Media Release:

Ratings On Taoyuan International Airport Corp. Affirmed At 'twAAA/twA-1+' On Government Support; Outlook Stable

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Rating Action Overview

- Taiwan-based **Taoyuan International Airport Corp.** (Taoyuan Airport) is the largest airport in Taiwan, with EBITDA of NT$5.78 billion in 2020.
- The negative impact of the COVID-19 pandemic on passenger travel could continue to weigh on Taoyuan Airport's revenue and EBITDA margin in 2021-2022. Capital expenditure on its third terminal will also weaken the airport's financial leverage. Given the high uncertainty over the pace of recovery, we have lowered the company's stand-alone credit profile to 'twa+'.
- We have affirmed our 'twAAA/twA-1+' issuer credit ratings on Taoyuan Airport given our continuing view of an extremely high likelihood of timely financial support for the company from the Taiwan government.
- The stable rating outlook reflects the outlook on the unsolicited issuer credit ratings on the government of Taiwan assigned by S&P Global Ratings (AA/Positive/A-1+) and our view of Taoyuan Airport's very important policy role and integral link to the government.

Rating Action Rationale

The pandemic continues to stifle passenger volume, which could prolong into late 2022. Despite improving control of the pandemic and a rising vaccination rate in Taiwan, recover in passenger traffic will likely delay to late 2022. Several countries have signaled looser conditional quarantine requirements beginning in November and December 2021. However, we believe the Taiwan government will take a more cautious approach and is unlikely to ease border controls aggressively until the fourth quarter of 2022. Therefore, we estimate Taoyuan Airport's ratio of funds from operations to debt could deteriorate to 1.5%-2.5% in 2021-2022 and accordingly we have lowered the company's stand-alone credit profile (SACP) to 'twa+'.

Air cargo demand and the Taiwan government's subsidy will partly offset the pandemic's negative effect on financial leverage in 2021 and 2022. Strong air cargo demand will sustain the airport's landing fee revenue at 60%-65% of the level in 2019 over 2021-2022, despite very low air passenger traffic. In addition, an upward adjustment to landing fees in September

2019 partly offsets the landing fee loss from fewer aircraft movements. Meanwhile, rent subsidies provided by the Taiwan government to airport facilities operators are likely to sustain the airport's concession revenue at 40%-45% of the 2019 level over 2021-2022. We anticipate the government will extend this subsidy program to 2023, considering the prevailing tight border controls and stagnant passenger volume. We therefore estimate Taoyuan Airport's revenue for 2021-2022 at only 43%-46% of the 2019 level.

We believe the airport's performance could rebound significantly in 2023 once the government eases restrictions on overseas travel under a much safer environment. The ratio of funds from operations (FFO) to debt is therefore likely to rebound to 8%-9% in 2023 when passenger volume and aircraft movement will likely be 50%-55% and 65%-70%, respectively, of the 2019 level.

Debt level to rise following the commencement of construction of the airport's third terminal and other long-term expansion plans, while business recovery from 2023 remains highly uncertain. Civil engineering and mechanical construction work on the airport's third terminal began in the second half of 2021. This could lead to a doubling of capital expenditure (capex) at over NT$23 billion from 2023 compared with the amount needed in 2021-2022. As a result, the airport's debt will gradually increase. We assume a significant passenger recovery from 2023 with rebounding operating cash flow to support part of its capex funding needs. The cash outflow for payment of the third terminal is more concentrated in 2024-2026. Therefore, we expect the airport's ratio of FFO to debt to recover to 8%-15% over 2023-2025. However, the airport's continuing massive capex plans, including the satellite terminal and a third runway, could continue to pressure the company's debt leverage even after passenger recovery begins.

Taoyuan Airport's very important role and integral link with the government of Taiwan continues to support the credit rating. We are keeping our assessment on the company's very important role and link to the government, given that the airport is the main air hub for Taiwan and is a wholly owned state enterprise. The government's extraordinary budget for the airport is a further indication of its support for on-going operations during the pandemic period.

Outlook

The stable rating outlook on Taoyuan Airport reflects our view that Taoyuan Airport's very important role for and integral link to the Taiwan government will not change over the next one to two years, despite weak air travel demand. This is because of the company's very important role to provide essential infrastructure and services in Taiwan.

A slump in air traffic demand globally has weighed heavily on Taoyuan Airport's operating cash flow generation since early 2020. The company's ratio of FFO to debt is likely to weaken to about 2% in 2021-2022 but recover to 8%-9% in 2023. However, we forecast Taoyuan Airport's stand-alone credit profile will remain stable over the same period due to a likely significant recovery in passenger volume in 2023.

