ratings List

**Ratings Affirmed**

| **Taoyuan International Airport Corp.** | |
|---|---|
| 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.