Downward scenario

We could lower the rating on Taoyuan Airport if S&P Global Ratings lowers its unsolicited ratings on the Taiwan government by more than one notch. We may also lower the rating if government support for the company diminishes due to 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

- S&P Global Rating's forecast for Taiwan's real GDP to grow 5.5% in 2021, 2.9% in 2022, and 2.6% in 2023. The GDP growth in 2021-2022 is likely to support strong demand for air cargo services over the same period.
- The airport's revenue to decline by 10%-15% in 2021, given the higher base in the first quarter of 2020. Revenue to increase by 3%-8% in 2022, mainly supported by increasing aircraft movements for cargo services with a slight improvement in passenger revenue.
- Growth in passenger volume to remain stagnant until the fourth quarter of 2022 and in 2023 reach 60%-70% of the 2019 level. This forecast includes a much safer environment and a loose quarantine requirement in Taiwan and other Asia countries.
- Aircraft movements could reach 40% of the 2019 level in 2021, 40% in 2022, and 65% in 2023, supported by solid demand for air cargo service.
- Extraordinary government subsidy to remain over 2021-2023.
- The ratio of operating cost and expense to stay as high as 100%-103% of revenue in 2021-2022 because Taoyuan Airport needs to fund substantial costs to maintain its full day service. The ratio could decline to 63%-68% in 2023 when revenue recovers moderately.
- Capex of NT$7 billion-NT$8 billion in 2021 for ongoing projects including construction of Terminal 3 and increasing to NT$9 billion-NT$11 billion in 2022 and NT$20 billion-NT$22 billion in 2023, with over 50% on the construction of the third terminal.
- NT$900 million capital injection in 2022 to support capacity expansion projects.
- No earnings distribution in 2021-2023 due to consecutive new loss.

Based on these assumptions, we arrive at the following credit measures:

- EBITDA margin of 45%-47% in 2021-2022 and 63%-65% in 2023, down from 49.9% in 2020.
- Ratio of funds from operations to debt of 1.5%-2.5% in 2021-2022, down from 4.2% in 2020, then recover to 8%-9% in 2023.
- Funds from operations cash interest coverage of 1x-1.5x in 2021-2022, down from 1.6x in 2020 but improving to 8.5x-9x in 2023.

Liquidity

The short-term issuer credit rating is 'twA-1+'. We believe that the company has adequate liquidity to meet its needs up to the end of September 2022, with a ratio of liquidity sources to liquidity uses of 2.6x during the period. While the company's upcoming capex requirements constrain our liquidity assessment, we believe the airport's liquidity sources will continue to exceed uses, even if 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 a high standing in local credit markets and sound banking relationships with banks in Taiwan. We base this on our view of the company's 100% government owned enterprise status, as indicated by its ample credit lines with lower interest rates. Except for an operating lease commitment, Taoyuan Airport carries a NT$1.5 billion bank loan as of the end of September 2021.

Principal Liquidity Sources

- Cash and liquid investments of NT$1.7 billion at the end of September 2021.
- Cash funds from operations of NT$100 million-NT$500 million up to the end of September 2022.
- Working capital inflow of NT$100 million-NT$300 million up to the end of September 2022.
- Capital injection of NT$900 million up to the end of September 2022.
- Ongoing government support (credit lines of government related banks) of NT$17 billion-NT$19 billion up to the end of September 2022.

Principal Liquidity Uses

- Short-term debt of NT$1.5 billion up to September 2022.
- Capex of NT$9 billion-NT$11 billion up to the end of September 2022.

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: Aggressive

- Cash flow/Leverage: Aggressive

Anchor: twa+

Modifiers:

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

Stand-alone credit profile: twa+

- Related government rating: AA
- Likelihood of government support: Extremely high (+4 notches from SACP)

Related Criteria & Research

Related Criteria

- General Criteria: Rating Government-Related Entities: Methodology And Assumptions - March 25, 2015
- General Criteria: Methodology For National And Regional Scale Credit Ratings - June 25, 2018
- 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
- Criteria | Corporates | General: Corporate Methodology - November 19, 2013
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities - November 13, 2012
- General Criteria: Principles Of Credit Ratings - February 16, 2011

Related Research

- Taiwan Ratings' Ratings Definitions – August 10, 2020

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

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.